

Response Template: Proposed ISQM 1

Note to Respondents:

- The questions below are from the exposure draft of proposed International Standard on Quality Management (ISQM) 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*, which is available at www.iaasb.org/quality-management.
- Respondents are asked to respond separately to each of the exposure drafts and the overall explanatory memorandum.
- We request that comment letters do not include tables as they are incompatible with the software we use to help analyze respondents' comments.

General Comments on Proposed ISQM 1

[Please include here comments of a general nature and matters not covered by the questions below.]

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: The fact that the new standards follow a risk-based approach, the increased emphasis on professional judgment, the fact that the quality objectives are outcome-based rather than input based to prevent a checklist approach, and the considerations of the nature and circumstances of the firm and the engagements it performs, are steps in the direction of more scalability. The development of practical examples is also preferred to theoretical guidance. This enhances quality and scalability.

The new quality management approach together with the various new requirements have added to the overall length of ISQM 1 compared to the extant ISQC 1. This reduces scalability.

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: Yes, in general.

- (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: The increased emphasis on professional judgment support the appropriate exercise of professional skepticism.

(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: The quality standards should be drafted by beginning with the definitions and general principles that are applicable to all practitioners, from sole practitioners to practitioners working in a network firm. From this, the standard should expand to principles that are not applicable to sole practitioners, but only to practitioners from SMPs to those working in a network firm. And last, the standard should have a section with principles that are applicable only to network firms.

This is the reversal of the extant ISQC 1, that has separate sections titled “Considerations Specific to Smaller Firms”.

The Restructured Code of Ethics is an example of how a separate section covers the principles for firms providing assurance engagements. That way, the standard considers the fact that there are firms that do not provide assurance engagements, but for example do provide assurance related engagements.

As stated in paragraph 5 of ISQM 1, the complexity and formality of a system of quality management of a firm that performs only compilation engagements or even reviews of financial statements, will be far less than that of a firm that performs audits for public interest or listed entities. The standard should be drafted accordingly.

It is regrettable that the draft examples of ISQM 1 follow this logic, but the draft standard itself doesn't. The draft examples distinguish three scenarios:

1. A small firm that performs only compilation engagements
2. A small firm that firm that performs compilation and review engagements
3. A larger firm with multiple locations that is part of a network and performs multiple engagements

If the standard would be drafted in such a way (with more nuances, as stated above), the practitioner wouldn't need to wade through the entire standard, and then discard those sections which aren't applicable to his situation. This is necessary because the new quality management approach together with the various new requirements have added to the overall length of ISQM 1 compared to the extant ISQC 1.

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: For being implemented on European Union level, this standard must pass the quality test of article 26, 3^o1 of the Audit directive² and a cost-benefit analysis.

¹ “Art. 26, 3. The Commission shall be empowered to adopt, by means of delegated acts in accordance with Article 48a, the international auditing standards referred to in paragraph 1 in the area of audit practice, independence and internal quality controls of statutory auditors and audit firms for the purposes of the application of those standards within the Union. The Commission may adopt the international auditing standards only if they:

- 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 development of practical examples is preferred to theoretical guidance. The distinguishing of different scenarios (small firms, larger firms; compilation engagements, review engagements, audit of financial statements of SMEs, audit of financial statements of public or listed entities, multiple engagements, ...) is also helpful.

Specific Questions

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

Response: IAB-IEC agrees with the eight components but does not agree with the structure of ISQM 1 (cfr. Question 1) (c)).

- 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: IAB-IEC supports the objective of the standard.

- 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: Generally, yes.

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: IAB-IEC believes that this should be investigated further.

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

Response: IAB-IEC supports the approach for establishing quality objectives as designed in ISQM 1.

In particular:

- i. Are the required quality objectives appropriate?

Response: The objectives are appropriate.

(a) have been developed with proper due process, public oversight and transparency, and are generally accepted internationally;
(b) contribute a high level of credibility and quality to the annual or consolidated financial statements in conformity with the principles set out in Article 4(3) of Directive 2013/34/EC;
(c) are conducive to the Union public good; and
(d) do not amend any of the requirements of this Directive or supplement any of its requirements apart from those set out in Chapter IV and Articles 27 and 28."

² Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

- 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, this is necessary to adjust to the specific situation of the firm. This is an important aspect for the scalability of the standard.

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

Response: In general, yes.

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

Response: Yes, this makes the standard more scalable.

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: This approach will lead to more tailored responses than the extant ISQC 1.

- 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: Yes, the standard is a minimum that should apply to all situations, to be universally applicable.

- 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: In the redraft of this standard, the situation of the sole practitioner or the SMP with only a managing partner should be more coherent. In the current draft, the requirements or references are to be found in different paragraphs. They should be grouped together in a single section.

- 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: Yes, under the conditions of paragraphs A36 and A37 of the draft.

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

Response: This has been sufficiently dealt with.

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

Response: The modernization was necessary to keep up with the technological evolution, for example cloud computing. The draft also considers the difference in the use of IT technology, depending on the size of the firm.

- 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: This has been sufficiently dealt with.

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: The requirements will result in proper identification of said engagements. The limiting of the scope of this review and the separate ISQM 2, makes the draft ISQM 1 more scalable than the extant ISQC 1.

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

Response: Prima facie, yes.

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: This bottom-up approach will lead to more innovation.

(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: It is regrettable that this requirement still exists. IAB-IEC doubts whether the enhancements will lead to an improved flexibility.

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

Response: In general, the framework looks adequate.

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

Response: Yes, with consideration of paragraph A180.

In particular:

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

Response: The draft explicitly states that the procedures undertaken to understand the root causes of an identified deficiency may be simple. The draft avoids overly complex procedures.

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

Response: As a whole, the response would be affirmative.

- (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: The feasibility of this may be questioned from the point of view of the sole practitioner.

- 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: In its entirety, the proposals address the issue.

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

Response: IAB-IEC supports these proposals.

- 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: Changes in title alone will not result in significant difficulties.

Editorial Comments on Proposed ISQM 1

[Please include here comments of an editorial nature.]