



Australian Government
Auditing and Assurance Standards Board

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Mr Willie Botha
Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
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Dear Willie,

AUASB Submission on the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews - Responses to Questions on proposed ISQM 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to submit our response on the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews.

The AUASB is a non-corporate Commonwealth entity of the Australian Government, responsible for developing, issuing and maintaining auditing and assurance standards in Australia. The AUASB's role and mandate extends to liaison with other standards setters and participation in global standard-setting initiatives, so we have a very strong interest in these IAASB Exposure Drafts and welcome the opportunity to comment.

In formulating our response to these proposed standards the AUASB sought input from its stakeholders in three principal ways:

1. From hosting a series of roundtable meetings with stakeholders in three large Australian cities. These roundtable meetings were attended by over 50 stakeholders representing a broad range of backgrounds, including assurance providers from a range of audit firms, professional accounting bodies, academics, those charged with governance and preparers of financial statements.
2. Through an open invitation to provide comments on the equivalent AUASB issued Exposure Drafts via the AUASB website.
3. Formal discussions and deliberations by AUASB members at recent AUASB meetings.

The AUASB supports the IAASB's objective to develop and maintain robust international standards that contributes to enhanced engagement quality and consistency of practice throughout the world, and strengthened public confidence in the global auditing and assurance profession. However, the AUASB notes with concern that the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews, all contain greater complexity and detail than the extant standards they are replacing. This makes the proposed standards more challenging for all auditors (especially those auditors of smaller and medium or less complex entities) to apply, and may result in increased costs with arguably no commensurate increase in the level of audit quality for auditors of all types of entities.

As the IAASB continues to revise these proposed quality management standards, the AUASB considers it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in each of the proposed standards (ISQM 1, ISQM 2 and ISA 220), and explicitly weigh these against the costs of transition and application, as a means to support the successful implementation of the proposed standards once they are finalised.

Detailed responses to the questions on the key issues considered by the IAASB in developing ED-ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* have been included in the Appendix to this letter. Additionally, individual responses to the questions contained in each Exposure Draft have been submitted via the IAASB's website.

However, as part of our overall submission on the IAASB's Exposure Drafts for Quality Management there are a number of specific matters which the AUASB would highlight in our response:

Overall considerations

Implementation Period

The AUASB considers that a longer implementation period is required, perhaps even considering a staggered implementation approach across key components. For example, commencing first with the governance and leadership components as the foundation of a firm's System of Quality Management, followed by the other components in subsequent periods.

ISQM 1 is expected to require a significant amount of firms' resources to put into place a risk assessment process and update firms' methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for some network firms will be particularly challenging as the network head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400) on top of the three new or revised standards included in the suite of Quality Management standards. The AUASB considers that for firms to implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these standards may be in the public interest.

ISQM 1

Structure and Granularity of the Standard

The AUASB supports a quality management approach to ISQM 1, however the AUASB is not supportive of the overall standard in its current form.

The AUASB considers the proposed standard to be a hybrid of risk-based quality management requirements that retains a granular level of prescriptive requirement carried over from the extant ISQC 1 standard, which undermines the proper application of a risk-based approach.

The main theme expressed by Australian stakeholders throughout the AUASB's outreach on ISQM 1 was related to its size and level of granularity. All practitioners, large and small, were concerned with the cost and resources needed to develop a quality management framework in line with the proposed standard as currently drafted. The AUASB encourages the IAASB to refine its drafting approach to reduce the length and complexity of the proposed standard, as well as the other proposed Quality Management Standards being exposed concurrently – ED-ISQM 2 and ED-ISA 220.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315 (i.e. the requirements being the "what", and the application material, appendices and guidance constituting the "why" and "how") would facilitate a better risk-based approach that is scalable to the specific circumstances of a firm. This may help mitigate the potentially large cost and resourcing burden that the implementation of this proposed standard imposes on practitioners.

