

July 1, 2019

## **IFAC Small and Medium Practices Committee Response to the IAASB's Exposure Draft for Proposed International Standard on Quality Management 1 (ISQM 1) - Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements**

### **INTRODUCTION**

The SMP Committee (SMPC) is pleased to respond to the IAASB's (the Board) Exposure Draft (the ED), for *Proposed International Standard on Quality Management (ISQM 1)*. The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPC are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPC are drawn from IFAC member bodies representing 22 countries from all regions of the world.

### **GENERAL COMMENTS**

The proposed ISQM 1 is a very important standard which will shape the foundation of quality management (QM) in SMPs for many years to come. We commend the significant amount of work that has been undertaken by the Board in progressing the project and support the main objective of enhancing QM at the firm level. It is critical that the standard can be operationalized for firms of all sizes and be applicable to all types and nature of audit, assurance and related services engagements in all situations.

The SMPC is pleased to have had the various opportunities to provide feedback and views on the QM proposals as they were developed over the past three years. Overall, we remain concerned about the cost and benefits when operationalizing the ISQM 1 due to its inherent complexity as proposed.

We question whether the three EDs as a whole will really increase audit quality from an SMP perspective. We are also concerned that the complexity of the QM Standards taken together may drive a compliance mindset, especially amongst smaller firms who become subject to proportionately greater documentation burdens to "explain/ prove" their compliance. In our view, it is important that IAASB ensure the final suite of QM Standards addresses this issue in order to foster an effective focus on the quality of the services each individual firm delivers, as opposed to compliance with complex standards.

Ensuring the quality of work is a significant issue for all firms, whatever the services they offer. The SMPC is concerned that the proposals are too focused on the PIE audit market, using a very narrow public interest lens, such that – for the reasons explained below in this letter – implementation in many SMPs that do not operate in this sphere would be overly costly compared to potential benefits of a "perceived" higher quality output. The IAASB acknowledges that firms will initially need to invest adequate time and resources to implement the revised standard. We believe that for a proposed standard of this magnitude, consideration should be given to a thorough cost-benefit analysis, especially as the public interest element is greatly promoted in the ED.



We also believe SMPs in particular may need more direction and guidance in respect of several key aspects of ED ISQM 1, which is covered in detail below.

The SMPC notes that a perceived need for support material indicates that the ED's requirements may not be sufficiently clear. IFAC looks forward to coordinating with the IAASB in developing implementation support material, including exploring a revised version of the [IFAC Guide to Quality Control for Small and Medium-Sized Practices](#) (QC Guide).

## DETAILED COMMENTS

We have outlined our responses to the questions (in bold) in the ED below.

### 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?**

In general, the SMPC supports the new QM approach using a risk management lens.

This notwithstanding, we believe that the IAASB needs to seriously consider the cost/ benefit of the proposed changes in terms of increased quality it anticipates from ISQM 1, as we suspect that under the current work effort in ED ISQM 1, the cost/ benefit ratios may differ depending on the size of firms affected.

Particularly sole practitioners, complying with the Standard in an efficient manner may be especially challenging.

The Committee is of the view that the current proposed risk-based approach with all the eight components can be further refined. For example, the establishment of a separate quality objective for "information and communication" in para 40 could be confusing. Information should be used to identify risks, assess risks, and address risks. Communication is a means of implementing policies and procedures, as well as being a risk response in and of itself. Hence, "information and communication" is relevant to all quality objectives, rather than being a stand-alone component. As such, SMPs may struggle to understand the rationale to require firms to establish quality objectives, quality risks and risk responses for this aspect.

Similarly, establishing quality objectives for "monitoring and remediation" is equally confusing, because monitoring and remediation are an integral part of the firm's QM process for each quality objective by element (or component). Hence, the need for such granularity is debatable. It could also be questioned whether the risk assessment process should be treated as a separate component, again for a similar reason.

- (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 many of these proposals should generate certain benefits for engagement quality subject to further steps being taken to address the SMPC's concerns as explained in this letter, especially in relation to the threshold for risk identification and assessment and complexity introduced by the proposed approach to multiple objectives.

Some refinements to the language may also help lead to a better outcome and hence, enhance engagement quality over time.

