

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

01 July 2019

Dear Sirs

**Request for Comments - Exposure Draft February 2019: Proposed International Standard on Quality Management (ISQM) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

PKF International Limited (“PKFI”), administers the PKF network of legally independent member firms. The PKF International network consists of member firms operating in over 100 countries providing assurance, taxation and business advisory services. PKF International Limited is a member of the Forum of Firms and is dedicated to consistent and high-quality standards of financial reporting and auditing practices worldwide. This letter represents the observations of PKF International Limited, but not necessarily the views of any specific member firm or individual.

We welcome the opportunity to comment on the International Auditing and Assurance Standards Board’s (IAASB’s) Exposure Draft (ED) on the Proposed International Standard on Quality Management (ISQM) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements.

We are supportive of the IAASB’s efforts to drive improvements in quality at both a firm level and the engagement level through its development of ED-ISQM 1 and related exposure drafts ISQM 2 and ISA 220. We believe that this suite of proposed quality standards will ultimately help to address the objectives that the IAASB set for this project.

We also believe that there is still an opportunity to make further enhancements to ED-ISQM 1, particularly in the following aspects:

*Scalability* – We believe that the requirements in ED-ISQM 1 for a firm to consider its own specific circumstances when assessing the risks to its quality objectives will ensure that a firm’s system of quality management is customized to its unique situation, avoiding a “one size fits all” approach. This is a welcome (intended) benefit of ED-ISQM 1 compared to ISQC 1. However, the inherent tension between scalability through the proposed standard’s new risk-based approach and the IAASB’s conclusion to retain the requirements from extant ISQC 1 as either required quality objectives or responses, negatively impacts on the potential for scalability. Additionally, there are certain specific parts of ED-ISQM 1 which could still be made more scalable than currently proposed. Given the wide range of size and circumstance of all the types of firm to which the proposed standard would apply, it is critical that it is written with scalability being a key objective. Our responses to the request for comments include several examples of where we believe further scalability could be introduced into ED-ISQM 1. For each of these we encourage the IAASB to consider them as part of its efforts to optimize the scalability of the standard in its final version.

*Clarity* – We believe that ED-ISQM 1 is a well-structured standard and that it has generally been written with both clarity, and practicality of application, in mind. Nonetheless, in our responses we have highlighted certain sections of ED-ISQM 1 which we believe should be revised in order to further enhance the clarity of their wording and to reduce the risk of varying interpretations. The broad range of stakeholders in the proposed standard (including national regulators, public oversight bodies, local standard setting bodies, members of the public and of the investment community, as well as the firms to which the standard's requirements will be applicable) will collectively increase the risks of inconsistent application and diverging interpretation of the requirements. We encourage the IAASB to address the areas of ambiguity that we have identified and, for each of these areas, to consider how to improve the clarity of the language used.

*Risk Assessment process* – we agree with the overall approach that ED-ISQM 1 takes on the risk assessment process, which places it as a critical and foundational part of a firm's system of quality management. In our comments, we have highlighted some specific concerns around the risk of varying interpretations on the requirements and guidance on risk assessment. We believe it is critical that the standard is abundantly clear and unambiguous on its requirements in this area, since the risk assessment process will form the basis for the design of the responses that a firm establishes in order to meet the objectives of its system of quality management. In a worst-case scenario, should a regulator or other oversight body take a differing view to a firm on how it should perform its risk assessment, this could render the firm's whole system of quality control as being non-compliant with the proposed standard. In order to reduce this risk, we encourage the IAASB to consider those aspects of the requirements and accompanying guidance on risk assessment in ED-ISQM 1 which are unclear or ambiguous and that it takes the opportunity to ensure that the wording is clarified in the final version of the standard.