The AUASB particularly highlights to the IAASB that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered. Whilst these examples being included in the proposed standard may assist with implementation, the AUASB suggests the IAASB review the underlying principles in the requirements to make them simpler and more straightforward, which should alleviate the need for many of the examples and illustrations being included in the application guidance and appendices.

Additionally, the AUASB considers that the risk assessment process as designed has the potential to be particularly onerous for practitioners when considering the overall number of prescribed quality objectives required by the proposed standard. To further support a risk-based approach, the AUASB recommends the removal of pre-defined required responses to quality risks in the standard as the AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

Public Interest Benefits

The AUASB considers that it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in ISQM 1, and explicitly weigh these against the costs of transition and implementation, as a means to support the successful implementation of the proposed standard once it is finalised.

Scope of Engagements Subject to Engagement Quality Review

The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review. The AUASB supports a risk-based approach to such a determination which is already required in the proposed standard, where a firm is required to determine whether an engagement quality review is an appropriate response to assessed engagement risks.

It is unclear whether the proposed standard would result in an expectation that an engagement quality review is performed on ALL charities and ALL public sector engagements as these entities will always have a large number and wide range of stakeholders. This may be an unintended consequence of the proposed drafting. Furthermore, the AUASB is concerned that ‘significant public interest’ entity cannot be defined consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

ISQM 2

Guidance regarding a “cooling-off” period should reside in the IESBA Code

The AUASB strongly recommends that all guidance relating to the independence and objectivity of the Engagement Quality Reviewer (EQR) should reside in the IESBA Code as it already addresses these matters. Specifically the inclusion of alternative guidance regarding “cooling-off” periods in ISQM 2 increases the risk of inconsistent application and increases complexity for practitioners who may need to consider two different sources when addressing this issue. The AUASB recommends that the application material in ISQM 2 relating to any “cooling-off” period of the (EQR) should be removed from this standard and a reference to the IESBA code instead be considered (if this application guidance is to be retained).

ISA 220

Inconsistency in the engagement team definition and application guidance between ISA 220 and ISQM 1

The AUASB raises a significant concern that the definition of engagement team may be interpreted differently due to the different application and explanatory material that applies to this definition in ISA 220 (paragraphs A16-A19) not being replicated in ISQM 1. The impact may be that engagement team members are interpreted differently when the different application and explanatory material in each proposed standard is applied. For example, an Engagement Quality Reviewer (EQR) may be considered to be excluded from the engagement team under the definition and application guidance in ISA 220, but included as part of the engagement team under the definition in ISQM 1.

Should you have any queries regarding this submission, please do not hesitate to contact me or the AUASB Technical Director, Matthew Zappulla (mzappulla@auasb.gov.au).

Yours sincerely,



Professor Roger Simnett AO
Chair



Overall Questions

Q1. 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?*

The AUASB supports a quality management approach to ISQM 1, however the AUASB is not supportive of the overall standard in its current form.

The AUASB considers the proposed standard to be a hybrid of risk-based quality management requirements that retains a granular level of prescriptive requirement carried over from the extant ISQC 1 standard, which undermines the proper application of a risk-based approach.

The main theme expressed by Australian stakeholders throughout the AUASB’s outreach on ISQM 1 was related to its size and level of granularity. All practitioners, large and small, were concerned with the cost and resources needed to develop a quality management framework in line with the proposed standard as currently drafted. The AUASB encourages the IAASB to refine its drafting approach to reduce the length and complexity of the proposed standard, as well as the other proposed Quality Management Standards being exposed concurrently – ED - ISQM 2 and ED - ISA 220.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315 [that is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”] would facilitate a better risk-based approach that is scalable to the specific circumstances of a firm which may help mitigate the potentially large cost and resourcing burden the implementation of this proposed standard imposes on practitioners. The AUASB particularly highlights to the IAASB that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered. Whilst these examples being included in the proposed standard may assist with implementation, the AUASB suggests the IAASB review the underlying principles in the requirements to make them simpler and more straightforward, which should alleviate the need for extensive examples and illustrations being included in the application guidance and appendices.

