

BY E-MAIL ONLY

International Auditing and Assurance Standards Board
529 Fifth Avenue
New York
10017 USA

Date: July 1, 2019

Subject: COMMENTS ON THE IAASB EXPOSURE DRAFTS FOR ISQM 1, ISQM 2 AND
ISA 220

Dear Sirs,

1. The International Forum of Independent Audit Regulators (IFIAR) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB) exposure drafts for ISQM 1 (*Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*), ISQM 2 (*Engagement Quality Reviews*) and ISA 220 (*Quality Management for an Audit of Financial Statements*).
2. The members of IFIAR share the common goal of serving the public interest and enhancing investor protection by improving audit quality globally, including through the promotion of high-quality auditing and professional standards and related pronouncements and statements.
3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all, of the members of IFIAR. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organisations.
4. Where we did not comment on certain specific matters, this should not be interpreted as either approval or disapproval by IFIAR.

General comments

5. We strongly support the IAASB's development of proposals to address firms' quality control systems and to strengthen the engagement quality review standard. We have identified the following areas where substantive improvements have been made to the extant standards:

ISQM 1

- Enhancements to Governance and Leadership that reinforce that the firm's leadership collectively has the responsibility and accountability for setting and demonstrating the firm's culture and values;

- Establishment of requirements relating to resources (including, but not limited to, personnel), networks and service providers. These improvements are required to respond to the evolution of the audit industry, including how firms are responding to environmental changes in order to provide services effectively and achieve the appropriate levels of quality;
- Expanded scope of engagements requiring engagement quality reviews;

ISQM 2

- Introduction of ISQM 2 which clarifies and strengthens the requirements relating to engagement quality reviews;

ISA 220

- Revision to the definition of engagement team (and supporting application material) that clarifies that all individuals who perform audit procedures on the engagement team are members of the engagement team. Importantly, we believe the change recognises that, regardless of where such individuals are located, or how they are related to the firm, if they are performing audit procedures, then the engagement partner is responsible for the appropriate direction, supervision and review of their work;
- Introduction of material that highlights the importance of professional scepticism, including examples of impediments to exercising professional scepticism and suggesting possible actions to deal with the impediments. We believe that this guidance is important and supports the application of the requirements in ISA 200 in respect of professional scepticism in the context of managing and achieving quality at the engagement level;
- Enhanced requirements regarding the responsibility of the engagement partner to communicate the expected behaviour of the engagement team members in the context of a culture of quality, including the emphasis on the importance of professional scepticism; and
- The stand back requirement in relation to the engagement partner's involvement throughout the audit. This increases the focus on the importance of the partner's involvement and has the potential to improve audit quality.

Professional scepticism

6. Professional scepticism is a key attribute for high quality audits. The lack of professional scepticism continues to be a driver for inspection findings. The standards need to reflect the importance of professional scepticism. We support the references to professional scepticism in the engagement performance sections of ISQM 1 (36(b)) and leadership sections of ISA 220 (12e) and paragraph 22(d)(i) of ISQM 2. We believe that the importance of professional scepticism should also be highlighted in the leadership and governance and engagement performance sections of ISQM 1 and ISA 220,

respectively, and make clear reference to professional scepticism in relation to engagement quality reviewers (“EQ reviewers”) for engagements for which professional scepticism is required (including audits), both in the assessment of whether the engagement team applied appropriate professional scepticism and the application of professional scepticism to the evaluation of significant judgements by the engagement quality reviewer.

Development of guidance and application material

7. The three exposure drafts include a substantially increased volume of application material and there is discussion of producing additional guidance to assist practitioners implementing the new standards. We encourage the IAASB to critically review the application material and any additional guidance and consider whether the relevant requirements could rather be improved or clarified in the first instance.

ISQM 1 QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS

Overarching

8. One of the key public interest issues raised by the IAASB at the onset of this project was the desire for more proactive firm leadership and management of quality. The exposure draft puts more emphasis on leadership and governance and introduces a new risk-based approach for managing quality; however, the exposure draft should go further in requiring firms to be proactive. We recommend greater emphasis on preventative required responses that enable the firm to identify and resolve audit quality issues in a timely manner through early identification, escalation and intervention, i.e., before risks materialize. For example, the requirements for the Monitoring and Remediation process stress the need for engagement inspections, but place less emphasis on other actions that can be taken to proactively address risks to audit quality. Further, firms should be explicitly required to demonstrate that their responses, whether preventative or detective in nature, are present and functioning.
9. IFIAR supports the IAASB’s efforts to renew and strengthen the requirements regarding quality management at the audit firm level and the related name change to International Standards on Quality Management. This reflects the evolving environment in which firms operate, the intensifying focus on quality and the increasing expectations of firms’ stakeholders that a quality standard that is based on fairly high level procedures is not fit for today’s environment and a more proactive approach to managing quality at both the firm and the engagement level is required. We also recognize and support the approach taken in view of scalability and adaptability for the varying practices worldwide. We believe that complex practices (and networks) may need to do significantly more than the minimum requirements set out in the exposure draft to meet the objective. The exposure draft also does not provide sufficiently clear direction on identifying and responding to risks that relate to the quality objectives. As a result, there is a risk that auditors may overlook or not pay sufficient attention to the general requirement for responding to risks in paragraph 30. Instead, they may focus too much on the multiple

