

## Appendix 1: EYG Response to ED-ISQM 1

Our responses to the specific questions on which the IAASB is seeking feedback from Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control 1) *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* are set out below. We have also added an 'Other matters' section, which includes comments on other matters within the standard for which we are suggesting enhancements or clarifications and drafting and editorial suggestions in the 'Editorial and typographical suggestions' section.

### **Proposed International Standard on Quality Management 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements***

#### **Overall questions**

**Q1. Does ED-ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard? In particular:**

***(a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?***

We support the quality management approach overall and agree that ED-ISQM 1 should enhance a firm's management of engagement quality by incorporating the identification and assessment of quality risks, which we believe will improve the design of responses to address those identified quality risks. Better tailored responses together with tailored monitoring activities over the responses should set the right foundation for enhancing engagement quality.

We also agree with incorporating formal leadership accountability for quality into ED-ISQM 1 and the proposed enhancements to the expectations for a firm-wide culture of quality enhances firms' management of engagement quality. Instilling responsibility for quality in firm leadership and governance is, in our view, fundamental to improving quality.

However, we believe that the scope of proposed ISQM 1 should be limited to firms that perform audit engagements and only as it pertains to the delivery of audit services. As noted in paragraph 8 of The IAASB's *Exposure Drafts for Quality Management at the Firm and Engagement Level*, in the Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits* that was released in December 2015, the following issues were identified:

- (a) Fostering an appropriately independent and challenging skeptical mindset of the auditor.
- (b) Encouraging proactive quality management at the firm and engagement level.

- (c) Exploring transparency and its role in audit quality.
- (d) Focusing more on firms' (including networks') structures and communication processes and their internal and external monitoring and remediation activities.
- (e) Reinforcing the need for robust communication and interactions during the audit engagement.

Items a, c, and e above specifically relate to enhancing the quality of audit engagements; therefore, limiting ED-ISQM 1 to the delivery of audit services would seem consistent with being responsive to the concerns identified in the ITC. The performance of quality audit engagements is integral to a firm's responsibility to serve the public interest and limiting the scope of ISQM 1 focuses the design, operation, and implementation of the system of quality management as it pertains to audit services. In doing so, the firm is investing its resources on a system of quality management for the engagement services with the highest level of risk to the public interest.

If ED-ISQM 1 is applied with respect to audit services only, we believe that there are several options that could be considered individually or in combination with respect to firm-level quality control for non-audit engagements addressed by the IAASB's International Standards, such as:

- ▶ Maintain an "ISQC 1-like" standard, which would focus on appropriate policies or procedures for quality control with respect to such engagements
- ▶ Encourage firms to adopt ISQM 1 for quality management over such engagements
- ▶ Revisit the applicability of ISQM 1 as part of a post-implementation review of the standard when concrete evidence about its implementation and its benefits and costs can be analyzed

It is our view that all of these options provide a level of quality control that is sufficient for non-audit services conducted in accordance with the IAASB's International Standards, while at the same time address the strong calls for change that are being made in the context of audit quality.

***(b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?***

Yes, we agree that the proposals will generate benefits for engagement quality as intended because ED-ISQM 1 requires a firm to develop a system of quality management that is tailored to the nature and circumstances of the firm and the engagements it performs. We also support how the standard addresses professional skepticism, which is supported by the requirements related to the firm's culture and tone set by leadership and the allocation of appropriate resources.

***(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?***

If ED-ISQM 1 is limited to audits only, we believe the requirements and application materials are scalable. As noted in our response in (a) above, we believe ISQM 1 has been developed due to demands for enhancements in audit quality. We see a high potential for scalability issues in having an equally demanding system of quality management over non-audit services, particularly without evidence from a thorough cost-benefit analysis, which could be informed by the experiences of implementing the standard with respect to audits.

We find the range of non-audit engagements conducted under the IAASB International standards to be quite wide as it relates to their nature and complexity, as well as their public interest role. We do not believe that the flexibility provided by the risk assessment process alone is enough to justify the application of this standard to all engagements, particularly those that involve obtaining no assurance, without further analysis of the implications and consideration of potential unintended consequences to the delivery of such services. As noted in our response to (b) above, we support the firm's ability to design, implement and operate a system of quality management based on the nature and circumstances of the firm as described in paragraph 85 of the explanatory memorandum of ED-ISQM 1.