Additionally, the AUASB considers that the risk assessment process as designed has the potential to be particularly onerous for practitioners when considering the overall number of prescribed quality objectives required by the proposed standard. Furthermore, to further support a risk-based approach, the AUASB recommends the removal of pre-defined required responses to quality risks in the standard as the AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

The AUASB consider it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in ISQM 1, and explicitly weigh these against the costs of transition and implementation, as a means to support the successful implementation of the proposed standard once it is finalised.

- b) *In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional scepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?*

The AUASB consider that a quality management approach to ISQM 1 provides an appropriate framework, but whether the proposals will generate the benefits intended will depend upon each firms implementation. Stakeholder feedback from practitioners of all sizes, indicates that implementing the proposals in the current form will be very challenging as they are resource intensive and costly.



Regarding professional scepticism, the AUASB considers paragraph 22 of ISQM 1 supports the appropriate exercise of professional scepticism at the engagement level.

- 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?*

The AUASB considers that the concepts of a Quality Management (QM) System should theoretically make the standard's requirements and application material scalable. However, in its current form we believe firms will find ISQM 1 overly granular and impractical to scale, which is counter intuitive to a risk-based approach. Such granularity may act as a barrier to its effective and consistent application, accordingly, as currently drafted, the AUASB does not consider the standard to be scalable.

The increased length of ISQM 1 is also a potential barrier to its understanding and application, particularly for small or sole practitioners with limited resources, and it is not clear how the additional cost associated with implementing the proposed standard will provide corresponding benefits for these practices. The AUASB encourages the IAASB to refine its drafting approach to reduce the length of the proposed standard where possible as a means of making them more accessible and understandable, which will in our view assist scalability.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315¹ would facilitate a risk-based approach scalable to the specific circumstances of a firm. As noted previously in our response to Question 1(a), the AUASB considers that the large volume of application material, appendices and guidance in the proposed standard needs to be reduced to improve the scalability of the proposed standard.

Furthermore, to further support a risk-based approach, the AUASB recommends the removal of pre- defined required responses to quality risks, as the AUASB considers it appropriate that firms should determine their own specific responses tailored to their specific risk circumstances.

Amendments suggested above would alleviate the volume and granularity concerns commonly expressed by stakeholders, for example:

- The granular requirements around design and implementation are considered to be counter intuitive to the very nature of a risk-based standard, these requirements could form an example of the “how” in application material.
- While the introductory paragraphs assist with understanding the risk assessment process and helpfully explain a number of important concepts in the standard, their inclusion is further evidence of ISQM 1s complexity. We would caution that extensive introductory paragraphs shouldn't be required for all IAASB standards. This introduction or ‘executive summary’ of the standard could be positioned outside of the standard, for example in the form of a “first time through document”.

In addition, the AUASB recommends that the IAASB provide more guidance and examples (e.g. in a “first time application” implementation guide) on how to effectively scale the work effort in ISQM 1 to less complex entities, such as examples of risks and responses that are specific to and appropriate for sole practitioners and what and how to document.

¹ That is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”



Q2. 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?

The AUASB considers that the implementation concerns described below could be alleviated if ISQM 1 is redrafted on the same basis as the proposed new drafting approach to ISA 315². Additionally, implementation concerns could be addressed by the removal of ‘pre-defined’ required responses to quality risks included in the proposed standard. The AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

Additionally the AUASB highlights a number of other areas in the proposed standard which we consider may enhance the implementation of the proposed ISQM 1:

Networks

The enhanced requirements around network firms, while supported by stakeholders, we consider will result in some practical implementation challenges for certain network firms. Some of the AUASB’s stakeholders expressed concern that the granularity of the requirements around relying on network firms may undermine the purpose of being in a network and lead to unintended consequences. Additionally, there was a level of concern raised by stakeholders as to the consistency of application across network firms in different jurisdictions and what this means from a regulatory perspective. As this issue impacts many audit firms across the globe the AUASB considers that more detail may be required in ISQM 1 to demonstrate how, for example:

- The same network requirements are applicable to firms operating in the same city or country versus those in different jurisdictions;
- Requirements may be different dependent upon how a network is structured; and
- Documentation requirements may be different dependent upon the nature of the network firm’s affiliation.

