27 June 2019

Our Ref.: C/AASC

International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor,
New York
NY 10017
USA

Dear Sirs,

Overall Explanatory Memorandum, The IAASB’s Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews (ED-OEM)
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 (ED-ISQM 1)
Proposed International Standard on Quality Management (ISQM) 2, Engagement Quality Reviews (ED-ISQM 2)
Proposed International Standard on Auditing (ISA) 220 (Revised), Quality Management for an Audit of Financial Statements (ED-220)

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory body in Hong Kong that sets auditing and assurance standards, ethical standards and financial reporting standards. We welcome the opportunity to provide our comments on the captioned IAASB Exposure Drafts (EDs).

Overall, we support the new quality management approach which focuses on proactively identifying and responding to risks to quality. We appreciate that IAASB has placed significant efforts in addressing scalability in the EDs. However, we consider that more practical guidance on how firms can develop the system of quality management would be helpful. In addition, firms are requesting IAASB to provide more documentation guidance and education on quality management in form of webcast, workshop or case study.

Our responses to the questions in EDs are included in the attachment. We trust that our comments are of assistance to the IAASB in deciding the next steps. If you require any clarification on our comments, please do not hesitate to contact our Selene Ho, Deputy Director at selene@hkicpa.org.hk.

Yours faithfully,

Chris Joy
Executive Director

SH/al
ED-OEM

Overall Questions

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

In principle, we support the approach and rationale for the proposed implementation period of approximately 18 months after the approval of the three standards by the Public Interest Oversight Board.

However, we would like the IAASB to clarify whether the 18-months implementation period includes the time for testing the effectiveness of the quality management system. The time for testing the effectiveness of the quality management system may be significant for firms. If the quality management system is expected to have been fully tested and confirmed as effective by the implementation date it may be difficult for firms to demonstrate that they comply with the three standards.

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

We appreciate that IAASB has placed significant efforts on addressing scalability in the EDs. We find the appendixes of the EDs that highlight how they are scalable to the nature and circumstances of the engagements and the video for SMPs on quality management useful.

However, we consider that more practical guidance on how firms can develop the system of quality management would be helpful. For example, IAASB may consider developing a case study to facilitate the firms transiting to the new quality management system.

ED-ISQM 1

Overall Questions

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?
We support the proposed quality management approach focusing on proactively identifying and responding to risks to quality.

(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?

We believe that the proposals will generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level. For example:

- The firm’s culture and the tone set by leadership should promote the importance of quality, and the need to exercise professional skepticism when performing audit, review or other assurance engagements.
- Allocating appropriate resources to perform engagements may prevent impediments to professional skepticism, such as limited time, knowledge or experience.

(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 proposed requirements and application materials of proposed ED-ISQM 1 are scalable as it requires firms to apply a risk-based approach in the design, implementation and operation of the system of quality management, taking into account the nature and circumstances of the firm and the engagements performed by the firm. In addition, an explicit requirement in paragraph 21 of ED-ISQM 1 indicates that there may be circumstances when a requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements facilitates the application.

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?

We understand that firms are concerned with the documentation expectation required for the quality management system as the requirements set out in ED-ISQM 1 are principles based. They have expressed concerns on whether the amount of documentation would meet regulator's expectations.

We consider it would be helpful for the IAASB to provide more guidance on documentation and education in form of webcast, workshop or case study. We understand that regulators would have influence over the level of documentation required and hence the IAASB encourages firms to have early discussions with their regulators.

3. Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?
We believe the application material in ED-ISQM 1 explains sufficiently what a requirement means or is intended to cover, which supports a consistent understanding of the requirements.

As highlighted in our comments to question 2 of ED-OEM, we consider that more practical guidance on how firms can develop the system of quality management would be helpful. For example, IAASB may consider developing a case study to facilitate the firms transiting to the new quality management system.

Specific Questions

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

In general, we support the eight components as the key components of the system of quality management as they are specifically designed and highly integrated. The sheer length of proposed ED-ISQM 1 may pose a challenge to readers. To help improve readability and scalability of the standard, it may be useful for IAASB to undertake a similar exercise to ED-ISA 315 (Revised) to present the requirements and application materials that broadly address varying sizes, complexity and requirements. The proposed ISQM 1 should be streamlined as far as possible focusing on "what are the requirements". For example, paragraph 4 somehow repeats paragraph 1 and the example in paragraph 5 which is also in paragraph A23, can be deleted in the standard itself.