***Q2. 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 believe there are several aspects of the standard that create challenges from an implementation perspective and while these implementation challenges are not insurmountable, they do take considerable time to address. These implementation challenges further support our comments in Q1 of the EYG comment letter on the overall explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*, that an implementation period of at least 24 months after Public Interest Oversight Board (PIOB) approval of the standards is needed. The following are specific aspects of the standard that we see create implementation challenges. Despite these challenges, we support the requirements that we refer to in our response to this question. These challenges do not require any adjustment to the proposed standard other than sufficient time to implement them. As noted in Q1 of the EYG comment letter on the overall explanatory memorandum for the quality management standards, we believe that the three standards should be effective at least 24 months after approval by the PIOB.

*Identifying individuals with operational responsibility*

As noted in Q1 of the EYG comment letter on the overall explanatory memorandum for the quality management standards, ED-ISQM 1 includes significant changes in the governance and leadership component of the standard and consideration will need to be given as to how to assign operational responsibility as required by paragraph 24(a) for the system of quality management, operational responsibility for compliance with independence requirements, and the monitoring and remediation processes in transitioning the roles that currently exist in the member firms within the EY network.

Creating these leadership structures, defining roles and responsibilities and fully transitioning the right people into these new roles and responsibilities in each member firm will likely take more than 18 months in an organization the size of the EY network.

Further, as noted in Q2 of the EYG comment letter on the overall explanatory memorandum for the quality management standards, the IAASB should consider implementation guidance for small network firms that geographically are clustered together from an operational perspective to clarify how the clustered network firms would apply the requirement in 24(a) to identify personnel who have operational responsibility for the system of quality management, compliance with independence requirements and the monitoring and remediation process.

*Implementing a consistent approach to the risk assessment process*

Consistent with our operating approach to foster consistent delivery of quality engagements across our network, our approach for designing member firms' systems of quality management will be for the network to centrally design a risk assessment process that is implemented by member firms locally, properly reflecting their individual nature and circumstances (which vary considerably in nature of services provided, size, complexity, and available resources). As noted in our response to Q1 in the overall explanatory memorandum, we believe that systems of quality management that operates consistently across the network will lead to enhanced quality and is in the public interest.

Therefore, a second significant implementation challenge is to design a risk assessment methodology and process that can be implemented consistently and result in systems of quality management across the network that are consistent to the degree expected or appropriate for our network of member firms. Designing a risk assessment process that achieves this objective will take time not only to design but to validate through piloting the process with member firms with varying nature and circumstances. For a network of our size, a technology solution for documenting the quality objectives, quality risks and responses for the applicable processes, as well as monitoring the responses, also is critical to driving consistent implementation throughout the network because operating systems of quality management across an organization with member firms in over 150 countries cannot be managed manually.

Once the risk assessment methodology and process is validated, we will need to implement it not only with our member firms but across the various network processes within the scope of the system of quality management, of which the operational responsibility is spread across many process owners and functions. Implementing the risk assessment methodology and process for network services and requirements will drive consistency in the documentation that is provided to the member firms.

*Design a comprehensive and innovative monitoring solution*

Another significant implementation challenge is the design and implementation of a comprehensive monitoring solution, including how to monitor network and member firm responses, the process to perform root cause and remediation and the development of an annual assessment processes. As noted above, our approach will be to design a monitoring process that is applied across the network and member firms. In the design of the monitoring solution, we want to consider how to include more innovative aspects of monitoring, such as real-time monitoring elements that could improve the quality of engagements that are in-process. We do not feel that developing, piloting and implementing the

overall monitoring process given the extent of human and technological resources that are needed can be adequately accomplished in 18 months, especially considering we cannot effectively design a monitoring process until the responses are designed.

**Q3. *Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?***

We generally believe the application material is helpful in supporting a consistent understanding of the requirements. We would recommend that the IAASB re-evaluate the application guidance for certain requirements such as 'Acceptance and Continuance of Client Relationships and Specific Engagements' in paragraphs A76 through A90 and the application material related to technological resources in paragraphs A124 through A131 because it is our view that there is an opportunity to further reduce the length by removing content that we don't believe is necessary to understand the requirements. For example, we believe paragraphs A128 and A129 could both be deleted as we don't believe this content is needed. See our response to Q6(c) below for additional information on why we think A129 should be removed from the proposed standard. Also see the 'Editorial and typographical suggestions' section for editorial suggestions to specific paragraphs in the 'Application and Other Explanatory Material' section.