The AUASB notes that the application material in relation to networks provides examples of the types of inquiries and documentation that the firm may consider, but it provides little or no guidance on the extent of the assessment that the firm should perform, nor the extent of the documentation required to evidence such an assessment. The AUASB recommends that such guidance be incorporated into the proposed standard to facilitate consistent and appropriate interpretation and implementation.

Implementation Period

The AUASB considers that a longer implementation period than that currently proposed by the IAASB is required, perhaps even a staggered implementation approach for example starting at with the governance and leadership component of the proposed standard.

ISQM 1 is expected to require a significant amount of firms’ resources to be spent in order to put into place an appropriate quality management process, as well as update firms’ methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for certain network firms and other audit firms will be particularly challenging. For example, for certain network firms, the network firm’s head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, on top of the three new or revised standards included in the suite of Quality Management standards, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400). The AUASB considers that for firms to

² That is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”



implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these Quality Management standards may be in the public interest.

Legislative instruments

The depth of considerations of the proposals of the standard may be greater and have more implications in jurisdictions where the suite of Auditing Standards (including the proposed ISQM 1) are legislative instruments and have the force of law, as is currently the case in Australia. The AUASB is concerned that the granular level of detail contained in the proposed ISQM 1 makes this standard difficult for practitioners to achieve compliance with the extensive list of requirements. This further supports the need for ISQM 1 to be a truly risk-based standard as described in our response to Question 1(a) above.

Documentation

Stakeholders consider that the requirement to document the quality objectives, quality risks and associated responses is onerous and time consuming. There are 8 components to the standard. If each component has multiple quality objectives and each quality objective may have multiple risks associated, and each risk requires a response to address that risk, the AUASB is concerned that meeting this documentation requirement may not have any benefit on quality, rather just become a compliance exercise.

Additionally, the AUASB raises for consideration that the definition of response in paragraph 19(t) includes policies implied through actions or decisions. An implementation challenge will be capturing the responses that are implied through actions or decisions and other responses that are informal in nature and not readily documented. An example of such a challenge is demonstrated in documenting responses required under paragraph 24(a)(ii) in relation to firm culture, where these responses may include informal staff meetings and common day-to-day actions and behaviours. The AUASB encourages the IAASB to provide examples of documentation which are likely to satisfy the needs of those reviewing a firm's system of quality control in these areas to assist with implementation and consistency of application.

Q3. 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?

The AUASB has not included in this response a comprehensive review of all the application material paragraphs in the proposed standard, as the AUASB considers that proposed ISQM 1 should be redrafted in a similar drafting convention being proposed to redraft ISA 315. As noted previously in our response to Question 1(a), the AUASB considers that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered in order to improve the scalability of the proposed standard.

The AUASB makes the following additional comments in relation to the application and other material included in the proposed ISQM 1:

- Whilst the introductory paragraphs assist with understanding the risk assessment process and helpfully explain a number of important concepts in the standard, the AUASB considers their inclusion is further evidence of ISQM 1s complexity. We would caution that extensive introductory paragraphs shouldn't be required for all IAASB standards. The AUASB recommends that the introduction or 'executive summary' of the standard could be positioned outside of the standard in the form of a "first time application" guide.



- The AUASB considers the appendix is educative in nature and while it provides useful information, could be positioned outside of the standard in the form of a “first time application” guide.
- There are several application material paragraphs that are duplicative of requirements or establish requirements, for example A49 and A59.
- There are several application material paragraphs that are duplicate of content elsewhere, for example A36 is duplicative of A32; A178 is duplicative of A174.
- There are several application material paragraphs that are too onerous in nature or too granular in detail, for example A130 in relation to technology; and A67 –A74 in relation to ethics where the IAASB have attempted to summarise the IESBA Code in a few paragraphs, whilst practitioners need to comply with the full Code.