*Harmonization with other jurisdictions* – we encourage the IAASB to maintain communications on harmonization of global standards on quality management with other standard setters in those countries and jurisdictions in which the ED-ISQM 1 would not be directly applicable, for example the USA. Additionally, we encourage the IAASB to provide related guidance for global networks and for ISQM 1 compliant firms which may intend to use a non-ISQM 1 firm as a component auditor in a group audit engagement. Such guidance should be aimed at helping networks and firms better understand both the risks to their own compliance with ISQM 1 which could arise through interactions with non-ISQM 1 firms, as well as how to design and implement acceptable responses to mitigate those risks.

We would like to thank the IAASB for the considerable efforts and wide-ranging consultation process undertaken in developing the exposure draft. Our individual responses to the IAASB's request for comments are set out in [Appendix 1](#) of this submission.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Jamie Drummond', with a stylized flourish at the end.

**Jamie Drummond**

Director of Assurance  
PKF International Limited

## Appendix 1

### Request for comments

#### Overall Questions

##### Question 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?*

#### Response

In our view the proposed requirements in ED-ISQM 1 in general will enhance firms' management of engagement quality.

While there is scalability to the application of ED-ISQM 1, its proposed requirements in combination will require that a firm allocates a significant incremental amount of time and resource to design, implement and operate its new quality management system, compared with the effort required to comply with extant ISQC 1.

Regarding its public communications around ED-ISQM 1, we recommend the IAASB provides clear communications to better manage firms' expectations on the extent of the incremental effort that will necessarily be incurred in complying with the standard's requirements. Such communications should be sufficiently clear to reduce the risk that firms misinterpret the scalability benefits of ED-ISQM 1, to infer that the new standard will take less effort to comply with than extant ISQC 1.

- a. In general, we support the new quality management approach.
- b. The proposals are likely to generate benefits for engagement quality. They will also support the appropriate exercise of professional skepticism at the engagement level.
- c. The requirements and application material do provide a degree of scalability to firms of varying size, complexity and circumstances. However, the precise degree to which ED-ISQM 1 can be scaled will require the exercise of professional judgement and is an aspect of the standard which may be open to varying interpretations. We have a concern that firms and regulators may apply differing interpretations on the extent to which ED-ISQM 1 can be scaled.

Outside of the main body of ED-ISQM 1, the IAASB has issued supplementary materials covering scalability of the proposed standard by Small- and Medium-Sized Practices (SMPs) which, for example, includes relevant guidance indicating that certain responses to quality risks may not necessarily need to be subject to documentation as a written policy or procedure by an SMP. We recommend that all such relevant guidance on scalability be

considered for inclusion within the main body of the standard, as opposed to being confined to webinars and other guidance. We believe that to do so would provide a more robust and authoritative basis for the scaling of the requirements of ED-ISMQ 1 and, in particular, would support SMPs in designing a system of quality management that is appropriately tailored to their circumstances.

The IAASB has also published the document “DRAFT EXAMPLES: HOW THE NATURE AND CIRCUMSTANCES OF THE FIRM AND THE ENGAGEMENTS IT PERFORMS AFFECT THE IMPLEMENTATION OF PROPOSED ISQM 1”. While it is helpful to provide examples of the application of ED-ISQM 1, the range of circumstances covered by the examples within this document is very narrow, omitting several other common circumstances encountered by many firms and networks. Therefore, we recommend that a wider range of additional examples should be included within the document.

## Question 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?*

## Response

We have commented elsewhere within this submission on those aspects of ED-ISQM 1 that may create challenges for implementation.

## Question 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?*

## Response

The application material is generally helpful in supporting a consistent understanding of the requirements.

However, as noted elsewhere within this response, there are certain sections of the standard, including within the application guidance, which we believe could be enhanced with additional guidance.

## Specific Questions

### Question 4

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

### Response

We support the eight components and the structure of the ED-ISQM 1.

We believe that the diagram depicting the eight components of the quality management systems (as set out on page 7 of the ED-ISQM 1 Explanatory Memorandum), could be inferred as

depicting a hierarchy of the eight components. However, ED-ISQM 1 indicates that the eight components are inter-related, which suggests that there is no hierarchical order to the components. To address the risk of misinterpretation, we recommend that the Explanatory Memorandum includes appropriate wording to clarify that the diagram of the eight components is presented for illustrative purposes only and does not represent a hierarchy of the components.