## **Specific Questions**

**Q4. *Do you support the eight components and the structure of ED-ISQM 1?***

We support the structure of the proposed standard into components because this structure provides a logical organization of the requirements of the standard and makes ED-ISQM 1 easier to read. We appreciate the flexibility expressed in paragraphs 13 and 26 of the explanatory memorandum and paragraph A5 of the 'Application and Other Explanatory Material' that firms are not required to organize their systems of quality management according to the components in ED-ISQM 1 and that firms may have different names for the components, may combine the components or may have additional components. This flexibility allows firms to organize their system of quality management in a way that best meets the needs of the firm to achieve the objective of the standard.

**Q5. *Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?***

We support the objective of the standard and understand that the objective of the firm, in the context of the standard, is to design, implement, and operate a system of quality management that achieves the objectives for the system of quality management. We believe that the supporting explanation of the relationship of the objective of the firm and the objective of the system of quality management is very clearly stated in paragraphs 16 and 17 of the explanatory memorandum. We recommend adding the text from paragraphs 16 and 17 of the explanatory memorandum that clarifies the objective of the firm and the objective of the system of quality management to either the introductory paragraphs or the draft frequently asked questions (FAQ) materials, which could also include the supporting graphic.

We agree with how ED-ISQM 1 explains the firm's role relating to the public interest and understand how achieving the objective of the standard relates to the firm's public interest role. The objective for the standard, like the objective for all standards, should be quantifiable and not subjective for the purposes of measuring the firm's achievement against the objective. We believe incorporating the public interest into the objective of the standard would run the risk of inconsistent interpretation and expectation of the system of quality management.

**Q6. *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?***

Yes, we agree that the application of the risk assessment process as defined in ED-ISQM 1 requires firms to establish appropriate quality objectives, quality risks, and responses such that the objective of the standard may be achieved. We also agree that the firm's risk assessment process should be applied to all components of the system of quality management. We believe the concepts included in paragraph 26 of the explanatory memorandum that the risk assessment process may be applied in a variety of ways should also be included in paragraph A48 of the application material to provide further clarity on how the risk assessment process may be performed.

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

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

We support the approach for the standard to include required quality objectives and the quality objectives identified in the standard generally seem appropriate and if achieved, should collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved.

Since the firm is responsible for the system of quality management, we observe that the quality objectives in paragraphs 38(d) and 38 (g) in the 'Resources' component and all the quality objectives in the 'Engagement performance' component are not worded as actions of "The firm..." Instead, the quality objectives noted above in the 'Resources' component and all of the quality objectives within the 'Engagement performance' component are directed at personnel or engagement teams. This seems contradictory to both the objective of the standard, which is directed at the firm, as well as to most of the other quality objectives in ED-ISQM 1. Therefore, we recommend these quality objectives be rewritten to require action by the firm to clarify that the responsibility for achieving all the quality objectives lies with the firm.

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

It is clear that the firm is expected to establish additional quality objectives if needed; however, it is not clear the types of circumstances that would require firms to create additional quality objectives as noted in paragraphs 10(a) and 26 and relevant application material. We believe criteria for determining when firms establish additional quality objectives and examples of possible additional quality objectives are needed in order for firms to practically and consistently apply these requirements.

Further, paragraph 29 of the explanatory memorandum states “The IAASB is of the view that the quality objectives in ED-ISQM 1 are comprehensive, and if properly addressed by the firm, will result in the system providing reasonable assurance that its objectives have been achieved.” We believe this concept should be incorporated into FAQ 3. We also recommend the IAASB perform a post-implementation review on ISQM 1 and an area of focus should include the comprehensiveness of the quality objectives.

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

We support the approach taken such that firms identify and assess their own quality risks and the fact that quality risks are not prescribed by the standard. We agree, as stated in paragraph 35 of the explanatory memorandum, this approach will result in the quality risks identified and assessed by a firm being customized and tailored to the nature and circumstances of the firm.

