

IAASB
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Date	Re	Our ref	Attachment
5 July 2019 (extended deadline)	ED for Quality Management ISQM1	KvH	-

Direct dial nr
020-3010281

Dear Mr. Seidenstein,

The NBA appreciates the opportunity to share our views and provide input on the *Quality Management Standards*.

Introduction and General Comments

In this letter we provide our response on the questions on *Proposed International Standard on Quality Management 1* (hereafter: ISQM 1). Some general remarks have been made in our cover letter.

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?

We support the quality management approach (QMA) including risk assessment. In general, the proposals are scalable because the quality management system can be tailored to the specific needs of a firm based on their risk assessment.

We struggle with the manner in which the QMA is implemented in the standard. In short the concept of the QMA is: Define relevant quality objectives, identify the risks that the objectives are not met and implement responses to control the risks.

In the standard quality objectives and responses are defined. In our opinion some of these detailed objectives reflect risks instead of quality objectives. Since the responses are not linked to risks and as such it is not clear why this responses are necessary (which influences scalability). We understand and support that from the perspective of the profession it is necessary to set some detailed requirements for a quality management system, but the manner in which this is currently implemented blurs the concept of a QMA and might impact the effective implementation of the standard.

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Last but not least we feel that there is a possibility to combine certain quality objectives and responses and that there is a need to work on the wording of quality objectives and responses. This could make the standard easier to understand and better scalable. The current level of required objectives and required responses is not necessary and too prescriptive for smaller firms and reduces scalability.

The IAASB might even think about splitting the new ISQM 1 in two standards. A standard with requirements for the implementation of a Quality management system and one setting requirements (currently quality objectives / responses) for such a system.

We are willing to explain our thoughts further and share more detailed ideas if this is helpful to the IAASB.

For very small firms ('micro' firms) we do not support the QMA approach. Quality management is only important if there is something to manage. We do not feel that in a 'micro' firm, for instance with one partner, a QMA approach drives quality. Neither would we expect to implement COSO in a small local grocery store. There are some issues regarding quality that should be taken care of, for instance a that there should be a policy to have an engagement quality review based on predetermined criteria. See Q1c.

We support that culture and tone at the top are mentioned as important factors. However, we are of the opinion that these factors should receive much more attention. In the new COSO ERM model, governance and culture receive much more attention as well. In recent business and audit failures, the deficiencies in 'soft controls' played an important part. See also Q7. The proposals mention the expected behavior of personnel, but it is difficult to influence this behavior. In order to influence behavior, a quality management system should meet the following criteria:

- Clarity: Does personnel understand which behavior is expected from them?
- Possibility to discuss: Does personnel feel free to share their opinion and learn from mistakes?
- Appropriate behavior/conduct of management: Does management act as role models and do they comply visibly?
- Involvement: Is personnel motivated and taken seriously?
- Practicality: How is personnel facilitated?
- Transparency: How is behavior visibly corrected?
- Accountability: Are responsibilities clear? and
- Enforcement: What are the consequences of unwanted behavior?

We recommend to take these elements into account to evaluate whether the behavioral aspects are considered sufficiently in the proposals.

We consider root cause analysis to be an important part of improving the system of quality management. This is yet addressed in the proposals.

(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?

In ISA 220 par. A27-A29 some clear examples of professional skepticism are given, which we support. However, In ISQM 1, par. 7 and 36(b) it is only mentioned that professional skepticism is exercised at the engagement level. We also see a role for the firm to actively support professional skepticism by engagement teams.

(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?

In principle a QMA is inherent scalable, given the fact that a firm should define quality objectives, identify risks and define responses to the risks. The fact that the standard defines a number of required objectives and required responses limits the scalability for smaller firms.

For 'micro' firms we feel that this scalability is not sufficient. We think that for these 'micro' firms a QMA is not appropriate, since we cannot see a need for managing quality in this manner and have a whole system.

In the Netherlands, after the *Invitation to Comment* (ITC) we already implemented a QMA system for non-statutory audits. We have implemented an alternative solution for sole practitioners and 'micro' firms with a maximum of 7 persons (2 engagement partners and 5 other staff. If they comply with certain criteria, only a few high level requirements are applicable ("light version"). We recommend considering having less requirements.

