ISQM 1: Overview of Feedback from the Exposure Draft

Presented by:
Karin French, ISQM 1 Task Force Chair

IAASB Meeting September 2019
Overview of Respondents

Left Pie Chart:
- Member Bodies and Other Professional Organizations: 38%
- Accounting Firms: 25%
- National Auditing Standard Setters: 14%
- Monitoring Group: 4%
- Individuals and Others: 2%
- Public Sector Organizations: 10%
- Academics: 1%
- Regulators and Audit Oversight Authorities: 4%

Right Pie Chart:
- Global: 25%
- Europe: 30%
- North America: 16%
- Asia Pacific: 17%
- Middle East and Africa: 8%
- South America: 4%

Legend:
- Asia Pacific
- Europe
- Global
- Middle East and Africa
- North America
- South America
New Quality Management Approach (QMA)

- **MG:**
  - Enhancements needed to improve proactive and preventative approach
  - Needs to be able to support enforcement
- **Other respondents:**
  - **Positive:**
    - Promotes tailored systems and a proactive, integrated and thinking approach to quality management (QM)
    - Will help firms meet challenges facing the profession
  - **Concerns:**
    - How ED-ISQM 1 incorporates a QMA - hybrid of a risk-based approach and prescriptive requirements
    - Length and complexity of the standard
  - **Suggestions included:**
    - Reducing prescriptiveness of quality objectives and responses and more explicitly addressing quality risks
    - Restructuring the standard
    - Emphasis on aligning QM with the firm's business strategy and incorporating QM into enterprise risk management
Benefits for Engagement Quality and Professional Skepticism (PS)

• MG:
  – Support how ED-ISQM 1 addresses PS
  – Also address PS in governance and leadership

• Other respondents:
  – SOQM is the foundation for consistently delivering high quality engagements
  – Governance and leadership is critical to embedding and supporting a culture of quality and a focus on professional skepticism
  – Effect of the standard and expected benefits would vary from firm to firm
  – Address PS in other areas of the standard, particularly governance and leadership
  – Concerns:
    • Benefits may be limited for SMPs
    • Prescriptiveness = checklist mindset = unlikely to improve engagement quality
    • Implementing standard will be resource intensive – possible negative effect on engagement quality
    • Cost-benefit analysis needed
    • Extent of documentation needed to demonstrate compliance with the standard
Scalability

- MG:
  - Need for larger firms to scale-up (i.e., additional to what is in the standard)
  - Length of standard and proposed additional guidance – need for a critical review and improved clarity of standard

- Other respondents:
  - Examples and guidance will be needed to demonstrate scalability – however, the need for examples and guidance indicates lack of clarity of standard
  - Concerns:
    - Prescriptiveness of the standard - not scalable, and having required responses with no quality risks indicates approach is not risk-based
    - Length and complexity
    - Threshold for identifying quality risks is too low
    - Documentation burden (“comply or explain”)
    - Standard appears written for large firms – bottom-up approach needed
    - Firms that perform non-audit services – increasing trends to perform other engagements instead of audits, wide variance in degree of public interest, ITC addressed audit issues, ED-ISQM 1 very audit focused, ED-ISQM 1 not suitable for firms performing related services engagements
Scalability (continued)

• Suggestions:
  – Separate requirements or standards for managing quality for non-audit engagements or audits of less complex entities
  – Simplify requirements and reduce repetitiveness
  – Use certain explanations and diagrams from the Explanatory Memorandum
  – More clearly signpost paragraphs that address scalability
  – Use the same approach that is being considered in the project on ISA 315 (Revised) (i.e., the what/how/why approach)
  – Place material outside of the standard
  – Digitize the standard
Challenges for Implementation

- Time, resources and expertise to implement the standard
- Firm-wide impact:
  - Need for a firm-wide mindset change, and influences the culture of the firm
  - Organizational restructuring, new IT systems
  - Affects other areas of the firm, e.g., human resources and IT functions
- Professional judgment – differing interpretations and concerns about level of documentation needed
- Firm’s risk assessment process (FRAP) – identified as particularly challenging to implement
- Other areas of challenge:
  - Monitoring and remediation (M&R) - root cause analysis, identifying and evaluating findings and deficiencies and firm leadership’s annual evaluation of the system of quality management
  - Consistent application for networks – includes challenges around consistency of global standards
  - Documentation – some consider standard too burdensome, others suggesting more clarity needed about what needs to be documented
- Length and complexity of standard – difficult to read and understand
- Strong call for support materials and guidance, including clarity regarding what has changed from extant ISQC 1
Components and Structure

- Standard has a logical organization and support flexibility of the components
- Concerns and suggestions
  - FRAP should be the first component – helps provide context to standard, even though governance and leadership is very important
    - Also clarifies that FRAP applies to the other components
  - FRAP and M&R are processes in nature and should not be described as components or treated in the same way as other components – “what” is managed vs. “how” it is managed
  - FRAP should not apply to M&R
    - Requirements in M&R already prescriptive – establishing quality objectives and identifying and assessing risks causes circularity
  - Information and communication are necessary for other components to function – should be integrated into the other components
Establish Quality Objectives (QO)

- **MG:**
  - Clarity needed on when and how additional QO should be developed
  - Suggested requirements that support establishing more granular quality objectives to support identifying and assessing quality risks (QR)

- **Other respondents:**
  - Mixed views
    - QOs are comprehensive, outcome-based and give a steer to firms about the starting point
    - QOs are too prescriptive – should be more high-level and fewer
  - Suggestions included
    - Include specificity of QO in quality risks
    - Clarify circumstances when additional QO should be established
    - More explicit in the standard that additional QO are not always required
    - Change the requirement to “a consideration” of whether additional QO are necessary
Identify and Assess Quality Risks (QR)

- **MG:**
  - QR with remote likelihood / significant impact should be considered by firms
  - Other enhancements needed:
    - Assess changes in the external environment and a firm’s own business model, need to be dynamic
    - Take findings from regulators into account as part of identifying and assessing QR

- **Other respondents:**
  - A threshold leads to a consistent approach, standard supports enhanced understanding of QR
  - Concerns about the threshold, i.e., “reasonably possible” and “more than remote”
  - Clarify meaning of “significant effect on the achievement of a QO”
  - Process for identifying and assessing QR overly prescriptive and does not provide flexibility - 2-step process is confusing and overengineered
  - Lack of required QR – illogical
    - Suggestions to repurpose required responses and granularity of QO or provide examples of QR
  - Clarity needed on how to document
  - General need for guidance
Design and Implement Responses

• MG:
  – Firms may be overly focused on required responses
  – Responses should be more proactive and preventative

• Other respondents:
  – Responses prescriptive = checklist mindset, limited tailoring
  – Firms may “backfill” QR to match responses – perpetuates inappropriate QR
  – Inconsistency in (or lack of) responses across components – appears some components more important than others
  – Firms should not be expected to design and implement additional responses in all circumstances, i.e., responses in the standard may be sufficient
  – Varying views on how to deal with responses
    • Application material vs. requirements
    • Repurpose as QR
    • Other suggestions to clarify requirement to design and implement additional responses
The Components and Structure of Proposed ISQM 1

**Question 1:**
Does the IAASB support reordering the standard, including relocating paragraphs 24(a) and 25, as proposed by the ISQM 1 TF?

**Question 2:**
Does the IAASB support that the firm’s risk assessment process and monitoring and remediation processes are “processes”? In particular, does the IAASB agree with:
(a) Introducing new overarching requirements for the firm to establish a risk assessment process / monitoring and remediation process?
(b) Removing the concept that the firm’s risk assessment process is applied to the monitoring and remediation process?

**Question 3:**
Does the IAASB support the conclusion that information and communication should remain a separate component, and that the firm’s risk assessment process would continue to apply to information and communication?
Question 4:
Does the IAASB support the proposals to revise the approach to required quality objectives, quality risks and responses in the components by:
(a) Revising the quality objectives to be higher level, which may result in fewer quality objectives;
(b) Introducing quality risk considerations; and
(c) Reducing the required responses?
Question 5:
The IAASB is asked to provide their views on the proposals addressing the requirements for the identification and assessment of quality risks, including whether:
(a) The IAASB supports simplifying the requirements, including condensing the two-step process and addressing the quality risk threshold through the definition of “quality risks” and application material?
(b) Proposed ISQM 1 should retain the concept of “reasonable possibility” in the context of likelihood, or whether another term should be used?

Question 6:
Does the IAASB agree with the suggestion to adjust the requirement to establish additional quality objectives to a “consideration”?
Question 7:
Does the IAASB agree that there is a need to develop separate requirements for firm-level quality management over related service engagements? If so:
(a) Does the IAASB agree that the requirements apply to firms as it relates to their management of quality for related services engagements?
(b) Should the separate requirements be included in:
   (i) A separate quality management standard (e.g., ISQM 3)?
   (ii) Proposed ISQM 1 as separate requirements?
   (iii) The related services standards themselves, i.e., in ISRS 4400 and ISRS 4410 (Revised)?

