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Mr. Willie Botha
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28 June 2019

Explanatory Memorandum: *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*

Dear Mr Botha

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, welcomes the opportunity to offer its views on the following Explanatory Memorandum and Exposure Drafts for quality management at the firm and engagement levels issued by the International Auditing and Assurance Standards Board (IAASB):

- ▶ *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews* (overall explanatory memorandum)
- ▶ Proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance Related Services Engagements* (ED-ISQM 1)
- ▶ Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED-ISQM 2)
- ▶ Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-ISA 220)

Overall, we are supportive of the objectives of the exposure drafts including the introduction of a new approach to quality management, a separate quality management standard for engagement quality reviews, and clarity in the role and responsibilities of the engagement partner. We believe that these proposed standards can help to improve quality at the firm and engagement level and the performance of engagement quality reviews. The standards' combined ability to generate improvements in quality is heavily influenced by having an adequate period of time to fully and effectively implement the standards. A rushed implementation to meet a shorter than appropriate transition period may create threats to firms' abilities to effectively design and implement systems of quality management, which may therefore lead to threats to engagement quality.

Proposed ISQM 1 represents a substantial transformative change from extant ISQC 1; therefore, we believe that the implementation period for instituting (i.e., designing and implementing) systems of quality management in accordance with the three interconnected standards should be at least 24 months after approval of the standards by the Public Interest Oversight Board (PIOB). Our intent is to develop a network level approach that can be implemented across the member firms as it is our view that a consist approach to the system of quality management will lead to higher quality and is in the public interest. We do not believe that an 18-month implementation period is sufficient to adequately develop our network approach, including the necessary technology to document and monitor a system of quality management for each member firm in our global organization. See our response to Q1 below for further details on our concerns with an 18-month implementation period.

In addition, we appreciate the IAASB's efforts to collaborate with other standard setters as we believe this collaboration is essential to promote consistency of the requirements of quality management standards and to reduce variations that do not benefit engagement quality.

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

We support the new approach in ED-ISQM 1 for a firm to develop a system of quality management, which is focused on the achievement of the required quality objectives included in the standard by designing and implementing responses based on the identified and assessed quality risks of the firm. We believe 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 the requirement to monitor all aspects of the system of quality management, compared to the requirement to monitor completed engagements under extant ISQC 1.

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. 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 a firm's investment on a system of quality management for the engagement services with the highest level of risk to the public interest. Refer to our response to Q1(a) in 'Appendix 1 EYG Response to ED-ISQM 1' for further comments on limiting the scope of ED-ISQM 1 to firms that perform audit engagements only. We also provide options that could be considered individually or in combination with respect to firm-level quality control for non-audit engagements.

As noted above, we support the risk assessment process included in ED-ISQM 1 that focuses a firm's attention on risks that, should they occur, would be likely to affect engagement quality for that firm, and for a firm to design and implement responses based on their own identified and assessed quality risks. Therefore, we believe that ED-ISQM 1 should place more emphasis on the importance of firms designing responses that are appropriately responsive to their own quality risks and less emphasis on required responses. The current approach of requiring a number of responses that are fairly specific in nature will, in our view, have the unintended consequence of firms focusing primarily on the required responses and not sufficiently focusing on designing and implementing a full suite of responses that

are appropriate to address the firm's quality risks. See our response to Q6(d)(i) in 'Appendix 1 EYG Response to ED-ISQM 1' for further comments on the required responses included in ED-ISQM 1.

We agree with incorporating leadership accountability into the standard and that leadership is responsible and accountable for the system of quality management that supports the consistent performance of quality engagements. However, we believe the requirement in ED-ISQM 1 is overly prescriptive as to who can have ultimate responsibility for the firm's system of quality management. Our recommendation in our response to Q7 in 'Appendix 1 EYG Response to ED-ISQM 1' is to expand who can have ultimate responsibility to provide firms with greater flexibility to place ultimate responsibility and accountability with individuals who should have that responsibility based on the governance structure of the firm and consistent with the intentions of the standard.

We agree with ED-ISQM 1 addressing the circumstances in which an engagement quality review should be performed and ED-ISQM 2 addressing the specific requirements for the appointment and eligibility of the engagement quality reviewer and the performance and documentation of the review. We also 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' because the term 'significant public interest' is not clearly defined. Refer to our response to Q11 in 'Appendix 1 EYG Response to ED-ISQM 1' for further information on our proposal that the standard either be specific as to the additional audits requiring an engagement quality review or remove the requirement in the proposed standard.

We are also supportive of the proposals addressing networks and 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 for a member firm to design, implement, and operate its system of quality management.