However, we disagree with the inclusion of potential quality risks in paragraph A129 as the firm should identify and assess its own quality risks. The inclusion of potential quality risks in the standard is not in line with the described intentions for the firm’s risk assessment process, which emphasize the importance of the risks being specific to the nature and circumstances of the firm. Examples of quality risks that are included in the application material could be misconstrued as quality risks that firms are expected to identify. Any example quality risks that the IAASB believes may be useful in firms’ efforts to implement ED-ISQM 1 are better suited to implementation materials, such as the FAQ materials.

In addition, see the ‘Other Matters’ section for suggested improvements to the practical example as it relates to the identification and assessment of quality risks

***(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?***

We fully support the approach for firms to design and implement responses based on the identified and assessed quality risks. Therefore, we believe that required responses in the proposed standard should be limited to as few as possible to emphasize the importance of firms designing responses that are appropriately responsive to firms’ quality risks. For example, the ‘Monitoring and remediation process’ component has a significant number of

very detailed required responses, which are not principles-based and are inconsistent in their nature and detail with the required responses in other components. See suggestions for paragraphs 44, 45, 46, 51, 53 and 54 of the 'Monitoring and remediation process' component in the 'Editorial and typographical suggestions' section below for proposals on how to make the required responses included in the component more principles-based. By limiting the number of required responses in the standard, it will appropriately promote the standard's intended behavior for firms to 'think through' the responses that are appropriate to implement based on the firm's nature and circumstances.

Further, required responses should be principles-based such that it is more evident that further tailoring to the required response for the firm's quality risks is required. Required responses that are principles-based also more easily allow for firms to make changes to their design to address future circumstances (i.e., 'future-proofing') and for firms to appropriately scale the required responses to the nature and circumstances of the firm.

We believe the IAASB should review all the required responses in ED-ISQM 1 and consider changes to those that are not sufficiently principles-based. The objective of the review is to avoid unintended consequences of narrowing a firm's consideration of the responses that are necessary in the firm's circumstances, which may be more or different responses to the narrow response identified. The consequences would then be that the required response will not mitigate the relevant identified and assessed quality risks and subsequently the related quality objective likely will not be met.

We also believe that the application material should be reviewed to avoid any examples in the application material being misconstrued to be additional required responses. The danger with overly prescriptive application material for required responses is the same as the concern noted above, that firms will focus on the responses in the application material instead of focusing on designing responses that appropriately address firms' quality risks. We believe the application material paragraphs (e.g., A68, A88, A95, A119, A134) include examples that are overly specific and should be considered for removal or relocation to implementation materials.

Finally, we believe that required responses that directly overlap with quality objectives should be removed from the standard to improve the readability and avoid the possible unintended consequences related to required responses described above. For example, in the 'Engagement performance' component, the required response in paragraph 37(f) that relates to the assembly and retention of documentation is duplicative of the quality objective in paragraph 36(c) that also addresses document retention. In this instance, we recommend the quality objective in paragraph 36(c) to be reworded to "The engagement documentation is appropriately assembled and retained for an appropriate period of time" and the required response in paragraph 37(e) be deleted. We believe all required responses warrant specific re-consideration from the perspective of whether they are already sufficiently covered by a quality objective and all responses viewed to be duplicative should be deleted.

- 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, it is clear to us that the required responses included in ED-ISQM 1 are not sufficient to meet the objective of the standard and that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard. To further clarify what is meant by responses, we recommend that the IAASB add the text from paragraph 36 of the explanatory memorandum that “responses to quality risks are analogous to controls” to the application material of the definition of response. We believe that providing this information in the application material will better assist firms to identify responses that are able to be effectively monitored.

**Q7. *Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?***

We understand the need for changes in the area of governance and leadership compared to ISQC 1. As noted above in Q1, instilling responsibility for quality into firm leadership and governance is fundamental to improving quality. However, the requirement in ED-ISQM 1 limits who can have ultimate responsibility to the firm’s chief executive officer or the firm’s managing partner (or equivalent) or, if appropriate, the firm’s managing board of partners (or equivalent). As noted in our response to Q6(d), we believe that the required responses in the proposed standard should be limited to as few as possible and be principles-based so that firms design and implement responses specific to the nature and circumstances of the firm; therefore, the requirement as to who can have ultimate responsibility should also be principles-based so that firms identify the person with the appropriate authority for the system for quality management.