Question 8:
Does the IAASB support issuing a survey to obtain stakeholder input on the proposed way forward?
Question 9:

Are there other issues arising from the comments on the questions summarized in Section B of this paper (i.e., question 1 and related subquestions, question 2, question 4, and question 6 and related subquestions) that should be considered by the ISQM 1 TF?
Feedback on Other Aspects of ED-ISQM 1: Initial Impressions

• References to the public interest in the standard
  – Support for references, although suggestions to clarify meaning of public interest

• Objective of the standard
  – Support for the objective
  – Additional suggestions include:
    • Incorporating public interest in the objective
    • Adjusting the objective to be more outcome-based
    • Clarifying concept of reasonable assurance in the context of a SOQM

• Governance and leadership
  – Support for the proposals in ED-ISQM 1
  – Concerns about prescriptiveness of requirements and scalability for SMPs – including requirement to assign responsibility for SOQM and aspects of the SOQM and undertaking performance evaluations
  – Clarity needed on certain requirements, e.g., requirement to assign responsibility for SOQM
  – Mixed views regarding the appropriateness of a requirement to assign responsibility for relevant ethical requirements and/or independence
Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (cont.)

- Relevant ethical requirements
  - Strong support for how ED-ISQM 1 addresses network independence

- Resources
  - Support for how ED-ISQM 1 addresses technological resources
  - Suggestions to clarify the scope of technological resources addressed by ED-ISQM 1
  - Calls for additional guidance

- Information and communication
  - Overall mixed views
    - Concerns that requirement is too prescriptive regarding reference to transparency reports (e.g., creates a de facto requirement)
    - Others (incl. investors) suggesting ED-ISQM 1 should do more in addressing external communication
  - Further clarity needed on who external stakeholders may be

- M&R
  - Overall views that will improve robustness of firms’ M&R
  - Concerns about scalability of requirements, level of prescriptiveness and whether will drive innovation
Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (cont.)

- M&R (continued)
  - Mixed views on the requirement addressing inspection of completed engagements
    - Requirement is prescriptive - suggestions that requirement should be more risk-based
    - The “3 year suggestion” in AM is a de facto requirement
    - Discourages or creates barriers to firms developing other monitoring techniques
  - Clarity needed on references to “in-process reviews”
  - Concerns that a lack of clarity of framework for evaluating findings and identifying deficiencies
    - Difference between findings and deficiencies is not clear
    - Consider a concept of “significant deficiencies”
    - Various comments and suggestions on definition of deficiencies
  - Support for new requirement to investigate root causes – further suggestions
    - Clarify the scope of root cause analysis
  - Mixed views about how standard addresses positive findings
  - Clarify the iterative nature of identifying and evaluating deficiencies and undertaking root cause analysis
Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (cont.)

- **M&R (continued)**
  - Many challenges identified regarding annual evaluation of SOQM
    - Too onerous for SMPs, suggestions that the evaluation is too frequent
    - Clarity needed on whether it is “a point in time” vs. “a periodic” assessment, including how to consider deficiencies in the process of being remediated
    - Clarity needed on meaning of “reasonable assurance” and how severity of deficiencies affects the evaluation
    - Suggestions that it is a self-evaluation so may not be effective
    - Expectations on an individual may be onerous (also in context of other requirements in the standard)

- **Networks**
  - Overall support for the requirements proposed in ED-ISQM 1
  - Proposals that firms should determine that network requirements / services are appropriate for use
  - Concerns about challenges in obtaining the information from the network
  - Various comments on information that is to be obtained by the firm about the overall scope and results of the monitoring activities across the network firms’ SOQM
  - Respondents seeking guidance on how requirements should be implemented
  - Ad-hoc concerns about whether standard is sufficiently robust to address networks themselves
Feedback on Other Aspects of ED-ISQM 1: Initial Impressions (cont.)

• Service providers
  – Overall support for addressing service providers in the standard
  – Concerns about
    • The scope of service providers
    • Obtaining information from service providers
    • Requirement being too onerous and not practical to implement
  – Respondents seeking guidance on how requirements should be implemented

• Application material
  – More examples needed of how standard is scalable
  – Reduce length of application material
  – Include helpful material from the Explanatory Memorandum
  – Support for additional FAQ and examples

• Strong call for additional support materials and guidance, particularly guidance supporting first time implementation, SMPs, monitoring and remediation, root cause analysis and documentation