



**INTERNATIONAL AUDITING AND ASSURANCE  
STANDARDS BOARD (IAASB)**

**EXPOSURE DRAFT**

**‘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’**

**RESPONSE FROM ICAS TO THE IAASB**

**1 JULY 2019**

## Background

ICAS is a professional body for more than 22,000 world class businessmen and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

## Key comments

ICAS welcomes the opportunity to respond to the International Auditing and Assurance Standards Board's (IAASB) Exposure Draft: *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*.

We are supportive of the new quality management approach, in particular, the new risk-based approach, which tailors the risk assessment process to an individual firm's circumstances and the nature of its engagements.

We are, however, concerned at the overall length of the proposed new standard. This is considerably longer than the extant ISQC1 without even taking into account the material transferred from the extant ISQC1 to ED-ISQM 2. This increased length raises some concerns that the standard may not be regarded as sufficiently scalable for smaller firms.

Furthermore, it is not clear as to whether the current approach to the firm's system of quality management will be sufficient to meet the new requirements, therefore greater clarity on this point would be welcomed. In this regard, we believe it would be advantageous for the IAASB to undertake a mapping exercise to identify and illustrate the linkage and key differences between ISQC1 and the new suite of Quality Management Standards.

We are aware of earlier discussions by the IAASB on a new approach to the revision of ISA 315 which signified a move back to more principles-based standards where the requirements focus on the objectives of the standard, with any supporting or implementation material located in another document or in an appendix to the standard. We would be supportive of the IAASB exploring such an approach in relation to its suite of Quality Management Standards as we believe this would be key to facilitating the proportionate application of the standards.

We understand that there has, and continues to be, considerable debate as to the inclusion of the risk management process as a component for an entity when designing and implementing a system of quality management. While we acknowledge that the components in ED-ISQM1 reflect what currently happens in practice, in our view it is not clear why the risk management process should be described as a component of that system. However, if the IAASB remains of the view that the risk management process does represent a component of the quality management system, we believe that the diagram on page 7 of the introductory material is a helpful demonstration of how the risk management process interacts with the other components of a

system of quality management. Therefore, we would suggest that this diagram should be included within the body of the final standard or as an appendix as this enhances the understandability of the proposed approach.

Our responses to the overall and specific questions are included below.

## **Responses to Overall Questions**

### **Question 1**

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?
- (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?
- (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?

### **Response 1**

We support the IAASB's new quality management approach, in particular, the transfer of the Engagement Quality Review elements to a separate standard, ED-ISQM 2, to reflect that this is not relevant to all firms.

The introduction of a new risk-based approach which can be tailored to an individual firm's circumstances and nature of engagements is also a positive step as this may encourage better documentation of the quality management process by the firm. We also welcome the increased emphasis on the need for the firm to regularly review and update its risk assessment process.

We are, however, concerned at the overall length of the proposed new standard, which is considerably longer than extant ISQC1, and excludes the material transferred to ED-ISQM 2.

This increased length adds to our concerns that the standard may not be regarded as sufficiently scalable for smaller firms. Therefore, we would suggest that the issue of the final standard should be accompanied by implementation guidance that focuses on the application of the standard by these entities. Any such guidance would need to be sufficiently detailed and specifically targeted towards smaller firms to support them in the application of the revised requirements.

We are aware of, and indeed are encouraged by, the IAASB's earlier discussions on a new approach to the revision of ISA 315 which signified a move back to more-principles based standards where the requirements focus on the objectives of the standard with any supporting or implementation material located in another document or in an appendix to the standards. We would be supportive of the IAASB exploring such an approach in relation to its suite of Quality Management Standards as we believe this would be key to facilitating the proportionate application of the standards.

### **Question 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?

### **Response 2**

Our main concern is that, as a result of the tailored approach, it may not be entirely clear for many firms whether what they are doing now will fit within the new requirements, or what they might need to do to ensure that they do comply. ED-ISQM1 places greater emphasis on the need for professional judgement in designing and implementing the system of quality management. In

this regard, we believe it would be advantageous for the IAASB to undertake a mapping exercise to identify and illustrate the linkage and key differences between ISQC1 and the new suite of Quality Management Standards.