It is not possible for the standard to address all possible legal and operational structures of firms. Our recommendation is for the required response in paragraph 24(a) to be updated as follows: “Assigning ultimate responsibility and accountability for the system of quality management to the firm’s chief executive officer or the firm’s managing partner (or equivalent) or, if appropriate the firm’s managing board of partners (or equivalent) or an individual with equivalent authority, competence and responsibility consistent with the governance structure of a particular firm.” Expanding who can have ultimate responsibility will provide firms with the flexibility to better align what is being required by ED-ISQM 1 with the operations of their organization so that the person assigned this role is ultimately responsible and accountable for the system of quality management, including performing the annual evaluation.

**Q8. *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?***

No, we don’t think that ED-ISQM 1 should require firms to assign responsibility for relevant ethical requirements to an individual in the firm. Firms and network structures vary widely and, as such, the standard should provide flexibility in determining the granularity needed for the roles and assignments of operational responsibility for the firm’s system of quality management. We do not believe any other operational responsibility roles beyond those

prescribed for the system of quality managing as a whole, independence and monitoring and remediation should be required by the standard.

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

We believe the standard appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons within the network.

***Q9. Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?***

We agree with expanding the scope of the 'Resources' component to include technological resources; however, we believe the standard should be clarified to state that the technological resources that are to be evaluated and documented as part of the system of quality management are limited to those that are **designed** to enable the system of quality management and the performance of engagements.

Specifically, paragraph 38(e) should be rewritten to be "The firm obtains or develops, implements, and maintains appropriate technological resources designed to enable the operation of the firm's system of quality management and the performance of engagements." We believe that, by indicating that the scope of the resources is those designed to enable the SQM and the performance of engagements, this clarifies which technological resources are in scope of ISQM 1 and that the scope does not include applications such as email, as mentioned in the FAQ materials. This change should be reflected in the supporting application materials (e.g., A205) and FAQs as appropriate.

***Q10. 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?***

Yes, we believe that the requirements for communication included in ED-ISQM 1 related to external parties promote the exchange of valuable and insightful information. For example, we believe that this will improve communications between the network and member firms and among member firms as it relates to the expanded requirements included in ED-ISQM 1 for resources.

We believe the communication requirements will lead to:

- ▶ Firms having a better understanding of what network services and requirements the network provides
- ▶ Firms identifying where there are gaps between network services and requirements and the responses needed to mitigate the quality risks identified and assessed by the member firms
- ▶ A network having an improved understanding of the member firms' systems of quality management

We believe the standard goes as far as it practically can regarding external communications due to the variation in local laws and regulations over transparency reporting and other external communications. We however would recommend that the reference to 'in a transparency report or otherwise' be removed from the requirement in 41(c)(iv) as we believe this reference is subject to misinterpretation, such that it can be misunderstood to be a requirement for firms to issue 'transparency' reports. It also will 'future-proof' the requirement as while such reporting may be referred to as transparency reporting today, this reporting is likely to evolve and could be referred to differently in the future.

**Q11. *Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?***

We agree with the proposed scope of engagements that should be subject to an engagement quality review except for the new requirement for audits of financial statements of entities that the firm determines are of 'significant public interest'. While we agree that there are audits of entities other than listed entities for which it may be appropriate to be subject to an engagement quality review, the term 'significant public interest' is not clearly defined. The lack of definition of 'significant public interest' is likely to result in confusion and inconsistent application.

We therefore propose that the standard either be specific as to the additional audits requiring an engagement quality review to ensure the requirements result in the proper identification of those audits that are to be subject to an engagement quality review or remove the requirement in 37 (e)(ii) and leave the determination of which other audits beyond audits of listed entities are subject to engagement quality review to the requirement in paragraph 37 (e)(iii)b.

In addition, there could be unintended independence consequences in jurisdictions where an entity is identified as one of 'significant public interest' for the purposes of engagement quality reviews but not defined to be a public interest entity for the purposes of the independence requirements. On the other hand, to assume that all public interest entities require an engagement quality review would not be appropriate because of the variation in the definition of this term globally. We recommend the IAASB coordinate with IESBA to determine whether this requirement, because of its use of the term "public interest" in relation to certain entities, may be viewed or misinterpreted to be imposing additional independence requirements.