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

We support the objective of the standard that an effective system of quality control provides the foundation for the approach to achieving consistent engagement quality.

We agree with how the standard explains the firm's role relating to the public interest by explaining the connection between the public interest and the objective of the standard (paragraph 7 of the ED-ISQM 1).

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:

We believe the objective of the standard can be achieved as the risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, which consists of establishing quality objectives, identifying and assessing quality risks to the achievement of the quality objectives and designing and implementing responses to address the assessed quality risks.

(a) Do you agree that the firm’s risk assessment process should be applied to the other components of the system of quality management?
We consider it will be more effective to adopt a consistent approach if the firm’s risk assessment process is 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?

In general, we consider the required quality objectives are appropriate. It is clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances as stated in paragraphs 26 and A49 of the ED-ISQM 1.

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

We support the process for the identification and assessment of quality risks, in particular the clarification that not every quality risk needs to be identified and further assessed. The firm identifies which quality risks need to be further assessed based on a preliminary consideration of the possibility of the quality risks occurring and the effect on the achievement of the quality objectives. Only those quality risks that meet both of the criteria in paragraphs 28(a) and (b) of the ED-ISQM 1 need to be identified and further assessed. The further assessment of the quality risks involves a more detailed consideration of the degree of the likelihood of the quality risks occurring and the significance of the effect of the quality risks on the achievement of the quality objectives.

(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?

We support and believe the approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks of the firm. Besides, the standard is explicit that the firm is required to design and implement responses to address the assessed quality risks, in addition to the responses required by the standard as stated in paragraphs 10(c) and A59 of the ED-ISQM 1.
7. Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

In general, we consider the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership which emphasize the responsibility of firm leadership to proactively managing quality.

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?

We believe it is the current practice of a majority of firms to assign responsibility for relevant ethical requirements, including independence requirements to an individual for operational purposes. Depending on the size of the firm, this individual may be supported by a team or other colleagues under the supervision of this individual.

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

We consider the standard appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons within the network as set out in:

- Paragraph 14 of ED-ISQM 1 acknowledges that the network is external to the firm and therefore does not form part of the firm’s system of quality management.
- Paragraph 28 of ED-ISQM 1 further emphasizes that in circumstances when a firm is a member of a network, the firm retains full responsibility for its own system of quality management, including complying with the requirements of ED-ISQM 1.
- In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the information and communication quality objectives, paragraphs 41(c)(ii) and A173 of ED-ISQM 1 requires the firm to establish policies or procedures that address the nature, timing and extent of communication and matters to be communicated with the network. Such communication may include matters related to independence, for example in circumstances when relevant ethical requirements include requirements for independence that apply to network firms or employees of network firms.

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

In general, we consider the ED-ISQM 1 has been appropriately modernized to address the use of technology by firms in the system of quality management, in particular, it covers the situation where IT applications (including commercial software) are used to monitor compliance with relevant ethical requirements, record and maintain information about independence and audit documentation.
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?

We consider the stakeholders’ perception of the quality of engagements performed by the firm may be improved when the firm is transparent about the activities that it has undertaken to address quality, and the effectiveness of those activities. Hence, we believe the requirements for communication with external parties can promote the exchange of valuable and insightful information about the firm’s system of quality management with the firm’s stakeholders.

We consider paragraph 41(c)(iv) of the ED-ISQM 1 does not specifically require firms to prepare transparency report and we support that because it may discourage the exchange of valuable and insightful information with external parties through alternative means, which may be more appropriate or effective than a transparency report given the circumstances of the firm.

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

We agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review as stated in paragraphs 37(e) and A101 - A105. In addition, more guidance will be helpful to assist firms to determine that an engagement quality review is an appropriate response to assessed quality risk according to the requirement set out in paragraph 37(e) of ED-ISQM 1.