Proposed International Standard on Quality Management 2, *Engagement Quality Reviews*

As noted above, we agree with ED-ISQM 1 addressing the circumstances in which an engagement quality review should be performed and having a separate standard (i.e., ED-ISQM 2) to emphasize the importance of an engagement quality review as it facilitates having all requirements related to the firm's performance of that review in one location. We also believe the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 are clear.

Further, we support inclusion of guidance regarding a "cooling-off" period before certain individuals can act as the engagement quality reviewer because such guidance is appropriate to support objectivity; however, we believe that the guidance should be further clarified and located in the IESBA Code because the cooling-off period is relevant to the engagement quality reviewer's compliance with the IESBA Code's fundamental principle of objectivity. See our response to Q4 in 'Appendix 2 EYG Response to ED-ISQM 2' for further information on our recommendations regarding the "cooling-off" period.

We agree with the enhanced requirements relating to the nature, timing and extent of the engagement quality reviewer's procedures as the requirements are both helpful to improve the robustness of the engagement quality review as well as consistency in the depth of the review. We

also support the added emphasis of the engagement quality reviewer's involvement at appropriate times throughout the engagement. The explanatory memorandum of the proposed standard includes information that is helpful in clarifying the confusion between significant judgments and significant matters. Refer to our response to Q5 in 'Appendix 2 EYG Response to ED-ISQM 2' for suggestions to enhance the guidance in the proposed standard.

Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements*

We support ED-ISA 220's focus on the sufficient and appropriate involvement of the engagement partner as part of taking overall responsibility for managing quality on the engagement. We understand that the engagement partner continues to take overall responsibility for achieving quality on the audit engagement even when the engagement partner assigns procedures, tasks, or actions to other members of the engagement team. However, we recognize that this standard also applies in the context of group audits and that the IAASB currently has a project underway to revise ISA 600 *Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)*. Given ISA 600 (Revised) will not be effective until after ISA 220 (Revised) is required to be implemented, we recommend the IAASB create non-authoritative guidance in the interim for implementing ISA 220 (Revised) in the context of group audits. See our response to Q1 in 'Appendix 3 EYG Response to ED-ISA 220' for further information on the areas for which we believe interim guidance is needed.

We also support the expansion of the resources assigned, allocated or made available by the firm to support the performance of audit engagements to include technological resources; however, we believe that the proposed standard should be further enhanced to more clearly state that technological resources that are not in the scope of the firm's system of quality management are the responsibility of the engagement partner. See our response to Q4 in 'Appendix 3 EYG Response to ED-ISA 220' for our recommendation on changes to ED-ISA 220.

In reviewing the updated objective in ED-ISA 220, it is unclear how we would determine that an auditor has "managed quality at the engagement level to obtain reasonable assurance that quality has been achieved." It is our recommendation that the objective of the extant standard be retained as it is more concise and measurable, with the minor change of updating "control" to "management." Refer to the 'Objective' sub-section within the 'Other matters' section in 'Appendix 3 EYG Response to ED-ISA 220' for our proposed edits to the objective.

Our responses to the specific questions from the overall explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*, are included below. In addition, we have created three appendices with our responses to each of the quality management exposure drafts:

- ▶ Appendix 1: EYG Response to ED-ISQM 1
- ▶ Appendix 2: EYG Response to ED-ISQM 2
- ▶ Appendix 3: EYG Response to ED-ISA 220

The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews

Overall questions

Q1. *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?*

No. While we understand the reasons provided in *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*, for proposing an 18-month implementation period for the three standards, including the importance of enhancing quality management at the firm and engagement levels, we believe that an 18-month implementation period is not sufficient. We agree with the statements in paragraph 24 that there are substantial differences in the quality management approach in ED-ISQM 1 and the existing standard on quality control. Those differences require an extensive re-evaluation of the current systems of quality control implementation by firms subject to the standard as well as how those firms interact with a network. This re-evaluation will result in considerable changes in the design, documentation, and monitoring of a system of quality management. Given the significance of the changes in the quality management approach in ED-ISQM 1 and the size and scale of our network, including the increased coordination between member firms and the network required under ISQM 1, an 18-month implementation period is not practical.

Concerns regarding the sufficiency of an 18-month implementation period

We do not agree that the proposed 18-month period is sufficient to allow enough time for firms to effectively implement ED-ISQM 1 and, therefore, we disagree with the statement in paragraph 25 that an 18-month implementation period is practical and in the public interest.