For example, the statement in para 10 could give a clearer message as to how the nature and circumstances of the firm and its engagements can impact whether adherence to the standard alone is or is not sufficient. Para 10(a) states that a firm is required to determine whether it needs to establish additional QM objectives to meet the overarching objective of the ISQM, with para A49 explaining that these would likely be of a more granular nature. Consequently, it is possible for firm to determine that no additional QM objectives are needed. In contrast, with regard to responses, para 10(c) categorically states that the responses required by the ISQM alone are not sufficient such that the firm is required to design and implement responses in addition to those "mandated". It seems illogical that even if a firm determines no additional QM objectives are required, it always has add-on QM risks and risk response(s) that need to be addressed. This may, unintentionally cause confusion for many firms, SMPs or otherwise.

In this context, the apparent lack of a clear, systematic approach may then foster a check-the-box mentality rather than true thinking about a firm's tailored QM process. We are of the view that a much simpler approach is to consolidate all the multiple objectives for each component (should IAASB decide to maintain all eight) into one. As most of the proposed objectives are, in essence, requirements, they could be rewritten as such.

We firmly support the IAASB's new emphasis on the use of professional judgement in tailoring the firm's system of QM to the nature and circumstances of the firm. Subject to our further comments, this is a key improvement to the extant ISQC 1 from the perspective of SMPs in terms of scalability. However, the audit standards have become increasingly prescriptive in recent years. Coupled with the length of these proposals, it may risk overwhelming practitioners rather than encouraging "standing back" – which is what professional judgement ultimately requires. In any case, it certainly is a timely reminder for the firm and especially, the engagement partners and teams.

While we are supportive of the IAASB's recent emphasis on the exercise of professional skepticism in audit engagements, we are not too sure if adding such a term in the text of a standard will actually drive a change in practitioner's behavior. A continuing educational strategy by educational institutions and Professional Accountancy Organizations (PAOs) may be a more effective solution. The SMPC has historically supported and encouraged appropriate coordination by the IAASB and the IESBA on the topics of professional skepticism, mindset and professional judgement. We believe such collaboration should continue to benefit the whole profession.

- (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 SMPC appreciates that the IAASB has expressly acknowledged that the degree of complexity and formality in firms' QM systems will vary (para 5 of the standard). We also note the inclusion of policies that are implied by actions and decisions in the definition of the term "responses" in para 19(t)(i), since in SMPs, actions often will provide evidence on existence of policies or procedures which might be documented in a more formal manner in larger practices.

We also appreciate the IAASB's consideration of scalability options and, in some cases, specific SMP examples. We particularly support the IAASB's decision not to require more granular quality objectives (para 30 of the Explanatory Memorandum [EM]), not to identify quality risks for all firms (EM para 35), not to include more prescriptive responses (EM para 39) and not to specify overly-prescriptive communication requirements (EM para 53). The SMPC agrees with the Board that further enhanced levels of granularity or prescription are not appropriate in a global standard for application in a wide variety of circumstances.

We also support the IAASB's decision not to require all firms to prepare and publish transparency reports (EM para 56) and to include consideration of relative severity of a deficiency regarding the required determination of root cause (EM para 71).

However, we believe that making the standard less complex to apply would go a long way to addressing the practical issues many SMPs would otherwise face and simultaneously, resolve many of the issues on scalability. Specifically by: 1) determining a more appropriate (i.e., higher) threshold for risk identification and assessment (instead of "more than remote likelihood of occurrence") – preferably one that takes both the likelihood of occurrence and likely magnitude of impact into account, and 2) setting far fewer and less granular objectives – in other words, setting a more appropriate objective for the standard as a whole, aligning quality to the firm's individual strategy with just a single objective, preferably for each relevant area that drives quality (i.e., personnel, IT applications, etc.).

It is likely that many smaller firms will benefit from assistance from their PAOs and other third parties for QM system support and methodologies. The SMPC is available to support implementation initiatives and IFAC will coordinate with the IAASB when exploring revising the QC Guide.