### Question 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?*

### Response

We support the objective of the standard, but in our view the standard could be improved by expanding on the definition of "reasonable assurance", which is a term that is integral to the objective of ED-ISQM 1. The concept of "reasonable assurance" is included within paragraph 18 of ED-ISQM 1, and this paragraph, more widely, sets out the overall objectives of the standard.

In practice, it will be important that firms adopt a consistent understanding of "reasonable assurance" but we are concerned that the definition of "reasonable assurance" in ED-ISQM 1 is too brief to allow for consistency. Consequently, we recommend the definition is expanded to reduce the risk of diverging interpretations and to promote consistent application.

Please also refer to our response below to Question 12 (e), which further addresses our concerns regarding the concept of "reasonable assurance".

We agree with how the standard explains the firm's role relating to the public interest. In our view the standard is sufficiently clear, both explicitly and implicitly, as to how the objectives of the standard relate to the firm's public interest role and it strikes the right balance without being overly prescriptive in this regard.

### Question 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?*
- (b) Do you support the approach for establishing quality objectives? In particular:*
  - i. Are the required quality objectives appropriate?*
  - ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?*
- (c) Do you support the process for the identification and assessment of quality risks?*

- (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?
  - 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?

## Response

We believe that the application of a risk assessment process will generally drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved.

- a. We agree that the firm's risk assessment process should be applied to the other components of the system of quality management.
- b. We generally support the approach in ED-ISQM 1 for establishing quality objectives.
  - i. In our view the required quality objectives are appropriate.
  - ii. We have a concern that the use of the word "expected" within this section of the standard may lead to varying interpretations of its meaning. In our view, there may be circumstances, particularly for SMPs, for which additional quality objectives beyond those required by the standard, would not be necessary. For such firms, there is a risk that the phrase "is expected to" may be misinterpreted to mean "shall". Consequently, we believe that ED-ISQM 1 should use "may" rather than "is expected to", where it refers to the firm establishing additional quality objectives beyond those required by the standard. We believe this will also help with the scalability of the standard.

Additionally, regarding question 6(b)(ii), in our view, to more clearly reinforce the point on firms establishing additional quality objectives beyond those required by the standard in certain circumstances, this guidance should be repeated within each of the separate components of ED-ISQM 1.

- c. In general, we support the process for identification and assessment of quality risks.

However, in our view there is a risk of varying interpretations of the requirements relating to the starting point of the risk assessment process. This concern arises from:

- the flow chart in paragraph 33 of Section 3 "Significant Matters", of the Explanatory Memorandum, which introduces the concept of the "whole population" of quality risks; and
- paragraph 27 of ED-ISQM 1, which requires a firm to form an understanding of the factors which could adversely affect the achievement of quality objectives. Such an understanding under paragraph 27, is required to be gained by firms prior to applying the threshold test to identified risks, as set out in paragraph 28.

We believe that the concept of the “whole population” of quality risks (as per the first bullet point above), and the open-ended nature of the understanding that needs to be formed (under the second bullet point above), could each be subject to varying interpretations. In our view, some firms and other stakeholders in the standard, could interpret these two points as acting in combination to require the firm to determine, for each quality objective, a comprehensive set of quality risks for which there is no level of risk threshold. In other words, the “whole population” of risks could be interpreted as including every possible theoretical risk, no matter how trivial the theoretical risk may be in context of the corresponding quality objective.

Under such an interpretation, this “whole population” of risks may subsequently be reduced after applying the risk threshold criteria in paragraph 28 of ED-ISQM 1, but only after the initial stage of identifying quality risks prior to applying any threshold. To interpret the proposed standard along the lines we have indicated, would lead to an overly onerous process of identifying the “whole population” of risks and would undermine the scalability objectives of the ISQM project.

