

June 25, 2019

Technical Directors
International Auditing and Assurance Standards Board

Re: The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level

The California Society of CPA's ("CalCPA") Accounting Principles and Assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 43,000 members. The Committee consists of 51 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee appreciates the opportunity to share the views of its members regarding the package of proposed quality management standards for which your organization is requesting comm. These views are included in the responses below.

Overall Questions

- 1) 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?

We think 24 months is more realistic than 18 given the potential regulatory changes and need for training and development of practice aids.

- 2) 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?

Publishers of practice aids will need to prepare sample quality management documents and software to facilitate the required quality management system documentation.

While it appears the IAASB elected to remove the sections relating to "Considerations Specific to Smaller Firms", development of an Appendix or paragraphs providing guidance specific to smaller firms' implementation of the contemplated quality management would be important in demonstrating and supporting the scalability of the standards' requirements. Furthermore, absent such guidance, SMPs may be inappropriately held to a higher standard with respect to the implementation and operation of a system of quality management. For example, an appendix could include:

- Limitations and Practicability Considerations - ICQM1 provides various examples of what a smaller firm may do in certain circumstances, including for example, instances where aspects of a system of quality management may be unnecessary, limited or impractical (e.g. .A20, .A28, .A42, .A47, .A121) . A section or appendix clarifying these and other limitations and practicability limitations would be helpful in driving clarity and instruction; and
- Quality Risks and Responses – As noted throughout the ED, risks will vary for firms based in part upon a firm’s size, service offering, clients and other factors. While EDCM1 provides requirements regarding the objectives of each quality component, limited examples are provided in terms of quality risks and responses. Implementation guidance specific to the types of risks and responses uniquely applicable to SMPs would assist practitioners.

We think the IAASB should offer webcast or other CPE type support to further explain the process. Materials could include illustrations of specific examples of risks, for example.

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

ISQM 1

Overall Questions

- 1) Does ED-ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard?

Yes

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?

It appears that the 'improvement in scalability' is expected to occur as a result of more effective use of firm and external resources as well as enhanced use of judgment, potentially eliminating the need for redundant or ineffective processes. We are generally supportive and agree that, if implemented properly, the new standard could improve, not diminish scalability.

If not implemented properly, however, we are concerned with the potential amount of effort to implement the new approach. While the proposed risk-based model appears to be a gold-standard, we specifically question both the scalability of the model and the level of engagement required in terms of the evaluation of whether a firm's system of quality management effectively provides reasonable assurance.

Regarding the latter, an evaluation of a system designed to provide reasonable assurance indicates a self-evaluation requiring audit level testing procedures. Although paragraph 18 notes that reasonable assurance "is obtained through the operation of the system as a whole", additional clarity is necessary to understand the nature and extent of procedures that must be conducted when evaluating the system of quality management is effective at providing reasonable assurance, particularly when deficiencies are identified (*i.e.*, inspection findings, regulatory findings, legal judgments where liability has been established, etc.).

In this regard, additional clarity could be provided regarding the specific evaluation process for evaluating the effectiveness of system of quality management, as contemplated in paragraph 42c and the documented basis for a firm's evaluation of whether the system of quality management satisfies the reasonable assurance objectives stated in paragraph 18(a) and (b)), when faced with multiple un-remediated deficiencies. This includes situations of multiple deficiencies associated with external inspections (regulator/peer review) where the firm is in the process of conducting a root cause analysis and remediating its policies and procedures and other responsive changes through pending implementation of controls.

- (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?

Quality management systems exist to (a) catch problems so they can be corrected, and (b) prevent problems, in part through the creation of an environment in which practitioners are guided and motivated to do quality work to avoid being penalized by the quality management system. That said, there are practitioners that are motivated to do quality work because of their professionalism and the quality management system is irrelevant to that motivation.

So, where quality is already taken seriously, we don't think the new approach is likely to result in benefits. However, for those firms that have been creating and implementing quality control systems without thinking them through, the new approach may force adaptations that will improve quality. But, we are not convinced the benefits will be worth the efforts.

In other words, we agree that a change in approach to audit quality is necessary and we believe this proposal, via a risk based approach with an emphasis on judgement, would be a positive change. However, the question of cost vs. benefit is at issue.

- (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?