**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 note the Board's view as explained in para 32 of the EM about consistency in approach with ISA 315 and the related potential to reinforce key concepts of this approach. In this context, we would like to highlight that there are many SMP firms worldwide that perform assurance and related services, but not audits, who will be required to apply ISQM 1. While ED ISQM 1 follows a risk-based approach that will be familiar to auditors applying ISA 315, such approach will not necessarily be familiar to practitioners who do not perform audits (i.e., many other SMPs). There are, thus, concerns that the ED is over-engineered in the way it follows this approach.

It is also our view that the standard establishes an excessively low threshold (see para A55 "...likelihood of occurrence is more than remote.") in terms of risk identification. Indeed, this threshold is not as clear as it should be, since the requirement refers to reasonable possibility of occurrence with application material essentially "defining" this term. We question why this is neither a definition or a requirement. Establishing



such a low threshold, in our mind, could result in a lot of unnecessary work including documentation for many SMPs in regards to risks that are less likely to occur. Notwithstanding the notion of a sliding scale approach as suggested in para A60, we continue to believe this increase in work effort will be disproportionate for many SMPs and will not commensurate with any potential increase in quality.

The IAASB should consider setting a more appropriate occurrence threshold and ensure that it is capable of being understood and applied consistently, since if the firm decides that there is no reasonable possibility (less than remote risk) of the risk occurring no further action is required irrespective of the risks' potential impact. Any misunderstanding of this threshold could result in either risks that should not have been identified being considered further (and documented), or – from a quality perspective even worse – risks that should have been addressed being ignored.

**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?**

The SMPC believes that examples would be helpful to demonstrate how an SMP can meet the requirements of the monitoring/ remediation process, in the same way that examples were provided for the quality objective/ assessed quality risks and responses. Such examples can start with a firm of a sole proprietor with non-professional staff and another firm of partnership with 2-5 partners<sup>1</sup>. These examples could be premised on the assumption that these firms do not provide audit services to listed companies or that they have clients with significant public interest. We suggest that rather than including more examples within the already lengthy standard, such examples might be best included in other supporting material.

The SMPC is also cognizant that it may be difficult for a firm to assess whether additional examples or other application material would be helpful at this stage. The firm will need to decipher the whole standard [as well as ISA 220 (Revised)] and implement the requirements throughout the firm or as per the client assignment to determine if further examples and guidance could be useful. Hence, the IAASB should be prepared to respond quickly to implementation issues once the standard is effective. This can be done through the issuance of staff publication or other shorter, more succinct materials. The EM includes various diagrams to explain the approach to particular issues, which are arguably easier to understand than the text of the ED. We believe that a similar approach should be adopted in the production of any future application support materials.

**Specific Questions**

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

We believe that the current proposed risk-based approach with all the eight components warrants further examination based on our response to Question 1. Some may be better termed as “over-arching factors” rather than components. As indicated in our response to question 1, there is also a question whether it makes sense for the risk assessment process to be applied to the firm’s monitoring and remediation process (i.e. process on a process?).

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<sup>1</sup> The QC Guide (under the extant ISQC 1) includes two illustrative examples – one, a sole proprietor with non-professional staff and another, a firm of 2-5 partners with a certain number of professional and non-professional staff. This guide has proven to be popular with SMPs and PAOs with 28 translations completed or in progress and more than 100,000 downloads, excluding those already translated into foreign languages (these are not tracked as they are not being housed by IFAC)



The ED requires a firm to set many quality objectives (specified in the ED on the various components), as well as requiring the firm to set additional quality objectives when needed beyond those set out in the ED in order for the firm to achieve the overall objectives of the standard.

The practical problem for practitioners with the proposed approach is that these detailed quality objectives serve as a catch all, because even when firms comply with all the requirements of ISQM 1 they have to essentially “step back” and consider whether compliance with the requirements has actually allowed the firm to fulfil the overall objectives of the standard. In practice, this will also lead regulators (this includes practice inspectors and peer reviewers) to challenge firms’ decisions, where regulators have the benefit of hindsight. This situation can lead to too much subjectivity and overly defensive attitudes both within firms and by the regulators responsible for oversight, which demand the use of valuable resources not directly related to quality engagement performance. For example, more resources being spent on compliance-driven documentation may not actually contribute to a better QM process.

The quality objectives as currently proposed represent procedures to respond to risks of not achieving quality objectives. They are far too granular. An alternative approach is to set out the actual quality objectives which have been aligned with the main drivers of quality (such as appropriate tone from the top, competent and motivated human resources, effective resource management and efficient engagement delivery) with the subsequent process of identifying quality risks relevant to the firm and responding to these risks based on the judgement of the firm such that the overall quality objectives can be achieved with a reasonable degree of assurance. For this later approach, there is no need for the introduction of “additional quality risks” as a “catch all” provision which may be confusing to some SMPs.

**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 refer to the points as mentioned under (1)(a) and (b) which the SMPC believes need to be better addressed although we do agree that the ultimate objective is to establish an effective QM framework that delivers high-quality services and ensuring the engagement reports issued by the firm are appropriate in the circumstances.

In addition, the SMPC has previously commented on the nuances of proposed wording concerning public interest. Not all activities performed by a professional accountant carry the same degree of public interest, and what constitutes public interest may also vary depending on circumstances. As currently presented, para A2 refers to responsibility to act in the public interest, potentially implying that this is a constant.

Para A23 notes the types of engagements, types of entities etc. as factors to be considered when taking into consideration the nature and circumstances of the engagements performed by the firm. However, it is not clear how these types of factors are expected to have an impact on public interest considerations and consequentially, the QM aspect of a firm. It would be helpful if the Board can clarify if there is supposed to be a sliding scale or just different areas of emphasis.

We continue to question the need to use different concepts (IESBA with “PIE” vs IAASB’s “listed or of significant public interest”) and using the same term with slightly different meaning or coverage (e.g. firm



and engagement team). This can be confusing and will not foster consistent application, which is not in the public interest. We strongly urge the two Boards to coordinate their efforts to resolve issues of these nature before the standard is finalized.

**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?**

The SMPC is of the view that the ED is over-engineered and too complex for many smaller SMPs that do not undertake audits of listed companies or entities of significant public interest. As previously mentioned, amongst other things, SMPs may struggle to understand the rationale of establishing quality objectives, quality risks and risk responses for the “information & communication component” as information, rightfully, should be used to identify risks, assess risks and address risks. Communication, on the other hand, is a means of implementing policies and procedures as well as being a risk response in and of itself. Our responses to Question 1(b) and (c) above may provide some solutions to this.

The fact that the threshold for risk identification is potentially too low is a further key concern in this context.

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

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

As mentioned earlier, the need for components on “information and communication” and to a lesser extent, the “monitoring and remediation” or – as explained – possibly on other matters remain debatable. These might be subsumed into the other components and potentially reduce the level of granularity. With this approach, the quality objectives will also need to be revised, where appropriate.

In other instances, the quality objectives are far too granular for smaller firms. For example, within the governance and leadership component in para 24(a)(iii), the firm is required to establish structures, reporting lines and appropriate authority for the system of QM as a whole. This objective is difficult to apply in a very small practice environment and is not applicable for a sole practitioner. A suggestion is to move some of the detail in the requirement to the application material if it was to be maintained.

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

Para 10 is clear that firms are required to establish additional quality objective(s) beyond those required by the ISQM 1 when those objectives are necessary to achieve the overall objective of the ISQM. Yet, para 22 may be confusing as it states that the proper application of the requirement is expected to provide a sufficient basis for the achievement of the objective of the standard. This text needs to clarify that the requirements are not self-sufficient, as they include a requirement to – where necessary or applicable – go beyond the required quality objectives and procedures as provided (see para 26) and that, the firm will still have to decide whether additional quality objectives are needed beyond those set out in ED ISQM 1.



This also means that, without greater clarity, regulators may still challenge the firm's decisions and judgements (and that all these will need to be adequately documented).

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

We support the principle of applying a risk-based approach that is tailored to the firm's nature and circumstances. This is an appropriate way of addressing QM for all firms of professional accountants. In our view, the statement in para A54 "...not every quality risk needs to be identified and further assessed..." is of such significance that it should be recognized in the requirements section. However, this statement also needs further clarification, since the diagram on page 13 of the EM indicates that the whole population of quality risks need to be considered at the start of the identification process (para 28) and only those risks failing this 2-step threshold test on preliminary consideration would subsequently be assessed using a more detailed consideration of the same 2-step threshold test (para 29). In our view, the difference between "preliminary consideration" and "more detailed consideration" needs to be made much clearer if this approach is to work efficiently in practice.