Specific Questions

Q4. Do you support the eight components and the structure of ED – ISQM?

The AUASB is supportive of the principles behind having the 8 components of a Quality Management System. Additionally, the AUASB supports the level of flexibility in the proposed standard whereby firms are not required to organise their systems according to these discreet components. A firm may have different names for the components and may combine components or have additional components.

As noted previously in our response to Question 1(a), the risk assessment process as currently designed in ISQM 1 we consider may be overly complex, based on the number of prescribed quality objectives required by this proposed standard, with each component having multiple quality objectives and multiple pre-defined required responses. The AUASB recommends the removal of pre-defined required responses to quality risks in each component of ISQM 1, as we consider it appropriate that firms determine their own specific responses tailored to their specific risk circumstances.

Q5. 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?

The AUASB supports the objective of the standard and notes that paragraph 7 of ED-ISQM 1 provides clarity on the relationship between the purpose of a system of quality management serving the public interest by supporting the performance of quality engagements. However, the AUASB considers that there is a strong need to more clearly demonstrate and articulate the benefits of the proposed quality management approach and explicitly weigh these against the cost to implement as the proposals are expected to be resource intensive and costly to implement.

Additionally, the AUASB considers that while a system of quality management provides an appropriate framework as is good business practice, whether the proposals will generate the benefits intended depend upon a firms’ implementation – that is, a “compliance” versus “transformational” mindset. The AUASB considers that the standard in its current form lends itself to a “compliance” mindset, which will not achieve the objectives of the standard.

Q6. 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?*

The AUASB supports the application of a risk-based approach to quality management, however the AUASB is not supportive of the standard in its current form. The AUASB considers the proposed standard to be a hybrid of risk-based quality management while retaining a granular level of prescription, thereby undermining a proper application of a risk-based approach. The main theme expressed by Australian stakeholders throughout the AUASB's outreach on ISQM 1 was related to its overall size and level of granularity. The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315³ would facilitate a risk-based approach.

(b) *Do you support the approach for establishing quality objectives? In particular:*

(i) *Are the required quality objectives appropriate*

The AUASB supports the need for firms to identify their own quality objectives specific to the circumstances of their organisation. However, the AUASB is not supportive of the quality objectives requirements of the standard in its current form. The AUASB considers the granular level of prescription of quality objectives to be counter-intuitive to the very nature of a risk-based approach.

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

The AUASB agrees with the IAASB's view expressed in paragraph 29 of the Explanatory Memorandum to ED-ISQM 1 that 'the quality objectives in ED-ISQM 1 are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved'. We encourage the IAASB to use this wording in the application material of paragraphs A49-A51 as the extent of establishing quality objectives beyond those required by the standard is unclear.

The AUASB understands that there could be certain circumstances that would require a firm to establish additional quality objectives beyond those required by the standard, but these circumstances may be limited. Specifically, the requirement in paragraph 26 of the proposed ISQM 1, as it currently reads, could be interpreted as firms always needing additional quality objectives, which the AUASB understands is not the intention of the standard. We accordingly believe this requirement in paragraph 26 of ISQM 1 needs to be redrafted to make the circumstances where additional quality objectives need to be established clearer.

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

The AUASB has concerns with the process to identify quality risks as described by paragraph 28 of ED – ISQM 1 with particular reference to:

- The threshold of 'reasonable possibility of occurring'. Reasonably possible was a concept introduced in the recent ISA 315 Exposure Draft where a reasonable

³ That is the requirements are the "what", the application material, appendices and guidance constitutes the "why" and "how".

possibility was equated with “more than remote”. ED-ISQM 1 follows the same approach in paragraph A55 and we reiterate our comment made in response to the ISA 315 exposure draft that the AUASB does not support this concept; and

