



Australian Government
Auditing and Assurance Standards Board

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Mr Willie Botha
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International Federation of Accountants
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Dear Willie,

AUASB Submission on the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews - Responses to Questions on proposed ISQM 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to submit our response on the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews.

The AUASB is a non-corporate Commonwealth entity of the Australian Government, responsible for developing, issuing and maintaining auditing and assurance standards in Australia. The AUASB's role and mandate extends to liaison with other standards setters and participation in global standard-setting initiatives, so we have a very strong interest in these IAASB Exposure Drafts and welcome the opportunity to comment.

In formulating our response to these proposed standards the AUASB sought input from its stakeholders in three principal ways:

1. From hosting a series of roundtable meetings with stakeholders in three large Australian cities. These roundtable meetings were attended by over 50 stakeholders representing a broad range of backgrounds, including assurance providers from a range of audit firms, professional accounting bodies, academics, those charged with governance and preparers of financial statements.
2. Through an open invitation to provide comments on the equivalent AUASB issued Exposure Drafts via the AUASB website.
3. Formal discussions and deliberations by AUASB members at recent AUASB meetings.

The AUASB supports the IAASB's objective to develop and maintain robust international standards that contributes to enhanced engagement quality and consistency of practice throughout the world, and strengthened public confidence in the global auditing and assurance profession. However, the AUASB notes with concern that the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews, all contain greater complexity and detail than the extant standards they are replacing. This makes the proposed standards more challenging for all auditors (especially those auditors of smaller and medium or less complex entities) to apply, and may result in increased costs with arguably no commensurate increase in the level of audit quality for auditors of all types of entities.

As the IAASB continues to revise these proposed quality management standards, the AUASB considers it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in each of the proposed standards (ISQM 1, ISQM 2 and ISA 220), and explicitly weigh these against the costs of transition and application, as a means to support the successful implementation of the proposed standards once they are finalised.

Detailed responses to the questions on the key issues considered by the IAASB in developing ED-ISA 220 *Quality Management for an Audit of Financial Statements* have been included in the Appendix to this letter. Additionally, individual responses to the questions contained in each Exposure Draft have been submitted via the IAASB's website.

However, as part of our overall submission on the IAASB's Exposure Drafts for Quality Management there are a number of specific matters which the AUASB would highlight in our response:

Overall considerations

Implementation Period

The AUASB considers that a longer implementation period is required, perhaps even considering a staggered implementation approach across key components. For example, commencing first with the governance and leadership components as the foundation of a firm's System of Quality Management, followed by the other components in subsequent periods.

ISQM 1 is expected to require a significant amount of firms' resources to put into place a risk assessment process and update firms' methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for some network firms will be particularly challenging as the network head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400) on top of the three new or revised standards included in the suite of Quality Management standards. The AUASB considers that for firms to implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these standards may be in the public interest.

ISQM 1

Structure and Granularity of the Standard

The AUASB supports a quality management approach to ISQM 1, however the AUASB is not supportive of the overall standard in its current form.

The AUASB considers the proposed standard to be a hybrid of risk-based quality management requirements that retains a granular level of prescriptive requirement carried over from the extant ISQC 1 standard, which undermines the proper application of a risk-based approach.

The main theme expressed by Australian stakeholders throughout the AUASB's outreach on ISQM 1 was related to its size and level of granularity. All practitioners, large and small, were concerned with the cost and resources needed to develop a quality management framework in line with the proposed standard as currently drafted. The AUASB encourages the IAASB to refine its drafting approach to reduce the length and complexity of the proposed standard, as well as the other proposed Quality Management Standards being exposed concurrently – ED-ISQM 2 and ED-ISA 220.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315 (i.e. the requirements being the "what", and the application material, appendices and guidance constituting the "why" and "how") would facilitate a better risk-based approach that is scalable to the specific circumstances of a firm. This may help mitigate the potentially large cost and resourcing burden that the implementation of this proposed standard imposes on practitioners.

The AUASB particularly highlights to the IAASB that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered. Whilst these examples being included in the proposed standard may assist with implementation, the AUASB suggests the IAASB review the underlying principles in the requirements to make them simpler and more straightforward, which should alleviate the need for many of the examples and illustrations being included in the application guidance and appendices.

Additionally, the AUASB considers that the risk assessment process as designed has the potential to be particularly onerous for practitioners when considering the overall number of prescribed quality objectives required by the proposed standard. To further support a risk-based approach, the AUASB recommends the removal of pre-defined required responses to quality risks in the standard as the AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

Public Interest Benefits

The AUASB considers that it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in ISQM 1, and explicitly weigh these against the costs of transition and implementation, as a means to support the successful implementation of the proposed standard once it is finalised.