paragraphs in the standard that set forth the minimum responses, and such responses may only address a subset of the risks related to a particular objective.

Focus on public interest

10. As audit regulators, we believe that consideration of the public interest, including the needs of investors and other users, should drive the projects to enhance auditing standards. We strongly support references in the exposure draft to the auditor's responsibility to act in the public interest. However, we continue to believe that the *objective* of ISQM 1 should refer to the public interest recognising the firm should act in a manner consistent with its responsibility to the public interest, including considering the needs of investors and other users.

Governance and Leadership

11. We support the enhanced requirements relating to governance and leadership, and also recognise the benefits of enhanced requirements relating to communication and monitoring and remediation. We suggest that an objective be developed in relation to the oversight by the firm's leadership of matters arising from other elements of the standard (further to the periodic assessment in paragraph 55), in particular the communication and monitoring and remediation elements. This could be the driver to enable the firm's leadership to proactively identify quality matters and intervene at the appropriate stage to prevent quality risks from materializing or minimizing their impact.

Quality objectives

12. The exposure draft requires firms to establish quality objectives and additional quality objectives beyond those required, when necessary, to meet the objectives of the standard but does not provide clear direction on when and how these additional objectives should be developed. The IAASB should also develop requirements to support additional or more granular objectives being set to support the subsequent risk identification and response assessment processes.

Quality risks

13. The prescribed objectives are understandably high level to facilitate their relevance to firms of differing natures and complexity. However, the high-level nature of the objectives may result in it being more difficult for firms to identify quality risks at the appropriate level of detail. We recommend that guidelines for developing quality risks be developed, that the risk assessment process includes requirements to assess changes in the external environment and a firm's own business model, and that the standard emphasize that the process for identifying and analysing risks must be dynamic. Strengthening of the requirements in this regard will better enable firms to more effectively assess risks and develop related responses and also to prioritize such responses, such that subsequent allocation of appropriate resources to the response can also be more effectively managed.
14. Audit regulators perform comprehensive inspection programmes and communicate

their findings to audit firms. Notwithstanding the inclusion in the ‘Monitoring and Remediation’ section of external inspection findings, there should be an explicit requirement for firms to take findings from regulators into account as part of their risk assessment process, in particular as part of their identification of quality risks. This could form part of a broader requirement to consider the outcomes from the firm’s monitoring process.

Resources

15. We support the expansion of the Resources section to extend beyond human resources, especially given the significant increase in use of technology by firms in support of their systems of quality management, but also at the engagement level. We however also support further increasing the emphasis in the standard on the aspect of quality control relating to firm resources. Other matters to consider as part of this section include considering risks that technology might introduce (at the firm and engagement level), setting clear expectations for how tools are to be used and the related responsibilities of engagement partners in this regard, and having proper processes and controls to manage use of technology and to upskill auditors on technology. There should also be more focus on evolving use of audit delivery models, in particular delivery centres. Delivery centres can be involved in supporting functions related to the systems of quality management, but can also be involved in performing procedures on audits. These delivery centres can be effective in managing quality risk, but if not well constructed or managed can introduce more risk. We suggest explicit requirements to address how delivery centres are managed by the firm and the responsibilities of engagement partners and teams when using work performed by delivery centres. For example, some firms have policies and procedures for more detailed reviews of work that is performed at a delivery centre, including emphasizing that the engagement partner remains responsible for the work performed by the delivery centre and that such work addresses entity-specific facts and circumstances.

The monitoring and remediation process

16. The definition of a deficiency has improved over the period of developing the exposure draft and has become more fulsome. However, we are concerned that the definition may now be over-engineered and unnecessarily complex. Part of this may stem from attempting to embed the criteria for undertaking root cause analysis into the definition. This definition could lead to firms to fail to address known defects in the systems of quality management and encourage firms to set only high-level objectives to avoid addressing defects. We recommend simplifying the definition and addressing the criteria for root cause analysis separately.
17. We welcome the developments in relation to performing root cause analyses of identified deficiencies. However, root cause analysis (or a similar process to address positive findings) should also emphasize consideration of good practice i.e., to determine factors contributing to high quality audits, and not just be limited to being a response to evaluating identified deficiencies. This is important to capture work which is performed to a high level of quality, but more importantly to demonstrably change the culture to an improvement focus rather than that of avoiding failure.