We also consider the IAASB may need to clarify the meaning of "significant public interest" in paragraphs 37(e) and A102 of ED-ISQM 1 as it is not defined, and how it relates to "public interest entity" as defined in The International Ethics Standards Board for Accountants International Code of Ethics for Professional Accountants. We understand the International Ethics Standards Board for Accountants (IESBA) will undertake a project to define "public interest entity" and we encourage IAASB to work closely with the IESBA to align a common definition of "significant public interest/public interest entity".

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?

We believe that the proposals would improve firms’ monitoring of the system of quality management as it is a continual and iterative process and is responsive to changes in the nature and circumstances of the firm and its engagements.
(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?

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

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

We agree the framework for evaluating findings and identifying deficiencies is clear, in particular, not all findings are subject to additional actions, such as investigating the root cause of the finding or remediating the finding. In addition, we support the definition of deficiencies as stated in the paragraph 19(a).

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

We agree with the new requirement for the firm to investigate the root cause of deficiencies and considered it may:

- Facilitate the design and implementation of more effective actions to address identified deficiencies.
- Directly contribute to the improvement of quality at the engagement level through the participation of engagement teams in the root cause analysis process.
- Enable those assigned ultimate responsibility and accountability or operational responsibility for the system of quality management to proactively monitor actions taken to address identified deficiencies.
- Facilitate more effective communication to personnel by explaining the actual root cause(s) of identified deficiencies, rather than the deficiencies themselves.

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?

We agree that the nature, timing and extent of the procedures to investigate the root cause is sufficiently flexible as it takes into account the nature of the deficiencies and their possible severity.

In addition, we agree that ED-ISQM 1 should not require firms to determine the root cause of positive findings because the priority is for firms to remediate deficiencies.

(e) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?
We have not received comments objecting to an individual assigned for the ultimate responsibility and accountability for the system of quality management to evaluate the achievement of objectives at least annually.

However, we would suggest IAASB to set out the frequency and timing for periodic "performance evaluations" of the individual(s) assigned with ultimate responsibility and accountability for the system of quality management in paragraph 24(b) to conform with the annual evaluation requirement of quality management system in paragraph 56.

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?

We support the proposals addressing networks with the aim to improve the robustness of the firm’s responsibilities for the network requirements or network services, so that the firm understands the network requirements or network services and the effect they have on the firm’s system of quality management.

In addition, we consider the ED-ISQM 1 emphasizes that the firm is responsible for its own system of quality management, thereby addressing the issue that firms may place undue reliance on network requirements or network services.

14. Do you support the proposals addressing service providers?

We support the proposals addressing service providers as a service provider provides a resource, and therefore the firm needs to determine that it is appropriate to use that resource in the system of quality management.

In addition, the IAASB may consider adding "obtaining results of the monitoring activities from the service provider" as one of the examples set out in paragraph A210 for determining the appropriateness of the service provider.

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?

There is no concern locally over the change in title to "ISQM".

ED-ISQM 2

1. Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

We support a separate standard for engagement quality reviews as it would provide a number of benefits, including:

(a) Placing emphasis on the importance of the engagement quality review.
(b) Facilitating the enhancement of the robustness of the requirements for the eligibility of engagement quality reviewers and the performance and documentation of the review.

(c) Providing a mechanism to more clearly differentiate the responsibilities of the firm and the engagement quality reviewer.

We agree that ED-ISQM 1 should address the circumstances in which an engagement quality review should be performed and ED-ISQM 2 should address the specific requirements for the appointment and eligibility of the engagement quality reviewer and the performance and documentation of the review.

2. Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?

We consider the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 are clear. The scope of ED-ISQM 2 is clearly set out in paragraph 1 and the linkage with ED-ISQM 1 is set out in paragraph 2.

3. Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer”? Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?

We support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer” in alignment with the proposed change in the name of ED-ISQM 1 from "quality control" to "quality management".

We do not believe that there will be any adverse consequences of changing the terminology in our jurisdiction.

4. Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

In general, we support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2. However, we would suggest the IAASB clarify whether professional staff assisting the engagement quality reviewer would be subject to any cooling-off period after serving as engagement team member for the engagement.

(a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?

We agree ED-ISQM 2 provides appropriate flexibility because it places the onus on the firm to establish policies or procedures that are appropriate to address the issue of "cooling-off" period. However, we would recommend more guidance, in addition to paragraph A5 to help support consistent application in practice.

