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Dear Tom,

### **Response to the IAASB's Proposed International Standard on Quality Management 1 and to the Overall Explanatory Memo**

EFAA appreciates the opportunity to provide our comments to the IAASB Consultation Paper, [Proposed International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements](#) (previously ISQC 1) and on the [Overall Explanatory Memorandum, The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews](#). Our response has been prepared with input from our Assurance Expert Group.

Given the lower relevance to SMPs we have not responded to [Proposed International Standard on Quality Management 2, Engagement Quality Reviews](#) nor [Proposed International Standard on Auditing 220 \(Revised\), Quality Management for an Audit of Financial Statements](#). We trust, however, that the IAASB will ensure that these standards are also made sufficiently scalable for SMPs.

The European Federation of Accountants and Auditors for SMEs ("EFAA") represents accountants and auditors providing professional services primarily to SMEs both within the European Union and Europe as a whole. Constituents are mainly small practitioners ("SMPs"), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs. EFAA represents 13 national accounting, auditing and tax advisor organisations with more than 370 000 individual members.

### **GENERAL COMMENTS ON PROPOSED ISQM 1 (ED-ISQM 1)**

We strongly support the IAASB's efforts in relation to quality management including the infusion of a risk assessment approach. SMPs have struggled to apply ISQC 1 arguing that it is mainly written with larger practices rendering audit in mind. ISQC 1 is also rather compliance driven. The focus on quality management is welcome since this promises to help practices continually improve the quality and relevance of their services to clients. In this sense it is more a practice development tool. We understand [ISO's 9000 suite of quality management standards](#) to be widely used and supplemented

by sector specific application material. While the ED-ISQM 1 is a technically robust document, expertly written and presented, we have serious reservations as to its scalability and usability by SMPs due to its highly prescriptive and detailed composition. We therefore urge the IAASB to make extensive changes in order to simplify it and make it scalable from the bottom-up.

## OVERALL QUESTIONS ON ISQM 1

**1) Does ED-ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard?**

***In particular:***

- (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?***
- (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?***
- (c) Are the requirements and application material of proposed ED-ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstances? If not, what further actions should the IAASB take to improve the scalability of the standard?***

We generally support the new quality management approach using a risk management approach.

While promising to follow a risk assessment approach the ED-ISQM 1 is overly prescriptive and detailed leaving little room for professional judgment in its application. Voluminous standards pose a significant challenge to SMPs. ED-ISQM 1 is considerably larger than ISQC 1. Every effort needs to be made to scale-back the length of this standard. The quality objectives are an exhaustive list.

It is vital that the approach is simple and straight forward if it is to be truly scalable. Making the standard less complex to apply would go a long way to addressing the practical issues many SMPs will otherwise face and simultaneously render the standard more scalable. Therefore, we suggest having a higher threshold for risk identification and assessment, in place of "more than remote likelihood of occurrence", preferably one that takes both the likelihood of occurrence and likely magnitude of impact into account. In addition, we suggest having far fewer and more general objectives. That is, we suggest having an overarching objective for the standard as a whole and then just a single objective for each relevant area that drives quality.

The proposed ISQM 1 risks creating a significant increase in documentation, especially in documenting what has not been done and why, as a result of the highly prescriptive nature of the standard. This burden will fall disproportionately on SMPs. We therefore welcome more guidance on what need to be documented and show how succinct this can be.

- 2) *Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?***

Many SMPs perform assurance and related services such as compilations, but not audits. This trend away from audit, driven in large part by the increasing frequency and size of audit exemption thresholds, looks set to continue. While ED ISQM 1 follows a risk-based approach that will be familiar to auditors applying ISA 315, such an approach will be alien to SMPs not performing audits. They will likely find the cost of complying with the standard in excess of the benefits of increased service quality. Consequently ISQM 1 is less likely to be adopted by firms when there is no jurisdictional requirement to do so. If the IAASB intends to develop standards suitable for all professional services, then ISQM 1 needs to be suitable for firms that do not perform audits at all. Presently it is not suitable.