Theoretically the new requirements are scalable, and we expect that the gigantic and large firms will expend far more effort and resources that will be required for smaller firms.

- 2) 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?

See above regarding the evaluation of whether a system of QC satisfies the objectives.

We think the biggest challenges will be in educating those firms that are accustomed to using a checklist approach to both the audit process and to QC. They may already have difficulty in applying a risk-based model in their audit approaches so this will be no different. Support materials could include resources that show and explain how to identify and remediate risks to quality, without the use of a checklist or detailed practice aid.

Another challenge will be in convincing firms the risk approach to QC, using judgement, will (or is expected to be) subjectively evaluated by external reviewers including applicable regulatory peer review. Many practitioners are hesitant to customize an approach to audit quality as a result of being afraid of an objective evaluation of a subjective process.

- 3) Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements?

Yes.

Specific Questions

- 4) Do you support the eight components and the structure of ED-ISQM 1?

For the most part, but we think there is some redundancy between governance, risk assessment and ethical requirements.

- 5) Do you support the objective of the standard, which includes the objective of the system of quality management?

Yes (paragraph 18).

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?

Yes.

- 6) 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?

Yes.

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.

- (b) Do you support the approach for establishing quality objectives?

This is where scalability may begin to break down. This may be overkill for smaller practice units.

In particular:

- i. Are the required quality objectives appropriate?

Governance and Leadership - Paragraph 23 – Generally the required quality objectives are appropriate, but (d) may be overkill (organizational structure)

although it might be argued that the size of the practice unit provides a practical constraint

Risk Assessment Process – Paragraph 26 – “additional quality objectives beyond those required when necessary to achieve the objective of the ISQM” – There is a potential problem here regarding diversity in application. How likely are practitioners to look for quality objectives beyond what is required?

Relevant Ethical Requirements – Paragraph 32 – Yes.

Acceptance and Continuance – Paragraph 34 – Yes. We believe that currently less attention is paid to continuance decisions. Perhaps the focus on a new model will help for a period of time.

Engagement Performance – Paragraph 36 – Yes.

Resources – Paragraph 38 – We think these objectives may be problematic and somewhat in conflict with AICPA guidelines that allow CPAs to take on work in unfamiliar areas. The implication, if not a requirement, in these objectives is that personnel are competent from the get go. There does not appear to be the opportunity to “get smart” before issuing a report.

Information and Communication – Paragraph 40 – Generally the required quality objectives are appropriate, however this may be an area where scalability is an issue.

Monitoring and Remediation – Paragraph 42 – Generally the required quality objectives are appropriate, although this may create problems unless the individual responsible for quality management is also the managing partner, or equivalent

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

We believe it is clear that the firm is expected to establish additional quality objectives beyond those required by the standard, but see immediately preceding comment re paragraph 26.

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

Yes.

- (d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks?

Yes.

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?

Yes.

- 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.

- 7) Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

Yes.

- 8) 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, this would be too narrow a requirement. It might work in a very small firm, but in a somewhat larger firm more people may need to be involved.

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

Paragraph 32 touches on independence, but independence can be a very big subject when multiple firms are involved. The short answer to this question is “no”.

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

Relating to the points made above, additional guidance could be provided regarding scalability of these issues to smaller practitioners, including for example an ability to conclude that risks relating to the use of technology maybe considered insignificant when the firm’s practice is to use non-customized audit tools and software purchased from third parties.

- 10) 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?

Paragraph 41(c) – We are not sure this will result in any communication other than that already required, but it does summarize when such communication is required.

- 11) 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?

Paragraph 37(e) – Yes, but additional clarity is necessary regarding PIEs and the determination of whether an EQR is required. In practice, particularly for small firms auditing local charities, determining the relative significance of such entities to specific “jurisdiction(s)” or “region(s)” may prove difficult and raise implementation questions as to how to determine relative significance (*i.e.*, amount of funds raised relative to other charities in the area, nature of those impacted by charities operations, key donors, etc.). While many firms, as a matter of practice perform EQRs, smaller practitioners, and sole practitioners more directly, may find themselves unable to service existing clients due to cost and related resource constraints to the extent EQR’s are deemed necessary.

- 12) In your view, will the proposals for monitoring and remediation improve the robustness of firms’ monitoring and remediation?

Paragraphs 42 – 57 - Yes, for some firms.

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, if they are not already doing so.

