

Proposed ISQM 1¹: External Communications - Additional Proposals for Consideration by the Board

Background and Request to the Board

Section B.5 of **Agenda Item 5** explains the ISQM 1 Task Force's (TF) proposals relating to external communications. At the time of posting the materials for the June 2020 meeting, the ISQM 1 TF was considering further revisions to the standard regarding communications with external parties. This paper sets out these further proposed revisions.

The Board is requested to consider the proposals in this paper along with the proposals explained in Agenda Item 5.

1. The provisions of proposed ISQM 1 addressing external communication deal with all communications about the system of quality management (SOQM) externally. The proposals, as currently reflected in the standard, require the firm to determine when it is appropriate to communicate externally. The ISQM 1 TF recognizes the Public Interest Oversight Board's encouragement for a more explicit requirement for the firm to communicate externally.
2. Enhanced transparency and communication with those charged with governance (TCWG) has been an important focus of the IAASB in recent years. For example, among the anticipated benefits arising from the new and revised auditor reporting standards is enhanced communication with TCWG.² ISA 260 (Revised)³ deals with the auditor's responsibility to communicate with TCWG in an audit of financial statements:
 - (a) Paragraph 4(a) of ISA 260 (Revised) explains that effective two-way communication with TCWG is important in assisting the auditor and TCWG in understanding matters related to the audit in context, and in developing a constructive working relationship.
 - (b) Paragraph 9(d) of ISA 260 (Revised) indicates that "promoting effective two-way communication between the auditor and TCWG" is among the objectives of the standard.
 - (c) Paragraph 3 of ISA 260 (Revised) highlights that the standard does not preclude the auditor from communicating any other matters to TCWG.
3. The ISQM 1 TF is of the view that communication with TCWG about the firm's SOQM is important because:

¹ Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control (ISQC) 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

² The IAASB's post-implementation review of the auditor reporting project may reveal further insights into whether and how it has resulted in improved communication with TCWG. It may also reveal whether there have been improvements in the audit of the financial statements as a result of the improved transparency in the auditor's report.

³ International Standard on Auditing (ISA) 260 (Revised), *Communication with Those Charged With Governance*

- (a) It enables TCWG to understand the SOQM and how it supports the consistent performance of quality audit engagements, which assists TCWG in providing oversight to the financial reporting process.
 - (b) It promotes transparency with TCWG (refer to **Appendix 1** which provides an analysis of comments from respondents who sought more explicit requirements in proposed ISQM 1 for external communication, and highlights that they mostly focused on firms being transparent).
4. The ISQM 1 TF considered the requirements of proposed ISQM 1 relevant to external communication, and in order to enhance two-way communication about the SOQM, is of the view that an additional requirement is needed to address communication with TCWG. However, the ISQM 1 TF recognizes that TCWG may have varied roles, which may depend on the extent of public profile or public accountability of the entity and requirements in law or regulation. For example, jurisdictional law or regulation may impose additional responsibilities on TCWG of listed entities, particularly with respect to their oversight role in the financial reporting process, the appointment of the auditor, and the audit process. The ISQM 1 TF recognizes that the requirements in ISA 260 (Revised) have been developed in a scalable manner, with certain communication requirements being applicable to audits of listed entities only. In view of this approach, the ISQM 1 TF is proposing a new requirement addressing communication about the SOQM with TCWG of listed entities for whom the firm performs audit engagements, with application material that deals with considerations for other engagements (a conforming amendment will be made to ISA 260 (Revised) to refer to proposed ISQM 1).
5. The ISQM 1 TF considered whether the requirement should further specify the matters that need to be communicated. The ISQM 1 TF noted that doing so could result in communication that is not meaningful and does not achieve the intended purpose, because the matters communicated and the form in which it is undertaken varies depending on the firm and engagement circumstances, as does the timing of when the communication is undertaken (e.g., as part of a tender or proposal, or as ongoing communication that is part of the audit engagement). The ISQM 1 TF also noted that a prescriptive requirement dealing with the content and form of the communication would likely drive a boilerplate description of the SOQM, which may not be useful to TCWG in the engagement circumstances, and may not promote innovation. The ISQM 1 TF agreed that the application material already set up in paragraphs A153GA–A153GD of proposed ISQM 1 provides robust considerations for firms in determining the matters to communicate and the form thereof.
6. Concurrently, the ISQM 1 TF is of the view that further exploring the information needs of TCWG and how TCWG may use information provided to them about the SOQM could be useful, in the context of the IAASB's future work plan. However, this would need to be a separate effort focused on ISA 260 (Revised) because ISA 260 (Revised) deals with the specific matters that need to be communicated to TCWG (including independence), and it therefore goes beyond the remit of the ISQM 1 project.
7. The table below sets out the proposals with respect to information and communication, and reflect the further enhancements to address communication with TCWG. The track changes reflected in the drafting below represent changes from **Agenda Item 5-A** (Extracts from the Draft of proposed ISQM 1 (Clean)).

Information and Communication	Information and Communication (Ref: Para. 40)
<p>40. The firm shall establish the following quality objectives that address obtaining, generating or using information regarding the system of quality management, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the system of quality management: (Ref: Para. A135)</p> <p>(d) Relevant and reliable information is communicated to external parties, including:</p> <p>(i) Information is communicated by the firm to the network or service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them. (Ref: Para. A141A)</p> <p>(ii) Information is communicated externally when required by law,</p>	<p><i>Communication with External Parties</i></p> <p>Communication with the Network and Service Providers (Ref: Para. 40(d)(i))</p> <p>A141A. In addition to the firm communicating information to the network or a service provider, the firm may need to obtain information from the network or a service provider that supports the firm in the design, implementation and operation of its system of quality management.</p> <div data-bbox="779 516 1976 678" style="border: 1px solid black; padding: 10px; margin: 10px 0;"> <p><i>Example of information obtained by the firm from the network</i></p> <p>The firm obtains information from the network as the relevant ethical requirements include requirements for independence that apply when the firm belongs to a network.</p> </div> <p>Communication Required by Law or Regulation (Ref: Para. 40(d)(ii))</p> <div data-bbox="709 764 1976 1219" style="border: 1px solid black; padding: 10px; margin: 10px 0;"> <p>A142. <i>Examples of when law, regulation or professional standards may require the firm to communicate information to external parties</i></p> <ul style="list-style-type: none"> • The firm becomes aware of non-compliance with laws and regulations by a client, and relevant ethical requirements require the firm to report the non-compliance with laws and regulations to an appropriate authority outside the client entity, or to consider whether such reporting is an appropriate action in the circumstances. • <u>Law, regulation or national standards require the firm to publish a transparency report and specify the nature of the information that is required to be included in the transparency report.</u> • <u>Stock exchange rules or regulations may require the firm to communicate certain matters to those charged with governance.</u> </div>

<p>regulation or professional standards, or to support external parties' understanding of the system of quality management. (Ref: Para. A142–A153)</p>	<p>Communication to External Parties to Support an Understanding of the System of Quality Management (Ref: Para. 40(d)(ii))</p> <p>A153. In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally.</p> <div data-bbox="781 407 1948 623"> <p><i>Examples of when the firm may be precluded from communicating information externally</i></p> <ul style="list-style-type: none"> • Privacy or secrecy law or regulation prohibits disclosure of certain information. • Law, regulation or relevant ethical requirements include provisions addressing the duty of confidentiality. </div>
Specified Responses	Specified Responses (Ref: Para. 41A)
<p>41A. In designing and implementing responses, the firm shall include the following responses in accordance with paragraph 22F: (Ref: Para. A153A)</p> <p>(dA) The firm establishes policies or procedures that address: (Ref: Para. A153FA)</p> <p>(i) When it is appropriate to communicate with external parties about the firm's system of quality management, <u>and shall require communication with those charged with governance when performing an audit of</u></p>	<p><i>Communication with External Parties about the Firm's System of Quality Management</i> (Ref. Para: 41A(dA))</p> <p>A153FA. The firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective communication between the firm and its stakeholders. In circumstances when the firm is transparent about the activities that it has undertaken to address quality, and the effectiveness of those activities, stakeholders' perception of the quality of engagements performed by the firm may be improved.</p> <p>A153FB. External parties who may use information about the firm's system of quality management, and the extent of their interest in the firm's system of quality management, may vary based on the nature and circumstances of the firm and its engagements.</p> <div data-bbox="781 1096 1948 1373"> <p><i>Examples of external parties who may use information about the firm's system of quality management</i></p> <ul style="list-style-type: none"> • Management or those charged with governance of the firm's clients may use the information to determine whether to appoint the firm to perform an engagement. • External oversight authorities may have indicated a desire for the information to support their responsibilities in monitoring quality of engagements across a jurisdiction. </div>

<p>financial statements of a listed entity; and (Ref: Para. A153FB–A153GAB)</p> <p>(ii) When the firm communicates with external parties, the matters to be communicated, and the nature, timing and extent and appropriate form of such communication. Ref: Para. A153GC–A153GD)</p>	<div data-bbox="783 196 1948 394" style="border: 1px solid black; padding: 10px;"> <ul style="list-style-type: none"> • Other firms who use the work of the firm in the performance of engagements (e.g., in relation to a group audit) may have requested such information. • Other users of the firm's engagement reports, such as investors who use engagement reports in their decision making, may have indicated a desire for the information. </div> <p>A153FC. Effective two-way communication with those charged with governance is important in assisting them in understanding matters related to the audit, and enables the auditor to develop a constructive working relationship with those charged with governance. ISA 260 (Revised) deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements, and addresses the auditor's determination of with whom to communicate⁴ and the communication process.⁵ In some circumstances, it may be appropriate to communicate with those charged with governance of entities other than listed entities (or when performing other engagements), for example, entities for whom the firm performs audits of financial statements that have:</p> <ul style="list-style-type: none"> • Public interest or public accountability characteristics, such as entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders including financial institutions, such as certain banks, insurance companies, and pension funds. • A high public profile, or whose management or owners have a high public profile. • A large number or diverse range of shareholders. <p>A153GA. The firm's determination of when it is appropriate to communicate with external parties about the firm's system of quality management, the matters to be communicated, and the nature, timing and extent and appropriate form of such communication, is a matter of professional judgment and may be influenced by matters such as:</p> <ul style="list-style-type: none"> • The types of engagements performed by the firm, and the types of entities for which such engagements are undertaken. • The nature and circumstances of the firm.
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⁴ [ISA 260 \(Revised\), paragraphs 11–13](#)