As noted in our response to Question 1) we believe the standard establishes an excessively low threshold in terms of risk identification. This threshold may result in a considerable amount of unnecessary work for many SMPs, especially in terms of documentation of risks that are unlikely to occur. This threshold needs to be raised.

- 3) *Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?***

We suggest the IAASB consider providing examples that demonstrate how very small SMPs that do not audit listed companies or PIEs can meet the requirements of the monitoring and remediation process.

#### **SPECIFIC QUESTIONS ON ISQM 1**

- 4) *Do you support the eight components and the structure of ED-ISQM 1?***

While we support the proposed risk-based approach we suggest further refinement. Some components, such as 'information and communication', 'monitoring and remediation process', 'governance and leadership' and especially 'risk assessment process', may be better presented as over-arching factors. This would reduce the number of quality objectives, reduce cross referencing and simplify the structure and substance of the standard.

- 5) ***Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?***

We suggest the IAASB consider an output-based objective of the standard that is, the provision of high-quality services.

We believe that activities performed by a professional accountant have different degrees of public interest. The public interest will vary according to the type of engagement, the type of client etc. However, paragraph A2 refers to responsibility to act in the public interest implying this is a constant. The standard should reflect this.

We suggest the IESBA and IAASB harmonize their concepts and terminology – “PIE” vs “listed or of significant public interest”, “firm” or “engagement team” - to reduce inconsistency and complexity.

- 6) ***Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved?***

***In particular:***

- (a) ***Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?***

While the application of a risk assessment process has the potential to drive the quality of services rendered by firms, we believe ED-ISQM 1 will need extensive modification before it can realize this potential.

ED-ISQM 1 is too prescriptive and complex especially for smaller SMPs and / or those that do not undertake audits of listed companies or entities of significant public interest. Above we suggest recasting some components as overarching factors, greatly reducing the number of objectives, and raising the threshold for risk identification can help achieve scalability.

- (b) ***Do you support the approach for establishing quality objectives?***

***In particular:***

- i. Are the required quality objectives appropriate?***

As we state above the list of quality objectives is exhaustive. We prefer much fewer quality objectives and where possible one per quality management area with a few robust overarching objectives. We suggest recasting some components as over-arching factors. This will facilitate a significant reduction in the number and complexity of the quality objectives. In any case the proposed quality objectives are far too granular for SMPs especially those that are smaller and those that do not audit listed or significant public interest entities.

**ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?**

While it is clear in ED-ISQM 1 that the firm is expected to establish additional quality objectives beyond those required we suggest scalability of the standard be improved by clarifying that for many SMPs no additional objectives are likely to be needed.

**(c) Do you support the process for the identification and assessment of quality risks?**

We support the principle of applying a risk-based approach that is tailored to the firm's nature and circumstances. However, the identification and assessment of quality risks is highly prescriptive and fails to allow much room for the exercise of professional judgement in its application. More flexibility would enhance scalability.

For many SMPs, the initial assessment of risk, and its documentation, is likely to prove especially challenging. ISQM 1 is a step change from ISQC 1 and entails significant change management.

**(d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks?**

**In particular:**

**i. Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?**

We support the IAASB's approach and consider it appropriate that SMPs identify, design and implement their responses to the quality risks to achieve the firm's quality objectives. However, we believe ED-ISQM 1 needs significant revision if it is to be truly scalable.

**ii. Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?**

Yes, it is clear. Scalability would be enhanced if ED-ISQM 1 clarified that for many smaller firms, no additional objectives are likely to be needed.

**7) Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?**

*While ED-ISQM 1 does address firm's governance and the responsibilities of firm leadership at an appropriate level, it appears to be based on larger firms and thus many SMPs, especially sole practitioners, will struggle to see its relevance and to apply it in practice.*

**8) With respect to matters regarding relevant ethical requirements:**

**(a) Should ED-ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?**

**(b) Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network?**

While we agree it is appropriate to assign an individual to be responsible for the relevant ethical requirements in a firm, we question whether such granularity is required in all firms. In very small firms few individuals will be available.