- The threshold of ‘if they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective’. In practice there could be challenges in the consistent interpretation and determination of the term ‘significant effect’.
- (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?*

The AUASB supports the need for firms to design and implement responses to address their specific quality risks identified. However, the AUASB is not supportive of the design and implementation requirements of the standard in its current form. The AUASB considers the granular level of prescription of design and implementation responses to be counter-intuitive to the very nature of a risk-based approach. Furthermore, the AUASB questions how the standard can propose granular requirements around design and implementation to respond to assessed quality risks when the standard does not have requirements around what those risks are. Additionally, the AUASB is concerned that the pre-determined required responses may not be applicable where a firm has no associated risk. The AUASB recommends that the IAASB provide guidance / clarity around this position.

This level of granularity undermines a proper application of a risk-based approach. Furthermore, the AUASB has concerns that providing a list of required responses may lead to a bottom up approach, starting with the checkbox compliance mentality and working backwards to identify risks to meet these responses.

As expressed in response to question 1(a), the AUASB considers the proposed standard to be a hybrid of risk-based quality management while retaining a granular level of prescription thereby undermining a proper application of a risk-based approach. The main theme expressed by Australian stakeholders throughout the AUASB’s outreach on ISQM 1 was related to its sheer size and level of granularity. The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315⁴ would facilitate a risk-based approach without the need for such granularity.

- (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?*

The AUASB understands the IAASB’s view - expressed in paragraph 37 of the Explanatory Memorandum to ED-ISQM 1 - that the responses in the proposed standard are not comprehensive and as a result the firm is required to design and implement responses to address assessed quality risks in addition to the responses required by the standard. However, other than perhaps for the ‘Resources’ component of ISQM 1, the AUASB considers that the need for additional responses beyond those required by the standard may be limited and does not support the wording in paragraph 10(c) and A59. The AUASB recommends that the wording in paragraph 10(c) is changed as follows:

*‘.....However, the responses required by this ISQM alone ~~will~~ **may** not be sufficient to....’*

⁴ That is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”.



The AUASB recommends that the wording in paragraph A59 is changed as follows:

*“However, the responses required by this ISQM alone ~~will~~ **may** not be sufficient to address all of the firm’s assessed quality risks, as explained in paragraph 10(c). Accordingly the firm ~~is required~~ **may need** to design and implement responses in addition to those required by this ASQM.”*

Additionally, the AUASB is concerned that the pre-determined required responses may not be applicable where a firm has no associated risk. The AUASB recommends that the IAASB provide guidance / clarity around this position.

Q7. Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

The AUASB is supportive of ISQM 1 addressing leadership and governance and agree with the principles of the importance of ‘tone from the top’. However, to reiterate the comments under 1(a) above, the requirements of the proposed standard need to be principles-based and not become prescriptive on how firms manage their businesses. A risk-based approach facilitates firms identifying their own quality objectives, quality risks and responses to address those risks. The AUASB does not consider that it is the role of the standards to prescribe audit firm governance.

An example of the level of granularity is in relation to paragraph 23(a), firm culture, where the AUASB considers that in practice it will be challenging to document the culture of the firm in order to meet the requirements of the standard.

Q8. With respect to matters regarding relevant ethical requirements:

(e) 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?

The AUASB understands that this is already common practice.

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

The AUASB considers that paragraph A71 appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons in the network.

Q9. Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?

The AUASB is supportive of the recognition of the use of technology in the proposed ISQM 1. The AUASB considers that the balance of requirements is appropriate and that the proposed standard is sufficiently principles based in this area.

The AUASB considers that further guidance and clarification on the scope of IT is required. The usage of customised IT applications in the performance of engagements is increasing rapidly. As part of the quality management system, the firm should establish the necessary processes and policies in place to govern the usage of customised IT applications by the engagement teams (ie identifying the risks that the engagement team must mitigate) as it will not be possible for the firm to determine these for every customised IT application.