**Q12. *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?***

Yes, we believe the proposals for monitoring and remediation of the entire system of quality management will improve the robustness of firms' overall monitoring compared to

the requirement to monitor completed engagements included in extant ISQC 1. Monitoring the entire system of quality management through activities beyond engagement inspection will promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques; however, as described in our response to Q2, we also believe the proposal will create significant implementation challenges from the perspective of the time it will take to design and implement a redesigned monitoring and remediation process, which is one reason we would like to have the standards effective at least 24 months after approval by the PIOB.

***(b) Do you agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?***

We disagree with the requirement in paragraph 45(b) to inspect completed engagements for each partner on a cyclical basis determined by the firm. As noted in our response to Q6(d), we fully support the approach for firms to design and implement responses based on the identified and assessed quality risks. We believe that including the very specific required response to perform inspections cyclically could lead to firms implementing an inspection process based solely on a cyclical cycle, e.g., three-years, when that may be inappropriate based on the assessed quality risks for the firm.

In addition to modifying the requirement in paragraph 45(b) to be more principles-based to allow for tailoring based on quality risks, we believe that paragraph A169 could be further enhanced by rewriting it as follows: The firm may establish criteria for inspecting engagement partners according to a variety of risk factors. The risk factors considered can be the category of engagements (e.g., audits of financial statements, compilations) or number of engagements performed.' By updating paragraphs 45(b) and A169 as suggested, it increases the probability that the firm implements an appropriate response based on the firm's assessed quality risks.

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

We agree that the framework, per the requirements in paragraphs 47 through 51, for evaluating findings and identifying deficiencies is sufficiently clear and we support the definition of deficiencies. While the term 'findings' (plural) and the corresponding framework for evaluating findings (plural) is also clear, paragraphs A175 and 176 use the term 'finding' (singular). Using the term 'finding' implies a singular matter that was detected and is not in keeping with the description of 'findings' in A172. Our view is that ED-ISQM 1 should consistently use the term 'findings', in the plural, throughout the standard, which allows firms flexibility in grouping individual exceptions and not requiring evaluation of each 'finding' on a standalone basis.

We also recommend including the definition of ‘findings’ in the definitions section using the text from A172 and removing this text from the application material. It is our view that this will enhance the understanding of the term.

***(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 agree with the new requirement for the firm to investigate the root cause of deficiencies and believe the nature, timing and extent of the procedures to investigate the root cause is sufficiently flexible.

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

Yes, we agree with the IAASB’s approach to describe the benefits of investigating the root cause of positive findings in the application guidance rather than to require firms to determine the root cause of positive findings because it provides firms with the flexibility to identify the number and types of positive findings to explore further.

***(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?***

In addition to the recommendation provided in response to Q7 that the changes to the criteria for the person that has ultimate responsibility are modified and in response to Q2 that we have sufficient time to make organization changes that are needed to support the assignment of ultimate responsibility, we believe further clarity is needed on the evaluation itself. Paragraph 75 of the explanatory memorandum states that “The IAASB envisages that the evaluation would involve a determination of whether the system provides reasonable assurance that the objectives are achieved at the point in time the evaluation is undertaken.” The concept that the evaluation is as of a point in time is not included anywhere in the draft standard and should be considered as a frequently asked question in order to provide firms with a better understanding of what the IAASB intended with regards to the annual evaluation.

In addition, jurisdictions may need to clarify the expected timing of the annual evaluation in correlation to inspection periods. This may also have an impact on the timing of providing the monitoring results of network requirements and services to member firms.

**Q13. 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 proposals addressing networks. We recognize the need for a member firm to have an understanding of network services and requirements, including the results of monitoring activities the network performs, in order to appropriately design, implement, and operate its system of quality management.

