July 1, 2019

IFAC Small and Medium Practices Committee Response to the IAASB’s Exposure Draft for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews (EQR)

INTRODUCTION

The SMP Committee (SMPC) is pleased to respond to the IAASB (the Board) Exposure Draft (the ED), for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews (EQR). 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, 2 and ISA 220 (Revised) are very important standards, which will shape the foundation of quality management (QM) in SMPs going forward. It is therefore critical that the standards can be operationalized for firms of all sizes and applicable to all types and nature of engagements within their respective scope in all situations. We commend the significant amount of work that has been undertaken by the Board in progressing the three projects and support the objective of enhancing QM.

The SMPC is pleased to have had the various opportunities to contribute to this project as it has progressed over the last three years. However, we remain concerned about the overall efficiencies and effectiveness when operationalizing these standards due to their complexities and believe revision is needed in respect to several key aspects, which will be covered in the respective EDs’ comment letters.

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.

In our opinion, an appropriate overall quality objective ought to be about obtaining, establishing and maintaining the firm capabilities to perform quality engagements on a consistent basis. However, the ED ISQM 1 has taken an approach in requiring a firm to set many detailed quality objectives, as well as requiring the firm to set additional quality objectives when needed beyond those already set out in the ED in order for the firm to achieve the overall objectives of the standard. Our concern here is that overengineering of the standard may drive firms to adopt an increasingly compliance approach, which risks their losing sight
of how best quality can be achieved in the individual circumstances of their practice. In our view, more emphasis should be placed on linking QM to the firms' strategy.

A further practical problem for practitioners with this 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 still have to essentially "step back" and consider whether compliance with the requirements has actually allowed the firm to fulfill the overall objectives of the standard. In practice, this will also lead regulators (these could also be practice inspectors or 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. We have elaborated more on this in our comment letter for ISQM 1.

The SMPC notes that a perceived need for support material indicates that the EDs’ 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) 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?

We are very concerned that the Board is proposing an implementation period of only 18 months after the PIOB’s approval. We acknowledge the rationale that it is in the public interest to have the revised standard implemented as soon as practicable with the aim of enhancing audit quality. However, the SMPC believes a too short implementation time-line may actually exacerbate the risks to quality for the reasons outlined above and hence, would be inconsistent with the Board’s final objective of enhancing the standards of QM among firms under the banner of public interest.

Under ISQM 1, the systems of QM in compliance with the standard are required to be established by the effective date. However, it is not clear what "established" means in this context. Is the expectation that the system of QM is designed and implemented by that date? Can processes relating to monitoring and remediation be designed and documented but not fully operationalized until a number of engagements are undertaken? It will be helpful if IAASB’s expectation can be clearer in this respect.

The volume of standards and implementation support that needs to be translated by many PAOs globally is already causing significant challenges and affecting application of international standards. There will also be a need to train firms on the new QM approach, develop new systems, policies and procedures and execute test runs to ensure the systems and procedures are functioning as expected and follow national
due process. We strongly believe that any implementation time line of less than 24 months cannot be expected to be reasonable.

At the very least, we encourage the Board to publish the final document in draft form (ahead of PIOB approval) as was done for ISA 540 (Revised) to facilitate adoption processes at a national level.

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?

IFAC had developed the QC Guide to provide non-authoritative guidance on applying the International Standard on Quality Control (ISQC 1). The Guide has been very well received with 26 translations completed, or in progress, and over 100,000 unique downloads since 2009 (excluding translated downloads). The Guide features two sample quality manuals applicable to either a sole practitioner with non-professional staff or a two to five partner firm. It is used as a basis for education and training and a similar product(s) is likely to be needed by SMPs as implementation support, which IFAC can explore developing in coordination with the Board.

We note the IAASB’s approach of not including “Considerations specific to smaller firms” in the text of the ISQM standards. However, some practitioners are concerned that this has decreased its usability and that this type of signposting in the past has been very helpful. Yet, ISA 220 (Revised) has been drafted differently. We thus suggest that consistency amongst the three standards will be highly responsive to the market demand for signposting, especially given the length of these revised standards.

It is highly probable that no firm will start with a blank sheet of paper when implementing these new standards. Those responsible for methodology within firms and training will all seek to ascertain what within the existing system can be retained and what needs to be added. Consistency will be easier to achieve if the Board can indicate in high level terms which areas firms should focus on when considering the need for new material (or processes) – through staff or other non-authoritative publications. The IAASB could also consider how the table on scalability in the examples provided could be expanded and utilized to assist with implementation support. Although the current examples have value, they are limited as they focus only on straightforward circumstances. It would be helpful if more nuanced examples could be developed. In addition, the Board could explore whether a flowchart of the QM process may also help firms to navigate the QM standards.

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 three EDs.

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

Sincerely,

Monica Foerster
Chair, SMP Committee