Additionally, the AUASB notes that paragraph A129 includes a bullet point on ‘*unauthorised access may result in breaches of confidentiality*’ The AUASB considers that this could be expanded to note that the firm / engagement teams will need to consider the application of relevant privacy legislation in the conduct of the engagement, including the extraction, storage and presentation of personally identifiable data. Equally this needs to be considered in the authorised access of the data by the engagement team in the conduct of the audit not just in the unauthorised access.

Additionally, the AUASB notes for consideration that paragraph A130 is an example of where the application material is too onerous. The specific application material that ‘it is necessary for the firm to **determine** that the IT application operates appropriately’ may imply a need to obtain absolute assurance rather than reasonable assurance that the quality objectives are being met. Furthermore, the last bullet point in paragraph A130 refers to the consideration that general IT controls are designed appropriately. Historically this would include consideration of controls to manage changes in the code and the prevent access by the users to the code. The AUASB understand that this is not possible in many new IT applications and therefore the engagement team will be required to implement additional mitigating controls. The AUASB recommends that this be considered in the application material.

Q10. 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

The AUASB is supportive of guidance around appropriate communications with external parties, however the AUASB is concerned with the drafting convention used in paragraph 41. Transparency reports are not always necessary and the AUASB recommends that the wording in paragraph 41(c)(iv) ‘*in a transparency report or otherwise*’ be moved to application material as an example of external communications. The AUASB considers that if the drafting conventions being proposed for ISA 315 are implemented to ISQM 1, this matter will potentially be resolved.

Q11. 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?

The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review. The AUASB supports a risk-based approach to such a determination which is already required in the proposed standard where a firm is required to determine whether an engagement quality review is an appropriate response to assessed **engagement** risks. Further to this, the AUASB suggests the following amendment to paragraph 37(e)(iii)(b):

*‘The firm determines that an engagement quality review is an appropriate response to assessed ~~quality~~ **engagement** risks, based on the reasons for the assessments given to those risks.’*

The AUASB does not consider that it is the role of the engagement quality review to respond to quality risks but rather engagement risks.

If the IAASB does not remove these entities from the scope, then the AUASB notes that application material paragraph A102 highlights that in making the determination of whether an entity is of significant public interest, firms would take into account whether the entity has a large number and wide range of stakeholders and the nature and size of the business. Accordingly, it is unclear whether the proposed standard would result in an expectation that an engagement quality review is performed

on ALL charities and ALL public sector engagements as these entities will always have a large number and wide range of stakeholders. This may be an unintended consequence of the proposed drafting. Furthermore, the AUASB is concerned that ‘significant public interest’ entity cannot be defined consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

Q12. 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?*

The AUASB considers that the proposals will improve the robustness of firms’ monitoring and remediation, particularly through the introduction of the investigation of root causes of deficiencies. The AUASB considers that the identification of root causes should improve the design and evaluation of the remedial actions as well as the evaluation of the system of quality management as a whole. Additionally, the AUASB supports monitoring procedures that can be performed before an engagement report is issued. The AUASB understands that firms use other forms of monitoring / data analysis in addition to reviews of in-process or archived file reviews. For example firms perform targeted activities (for example impairment reviews). The AUASB considers that it is appropriate for the IAASB to recognise other forms of monitoring activities in the proposed standard to recognise the range of such activities.

Again, the AUASB draws attention to the response to question 1(a) in redrafting ISQM 1 in the same manner as proposed redraft to ISA 315. An example of where this is required is in relation to monitoring and remediation: paragraph 45 (inspections may include in-process reviews) is not strictly a requirement. The idea of an in-process review is often more proactive and preventative than monitoring completed engagements, however, if this is not required, and may not replace the inspection of a completed engagement, the AUASB recommends that this should only be referenced in application material.

- 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?*

The AUASB supports the proposal to retain the requirement for the inspection of completed engagements on a cyclical basis. The AUASB is supportive of the guidance in paragraph A169 regarding the ability of firms to establish different cyclical periods, however to promote consistency in application and consistency in quality across firms and jurisdictions, further guidance and examples within this paragraph could be enhanced. For example, refer to nature or assessed risk of engagements (different approaches for “PIE” and “non PIE”) as a way to demonstrate flexibility in the cycle or how the results of in-process reviews may impact the cycle.