Our key concern in this context is still the overly low threshold as proposed (see above).

For many firms, the initial assessment of risk in particular is likely to be challenging. Assessments are likely to vary and firms might need extensive documentation to demonstrate why they have assessed risk in a particular way. This will be exacerbated as the firm reacts to changing circumstances etc. on an ongoing basis. In our view, the IAASB needs to better explain the extent of documentation it expects in this area.

**(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?**

Yes, the SMPC supports the IAASB's approach in this respect. It is appropriate for SMPs to identify, design and implement their responses to the quality risks to achieve the firm's quality objectives. However, it is the SMPC's contention that the standard, as it is, is too granular in trying to cater to all sizes of firms and thus, the costs of implementation may outweigh the perceived quality benefits for certain smaller SMPs

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

Yes, the SMPC is of the view that the standard is clear in this respect, but awkward in practical application.

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

Although the standard does address firm's governance and the responsibilities of firm leadership at an appropriate level, the ED seems based on a larger practice scenario and thus, many SMPs will struggle to identify with the degree of detail and have issues with the practical application. For example, in a small firm, the act of responsibility assignment required by para 24(a) may be achieved by relatively informal means whereas holding them to account using periodic performance evaluations (para 24(b)) could be seen as



being a mere compliance act (i.e., form over substance). In such cases, the day to day observations and actions of fellow partner(s) should adequately serve as a reprimand if the individual continues to demonstrate substandard behavior over time.

The overall observation is that this component is also too granular for firms with very few partners. It is not unusual for a single partner to be responsible for ALL roles and responsibilities within this component.

**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?**

Although it is appropriate to assign an individual to be responsible for the relevant ethical requirements in a firm (probably, the same individual will also be responsible for compliance with the independence requirements applicable in the firm for many SMPs), it is debatable whether such level of granularity is required in all firms. SMPs may also struggle with this due to small number of suitable individuals available – for a sole practitioner, “assignment” is misplaced – he or she would need to acknowledge their responsibility for all quality matters (unless suitably qualified staff are available). Being too prescriptive could result in an SMP assigning as a mere compliance act (i.e., form over substance) to anyone available to comply with the requirement “to assign”, whereas other interventions may be more appropriate in terms of achieving quality objectives.

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

Considering that most national oversight systems cannot likely “police” the other firms or persons within the network, the SMPC is of the view that the current proposed standard that allows for a principled-based approach in dealing with network resources and people is an appropriate approach to adopt.

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

Yes, the proposed standards have been appropriately modernized to address the use of technology.

However, it is important for IAASB to ensure that these requirements should not become a barrier to SMPs being unable to meet such growing expectations.

- 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?**

Whilst we support transparency, we are yet to be convinced that communication with external parties can promote the exchange of valuable and insightful information between the firm and its stakeholders in all cases (and especially for smaller owner run entities), partly because there is a lack of guidelines on such scope of communication in the standard. If this requirement is to be retained, then it is important that the



guidelines for producing it are clearly defined. For example, in certain jurisdictions, the phrase “Transparency Report” is already defined and has specific legal meaning.

We acknowledge the requirement of para 41(c) (iii) that states “when the firm determines it appropriate to do so” but continue to believe that it would be helpful to clarify that this does not apply to smaller firms or to recognize the fact that such communication to any external parties is limited when firms do not provide audit services to listed companies or PIEs. Without a clear message, there is a danger that over time it could be assumed as best practice.

In addition, it may also be useful to clarify who the external parties are e.g. regulators, PAOs, TCWG – when deciding to disclose to the public or otherwise – Para A142.