Without such clarification, there is a danger that some smaller firms may adopt a risk averse approach and over-engineer the quality management system to avoid any future regulatory challenge. This is likely to place an additional burden, and cost, on these firms in order to comply with ED-ISQM 1. For smaller practices, such costs may not be so easily capable of being absorbed. Therefore, there is a danger that many of these firms may not be willing to continue with their audit and assurance related work because of the associated compliance and cost burdens. This is inconsistent with one of the objectives of the current reviews into the UK audit market which aims to enhance the choice of auditors, albeit the focus at the moment is on the audits of UK Public Interest Entities.

### **Question 3**

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?

### **Response 3**

As previously mentioned, the standard is currently longer than extant ISQC1, therefore, we would not be in favour of increasing the application material currently included within the standard.

When we refer to a need for greater clarity in some areas, we would not propose further detail to be included within the standard itself. Rather, we would support content that sits outside the standard. For example, the production of a list of frequently asked questions or a series of practical implementation tools and resources may be a helpful alternative source of reference and would help to support consistent application and understanding of the requirements.

## **Responses to Specific Questions**

### **Question 4**

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

### **Response 4**

While we acknowledge that the components in ED-ISQM1 reflect what currently happens in practice, in our view, it is not clear why the risk management process should be described as a component of that system. However, if the IAASB remains of the view that the risk management process does represent a component of the quality management system, we believe that the diagram on page 7 of the introductory material is a helpful demonstration of how the risk management process interacts with the other components of a system of quality management. Therefore, we would suggest that this diagram should be included within the body of the final standard or as an appendix as this enhances the understandability of the proposed approach.

### **Question 5**

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?

### **Response 5**

We would seek greater clarity in relation to the objective in paragraph 18(a). This states that 'The firm and its personnel fulfil their responsibilities....'. We ask the IAASB to consider whether there is also a need to include a specific reference in the objective to persons who are also involved in engagements but are not personnel of the firm.

We believe that the standard should include a statement that specifically refers to the firm's role in relation to the public interest. The IAASB should give further consideration to this matter as part of its ongoing coordination activities with IESBA.

### Question 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? 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?
- (b) Do you support the approach for establishing quality objectives? In particular:
  - i. Are the required quality objectives appropriate?
  - ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?
- (c) Do you support the process for 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?
  - 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?

### Response 6

We have concerns that the process for the identification and assessment of quality risks is very onerous and, to some extent, too prescriptive. This creates the risk, specifically in smaller firms, of them failing to fully understand the underlying concept of what is required and therefore, by default, adopting an approach which is too burdensome. Accordingly, this may inhibit the perceived ability of such firms to tailor the quality management system to the firm's specific requirements.

We are concerned that the number of quality objectives within paragraphs 23,32,34,36,38,40 and 42 is excessive and we would favour an approach that includes fewer per component, but rather requires strong and clear overarching objectives. Some quality objectives do not seem to be objectives, but rather risks for not achieving a quality objective. We refer, for instance, to the one included in paragraph 34 c) about the firm's financial and operational priorities not leading to inappropriate judgements in relation to accepting or continuing with an engagement. We do not see this as a quality objective and are concerned about how a firm could fulfil it and demonstrate it in practice.

As a result, from the scalability perspective, ED-ISQM 1 may be challenging to apply. Larger firms would be supported by staff that have a broad skillset, including risk management skills, while small and medium sized practices may experience significant difficulties in this regard as a result of not having staff with similar skills inhouse.

Finally, we do not support the introduction of PCAOB terminology. We do not believe that this is appropriate in an ISA environment. While the notion of 'reasonable possibility' is helpful in explaining the level of likelihood, a different term should be used because of its connotations with standards issued by the PCAOB. In addition, associating this notion with the wording 'more than remote' is confusing in an ISA environment. It implies a lower threshold than the ISA term 'acceptably low level' and could create confusion among practitioners.

