



MGI Worldwide response to ED-ISQM 1

Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

Overview

MGI Worldwide welcomes the aim of the proposed standard, especially in regard to proportional application by small and medium-sized practitioners (SMPs), who make up our network membership. We agree with those reservations outlined in paragraph 6 of the Explanatory Memorandum that any new standard should not result in add-ons to the existing approach which would be increasingly onerous for our members to comply with.

The focus on a risk- and outcome-based approach to quality management (paragraph 5) should focus our firms' resources on the specific risks in their firms, rather than just a generic list of policies and procedures to be adopted. We believe that this is more appropriate for a global network, where local risks and regulations will change the risk management environment for each firm.

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?

Response

We support the new quality management approach as conceived, as it is more scalable and less prescriptive, allowing each firm to consider where their areas of risk exist and to design appropriate responses to those risks, in addition to the required response.

(b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional scepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?

Response

Whether the proposals will generate the expected benefits will, of course, depend on how well they are understood and applied by firms. On their own, the proposals will not suddenly increase the exercise of professional scepticism on engagements or change culture within firms. The application material helps here but the key will be how well the new standard is embedded and compliance monitored in territories around the world. Rather than improvements to the standard, the IAASB need to be clear and robust in its communications around the key changes from ISQC 1 and provide examples and guidance to firms on what this may mean for them, aimed especially at SMPs who do not have large technical teams to interpret what the requirements mean for them and how best to adapt.

In the application material, paragraph A41 indicates that a "firm *may* take corrective actions to address a negative performance evaluation that may affect the firm's achievement of its quality objectives" (our emphasis). As the standard's aim is to help firms improve engagement quality, we consider there should be a requirement to take corrective actions in such cases. The extent of those actions would be determined by the firm but indications of potential deficiencies in quality management should be robustly dealt with.

(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

As the overall approach is less prescriptive, the requirements and application material appear scalable and this is a key message coming through the Explanatory Memorandum and the draft standard itself. The promised guidance that will be aimed at SMPs (as set out in paragraph 89 in the Explanatory Memorandum) will be essential.

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

As the standard is longer than ISQC 1 and less prescriptive, significant time and effort will be required to implement it at firm level. Developing and documenting a specific risk assessment and the associated responses will take time and this may deter SMPs from implementing the standard as designed. There could be a tendency to consider only the required responses to the risks and nothing else.

The requirement to evaluate the performance of those undertaking leadership roles may be difficult in SMPs, especially where there is only one principal/partner (paragraph 24(b)). A42 recognises this and states that the results of any monitoring activities that are performed by, say service providers, can be considered here. This may place an expectation on such firms to have external assessments/reviews from service providers/independent parties at increased cost to the firm.

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

The application material is generally helpful in explaining the requirements and providing examples of what the requirements mean and how they may be addressed. Any help that can be provided to users of the standard will be useful and should be encouraged. We feel that the application material (or further guidance to be issued by IAASB) should use less technical language to be more approachable and understandable, especially for those whose English is not the first language.

Specific questions

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

Response

Paragraph 8 in the standard indicates that the system of quality management “does not operate in a linear manner” and moves on to identifying the eight components, highlighting that these are highly integrated.

The presentation of these components appears as a linear list – starting at the top of the firm, with the tone at the top/leadership and moving “down” through the other components. We support the components, but the structure of their presentation could be taken by some as a linear progression through a “process” and the interrelatedness of the components overlooked.

These components are to be managed by establishing quality objectives, some of which are required in the standard and others are to be determined for the specific circumstances of the firm (paragraph 10(a)). There are required responses to each of the objectives and firms will also need to assess whether there are specific objectives and responses that need to be added to reflect the risks for their specific business (paragraph 10(c)). Setting out required objectives and responses may mean firms focus only on these requirements so that a “minimum” level of compliance is achieved, this is especially the case in SMPs which may lack the time/expertise to be able to risk assess their firms and design appropriate responses. The application material and examples from IAASB will be essential to assisting firms here.

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

Yes. The explanation of the “public interest” role of the firms is clear, and the examples provided of a client that may be of “significant public interest” is more helpful than the current “public interest entity” focus.

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?

Response

There will be a risk that firms may only apply the required responses for the eight components and the associated quality risks but the application of the risk assessment process across all components (properly applied) should enable a more tailored management approach to quality.

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

i. Are the required quality objectives appropriate?

Response

Yes

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

Response

This is clear from the standard, but whether it will happen in practice will vary.

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

Response

The process should help to focus management on those risks that could have a significant impact on achieving the quality objectives, so should help to focus the firms where required, rather than wasting resources on every risk that could arise.

(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?

Response

In good firms yes, in other firms, there may be too much reliance on only the required responses, which will be implemented, but the additional objectives and responses may be missed.

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

It is clear but leaving judgment to the firms may mean inconsistency of approach unless the monitoring of compliance with ISQM 1 is undertaken robustly and communications at the outset are clear on the expectations.

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

Yes, whilst it is clear that the “tone at the top” remains key to the overall direction and culture of quality within a firm, the draft standard allows for delegation of individual roles and responsibilities (reporting up to the person with ultimate responsibility) which could encourage involvement across the firm, embedding that commitment to quality throughout (paragraph 24(a)iii).

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?

Response

Whilst appointing an “ethics partner” within larger firms may be appropriate, having a very formal structure for SMPs may not be appropriate where the choice is limited as to who could take on the role. In the spirit of the draft standard, this should be scalable and apply on a risk basis for each firm.