More specifically, the EY network drives consistency throughout its member firms by providing its member firms certain consistent network requirements and services, and we believe these requirements work with our network approach. It is in the public interest for there to be consistency in the operation of the systems of quality management across member firms as it provides the ability for member firms to have a basis for using the resources or services of other firms within the network. Member firms need to obtain an understanding of network services and the member firms' responsibilities for operating them effectively. In addition, the member firms should be provided information from the network about any deficiencies or issues in the network services to design timely compensating responses or controls and to understand any limitations of the network services.

From a practical implementation standpoint, our network will be incentivized by these new requirements in ED-ISQM 1 to provide consistent information about the network services to all member firms in a consistent manner (i.e., we would not expect each member firm to submit an information request and for the network to respond individually to each member firm; such a process would be unmanageable for our network).

We also believe that the risk assessment process requirements drive action at the network level. As mentioned in Q2 above, this standard is driving networks to a consistent approach to the risk assessment process across the network and follows through into the design of the monitoring and remediation process. It is our understanding that the intent of the standard is for networks to "think about" the system of quality management from the perspective of the member firms for the purposes of determining how best to support the individual member firms across the network. We agree with this intent and suggest that perhaps this intent could be made clearer in the standard itself (e.g., in application material or introductory paragraphs).

Overall, although the requirements in ED-ISQM 1 are not directed at the network, we do strongly believe that the standard drives behavior and actions at the network level to drive consistency to the extent appropriate across the member firms' systems of quality management.

**Q14. Do you support the proposals addressing service providers?**

We agree with the proposals addressing service providers as they relate to human resources; however, as it relates to technological resources, we believe that the IAASB needs to re-evaluate what information is realistic to obtain from a service provider. Specifically, we disagree with the example included in paragraph A210 that states in determining if the resource is appropriate, the firm may request documentation of "for technological or intellectual resources, the procedures undertaken in designing, implementing, and operating the resources." It is very unlikely that service providers would comply with this request as it could be interpreted as a request for trade secrets.

Consistent with our concern on paragraph A210, in FAQ 15, it is unrealistic to expect firms that use third party applications to be able to make inquiries and expect a thorough response as to common errors, functionality issues, or how the changes are tested before being deployed. It is our experience that a vendor providing technological resources would not likely provide a list of common errors or information as to how an application is designed. We recommend that the IAASB perform outreach to service providers of technological resources to determine what is reasonable for firms to obtain (i.e., operations manual, service organization control reports) and update the standard and implementation materials accordingly.

**Q15. *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?***

No comment.

**Other matters**

**Draft examples: How the nature and circumstances of the firm and the engagements it performs affect the implementation of proposed ISQM 1**

We recognize that the example is not intended to represent how a firm should document its quality objectives, its identification and assessment of quality risks and its related responses. However, we believe that the example could be improved if the following were clarified:

- ▶ The example includes a section titled "Assess identified quality risks" that contains information as to whether a quality risk is more or less likely to occur. Per paragraph 30 of ED-ISQM 1, "The design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks." We recommend updating this section to show how the design of the response is responsive to the assessment of the risk.
- ▶ As stated in paragraph 36 of the explanatory memorandum of ED-ISQM 1, "responses to quality risks are analogous to controls," yet several of the responses in the example seem to be processes and/or the results of the application of controls, rather than controls (i.e., The firm assigns operational responsibility for compliance with independence requirements to the firm's managing partner). We think that it would be more appropriate for the responses to be examples of controls such as "The independence policy is reviewed and approved timely by the individual with operational responsibility for compliance with independence requirements."

**Draft frequently asked questions regarding proposed ISQM 1**

In addition to the feedback provided in our responses to Q5, Q6, Q9 and Q14 on the content included in the frequently asked questions document, the following are suggestions for further improvement to the frequently asked questions document:

- ▶ We suggest updating FAQ 2 to include the detail from paragraph 26 of the explanatory memorandum, which includes useful information for firms to consider when determining how

to organize their system of quality management (i.e., by component, by business unit, by service line).

- ▶ The response to FAQ 4 states that “the firm is required to document the identified quality risks and their assessment as per paragraph 67(a).” That is not consistent with the wording of paragraph 67(a). Paragraph 67(a) states that the firm shall prepare documentation of the “firm’s quality objectives and assessed quality risks.” Documenting the assessed quality risks (i.e., the list of risks that have been assessed) and documenting the actual assessment are two different things. If the IAASB intends for firms to document the assessment, paragraph 67(a) should be amended to clarify this.