Due to the introduction of a formalized risk assessment process in ED-ISQM 1 that requires a new approach to the design and implementation of a firm's system of quality management and the significantly expanded requirements for the design and implementation of a firm's monitoring and remediation process, we believe it will take more than 18 months to effectively design and implement proposed ISQM 1 in a network organization like EY with member firms in over 150 countries that will require systems of quality management tailored to their individual firm circumstances and services. The structure of our organization is complicated by significant variations in size and complexity of the member firms. The differences in structure in many cases result from local laws regulating the size and scope of an entity's operations and different responsible parties among various member firms within the same country.

Our goal as a network is to achieve consistency in the approach to the development and operation of systems of quality management across all member firms. We believe that systems of quality management that operate consistently across the network will lead to enhanced quality and is in the public interest. Our implementation effort also will require the design and construction of an information technology platform to facilitate this consistency. In addition, because of the size and

complexity differences between member firms, and the significant changes in the governance and leadership component of the standard, the change management challenges are also significant.

We believe that an implementation period that would allow sufficient time to overcome the implementation challenges we foresee and achieve compliance with the standards needs to be at least 24 months after the approval of the three standards by the Public Interest Oversight Board.

We fully recognize the magnitude of the proposed changes and have begun to think through re-designing the systems of quality management of our member firms so that we can move as quickly as possible after the quality management standards are approved; however, these early efforts cannot fully compensate for the time needed to fully and effectively implement the final standards, recognizing that the standards will evolve based on comments received on the exposure drafts consistent with the IAASB's due process. In addition, if there are significant changes to any of the quality management standards, we strongly believe that re-exposure needs to be given serious consideration by the IAASB due to the pervasive effects on firms' systems of quality management and on engagement partners' responsibility to manage and achieve quality at the engagement level.

See our response to Q2 in 'Appendix 1 EYG Response to ED-ISQM 1' for further comments on implementation challenges related to ED-ISQM 1.

Concerns with respect to services other than audits

As noted in our comments to Q1 in 'Appendix 1 EYG Response to ED-ISQM 1', we believe that the quality management approach set forth in ED-ISQM 1 is most suited to audits and that the driving need for this approach, as well as its expedited implementation timing, is to enhance audit quality in the public interest, consistent with theme of the 2015 Invitation to Comment.

Also related to the applicability of ISQM 1 to services other than audits, we are concerned with the proposed timeline for conforming and consequential amendments to the International Standards that address non-audit engagements. The amendments are also proposed to be effective December 2021 but PIOB approval of those amendments does not appear to be expected until December 2020. We assume that such conforming and consequential amendments may involve substantive enhancements to engagement-level quality management requirements for engagements other than audits. Accordingly, we are concerned that a 12-month transition period will not be sufficient to implement new engagement-level requirements.

If the scope of ISQM 1 is not amended to apply to audits only, we believe the effective date should at least be stratified to allow firms to focus on implementation for audits first and foremost and then cascade the required implementation with respect to other services with an effective date of at least 12 months subsequent to the effective date with respect to audits. Cascading the date in this manner would also address our concern regarding the timing of the approval of the conforming and consequential amendments.

Because of the significance of the implementation challenges outlined above, our recommendation for an effective date of at least 24 months after approval by the PIOB applies even if the scope of the standard is amended to apply to audit services only.

Q2. *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?*

We do believe additional implementation materials would be beneficial for SMPs, including those that operate as part of a network. Specifically, 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 paragraph 24(a)(iii) to identify personnel who have operational responsibility for the system of quality management, compliance with independence requirements and the monitoring and remediation process.

The IAASB should also consider periodic webinars during the transition period to provide the opportunity for firms to ask the IAASB questions and the FAQs should be updated on an on-going basis as new questions arise.

We also have suggestions on how to improve the FAQs and practical example for ED-ISQM 1 and have included those thoughts in the 'Other Matters' section of 'Appendix 1 EYG Response to ED-ISQM1'.

General questions

In addition, the IAASB is also seeking comments on the general matters set out below for all three EDs:

- (a) *Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposals, in particular, on any foreseeable difficulties in applying it in a developing nation environment.*

No comment.

- (b) *Public Sector—The IAASB welcomes input from public sector auditors on how the proposed standards affect engagements in the public sector, particularly regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.*

No comment.

- (c) *Translations—Recognizing that many respondents may intend to translate the final ISQMs and ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed standards.*

No comment.



We would be pleased to discuss our comments with members of the IAASB or its staff. If you wish to do so, please contact Kurt Hohl, Global Deputy Vice Chair, Professional Practice (Kurt.Hohl@eyg.ey.com).

Yours sincerely,

Ernst + Young Global Limited