**9) *Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?***

Yes, ED-ISQM 1 has been appropriately modernized to address the use of technology. However, we suspect that many SMPs are not as advanced as larger firms in terms of their technological maturity. We hope PAOs will collaborate to provide tools to help SMPs with their quality management.

**10) *Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so?***

While in general transparency is to be encouraged as it promotes trust, accountability and shared learning, communication with external parties is typically regulated by regional or local regulation and in the case of non-audit services communication to any external party is limited.

**11) *Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?***

We are generally supportive of the proposals addressing the scope of engagements that should be subjected to an EQR.

We suggest that the IAASB elaborate what is meant by significant public interest as this is a new term and consistent application is crucial.

**12) *In your view, will the proposals for monitoring and remediation improve the robustness of firms' monitoring and remediation?***

***In particular:***

***(a) Will the proposals improve firms' monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?***

***(b) Do you agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?***

***(c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?***

***(d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies?***

***In particular:***

- i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?*
  - ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?*
- (e) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?**

We encourage greater effort to enhance scalability in this area.

Many SMPs, especially the very small, there are no formal system of monitoring, the issues are likely to be more of the one-off nature and thus, the impact on quality from the monitoring activity will also be limited.

We support flexibility in the form and nature of a firm's internal monitoring activities. However, we question the retention of a requirement to include inspection of one completed engagement for each engagement partner as this seems overly prescriptive and unnecessary for many SMPs.

The requirement for a specific individual assigned ultimate responsibility and accountability for the system of QM to understand the entire standard and how they are being implemented through the firm's methodology can be particularly onerous especially for a sole practitioner of very small SMP.

An annual evaluation as to whether the system is working is unnecessary for many SMPs. A once every three-year evaluation of the system of quality management may suffice.

- 13) Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?**

Yes, we support the proposals.

- 14) Do you support the proposals addressing service providers?**

Yes, we support the proposals.

- 15) With respect to national standard setters and regulators, will the change in title to "ISQM" create significant difficulties in adopting the standard at a jurisdictional level?**

We do not foresee significant difficulties but the IAASB should be mindful that it will take time for legislation to be amended and that new terminology may present challenges to translators.

#### **OVERALL QUESTIONS IN EXPLANATORY MEMO**

- 1) Do you support the approach and rationale for the proposed implementation period of approximately 18 months after the approval of the three standards by the Public Interest Oversight Board? If not, what is an appropriate implementation period?**

We believe the proposed implementation period will be too short.

The changes are fundamental changes and will demand a considerable effort on the part of the profession to make the necessary changes. Hence, we urge a longer period of transition, possibly up to three years.

**2) *In order to support implementation of the standards in accordance with the IAASB’s proposed effective date, what implementation materials would be most helpful, in particular for SMPs?***

Implementation efforts need to be primarily directed at those most in need, namely SMPs. The standard, even in a more scalable guise, will demand a step change in quality management for many SMPs and they will need guidance on making the transition. SMPs will rely on their professional accountancy organizations (PAOs) and other third parties for QM system support and methodologies. We suggest the IAASB works with the IFAC SMP Committee to lead implementation efforts including, perhaps, updating the QC Guide.

#### **SPECIFIC QUESTIONS IN EXPLANATORY MEMO**

**(a) *Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposals, in particular, on any foreseeable difficulties in applying it in a developing nation environment.***

Our membership includes some developing nations. We believe many of the problems cited above will be even more acute for them. We suggest the IAASB and IFAC consider how to facilitate the sharing and transfer of knowledge and expertise from more advanced PAOs to those that are developing.

**(b) *Public Sector Sector—The IAASB welcomes input from public sector auditors on how the proposed standards affect engagements in the public sector, particularly regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.***

We have no remarks.

**(c) *Translations—Recognizing that many respondents may intend to translate the final ISQMs and ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed standards.***

The proposed standards include many long, complex sentences and sophisticated language. We urge the IAASB to use simpler language and sentence construction.

#### **CONCLUDING COMMENTS**

We trust that the above is clear, but should you have any questions on our comments, please do not hesitate to contact us.

Yours faithfully,

Salvador Marin  
President

Paul Thompson  
Director