We support that the board feels a need to define required objectives and responses for larger firms. That does not mean that we support all the required objectives and responses. We encourage the board to evaluate whether all these required objectives and required responses are necessary for all firms, or whether it is possible for smaller firms or firms that only provide certain services to provide objectives and responses less detailed as currently described in the proposals ('scaling up' instead of 'scaling down').

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?

Evaluating whether the system of quality management provides reasonable assurance represents a challenge. It is difficult to determine whether "reasonable assurance" is obtained with regard to the system. The question could be asked whether reasonable assurance is achieved when there is a thorough process, but some deficiencies exist or whether reasonable assurance is only achieved when engagements are performed in compliance with laws and regulation. See Q4 and Q5.

Root cause analysis might also represent a challenge. Firms need to show their vulnerability and build a culture of transparency where they are open about their failures/errors. Root cause analysis helps to establish a learning organization. At the same time this might make firms vulnerable for enforcement actions by regulators.

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?

In general we recommend to apply the approach of draft revised ISA 315 where "what needs to be done" is separated from "why" and "how". Furthermore, in our opinion there is quite some overlap between ISQM 1, ISQM 2 and ISA 220. We recommend to restrict this overlap to the minimum necessary. For example ethical requirements are described extensively in all three standards (ISQM 1 par. 32-33 and A67-A75, ISQM 2 16b, 17b and A5, A13-A14 and ISA 220 14-19 and A31-A41). In some of these paragraphs the IESBA Code is explained. In our opinion a reference would also be sufficient. We also recommend to remove the duplicative texts in the application material. For example, paragraphs A6-A9 of ISQM 1 explain the authority of the standard, but could either be shortened or removed as this seems obvious. Another example is paragraph A21 of ISQM 1 where paragraph 55 is repeated. Concrete examples are useful. However, they could also be incorporated in an appendix or outside the standard (see also overall Q2).

Specific Questions

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

Yes, in general we do support the eight components. The structure seems logical and the model is robust. Nevertheless, we recommend to clearly make a distinction between "what needs to be managed" and "how it needs to be managed". The "building blocks in the house" represent what needs to be managed and the two arrows (risk assessment process and monitoring & remediation) represent the process to manage.

Our experience in the Netherlands has learned us that it might not be clear when the objective is achieved. Is that when the process works and deficiencies are identified? Or is that only when the system has no deficiencies? The principle reason for evaluating the system, is the fact that a system will have deficiencies and needs changes due to changed circumstances. However, it takes time to solve deficiencies.

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?

We have some questions regarding the objective of the standard. We are aware of the fact that the term "Reasonable assurance" was used in ISQC1. Nevertheless we experience that in reality it is difficult to determine whether a system provides reasonable assurance. In the draft standard, the term "reasonable assurance" relating to the system of quality management has a different meaning than in the ISAs and other standards.

Furthermore, we refer to our remarks above that the system of quality management and the process of improvement are in fact two interrelated objectives that a firm needs to achieve. When and how is reasonable assurance accomplished? Are there specific frameworks that can be considered such as COSO?

A last aspect that we want to bring to your attention is the fact that maintaining the system takes time. Does the system of quality management provide reasonable assurance if deficiencies are identified, but cannot be solved immediately? In our opinion, this is reality in practice. We recommend to recognize this in the standard and allow an acceptable period to solve deficiencies. In the Netherlands firms are given such a period in the local standard as a response to the first experiences.

We believe that acting in the public interest should be explicitly stated in the objective. The public interest should be incorporated in all professional actions and behavior of all employees and partners of the firm. It is the cornerstone of the profession. However, it may not be clear for everyone that appropriately applying the standards is in the public interest if this is not stated explicitly. Therefore, we recommend incorporating this in the objective in paragraph 18a at the end (...and requirements and thereby act in 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?

We agree. The firm's risk assessment process is similar to the risk assessment process that is performed in engagements and is based on the COSO model. This enables firms to focus on priority issues. The pictures on page 13 and 14 of the explanatory memorandum helps to understand how risks should be assessed. However, the level of detail that needs to be considered might be challenging. We recommend clarifying this.