Consequently, in order to promote consistent interpretation and to help achieve scalability, we believe the IAASB should revise the wording on the initial stage of identifying quality risks, to provide a clearer, less ambiguous explanation on the design of this stage of the overall risk assessment process, and the related documentation requirements.

- d. We support the approach that requires the firm to design and implement responses to address the assessed quality risks.
  - i. We believe that the approach will result in a firm designing and implementing responses that are tailored to, and which will appropriately address, the assessed quality risks.
  - ii. It is generally clear within ED-ISQM 1 that the firm is expected to design and implement responses in addition to those required by the standard in certain circumstances. However, in our view, this point should be reinforced by including an additional paragraph within each of the separate components of ED-ISQM 1 which repeats the expectation for the firm to design and implement responses in addition to those required by the standard in certain circumstances.

In addition, we have a concern that the use of the word “expected” within this section of the standard may lead to varying interpretations in practice. In our view, there may be circumstances, particularly for SMPs, for which additional responses beyond those required by the standard, would not be necessary. For such firms, there is a risk that the phrase “is expected to” is interpreted to mean “shall”. Consequently, we believe that ED-ISQM 1 should use “may” rather than “is expected to”, where it refers to the firm establishing additional responses beyond those required by the standard. We believe this will also help to scale the application of the standards.

### Question 7

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

### Response

In our view the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

However, the standard contains inconsistencies in its requirements for periodic performance evaluations for those with ultimate and operational responsibility for the firm's system of quality management, specifically in context of an SMP firm. For example, in paragraph 24 (b) of ED-ISQM 1 there is a required response that a firm shall establish policies and procedures over the process for such an evaluation, without any exemptions from these requirements for a smaller firm. But the related application guidance in paragraph A42 of EDISQM 1 indicates that the results of a firm's monitoring process may provide an indication of the performance of those with ultimate and operational responsibility for the firm's system of quality management, where it is impractical to conduct performance evaluations.

The use of the word "may" in paragraph A42 of ED-ISQM 1 versus "shall" in paragraph 24 (b) of ED-ISQM 1, could lead to diverging views on how formalized an SMP's performance evaluation process should be for those with ultimate and operational responsibility for the system of quality management.

### Question 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?*

### Response

- a. We do not believe that the ED-ISQM 1 should require the firm to assign responsibility for relevant ethical requirements to an individual within the firm. Relevant ethical requirements and related ethical principles could in part be met through other elements of the quality management system (such as Resources). Assigning responsibility for ethical requirements broadly will simply not be practical or feasible.

We believe the narrower focus on independence should be retained. However, we suggest that firms should only be required to assign responsibility for compliance with independence requirements to an individual where independence has been identified as a risk (e.g. if firms do not perform any assurance or other work for which independence is required, this should not be a required response).



Firms who are subject to independence requirements generally invest significant resources into managing independence, and complex independence considerations often need to be considered by those with specialist knowledge. Where a risk to independence of such a nature has been assessed by a firm it therefore follows that overall responsibility should be assigned for independence.

We believe that the firm should have the ability to determine how to design an appropriate response to this aspect of its system of quality management, based on its own risk assessment, rather than ED-ISQM 1 providing specific requirements. This approach would also help with the scalability of the standard and would be particularly beneficial to SMPs that do not perform audit work.

- b. In our view, the standard appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons within the network, through its principles-based requirements addressing relevant ethical requirements.

### Question 9

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

### Response

In our view, through its principles-based approach to technological resources, ED-ISQM 1 has been appropriately modernized to address the use of technology by firms in the system of quality management.

### Question 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?*

### Response

In our view, the requirements in ED-ISQM 1 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.

While these requirements may not be as relevant to smaller firms, the proposals are likely to encourage larger firms, or firms providing audit services to public interest or listed entities, to communicate via a transparency report.

### Question 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?*

### Response

We generally agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review, and that the requirements should result in the proper identification of engagements to be subject to an engagement quality review.