### Question 7

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

**Response 7**

We believe that the revisions to the standards appropriately address firm governance and the responsibilities of firm leadership.

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

**Response 8**

We agree and believe that this is consistent with the content of the extant version of the IESBA Code. This states at paragraph 900.3 that many of the provisions of Part 4B do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to “firm” for ease of reference. Firms assign responsibility for a particular action to an individual or a group of individuals (such as an assurance team) in accordance with ISQC 1. In addition, an individual professional accountant remains responsible for compliance with any provisions that apply to that accountant’s activities, interests or relationships.

We welcome the intention of the substance of paragraph 34 a) whereby “the firm shall obtain sufficient appropriate information about the nature and circumstances of the engagement and the *integrity and ethical values of the client...*”. However, we question whether the application material provided would help an auditor to facilitate a judgement in relation to this matter. We therefore believe that this is another matter that would be worthy of consideration as part of the ongoing coordination between IAASB and IESBA.

**Question 9**

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

**Response 9**

We are aware that several of the large firms have invested significantly in technology as part of their audit function and therefore we welcome the additional material within ED-ISQM1 to address the use of technology. However, we would highlight that many smaller audit firms do not have the resources available to be able to invest in such technology and therefore the requirements need to be sufficiently flexible in order that they are capable of application by these firms.

Furthermore, many of the firms, particularly the smaller firms, will obtain many of the automated tools to facilitate compliance with ED-ISQM1 from an external software provider. Therefore, we recommend that the relevant regulators, standard-setters and professional bodies engage in early dialogue and discussions with these providers to help ensure that they will be fit for purpose and ready by the proposed implementation date.

**Question 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?

**Response 10**

We believe that the proposals might lead to more constructive dialogue between audit firms and external parties.

**Question 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?

**Response 11**

We agree that the proposals should result in the proper identification of engagements to be subject to an engagement quality review.

We are concerned that the IAASB has introduced the requirement for the firm to include entities that are of “significant public interest” as a condition when determining the need for an engagement quality review as part of its system of quality management. The determination of what would represent a “significant public interest” entity is more critical to this standard than to the other ISAs (ISA 260 and ISA 700) in which it is found. The lack of a clear definition of what would constitute “significant public interest”, increases the reliance on the application of professional judgement which may give rise to inconsistencies in application and regulatory approach. This is another area in which there would be benefit in the matter being considered as part of the ongoing coordination between IAASB and IESBA.

**Question 12**

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?
- (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?
- (c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?
- (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?
  - ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?
- (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?

**Response 12**

We welcome the introduction of a requirement for root cause analysis to be performed but would propose that it should also have a greater focus on positive findings. However, we acknowledge that this will impose an additional burden for some firms and therefore greater implementation material around proportionality and scalability will be necessary.

We would also highlight that there is a lack of consistency between regulators and their respective assessments of what constitutes a significant deficiency. This varies between jurisdictions.

**Question 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?

**Response 13**

We support the IAASB's proposal to address networks. From a practical point of view, we do not believe it would be possible to standardise the requirements in another way. Nevertheless, it does not mean that it will not be burdensome for all firms within a given network to comply with the requirements as set out in the proposed quality management standard. The burden will be on firms to evaluate, design and implement the network's controls operating in other jurisdictions. In some cases, firms may struggle to obtain the relevant information and this situation could create tension that will not help enhance audit quality.

**Question 14**

Do you support the proposals addressing service providers?

**Response 14**

We support the proposals addressing service providers but would welcome more detailed guidance on the approach when dealing with alternative audit delivery models.

**Question 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?

**Response 15**

We do not envisage any significant difficulties arising from the change to ISQM in the UK but are aware that there are some jurisdictions where a change in legislation may be required when a reference to ISQC 1 is included.