The 'preliminary consideration' and 'more detailed consideration' as described in paragraph 33 of the explanatory memorandum are not so clearly described in paragraphs 28 and 29 of the exposure draft itself. It is also not mentioned that this consideration could be combined. We prefer a combination of the considerations. We recommend to make more clear that the two phase process can be combined.

(b) Do you support the approach for establishing quality objectives? In particular:
i. Are the required quality objectives appropriate?

In our opinion there are too many detailed quality objectives as mentioned earlier. See Q1a and Q1c. Furthermore, we have some remarks at the individual components.

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

It is clear that additional quality objectives may be required. We feel that for certain (smaller) firms the current set of objectives might be sufficient and thus it might not be necessary to identify further quality objectives. The standard should reflect that and not require more quality objectives, but require evaluation whether more quality objectives are necessary (including implementing them when necessary). Some examples might help to make it more concrete (in or outside the standard). The option that more granular quality objectives may be considered is useful. We agree that this should not be a requirement, but depends upon the circumstances.

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

We support this process. The distinction between preliminary and detailed process could also be combined (see also Q6a). We think that there is a spectrum of risks just like in ED ISA 315. This is not mentioned explicitly. For consistency purposes, the spectrum should be considered. We also recommend to clarify what is meant by 'more than remote' in paragraph A55 as explanation for 'a reasonable possibility of occurring'.

- (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?*

Apart from the fact that we do not believe that this approach works for 'micro' firms (see above), we feel that this approach will help the firms designing and implementing responses that are tailored to and appropriately address the assessed quality risks. But we worry that the high number of required objectives and responses might lead to boilerplate implementations.

- 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?*

We wonder whether this is clear. In paragraph 30 is stated that the firm shall design and implement responses to address the assessed quality risks, including the responses required by this ISQM. Implicitly this assumes that there are additional responses, but we think that this could be made more explicit.

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

Some attention is given to actions to be taken to establish the expected behavior, but this is difficult to establish as this relates to 'soft controls'. As mentioned earlier (see Q1a) more attention should be paid to 'soft controls'. Although 'tone at the top' is mentioned in paragraph A27, this should be explained more in detail. For example, it is important to have an open culture where learning from mistakes is essential.

Furthermore, we have questions about the responsibilities the firms versus the individual engagement partners. This is very important for the firms in practice. Where do the responsibilities of the firm end and where do the responsibilities of the individual engagement partner begin? This might be different for certain jurisdiction, but when it comes to claims this can become a serious issue. The engagement partner is responsible for the opinion/conclusion for which he uses professional judgment. However, he needs the support of the firm, the network and service providers to be able to do so.

The quality management system of the firm should enable the engagement partner to take responsibility for the engagement. The firm is responsible for the system of quality management to ensure that the engagement partner is doing his work properly.

Furthermore, the definition of engagement team seems very broad. It also seems to include component auditors. We wonder whether this was intended. We recommend considering whether component auditors should be excluded from this definition in order to have clear responsibilities.

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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?

In our opinion, ultimate responsibility for relevant ethical requirements should be addressed at firm level and to the ultimate individual responsible for quality. This can be organized in various ways. The tasks could be spread across different individuals and individuals should also be allowed to combine this with other tasks (they do not have to be dedicated to a single task).

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

Yes.

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

It is mentioned that the use of technology may give rise to quality risks (par. A129). We support this in principle. More attention could be given to the fact that adequate responses need to be developed to address these risks. It is mentioned that general IT controls may be part of the response, but other examples could be given as well. Furthermore, technology could be used as responses to risks and used in a positive way. Finally, we agree that the standard should remain fit-for-purpose and not become too much dependent upon specific technology which may become obsolete.

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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?

It is stated that the firm communicates to external parties as the firm determines to be appropriate. This leaves room for interpretation. The balancing of interests should be clear. The proposals speak about "users that might be interested" which may be very broad.

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?

We agree in principle. However, the term of 'significant public interest' is subjective in our opinion. We recommend to change this and use the term public interest entities. We do realize that this term may differ per jurisdiction, but it is clearer than 'of significant public interest'.