Networks and shared services

18. We welcome the addition of requirements relating to network resources or services used locally. However, the proposed requirements fall short of addressing the determination of the appropriateness of using network resources or services at the local firm. In particular, the proposed requirements do not address an evidenced evaluation (at network and/or local level) and conclusion by the local firm as to whether, and the extent to which, the network resource or service (e.g. audit tools, independence systems) is appropriate to use. Further, it is unclear why requirements for the use of service providers are more robust than those relating to network resources and services. The application material (paragraph A195) also allows for the understanding of network resources and services to be performed by inquiry alone, which is not sufficient or appropriate. We also question what work effort should be done to support the “evaluation” referred to in paragraph 59.

ISQM 2 ENGAGEMENT QUALITY REVIEWS

19. The eligibility of individuals to act as an EQ reviewer is critical to safeguarding the effectiveness of the EQ review. Key areas include objectivity and appropriate authority. While the application material relating to objectivity refers to a minimum cooling off period of 2 years or more if local regulations are more stringent, the exposure draft would be enhanced if the requirements set this out as a criteria for EQ reviewers of listed and/or public interest entities.
20. The exposure draft allows other individuals to assist the EQ reviewer. We believe that there should be clarity over what work and how much work could be assigned to these individuals. Where this is permitted, requirements for the direction and oversight of the individuals assisting the EQC reviewer should be developed to support the proposed requirement for the EQ reviewer to take responsibility for the EQ review.
21. The exposure draft continues to require EQ reviewers to identify and select areas of significant judgement for their review. Application material is largely limited to referring to the application material to ISA 220 setting out possible criteria for other matters for an audit partner to consider. An effective and consistent EQ review will require a framework to ensure appropriate areas of the audit are reviewed. This framework should also clearly require review by the EQ reviewer of matters that are key audit matters and/or significant risks. The exposure draft also does not address whether significant components in a group audit context should be subject to the scope of the EQ review.
22. The documentation requirements (paragraphs 25-27) in the exposure draft are limited in nature. The proposed requirements may result in a tick box/checklist approach to documentation. Requirements need to include the EQ reviewer’s commentary on:
- Assessment of the significant judgements reviewed (and accordingly the review of the audit team’s risk assessment); and
 - How the EQ reviewer was able to conclude on significant judgements following the

review of selected working papers.

The documentation requirements should not only demonstrate that an EQ review has been performed, but indicate what was reviewed, what matters were discussed and how the EQ reviewer was able to conclude.

ISA 220 QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS

23. While we support the stand back requirement, it raises a question as to why an explicit step for engagement partners to plan/set out their planned level of direction, supervision and review at the onset of the audit has not been included. This would aid engagement partners in assessing their subsequent involvement during the audit.
24. Further clarity is also required over what procedures the engagement partner cannot assign to others. In particular, these changes need to ensure that certain poor practices identified from inspections at firms (for example, in the audit of letterbox companies) are clearly not permissible. The IAASB should:
- Consider whether certain matters should be identified, which cannot be assigned to others.
 - Revisit use of the term ‘monitor’ in paragraph 13 which is too passive. This is also less robust than the term ‘supervise’ used elsewhere in the proposed standard.
25. The leadership responsibilities section has been improved from the extant standard. Notwithstanding the improvement noted, the following improvements are also required:
- Communicating expected behaviours to the engagement team should also refer to the public interest in audit and the associated responsibility of the auditor to investors and other users.
 - While the Introduction sections refers to impediments to professional scepticism and resource constraints, there is scope for the leadership section to include a requirement to consider and assess threats to quality and address them. Threats to audit quality should also include:
 - Commercial pressures, both externally and from within the firm; and
 - Difficult and/or challenging audit clients.
26. There is no reference to audit delivery models and the use of network and firm policies and procedures in the requirements. As these matters are likely to directly impact the audit, the IAASB should seek to introduce relevant material to bridge the gap between firmwide level considerations and those applicable to the engagement level. The firm should also consider whether quality considerations are sufficient when the engagement team uses the work of an auditor’s expert in light of developments on the quality management standards.

Should you wish to discuss any of our comments, please do not hesitate to contact me or Marjolein Doblado, Chair of the IFIAR Standards Coordination Working Group.

Yours faithfully,



Franck Schneider
IFIAR Chair

Cc: Duane M. DesParte, IFIAR Vice Chair,
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