- (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?

Paragraph 45 - Yes

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

Paragraph 47 – Yes.

Definition in Paragraph 19(a) – Yes.

- (d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies?

Paragraph 48(a) – Yes.

In particular:

- i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?

Paragraphs A178-A182 – Yes.

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

Paragraph A178 – Yes.

- (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?

No, other than having the time to do it. Once again this should not be an issue in a large enough firm, but in smaller firms may find this is another scalability issue.

- 13) 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?

Paragraphs 58-63 and A192-A204- We think this may make it very tough for members of networks to place any real reliance on other members being in compliance with network requirements.

As an aside, paragraph 203 says paragraph 42 includes networks requirements, but paragraph 42 is actually silent about networks. Possibly paragraph 42 should be edited to specifically mention networks with a reference to the more detailed guidance.

- 14) Do you support the proposals addressing service providers?

Paragraphs 64-65 – Yes.

- 15) 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?

This may be more of an issue at the international level, although there may be some individual U.S. jurisdictional issues.

ISQM 2

- 1) Do you support a separate standard for engagement quality reviews?

Yes.

In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

Yes.

- 2) Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?

Yes.

- 3) Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?”

Is there really any difference?

Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?

No.

- 4) Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

Yes.

- (a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?

Paragraph 16 – A cooling off period is necessary for the EQR to not be dealing with his or her own decisions, but the Board could consider whether the length of the cooling off period should be a matter of firm policy. There are arguments in favor of variable cooling off periods, although this would be difficult to implement. However, no more difficult and subjective than the other elements of this proposal.

- (b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?

Yes. If there is to be an ISQM 2 it should be comprehensive.

- 5) Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer's procedures?

Paragraph 22 – We think it should be made clear that the time to assign the EQR is before the engagement starts so that the EQR can be involved in the planning.

Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?

Yes. We don't see these as directly related. Whatever are the engagement partner responsibilities, the EQR's responsibilities do not change.

- 6) Do you agree that the engagement quality reviewer's evaluation of the engagement team's significant judgments includes evaluating the engagement team's exercise of professional skepticism?

Yes, but the evidence may be limited to inquiry and be more in the nature of nothing coming to the attention of the EQR that caused the EQR to believe the engagement team did not exercise appropriate professional skepticism.

Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer?

Yes.

If so, what suggestions do you have in that regard?

Provide some examples of what an EQR can do to evaluate whether the engagement team exercised appropriate professional skepticism e.g. did the engagement team follow up on inconsistent audit evidence?

- 7) Do you agree with the enhanced documentation requirements?

Not necessarily. Some of the required documentation may be evident from various sign-offs. Is this requiring that in addition there be a separate document where all of the required information is summarized?

- 8) Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity?

Yes.

If not, what else can be done to improve scalability?

ISA 220 (Revised)

- 1) 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?

Yes, generally, but at a practical level it may be too much, e.g. paragraph 19 re independence. In many firms this determination will be made by others. Another example would be paragraph 24 where a firm expert might be involved. Can the EP be expected to determine the individual possesses appropriate competence? Perhaps 19 and 24 should be worded more like 20.

Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?

No. We believe too much is concentrated on the engagement partner where the firm is big enough to have others involved.

- 2) Does ED-220 have appropriate linkages with the ISQMs?

No. We believe the standard could more clearly differentiate that which is handled at the firm level and allow the EP to place reliance on the firm systems unless the EP has reason to believe the firm systems are not appropriately designed or are not operating properly.

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?

Where is this in the standard? A7? If this is it, it is insufficient.

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

Yes.

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

Where is this discussed? Engagement Resources paragraphs 23-26? If yes, it's too oblique. The application material in A52 – A67 has more, but it's pretty general and really just scratches the surface. In all it's very principles-based language. This may a place where a tighter tie-in to firm level resources is needed.

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

Yes.

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

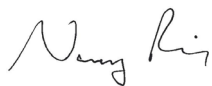
Yes.

- 7) 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?

We believe it's easier for an EP to meet the requirements of ISA 220 in a small audit scenario. As the size/complexity of the audit ramps up, the EP will be hard pressed to be as involved as ISA 220 requires.

We thank you for your consideration of this request. We would also be glad to discuss our experiences with you further should you have any questions or require additional information.

Sincerely,



Nancy A. Rix, Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants