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Professor Arnold Schilder
Chairman
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York NY 10017
United States of America

1 July 2019

Dear Professor Schilder,

IAASB Proposed International Standards on Quality Management (ED- ISQM1 and ED-ISQM 2) and ED-ISA 220 Quality Management for an Audit of Financial Statements ('ED- ISA 220')

RSM International Limited, a worldwide network of independent audit, tax and consulting firms, appreciates the opportunity to comment on the IAASB's Proposed Standards on Quality Management.

We welcome the proposals in ED-ISQM1, ED-ISQM 2 and ED-ISA 220 and believe they provide the basis to achieve a step change in audit quality. We see this combined suite of standards as essential for continued improvement in audit quality. We have a number of comments on the Exposure Drafts and our responses to the specific questions posed in ED-ISQM 1 are attached.

Due to the comprehensive nature of the changes, significant practical implementation guidance and training will be required. Assistance with implementation through a comprehensive example or guidance will be particularly critical for smaller firms and will assist in setting a framework for regulators when they inspect firms for compliance.

We would be pleased to discuss our views further with you or your staff. If you have any questions regarding our comments, please contact Steve Whitcher (steve.whitcher@rsm.global) or me at (marion.hannon@rsm.global).

Yours sincerely,



Marion Hannon
Global Leader, Quality & Risk

Response Template: Proposed ISQM 1

General Comments on Proposed ISQM 1

We believe that ED ISQM 1 will facilitate a step change in audit quality and improve consistency in audit quality delivery. It outlines an approach to quality management that is demanding but also necessary to facilitate marked improvement.

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?

Response: Yes, we believe that ED-ISQM 1 will substantively enhance firms' management of engagement quality. However, the challenges of implementation should not be underestimated. On an ongoing basis we believe the standard is scalable but initial activity necessary to implement the standard is significant and not particularly scalable. In the timeframe indicated smaller firms may struggle to:

- evaluate the new rules and implement changes to their systems and controls
- improve their documentation
- put in place systems to satisfy the monitoring and remediation requirements due to limited resources and the inherent risk of self-review

To assist smaller firms during the implementation period, a comprehensive example of a quality management system for a smaller firm will be important.

See detailed responses below.

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 and believe it will facilitate a step change in quality improvement. We particularly like the change in focus from quality control to quality management as a more pro-active way of viewing this topic. See also our response to (b) below.

(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?

Response: We believe implementation of the proposals in ED-ISQM 1 will enhance firms' management of engagement quality. They will enable firms to evaluate their existing quality control systems and enhance controls or documentation in areas which require it. We agree that the emphasis for managing quality is with individual firms and audit partners. We believe the proposed standards will ensure that accountability for audit quality will be clearer.

The topic of professional skepticism is more prevalent in ED-ISQM 2 and ED-ISA 220 than in ED-ISQM 1. This seems to us to be the correct balance.

- (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: Yes, the requirements are scalable on an ongoing basis, but initial activity required for implementation is not as scalable and smaller firms may be challenged by the volume of implementation requirements.

We believe a comprehensive example of how all of the elements in ED-ISQM 1 could be applied in smaller firms is important. It would be helpful if the example reflected structures where there are fewer layers of controls than in larger firms. This will also avoid firms reading ED-ISQM 1 and thinking they can just ignore or not apply certain areas.

The biggest risk to scalability will be implementation. The comprehensive example referred to above would enable the IAASB to illustrate comprehensive yet streamlined considerations for smaller firms against which the regulators can then inspect.

- 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 discussed above, the main challenge for implementation will be scalability and therefore we do place great importance on a comprehensive example to help smaller firms.

Another difficult area will be assessing the firm's quality risks and, due to the inherent differences in each firm, it will be challenging for firms to understand how to embark on this evaluation.

Whilst we appreciate the existing guidance in the form of explanatory memos, webcasts and videos, further implementation guidance, such as a comprehensive example, will be essential.

We agree with the need to provide examples and guidance however, we find Scenario 3 in the Draft Examples document to be confusing. It implies a ranking of risk based on likelihood of occurrence and the effect on the achievement of a quality objective, which is not required by the standard. It also seems to set out a need to establish sub-objectives. Whilst seeking to be helpful, an example that is 5 pages long and is based on just one requirement, implies a process that will overwhelm firms.

In addition, we note:

- Any implementation example and guidance will need to be drafted to enable firms to fully engage with the principles of the three proposed standards but to avoid ending up with a checklist approach where this guidance is seen as a minimum level of compliance; and
- Firms will inevitably start by reviewing their existing quality management processes and controls, without comprehensive guidance they may struggle to determine what they should be doing differently.

The FAQ document is very helpful. The IAASB should gather insights from the comment letters and add more FAQs to aid with implementation.

- 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: As discussed above, whilst the existing application material is helpful, we do consider that a comprehensive example will be necessary to assist smaller firms to successfully implement ED-ISQM 1.

Specific Questions

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

Response: Yes.

Paragraph A5 states that different terminology or frameworks may be used to describe the components of quality management. We think clarification should be made that if different terminology or frameworks are used, a firm should demonstrate that it still addresses all 8 components.

We do not understand the purpose of Appendix 1 and it does not add value to understanding ED-ISQM 1. If explanations are needed, they should be in the body of the standard or in the application paragraphs.

- 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: We agree with the objective of the standard. The relationship between the objective of the firm and the objective of the system of quality management is very well explained in paragraphs 16-18 of the Explanatory Memorandum. We believe this should be added to the standard through revisions in the introduction section or application guidance.

- 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?

Response: Yes but a comprehensive example will be crucial in this respect.