(b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?
We agree that such guidance should be located in proposed ISQM 2 to make it more comprehensive as this is a standard on quality management of engagement quality review. In addition, we consider the proposed ISQM 2 should emphasise that more stringent requirement should be applied by firms where local ethical requirements go beyond the requirements of ISQM 2.

5. Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?

In general, we agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures. However, we would like the IAASB to clarify whether the requirement set out in paragraph 22(f) "For audits of financial statements, evaluate the basis for the engagement partner's conclusion that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement." applies to engagements other than audit engagements as well.

We consider the engagement partner should take responsibility for the overall quality on management. In addition, the responsibility of the engagement quality reviewer should not outweigh those of the engagement partner and the performance of an engagement quality review does not reduce the responsibilities of the engagement partner.

6. Do you agree that the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional skepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

We agree the engagement quality reviewer should evaluate the engagement team’s basis for making significant judgments including, when applicable, the appropriate exercise of professional scepticism.

We are of the view that the engagement quality reviewer is not a member of the engagement team and is not required to obtain evidence to support the opinion or conclusion on the engagement (i.e. no need to exercise of professional skepticism).

7. Do you agree with the enhanced documentation requirements?

We agree the enhanced documentation requirements, in particular, paragraph 27 of ED-ISQM 2 which requires the documentation to be sufficient to enable an experienced practitioner, having no previous connection to the engagement, to understand the nature, timing and extent of the engagement quality review procedures performed.

8. Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?
We appreciate the efforts made by the IAASB in addressing the scalability for firms of varying size and complexity. In particular, we find the Appendix helpful as it highlights how the proposed ISQM 2 is scalable to the nature and circumstances of engagements that the firm performs.

However, we would like to share a feedback from our SMPs that it is difficult for sole proprietors and even medium sized firms to locate external quality reviewers as there are limited professionals offering quality review services in Hong Kong. In addition, they consider that it is difficult for the firms to ensure the quality of external individuals.

**ED-220**

1. **Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?**

   In general, we support the focus on the sufficient and appropriate involvement of the engagement partner as part of taking overall responsibility for managing quality on the engagement.

   We consider the proposed ISA appropriately reflects the role of other senior members of the engagement team. For example, the role of other members with assigned supervisory role in paragraph A30 and the role of engagement quality reviewer in paragraph A19.

   However, we would like the IAASB to clarify whether the engagement team as defined under paragraph 10(d) of ED-220 includes component auditors (in the case of a group audit) and reviewers who perform other types of engagement review as mentioned in paragraph A95 of ED-ISQM1.

2. **Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures?**

   We consider the ED-220 includes appropriate links with proposed ISQM 1 and ISQM 2, for example:

   - Requiring the engagement partner to take responsibility for the engagement team consulting on matters where the firm’s policies or procedures require consultation (paragraph 32(a)).
   - Aligning the requirement to cooperate with the engagement quality reviewer with proposed ISQM 2 (paragraph 33(b)).

   We support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures. The “depend on the firm’s policies or procedures” approach can avoid the risk that the engagement team blindly relies on the firm’s system of quality
management without taking into account whether the firm’s quality management policies or procedures are “fit-for-purpose” in the specific circumstances of the engagement.

3. Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)

We support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level.

4. Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

We consider ED-220, in particular, paragraphs A34 and A57-A59 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology.

5. Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

In general, we support the revised requirements and guidance on direction, supervision and review.

6. Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?

We consider ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation.

7. Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?

We appreciate the effort made by IAASB in addressing the scalability for engagements of varying size and complexity. In particular, we find the Appendix helpful as it highlights how the proposed ED-220 is scalable to the nature and circumstances of engagements that the firm performs.

Editorial comments:

ED-ISQM 2
● Paragraph 21(b) should be amended to ".... dating the engagement report until the completion of the engagement quality review" to specify it is referring to the engagement quality review.

ED-220
● The reference in paragraph 36 should be amended to A95-A98.
● The footnote 3 under paragraph A47 may not be appropriate as it referred to ISQM 1 and not ISA 210.

~ END ~