Scope of Engagements Subject to Engagement Quality Review

The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review. The AUASB supports a risk-based approach to such a determination which is already required in the proposed standard, where a firm is required to determine whether an engagement quality review is an appropriate response to assessed engagement risks.

It is unclear whether the proposed standard would result in an expectation that an engagement quality review is performed on ALL charities and ALL public sector engagements as these entities will always have a large number and wide range of stakeholders. This may be an unintended consequence of the proposed drafting. Furthermore, the AUASB is concerned that ‘significant public interest’ entity cannot be defined consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

ISQM 2

Guidance regarding a “cooling-off” period should reside in the IESBA Code

The AUASB strongly recommends that all guidance relating to the independence and objectivity of the Engagement Quality Reviewer (EQR) should reside in the IESBA Code as it already addresses these matters. Specifically the inclusion of alternative guidance regarding “cooling-off” periods in ISQM 2 increases the risk of inconsistent application and increases complexity for practitioners who may need to consider two different sources when addressing this issue. The AUASB recommends that the application material in ISQM 2 relating to any “cooling-off” period of the (EQR) should be removed from this standard and a reference to the IESBA code instead be considered (if this application guidance is to be retained).

ISA 220

Inconsistency in the engagement team definition and application guidance between ISA 220 and ISQM 1

The AUASB raises a significant concern that the definition of engagement team may be interpreted differently due to the different application and explanatory material that applies to this definition in ISA 220 (paragraphs A16-A19) not being replicated in ISQM 1. The impact may be that engagement team members are interpreted differently when the different application and explanatory material in each proposed standard is applied. For example, an Engagement Quality Reviewer (EQR) may be considered to be excluded from the engagement team under the definition and application guidance in ISA 220, but included as part of the engagement team under the definition in ISQM 1.

Should you have any queries regarding this submission, please do not hesitate to contact me or the AUASB Technical Director, Matthew Zappulla (mzappulla@auasb.gov.au).

Yours sincerely,



Professor Roger Simnett AO
Chair

Q1. Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?

In general the AUASB is supportive of the IAASB clarifying the engagement partner’s responsibilities and emphasising that the engagement partner has ultimate responsibility for the engagement. However, the AUASB considers that it may be difficult to practically meet the requirements in paragraphs 11-13 on a larger audit engagement (such as a multinational or group audit), particularly allowing for the broader Engagement Team definition now contained in the proposed standard. The AUASB specifically draws attention to the requirement in paragraph 13(b) outlining the engagement partner’s responsibility to monitor and review the work of assignees, which we consider may be difficult to achieve with this expanded engagement team definition in place.

The AUASB is cautious that the broad definition of engagement team may draw in unintended personnel into the engagement team giving rise to a number of challenges for the engagement partner being able to satisfy the requirements in paragraphs 11-13.

With regard to the roles of other senior members, including other partners, the AUASB would like the IAASB to provide further guidance dealing with situation where there are multiple partners on an engagement. Whilst Australian stakeholders did not view this as a significant issue with the proposed standard, the AUASB considers that with global actions in response to audit quality, such as proposals for more than one audit firm to perform an engagement, the need for clarification will arise in the future and should be addressed now to avoid reopening the standard.

Q2. Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures?

Overall the AUASB considers that ISA 220 links, where appropriate, to the ISQMs. However, the AUASB raises a significant concern that the definition of engagement team may be interpreted differently under ISA 220 and ISQM 1 due to the different application and explanatory material that applies to this definition in ISA 220 (paragraphs A16-A19) not being replicated in ISQM 1. The potential unintended consequence of this different application guidance is that engagement team members could be interpreted differently when the different application and explanatory material in each proposed standard is applied. For example, an Engagement Quality Reviewer (EQR) may be considered to be excluded from the engagement team under the definition and application guidance in ISA 220, but included as part of the engagement team under the definition in ISQM 1.

The AUASB also raises for consideration whether an appropriate balance has been achieved between the role of the engagement partner under ISA 220 and the role of the EQR under ISQM 2. In particular, the AUASB draws attention to paragraph 22(c) of ISQM 2 where the EQR is required to “identify” areas involving significant judgments rather than “evaluate” the areas identified by the engagement team; and paragraph 22(f) where the EQR is required to evaluate the Engagement Partner’s (EP) stand-back requirement. The level of work expected of the EQR in some areas appears to be at the same level as an EP and, in the view of the AUASB, is not in line with the objectives and proportionate responsibilities of an EQR.