However, the use of the term “entities that the firm determines are of significant public interest” in paragraph 37 e (ii) of ED-ISQM 1, may lead to confusion with other similar terms (such as “Public Interest Entities”) that are commonly used by firms or may already be defined by regulators and other public oversight bodies in certain jurisdictions.

Consequently, we have a concern that the proposal to perform an EQR for “audits of financial statements of entities that the firm determines are of significant public interest” may result in inconsistent interpretations by firms and by regulators. As the terminology is used in existing ISAs we do not propose a change to the terminology in ED-ISQM 1. However, we recommend that paragraph 37 (e) in ED-ISQM 1 be amended to the effect that “entities that are of significant public interest” be included in the examples of entities that a firm should consider, rather than creating an explicit requirement around an ambiguous concept.

## Question 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?*

## Response

In our view the proposals for monitoring and remediation will generally improve the robustness of firms’ monitoring and remediation.

- a. In our view, in order that the proposals are more likely to support an improvement in firms' monitoring of the system of quality management as a whole, we recommend that this component of ED-ISQM 1 makes explicit reference to "system of quality management as a whole". This may help to reduce the risk of firms misinterpreting this requirement as applying only to the monitoring of engagements, rather than being applicable to the monitoring of all components of the system of quality management.

Otherwise, in our view the proposals will promote more proactive and effective monitoring activities, including the development of innovative monitoring techniques.

- b. We agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each partner on a cyclical basis.

We also agree with the enhancements in the standard to improve the flexibility of the requirement and the focus on other types of reviews. However, in our view the standard would benefit from additional guidance on in-process reviews, including guidance on how the firm should determine the appropriate mix of both in-process and completed engagement reviews.

In our view ED-ISQM 1 does not go far enough in promoting scalability for this component. We believe that scalability is highly relevant to monitoring activities, given firms' circumstances can vary significantly. Consequently, we recommend that the IAASB reconsiders where it can introduce more scalability into this component of the standard.

- c. The framework for evaluating findings and identifying deficiencies is helpful and we believe that it is appropriate for its inclusion within ED-ISQM 1.

However, to promote consistency of interpretation, the proposed wording could be made clearer by including a definition of, plus supplementary application guidance on, the term "finding". This term is a critical aspect of the monitoring process, and it is used frequently throughout ED-ISQM 1 but it is not defined.

- d. We agree with the new requirement for the firm to investigate the root cause of deficiencies.

i. We also agree with the requirements on the nature, timing and extent of procedures to investigate the root cause.

ii. Additionally, we agree that the manner in which ED-ISQM 1 addresses positive findings is appropriate.

- e. In our view, the key challenge that may arise in fulfilling this requirement, is regarding the term "reasonable assurance". In our view, this term is not adequately defined in ED-ISQM 1 and there is a risk that it may be subject to varying interpretation. Consequently, to promote a more consistent interpretation, we recommend the definition of the term "reasonable assurance" should be expanded to provide a more comprehensive explanation of its meaning.

Additionally, we believe the following excerpt from paragraph 18 of the Explanatory Memorandum to ED-ISQM 1 would be useful if included in the main body of the proposed standard:

“In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (i.e., in the case of an assurance engagement). Instead, reasonable assurance is obtained through the operation of the system as a whole.”

This would provide additional guidance to the firm on the nature of the process that it should undertake in order to gain reasonable assurance.

### Question 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?*

### Response

We support the proposals addressing networks. In our view, the proposals will help to address the issue of firms placing undue reliance on network requirements or network services.

### Question 14

*Do you support the proposals addressing service providers?*

### Response

We support the proposals addressing service providers.

### Question 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?*

### Response

In our view, the change in title to “ISQM” will not create significant difficulties in adopting the standard at a jurisdictional level.

## Glossary of terms

ED-ISQM 1	Exposure draft February 2019: International Standards on Quality Management 1
ISQC 1	International Standards on Quality Control 1
IAASB	International Audit and Assurance Standards Board
SMP	Small and medium-sized practitioners
EQR	Engagement Quality Review
ISA	International Standards on Auditing