In our opinion, for voluntary engagement quality reviews attention should also be paid to threats of independence, possibility of modifications to the opinion/conclusion, signals of fraud or non-compliance in the selection of engagements for engagement quality reviews. We recommend to add these to the issues mentioned as examples in paragraph A104.

Furthermore, attention could also be paid to other reviews that are not engagement quality reviews. Other reviews such as in-process reviews are mentioned in paragraph 45 as part of monitoring activities, but some more attention could be paid to the various types of other reviews in the application material.

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?

We consider the proposals to be an improvement. Robustness could be further improved in the proposals by describing innovative monitoring techniques such as using dashboards. Another improvement would be to mention whistleblower procedures as part of other information sources. The last improvement would be to mention disciplinary actions in the remediation process.

(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?

We agree for larger firms.. However, for smaller firms with only a few partners we are wondering whether this means that inspection of files will take place annually as the evaluation of the system of quality management needs to take place annually. This seems a large burden. We recommend to align the various requirements and provide further clarification.

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

We recommend to make the framework clear by incorporating the figure on page 23 of the explanatory memorandum in an appendix or supporting material. Other figures in the explanatory memorandum might also be useful to include there as well.

We support the definition of deficiencies. This definition is to be separated from the definition of deficiency in internal control.

(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?

We agree. The firms are required to perform a root cause analysis of deficiencies. The nature, timing and extent of the procedures however are dependent on the nature of the deficiencies and their possible severity (par. A180). This enables sufficient flexibility. Some complicating factors are also mentioned. Nevertheless, in practice it may remain difficult to perform an appropriate root cause analysis and find remedial actions. It should be established that there is an open culture where individuals and groups can learn from their failures/errors. Some more attention could be paid to this aspect. Further we refer to our remarks on Q2.

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

No, we feel that positive findings could be more highlighted in the standard. They are mentioned in paragraphs A173 and A178, but it is only said that this could be useful. We recommend to stress more the importance thereof. Good examples/best practices can help the firm to make overall improvements.

(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?

In our discussions we have learned that the concept of reasonable assurance that a quality management system achieves the objectives in paragraph 18 is not well established.

In the first place there are questions whether reasonable assurance in the standard relates to the process or to the status quo at a certain moment in time. You could argue that it is possible to have reasonable assurance about the effectiveness of the process. There is effective monitoring which identifies deficiencies and these deficiencies are resolved within a reasonable time period, but where the deficiencies might not have been resolved at the moment the system is evaluated. But we have also heard arguments that the reasonable assurance is about the effectiveness of the system to achieve the objectives at a certain moment in time. (See Q5).

Secondly it is not fully clear what the acceptable level of non-compliance is to be able to state that reasonable assurance has been achieved.

Therefore it will be challenging for the individual assigned ultimate responsibility for the system of quality management to evaluate whether the system provides reasonable assurance that the objectives of the system have been achieved.

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?

We acknowledge that firms cannot simply rely on networks and have their own responsibility to evaluate the appropriateness of the policies, procedures and solutions provided by their network. At the same time networks currently play an important role in providing audit approaches and tools to local firms. We feel that they also have an important role to play in achieving consistent audit quality within a network. This role is important to overcome the risk of undue reliance of individual auditors on the work performed by component auditors in network firms in other countries.

Therefore we suggest that ISQM 1 sets an expectation that firms apply network requirements and network services whenever possible and inform networks whenever they feel that material made available to them by the network is not fit for purpose.

14) Do you support the proposals addressing service providers?

Undue reliance on service providers is clearly stated. However, especially for sole practitioners and smaller firms, service providers are sometimes essential. We recommend to make clear that service providers can be valuable to the firm and relied upon if the auditor has evaluated that their services are appropriately designed and operating effectively.

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?

We have no problems with changing the title into our own Dutch regulation. However, in the EU Directive the old title of ISQC1 is mentioned. This might create difficulties at the European level.

Closing Remarks

For further information, please contact Jan Thijs Drupsteen (j.th.drupsteen@nba.nl).

Yours sincerely,

NBA, the Netherlands Institute of Chartered Accountants,



Anton Dieleman
Chair of the Dutch Assurance and Ethics Standards Board,
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