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Subject: IAASB invitation to comment on proposed International Standard on Quality Management 1 (ISQM 1)

Referent: Mag. Gerhard Prachner

Dear Sir or Madam,

KSW¹ is pleased to provide you with its comments on the IAASB invitation to comment on ISQM 1.

We support the work that has been done by the IAASB to enhance quality management and are in favor of the risk assessment approach to drive quality. We have nevertheless a number of important points below that could help improve the ED and its implementation.

For further information on this KSW letter, please contact.

Yours sincerely,

Mag. Philipp Rath e.h.
(stv. Vorsitzender des Fachsenats für
Unternehmensrecht und Revision)


Mag. Gregor Benesch
(stv. Kammerdirektor)

¹ Kammer der Steuerberater und Wirtschaftsprüfer

Appendix

Comments on the clarity, understandability and practicality of application of the requirements and related application material of ED-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? 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?*

Answer: We support the work that has been done by the IAASB to enhance quality management and we favor the risk assessment approach.

Although it should be stated somewhere in the final ISRM 1 that managing quality should be aligned with firms overall strategy.

It appears that the draft has covered the risk assessment approach in a very detailed and prescriptive manner, there is no room for flexibility. We also fear that scalability is an issue.

In particular, the long list of quality objectives is very detailed and leads to over complication. We would favor an approach with fewer maybe just one objective per quality management area, but strong and overarching objectives.

Additionally, ISQM 1 as drafted may create a lot of additional documentation requirements, especially in documenting what has not been done and why. We do not think that this compliance exercise would help enhance quality. Overall, we think that the IAASB needs to provide more guidance on what need to be documented. The mix of requirements and guidance leads to confusion when it comes to documentation.

- 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?**

Answer: It is not clear what more needs to be done in comparison with what is currently performed under ISQC 1 and we think that this will create challenges for implementation, especially for small firms and networks. The IAASB needs to reflect on how to communicate to firms if this is a step-up in quality management, and for which aspects specifically. The IAASB should realize that those with responsibility for methodology in their firms will not start with a blank sheet of paper but will seek to extract what is new. This is the type of analysis that should be shared with the firms to ease implementation and most importantly avoid inconsistency.

The volume of the proposed ED-ISQM 1 is already a challenge in itself for implementation. There is a lot of background material included, especially at the beginning of the standard. This background material, if in fact it is needed at all, could be placed outside the standard. Indeed, the IAASB should be mindful that large volumes of material can overwhelm firms and practitioners and detract from the central messages of the standard. Additionally, no matter how voluminous the material, it will never cover all the firms' ways of working. In terms of supporting material for implementation, an update of the ISQC 1 guidance published by the SMP committee could be useful¹ while it might sound counterproductive and even ironic that smaller firms need more guidance to implement ED-ISQM 1.

- 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?**

Answer: The application material is very helpful and already very voluminous. Nevertheless, additional examples would be supportive, especially for smaller firms to help implementation. The additional material should be placed outside the standard otherwise, they could be treated as authoritative or as best practice.

Specific Questions

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

Answer: We broadly support the eight components. Although we are not clear that the risk assessment process is clearly separated from the components. There is a lot of overlap between components that could generate confusion and potential inconsistency in practice.

- 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?**

Answer: Yes, we support the objective of the standard. We think that paragraph 7 is explicit enough and there is no need for more explanation about the firm's role relating to the public interest.

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?*

Answer: Yes, we agree.

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

i. *Are the required quality objectives appropriate?*

Answer: As mentioned above, in our response to Question 1, the list of quality objectives is very detailed and we would favor an approach with fewer per quality management area, but strong and 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 judgment. We wonder how this can be treated as a quality objective, and how the firm can fulfil it and demonstrate it in practice.

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

Answer: It seems clear in ED-ISQM 1 that the firm is expected to establish additional quality objectives beyond those required, in certain circumstances only. It would improve scalability if the IAASB made it clear that, for many smaller firms, no additional objectives are likely to be needed. Some objectives might not even be applicable for smaller firms.

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

Answer: The process for the identification and assessment of quality risks is very prescriptive and does not provide a lot of flexibility in the application. From the scalability perspective, it may therefore be challenging to apply. Big firms would be able to be supported by staff that have a broad skillset including risk management, while smaller firms may fall short in having staff with such competences in house.

We did not support the introduction of PCAOB terminology that we find inappropriate 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 will confuse practitioners.

We also want to stress, that using terms with only small nuances in English will trigger translation issues.

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?

Answer: Yes, however we believe that especially for small firms more specific guidance is required; a catalogue of typical risks and related responses which can be then modified according to the specific circumstances would be helpful. This guidance should be separate from the standard.

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?

Answer: 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?

Answer: Yes, however guidance is missing on actions which should be taken if the responsibility is not fulfilled (such as ongoing negative results in monitoring activities, lack in tone at the top, ...). Application Guidance A123 contains guidance on actions to be taken for personnel who demonstrates actions or behaviors that negatively affect quality, similar guidance should be included if persons with the ultimate responsibility and accountability for the system of quality management demonstrate actions or behaviors that negatively affect quality.

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?*

Answer: In relation to ethical requirements, the requirement should be dependent of the size of the firm. For independence we consider it essential to have a designated person as the topic is quite complex and often requires consultation. For larger audit firms, where complex independence issues are more likely to occur, there should be a requirement that independence function is adequately staffed to ensure compliance with all relevant laws and professional rules prevailing.

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

Answer: Duplication of regulations should be avoided, as this could lead to different interpretations in practice. The application guidance is very vague and should include more specific references to the IESBA Code.

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

Answer: Yes, further guidance specifically for smaller firms is required. We believe that general IT controls as mentioned in A 129 shall be part of the responses designed and implemented by the firm to address quality risks identified and assessed by the firm. A “may” does not address the current use of technology in the audit nor does it address future developments.

We welcome the reference to the use of technology but believe that technology could be addressed in greater detail.

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?

Answer: ISQM 1.41 lit. c. should be removed. Usually larger audit firms are required to issue a transparency report by law due to their client base including PIEs. Even without such a paragraph, every audit firm can include comments on their QMS on its homepage, in audit proposal or other communications. Including a paragraph in ISQM1 could lead to creating a requirement, which goes far beyond practicable regulations for smaller firms.

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?

Answer: The IAASB has introduced the term “significant public interest”. This is critical to this ISA, but not to the other ISAs in which it is found. Without further elaboration, it is likely to give rise to inconsistencies in application. It lacks clarity, what does “significant” mean in the context of public interest.

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?*

Answer: The distinction between findings and deficiencies is insufficiently clear. Many firms will see all findings as deficiencies, which is not the case.

Evaluating annually whether the system is working is unnecessary for small firms in simple circumstances. We suggest mentioning that a three-year evaluation of the system of quality management could be sufficient for small firms.

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?

Answer: We support the IAASB's proposal to address networks. From a practical point of view, we do not think it is possible to standardize it 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 in the proposed quality management standard. The burden will be on firms to evaluate design and implementation of the network's controls operating in other countries. In many cases, firms will struggle obtaining the relevant information and this situation could create tension that would not help enhance audit quality.

14) Do you support the proposals addressing service providers?

Answer: Basically we support the proposals addressing service providers, but alternative audit delivery models are not dealt with in sufficient detail.

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?

Answer: No, we do not think so. In practice, there might be translation issues with new terminology.