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: Yes

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

Response: Yes

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: Yes, it is clear but we do not support this requirement. We believe that firms may encounter difficulty in trying to define quality objectives beyond those identified in the standard. Our view is that the quality objectives set out in ED-ISQM 1 are appropriate for all firms.

As such, we believe the quality objectives should be implemented by each firm related to their environment, but a separate evaluation of what may be missing from the quality objectives is not needed or beneficial. If the comment letters received in respect of ED-ISQM 1 identify additional quality objectives which the IAASB considers valid then these should be included in the final standard.

In our view, the open-ended nature of paragraph 26 is an invitation to Regulators to impose quality objectives on firms that are not appropriate.

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

Response: Yes, but we believe this will be challenging for firms and implementation guidance is needed.

The explanatory memorandum paragraph 33 describes a two step process for the evaluation of quality risks. This process is implied, but not explicitly stated in paragraphs 28 and 29 of ED-ISQM 1. The explanation in the explanatory memorandum is helpful and should be included in the standard or application guidance. It should be emphasized more strongly that risks need to address both aspects of paragraph 28 to avoid firms believing that all potential risks would need to be considered and documented, even insignificant or unlikely risks.

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

Response: Yes, we agree with this approach. We believe this is a key foundation to the scalability of the standard. However, we think firms will struggle to understand how to do this and therefore why we believe significant implementation guidance and training is required.

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: Yes as set out in (d) above

- 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: Paragraph A59 is very clear, but we believe that this needs to be explicitly stated in the requirements section. We propose that paragraph 30 be revised as follows:

30. The firm shall design and implement responses to address the assessed quality risks, including **but not limited to** the **specific** responses required by this ISQM. The design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks.”

In addition, paragraphs 24, 30, 33, 35, 37, 39, and 41 should be conformed to the following template:

~~In designing and implementing responses to~~ **To** address the quality risks identified and assessed by the firm relating to the [component name] quality objectives, the firm shall **design and implement responses that** include, **but are not limited to**, the following responses:

- 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 these are addressed. However, we believe that further clarity is needed between the requirements in paragraph 24(b) and the guidance in A42. Paragraph 24(b) establishes requirements for periodic performance evaluations of the individuals assigned ultimate responsibility for the firm’s system of quality management, whereas the guidance in A42 recognizes this may not be practical in smaller firms. This discrepancy could be open to Regulator challenge if smaller firms determined not to carry-out performance evaluations. We recommend the application to smaller firms should be made clear in paragraph 24(b).

- 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: We do consider it necessary to require a firm to assign responsibility for ethics and/or independence to an individual and therefore recommend that this is made clear in the

final standard. Accountability and ownership of ensuring compliance with ethical and independence requirements are critical to audit quality.

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

Response: Yes these are appropriately addressed.

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

Response: Yes.

- 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: Yes although we recommend that paragraph 41(c)(iv) or the associated guidance is clarified to state explicitly that a transparency report is not a requirement of ED-ISQM 1 but may be required by local law or regulation. We note the language in this paragraph, but it could be made clearer.

- 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 general, we agree with the requirements. However, we are concerned about the use of the term "significant public interest" in paragraph 37e(ii). We consider that this definition should be amended to PIEs as defined in the IEBSA Code.

The guidance in A102 could produce a checklist approach and the use of "certain" in describing not for profit entities in scope for an engagement quality review is not clear. "Certain" is not defined or implementable.

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

Response: Yes, but please see responses below.

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: We support the proposals, in particular the inclusion of the ability to inspect in-process engagements as part of this Proposed Standard and we note that this could be described as innovative. However, we do not understand how the other aspects of monitoring will promote innovation. We also consider a comprehensive example is needed to support smaller firms in implementing effective monitoring procedures that would fulfil the requirements. Smaller firms commonly face challenges in committing the necessary resources to conduct on-going monitoring activities and persons assigned to such activities may lack the objectivity to make these processes meaningful.

- (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 review on a cyclical basis and support firm flexibility in deciding the cycle.

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

Response: We support the definition of deficiencies but consider that the difference between negative findings and deficiencies in the standard is still confusing, for example, the use of findings and deficiencies in paragraphs 51 and A185. The last sentence in paragraph A185 implies the findings were considered a deficiency. Is this a deficiency in the engagement or in the system of quality management? The heading of paragraph 51 should be described "deficiencies" rather than "findings" as both (a) and (b) represent failings in quality.

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

Response: We strongly support the requirement for root cause analysis. However, we believe implementation support will be required as this is not an area that all firms currently undertake and it could lead to challenges in performing an effective analysis. We also think that more clarity should be added on whether all deficiencies require a root cause analysis. Paragraph 48(a) seems to indicate that a root cause analysis is required for all deficiencies but paragraphs 48(b) and A183 could imply that some deficiencies are not severe and pervasive and, as such, a root cause analysis may not be needed.

In particular:

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

Response: Yes and we welcome this flexibility.

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

Response: Yes and we welcome the recognition of positive findings and the benefits to the wider firm as noted in paragraph A174.

- (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: If the firm implements a system of quality management in compliance with ED-ISQM 1, then the biggest challenge will be designing a reporting mechanism to gather data on a timely basis for the individual responsible to be able to make the required evaluation. As described in A189, this is one area in which larger firms may find the process more difficult than smaller firms due to their more decentralized nature.

- 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: Yes, although we suggest that it could be made clear that information regarding trends and common areas of identified deficiencies across the network would normally be anonymized and not name individual member firms.

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

Response: Yes, we support these proposals, but more implementation guidance will be needed to ensure consistency of application.

- 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: We do not believe this will cause an issue.

Editorial Comments on Proposed ISQM 1

Please see notes above