**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?**

Although we are generally supportive of the proposals addressing the scope of engagements that should be subjected to an EQR, we have some reservations on para 37(e)(iii)(b) which we will be commenting on separately in ED-ISQM 2. We are also of the view that para A102 will likely be very subjective and ultimately open to interpretation and challenge by regulators. This is going to be an area that will require specific guidance for SMP firms. Again, this is potentially an area where expectation gaps could arise in the SMP audit market, unless the IAASB makes its intent sufficiently clear

**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?**

This remains a significant area of contention for many SMPs and especially sole practitioners. The need for a practical approach, that possibly demonstrates using a sliding scale is key but this does not come across well in the standard. Specific recognition of SMP circumstances is needed in this area to create a workable approach and to manage any regulatory and other key stakeholder’s expectations.

In a large firm environment, there may be systemic issues that can be uncovered by monitoring measures. However, for SMPs, especially from the very small scale where often there are no formal system of monitoring, the issues are likely to be more of the one-off nature and thus, the impact on quality from the monitoring activity will also be limited. At the very least, the IAASB should acknowledge this in the application material.

We are also not sure that the ED will encourage development of innovative monitoring techniques over time. If this is the Board’s expectation, we suggest it is articulated in the Basis of Conclusion once these standards are finalized.

**(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?**

Generally, we are supportive of the flexibility accorded to a firm's internal monitoring activities – e.g., in-process or completed engagements (para 45) and the notion that the cycle's length or triggers for inspections shall be tailored to the firm's circumstances (see A169).

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

The framework for evaluating findings and identifying deficiencies can be further enhanced since the relationship between findings and deficiency is not very clear to some readers. A finding is not defined, a deficiency is and while it seems clear that most deficiencies will be identified as a result of internal or external findings, the definition of deficiency does not refer to findings and it is not sufficiently clear what, if any, criteria practitioners should apply when evaluating findings for the purposes of determining whether they are in fact deficiencies. We suggest the Board should acknowledge that a significant level of judgement will be involved in this respect.

In order to further enhance the readability of the standard, the IAASB may want to include a list of examples under para 19. This can cover areas such as violation of independence requirements, lack of compliance with national CPD program, management of issuance of auditors' reports and audit documentation wrap-up etc.

**(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?**

We are of the view that the nature, timing and extent of the procedures to investigate the root cause is sufficiently flexible based on the proposed standard. However, we do have two significant concerns with this new requirement for root cause analysis (para 48). This term is defined differently in different jurisdictions and may not be consistently understood across or even within the same jurisdiction. Therefore, it may not be clear what is intended or how it should be documented. Hence, an SMP with only a few deficiencies could spend a disproportionate amount of time performing and recording this analysis.

The other concern is that with some more developed jurisdictions such as the United Kingdom, the regulator has developed a prescriptive framework on what is expected of a root cause analysis. Without proper guidance or supporting application materials available in ISQM 1, there is a danger that authorities will start prescribing a framework that is too onerous for SMPs to effectively apply.

Paras 49 and 50 require remedial actions to be designed and implemented to address identified deficiencies. However, it is not clear how SMPs will deal with this, especially with one off errors or deficiencies. Para A184 is implying that having weighed up certain factors, the firm always needs to take remedial action if a deficiency is sufficiently severe, whereas in reality, a simple mistake may be severe but cannot be addressed by remedial action. This leads to questions on how a firm should act in such cases. Specific supporting material may be helpful here.



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

We noted, in two instances, where positive root cause analysis has been introduced in the standard (paras 12 and A178) as a possible response. While we agreed that these should not be a requirement, we also question the appropriateness of including this type of material in the standard at all. Potentially, it could lead to expectations by regulators that firms will eventually need to comply with such practice, which goes beyond the option as provided in the standard.

**(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 requirement for a specific individual assigned ultimate responsibility and accountability for the system of QM to understand the entire standard and how they are being implemented through the firm's methodology cannot be under-estimated. It can be onerous especially for an SMP practitioner as he or she will have to understand everything, assess what is not applicable and potentially need to document his/ her justification. A better approach, using some sliding scale example (from a sole practitioner up to a firm of 2-5 partners) may be helpful to demonstrate how the standard is expected to operate in a real life environment.

The Board could also reflect on whether an annual evaluation is necessary for all firms. If the risk to quality is low because of the nature and circumstances of the firm and its engagements, is the annual evaluation really needed? It's a high hurdle for smaller practices – just to document such an annual process.