## Editorial and typographical suggestions

### Paragraph 19(b)

- ▶ Consider rewriting the definition for ‘engagement documentation’ to “The record of work performed, results obtained, and conclusions the practitioner reached which supports the engagement report issued (terms such as “working papers” or “work papers” are sometimes used).”

### Paragraph 19(f)

- ▶ Consider rewriting the first sentence of the definition for ‘engagement team’ to: All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, including individuals engaged by the firm or a network firm, to support the engagement report issued.

### Paragraph 19(k)

- ▶ The application material for networks in paragraph A13 says “in all cases networks are external to the firm” which contradicts the application material for service providers in paragraph A205 which says, “The service providers used by the firm include individuals or organizations that are external to the firm, excluding networks, network firms or other structures or organizations in the network.”
- ▶ Our recommendation is for A13 to be rewritten to say “networks are external to the firm; however, are not considered as service providers” to avoid confusion.

### Paragraph 19(v)

- ▶ Remove the definition of the system of quality management as the definition of system of quality management is redundant with the objective in paragraph 18.

### Paragraph 36(b)

- ▶ The word 'appropriate' in "Engagement teams exercise appropriate professional judgment" is open to interpretation and is vague. Our view is that it is superfluous and thus we propose removing the word 'appropriate'.

#### Paragraph 37(c)

- ▶ We recommend adding to paragraph "Establishing policies or procedures addressing consultation on difficult or contentious matters or areas of significant judgment, including the ..."

#### Paragraph 44

- ▶ Paragraph 44 isn't written as a response, but rather the sub-bullets are items for the firm to consider when designing and implementing its monitoring activities. We recommend that these attributes be incorporated into the application material.
- ▶ If the IAASB leaves paragraph 44 as is, we recommend rewriting or eliminating 44(b) as it currently reads "In designing and implementing the monitoring activities, the firm shall take into account for monitoring activities over the firm's risk assessment process, the design of that process." Repeating the phrase "monitoring activities" makes the requirement difficult to read.

#### Paragraph 45

- ▶ We recommend updating paragraph 45 as follows "The firm's monitoring activities shall include the inspection of engagements to determine whether the responses that are required to be implemented at the engagement level have been implemented and to otherwise provide relevant, reliable and timely information about the design, implementation and operation of the components of the system of quality management."

#### Paragraph 46(a)

- ▶ We recommend that paragraph 46(a) be deleted as it is repetitive of the requirements in paragraph 25.

#### Paragraph 51

- ▶ Paragraph 51 isn't written in a style consistent with the other required responses in the standard (i.e., The firm shall establish policies and procedures...) and we recommend rewriting it.

#### Paragraphs 53 and 54

- ▶ Paragraphs 53 and 54 within the 'Monitoring and remediation process' component are duplicative of paragraphs 40(b) and 40(e) and 41(c), respectively. In removing these paragraphs, the IAASB should also evaluate the corresponding application material for

paragraphs 53 and 54 and whether the contents should be included in the application material for paragraphs 40(b), 40(e), and 41(c).

- ▶ Removing paragraphs 53 and 54 can help streamline the required responses in the 'Monitoring and remediation process' component which has a significant number of detailed and out of balance with the rest of the standard. See comments in the 'Responses' section of 'Other matters' above for more details.

#### Paragraph A4

- ▶ Remove the first bullet "The appropriate organizational structure..." and the fifth bullet "The resources and information and communication that are appropriate..." as these are both covered by the fourth bullet "The appropriate nature, timing, and extent..."

#### Paragraph A117

- ▶ We are unclear what is meant by "a defined standard" and recommend it be removed from the paragraph improve the clarity of the proposed standard.

#### Paragraph A196

- ▶ We believe paragraph A196 should be deleted as it repeats the requirements included in paragraph 41(c) and does not add any new information.

#### Paragraph A214

- ▶ The application material in paragraph A214 states that "In some circumstances, it may be appropriate for the firm to document its processes and analysis for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks to provide a history of the basis for decisions." It is unclear what circumstances the application material is referring to and we have concern that by including such a statement in the standard, it will be expected that such documentation is done. We recommend A214 be clarified on regarding what the "circumstances" are.