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

The AUASB does not consider the distinction between a finding and a deficiency to be clear. The AUASB considers that illustrative examples of what would be a finding and what would be considered to be a deficiency would be helpful. Additionally, the AUASB notes that while deficiency is defined, there is no definition of a finding. The AUASB recommends that the definition of finding be incorporated into the proposed standard. This is particularly important given that firms will be required to respond in different ways. Stakeholders expressed concern that a root cause analysis may be required in order to determine whether a finding is a deficiency. The AUASB recommends that the



language should be clearer to clarify that a root cause analysis is not required to be performed for all findings; rather, firms' policies or procedures should address when a root cause analysis is appropriate. In practice, firms may be performing root cause analysis on findings categorised as "high", i.e. those findings for which there is a high risk of a material misstatement occurring.

- 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?*

In its current form, without the clarity around findings versus deficiencies the AUASB does not support the incorporation of a new requirement to investigate the root cause of identified deficiencies and does not consider that the application material allows for sufficient flexibility. The AUASB supports a root cause analysis on "significant" deficiencies as detailed in the response to question 12(c).

- (ii) *Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?*

The AUASB supports that there is no requirement to undertake root cause analysis of positive findings, however supports the encouragement, through application material paragraph A178, for firms to consider performing root cause analysis on positive findings where considered beneficial. The AUASB considers that positive findings have the potential to be applied more broadly across the firm and assist with improvements in audit quality. Positive findings also supports the development of the culture required by the governance and leadership component of ISQM 1.

- 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?*

The AUASB considers there are challenges to fulfilling the requirement particularly for sole practitioners. In such situations, requiring individual(s) to evaluate the system of quality management for which they are ultimately responsible may not enhance quality, unless this evaluation can be supported by information gathered by other individuals. This may be more practicable for larger firms but may not be effective for SMPs where the individual(s) evaluating the system of quality management is(are) also involved in the engagements that are performed. Additionally, this requirement may also be difficult to achieve for certain network firms where there may not necessarily be one individual tasked with ultimate responsibility and accountability for the system.

Q13. 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?

The AUASB supports the concepts to address network firms perceived or actual undue reliance on network requirements or services. The enhanced requirements around network firms, while supported by stakeholders, is seen to be a practical challenge that will need to be worked through by network firms. Some stakeholders expressed concern that the granularity of the requirements may undermine the purpose of being in a network and may lead to unintended consequences. Additionally, there was a level of concern raised by stakeholders as to the consistency of application across network firms in different jurisdictions and what this means from a regulatory perspective. As previously described in



our response to Question 2, the AUASB considers that more detail may be required in ISQM 1 to demonstrate how this can be achieved.

The AUASB notes that the application material in relation to networks provides examples of the types of inquiries and documentation that the firm may consider, but it provides little or no guidance on the extent of the assessment that the firm should perform, nor the extent of documentation required to evidence such an assessment. The AUASB recommends that such guidance be incorporated into the proposed standard to facilitate consistent and appropriate interpretation and implementation.

Q14. Do you support the proposals addressing service providers?

The AUASB supports the proposals addressing service providers in ISQM 1, but recommends that the term ‘service provider’ is more clearly defined within ISQM 1, with examples provided to assist practitioners identify not only who is a service provider captured under ISQM 1, but also to provide clarity as to who is outside the definition.

Q15. 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?

The depth of considerations of the proposals of the standard may be greater and have more implications in jurisdictions where the suite of Auditing Standards (including ISQM 1) are legislative instruments and have force of law implications. The AUASB is concerned that the granular level of detail contained in proposed ISQM 1 makes this standard difficult for practitioners to achieve compliance with all the requirements. This further supports the need for ISQM 1 to be a risk-based standard as described in Question 1(a) above.