Some SMPs are also asking for more guidance on what will constitute “reasonable assurance” in the face of deficiency findings.

Para 74 of the EM has taken the position that ISQM 1 implicitly creates a need for the firm to collate all of the information about the system of QM within the firm and for the leadership to evaluate this information in forming an overall view about the “reasonableness” of the system. The bigger question for SMPs will be the documentation of their many informal processes in order to reach such reasonable conclusion without being challenged.

The Board may also want to reflect on whether the level of specificity on the evaluation of the QM system and the potential course of action to be taken in the event where a reasonable assurance assessment cannot be achieved (see paras 55-57) could result in some SMPs following a checklist approach (with a compliance mindset) rather than working towards a better QM system, befitting their nature and circumstances.

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

Yes, we support the proposal addressing network and the network requirements although we suspect para 61, for example, will be hard to operationalize. However, this should not stop IAASB to consider including



a requirement or other mechanism in ISQM 1 given that the Board is of the view that networks would likely need to provide such information to all network firms as a response to the proposed standard, going forward.

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

Yes, the SMPC is supportive of the approach in ISQM 1 in addressing these service providers. In practice, while some larger firms might look to assess different service providers formally, smaller firms usually make these assessments informally through usage. It is not clear what the more formal assessment implied by paras 64 and 65 would look like and some examples of this would be helpful.

**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 will be a need for national regulators to make the necessary amendment to the local legislation. It is important for the IAASB to be cognizant of such time frame.

**ADDITIONAL COMMENTS**

We continue to be concerned that SMPs cannot easily navigate the standard to ascertain which requirements are not relevant to their circumstances. Besides this, the approach to non-compliance with a requirement is likely to be problematical for some SMPs. Para A20 explains two examples of requirements that may not be relevant and thus not applicable for some SMPs. These materials could be expanded upon, as it could give a false impression that very few requirements would not be relevant. Also, for SMPs, it would be preferable if all such requirements could be reworded in such a way that it is clear that they are conditional.

In this context, the requirements of para 24(a) (iii) (b) as well as 32 regarding independence is a good example. Firstly, assignment of responsibilities to the degree foreseen in the ED may be unnecessary/ impossible for some SMPs and secondly independence may not be a factor for all professional firms (many SMPs undertake no assurance services). We therefore do not see the rationale for overly focusing on independence as proposed.

In general, whilst we accept that there are more “nuggets” for SMPs in the application material, these are not visible – even the EM only cites two examples (Para. 88). Perhaps, a separate staff publication covering all this material could be helpful for SMPs. Again, if it is within the standard, “Consideration specific to smaller firms” will be tremendously helpful.

In certain jurisdictions, professional accountants may be subject to legal requirements that require them to e.g., properly identify/ verify the identity of their clients (e.g., anti-money laundering legislation). The requirements proposed in para 34(a) require obtaining sufficient appropriate information about the integrity and ethical values of clients (management and those charged with governance) prior to engagement acceptance. We note that integrity and ethical values are soft characteristics that by their nature, usually do not lend themselves to corroboration (unless e.g., criminal records point to a court decision indicating a lack thereof of integrity and ethics). In this respect, the proposed requirement may pose practical challenges for firms with what is considered “sufficient appropriate information”. Again, more guidance from the IAASB will be helpful.



Para 46(b) will also likely be problematical for many SMPs, since it precludes engagement team members or the EQ-reviewer from performing any inspection of an engagement (this issue is not new and has long been an issue with ISQC 1). However, it should be recognized that this requirement may not be able to be adopted in some jurisdictions due to its implications for restraint of trade under competition law for small practices without qualified individuals outside of the engagement team for engagements other than audits of financial statements of listed entities or PIEs. The question arises whether the phrase “unless prohibited by law or regulation” might need to be inserted in an appropriate way to address this issue in the standard.

### **CONCLUDING COMMENTS**

We hope that the IAASB finds this letter useful. We are committed to helping the Board in whatever way we can to build upon the results of the ED.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

*Monica Foerster*

Monica Foerster

Chair, SMP Committee