⁵ [ISA 260 \(Revised\), paragraphs 18–22](#)

	<ul style="list-style-type: none"> • The nature of the firm's operating environment, such as customary business practice in the firm's jurisdiction and the characteristics of the financial markets in which the firm operates. • The extent to which the firm has already communicated with external parties in accordance with law, regulation or national standards (i.e., whether further communication is needed, and if so, the matters to be communicated). • The expectations of stakeholders in the firm's jurisdiction, including the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm's processes in performing the engagements. • Jurisdictional trends. • The information that is already available to external parties. • How external parties may use the information, and their general understanding of matters related to firms' system of quality management and audits or reviews of financial statements, or other assurance or related services engagements. • The cost of external communication (monetary or otherwise) and whether it would reasonably be expected to outweigh the public interest benefits of such communication. <p>A153GC. The firm uses professional judgment in determining the form of communication that is suitable in the circumstances. Accordingly, the form of communication may vary.</p> <div data-bbox="779 967 1948 1318"> <p><i>Examples of form of communication to external parties</i></p> <ul style="list-style-type: none"> • A webpage, videos or interviews. • A publication such as a transparency report or audit quality report. • Targeted communication to specific stakeholders (e.g., information about the results of the firm's monitoring and remediation process). • Direct conversations and interactions with the external party, including through social media- (e.g., discussions between the engagement team and those charged with governance). </div>
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	<p>A153GD. The firm may consider the following attributes in preparing the information that is communicated to external parties about the firm's system of quality management:</p> <ul style="list-style-type: none"> • The information is specific to the circumstances of the firm. Relating the matters in the firm's communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time. • The information is presented in a clear and understandable manner, and the manner of presentation is neither misleading nor would inappropriately influence the users of the communication (e.g., the information is presented in a manner that is appropriately balanced towards positive and negative aspects of the matter being communicated). • The information is accurate and complete in all material respects and does not contain information that is misleading. • The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources (e.g., the firm's website). <div data-bbox="772 846 1948 1336" style="border: 1px solid black; padding: 10px; margin-top: 10px;"> <p><i>Examples of matters that may be communicated by the firm about its system of quality management</i></p> <ul style="list-style-type: none"> • The nature and circumstances of the firm, such as the organizational structure, business model, strategy and operating environment. • The firm's governance and leadership, such as its culture and commitment to quality, and assigned roles, responsibilities and authority with respect to the system of quality management, and information about the individuals responsible for the leadership of the firm. • How the firm fulfills its responsibilities in accordance with relevant ethical requirements, including those related to independence. • Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with narrative to explain the indicators. </div>
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		<ul style="list-style-type: none">• The results of the firm's monitoring activities and external inspections, and how the firm has remediated identified deficiencies or is otherwise responding to them.• The evaluation undertaken in accordance with paragraph 65A and 65AA of whether the system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved, including the basis for the judgments made in undertaking the evaluation.• How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes.• The relationship between the firm and the network, the overall structure of the network, a description of network requirements and network services, the responsibilities of the firm and the network (including that the firm is ultimately responsible for the system of quality management), and information about the overall scope and results of network monitoring activities across the network firms.	
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Matter for IAASB Consideration (Addition to Question 8 of Agenda Item 5)

8A. Does the IAASB support the revisions to paragraph 41A(dA)(i) of proposed ISQM 1 to require communication with those charged with governance of listed entities for whom the firm performs audit engagements?

Appendix 1

Further Analysis of Respondent Comments Seeking More Robust Requirements on Communication Externally

	Require transparency reports for all firms	Require transparency reports for certain firms	Require firms to be transparent (i.e., form of communication not specified)	Require firms to be transparent about certain information	Address investor engagement
International Organization of Securities Commissions			X		
International Corporate Governance Network					X
The Corporate Reporting Users' Forum			X		
Committee of European Auditing Oversight Bodies			X		
Independent Regulatory Board for Auditors		X			
Irish Auditing and Accounting Supervisory Authority			X		
Office of the Auditor General New Zealand	X				
Office of the Auditor General of Alberta				X	
Institute of CPAs of Uganda				X	