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

Response

Yes – we consider that any proposals to duplicate the requirements on networks for ensuring and monitoring independence through more prescriptive requirements are already addressed within the principles-based approach at the firm-level.

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

Response

We have no strong view on this point as our member firms are at varying stages of their technological development in respect of audit and assurance and practice management tools.

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

The requirements promote the idea of an exchange of valuable and insightful information but we doubt that many SMPs (unless they have listed or other public interest entity clients) would actually produce a transparency report where it is not the norm within the territory.

Following on from A152, the network would consider producing a network transparency report for member firms to refer to given that individual transparency reports or other external reporting of the individual firms' quality rating as determined by the network quality assurance process, may not be a favoured option for many members.

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

In the interests of maintaining quality for clients that are potentially higher in the public profile, expanding the EQCR requirement to clients of "significant public interest" is to be encouraged. However, the judgment around what a "significant public interest" is for certain clients will need to be communicated well to firms and challenged by leadership to ensure that these reviews, seen as a burden and additional cost, are not side-stepped.

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?

Response

A key area where firms are often confused regarding monitoring is where they do not believe that any internal monitoring is required because there is an external monitor. We welcome the guidance in A167 that states that "external inspections are not a substitute for the firm's internal monitoring activities". Many SMPs will need guidance on how to design appropriate monitoring responses, both on the ongoing and periodic basis.

(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?

Response

We agree with this conclusion in paragraph 45 and with the flexibility for each firm to determine the cycle on which such reviews should be performed (A168-A170). This should be risk-focused, such that principals with quality failings should be reviewed more frequently, as should those with listed entities. As noted above though, there must also be a mechanism within the firm to deal with quality failings with the individual through their performance reviews and compensation as necessary.

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

Response

This is clear as is the definition of a deficiency taken together with the information in the Explanatory Memorandum. Guidance on deficiency identification and practical examples would be of help to SMPs here.

(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?

Response

We welcome the move to a root cause analysis of deficiencies to avoid "default" responses for many review findings (lack of training, lack of time) in paragraph 48. Guidance will be needed for firms to be able to undertake such a review effectively and the network would bring this into the scope of the network monitoring undertaken across all firms on a cyclical basis. The barriers are, as ever, time and understanding of what is required.

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

Response

Although considering positive findings is valuable for the efficiency and effectiveness of the firm (as noted in paragraphs A173 and A178), requiring these to be included in the root cause analysis would be overly-burdensome for our members. A firm should be commended for reviewing such findings, but it should not be a requirement.

(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

In SMPs there is not likely to be the time or objective personnel to be able to complete this evaluation appropriately (to comply with paragraph 55). This may mean that the SMP uses a service organisation to provide this evaluation, at additional cost but greater reliability (especially for the other network members if the results were to be communicated).

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

We are pleased with the statement in paragraph 14 that reiterates that “the firm remains responsible for its system of quality management” regardless of whether the firm uses network services or complies with network requirements.

Our network provides few network services directly to firms in relation to quality management and the network requirements reflect the wide-ranging regulatory locations and sizes of member firms in being lighter-touch. There is a greater focus on local regulatory and firm-level quality services and requirements as a result.

We do undertake quality assurance review of member firms on a cyclical basis but those reviews are NOT designed to provide reasonable assurance regarding compliance with existing ISQC 1 or ISAs nor the proposed new standards (see paragraphs 59 and 60). Our communication with member firms will need to reiterate how these reviews (and the associated self-assessment questionnaires which firms complete annually) can fit into their firm-level responses and what other reviews or monitoring would be needed. We would look at revising the self-assessment quality questionnaires, which may be used by firms incorrectly to “confirm” their annual compliance with quality management principles.

We will work with members to aid their compliance with paragraph 41(c)(ii), in respect of improving communication (in respect of the extent of the communication and the matters to be communicated) within the network, as this is an area we consider needs improvement. Although we have implemented a formal feedback mechanism for members to use on other members, there is an apparent reluctance to use it and this means that communication amongst network members can be informal and anecdotal, which does not always lead to improved quality outcomes.

We note the requirement in paragraph 61 that will require “The firm shall, at least annually, [to] obtain information from the network, about the overall scope and results of the monitoring activities across the network firms’ systems of quality management and:

- (a) Consider the effect of such information on the nature, timing and extent of the monitoring activities that need to be undertaken by the firm; and
- (b) Communicate the information to personnel to the extent that it is relevant to their responsibilities such that personnel take prompt and appropriate action in accordance with their responsibilities (including as it relates to the performance of engagements).”

We will look at how we can provide appropriate feedback on the network’s systems of quality management, other than a summary of the results for the previous review year which are provided at our Global AGM in October each year. We are unsure whether the required response envisages a member firm being informed of the assessed quality outcomes for another member firm (currently based on a quality rating system) or whether the overall results for the latest review years will be sufficient. More guidance here would clarify matters.

14) Do you support the proposals addressing service providers?

Response

Where a firm is relying on service providers for key elements of their quality management (such as the quality of financial statements, audit engagements etc.), we believe the firm should assess the reliability, expertise, independence etc. of such service providers as this is analogous with using a service organisation or expert in an audit and assurance engagement.

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

N/A

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Contact

Clive Viegas Bennett, CEO clive.bennett@mgiworld.com