Q3. Do you support the material on the appropriate exercise of professional scepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)

The AUASB is supportive of the inclusion of the material on the exercise of professional scepticism, however, the AUASB views that the objective of paragraph 7 is unclear. Presently, the requirement may appear to lead engagement team members to question or ‘second guess’ their colleagues and/or the firm in meeting the requirements of this standard. The AUASB questions whether this was the intention of this revision to the proposed standard and considers that paragraph 7, and other appropriate areas of ISA 220, should more clearly emphasise how the engagement partner is responsible for establishing an environment that supports the exercise of professional scepticism and setting an appropriate ‘tone from the top’ across the engagement team.

The AUASB supports the application material which more clearly articulates this responsibility. For example, paragraph A27 outlines the impediments to the engagement team’s ability to exercise professional scepticism that an engagement partner may have to deal with. The AUASB recommends the inclusion of other impediments to the exercise of professional scepticism at the engagement level to assist the engagement partner in establishing an environment that allows the engagement team to exercise appropriate professional scepticism.

Q4. Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

The AUASB welcomes the introduction of application and explanatory material in the standard on the use of technological resources. However, as presently drafted, the AUASB considers that the standard does not adequately deal with advances in technology and potential changes in the auditing environment. For example, as the use of Artificial Intelligence/machine learning becomes more common, it is unclear how the review requirements of the standard will be met, particularly where specialist knowledge is required to review such tools.

The AUASB recommends that the IAASB considers the impact of new and emerging technology on all aspects of the engagement partner’s responsibilities and is not limited to engagement resources. In the absence of appropriate technology considerations within the standard, additional implementation and guidance materials may be required to support practitioners to understand how an engagement partner can meet the requirements of the standards in a modern environment.

Q5. Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

The AUASB considers that whilst the direction, supervision and review requirements on their own do not appear overly onerous, they may not be practically achievable as a result of the broader engagement team definition. The AUASB is concerned that the broad definition of engagement team may draw in unintended personnel into the engagement team.

In particular, it is presently unclear whether a component auditor engagement team is captured as part of the engagement team under ISA 220. The AUASB considers it is impractical to expect an engagement partner to perform the direction, supervision and review requirements for component auditor team members, and in practice this is more likely performed at the component auditor team level.

The application material of the engagement team definition draws in service delivery centres and may also draw in technology support staff assisting the engagement team in using tools and processing data. It may be impractical for the engagement partner to meet the direction, supervision and review requirements for each of these possible groups of engagement team members, particularly where they only perform functions to support the engagement team.



The ability for the engagement partner to practically meet the review requirements of ISA 220 is further impacted by the use of technology in the audit. In an environment where the use of technology and handling large volumes of data becomes common, engagement partners may not have the specialist knowledge required to review the outputs of such tools.

Overall, the ability to practically meet the direction, supervision and review requirements of the proposed standard is further impacted by removal of paragraph 4 from the extant ISA 220 which stated “Engagement teams are entitled to rely on the firm’s system of quality control process, unless information provided by the firm or other parties suggests otherwise”. The IAASB’s proposed approach of using the terms “shall be satisfied” and “shall determine” to differentiate between actions that can occur at a firm level and actions that must occur at an engagement level is not clearly articulated in the body of ISA 220 and is not commonly used throughout the suite of auditing standards which may result in diverse interpretation.

The AUASB understands the IAASB's concerns regarding the over reliance on firm policies and procedures by the engagement teams, however, some quality risks are more effectively and efficiently responded to at a firm level. The situations where an engagement team can rely on the firm’s systems should be more clearly articulated in the standard, as well as what is required of an engagement partner where they choose to rely on those firm systems.

Q6. Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?

The AUASB generally views that the documentation requirements in conjunction with the requirements of ISA 230 provide sufficient guidance on documentation although this can be enhanced by a link between the review requirements of the engagement partner and the documentation requirements to evidence this review.

Q7. Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?

Australian stakeholders raised that the removal of paragraph 4 from the extant ISA 220 which stated “Engagement teams are entitled to rely on the firm’s system of quality control process, unless information provided by the firm or other parties suggests otherwise” and changes to the standard to explicitly state that the firm’s system of quality control cannot be relied upon in certain situations may impact on scalability. Stakeholders viewed that the benefits of being part of a network may be lost, therefore placing more onus on individual firms and partners impacting scalability.