

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

The Instituto de Censores Jurados de Cuentas de España (hereinafter ICJCE) is pleased to provide its comments to the IAASB proposed International Standard on Quality Management 1 (ED-ISQM 1).

In general terms we support the new approach to the quality management of firms, although the change to a risk approach may be challenging for firms.

Attracting and retaining the specialised personnel; implementing new IT tools and setting policies and procedures as well as the IT system to manage independence risks may be also challenging specially for smaller firms with lower capacity. In Spain, some of these challenges may be even more demanding because of the application of some requirements to a wider scope of entities or people. In this regard, we refer to our answer to questions 2 and 11.

Finally, in our answers to the specific questions you may find some request of further guidance to help SMPs, including an illustrative list of main quality risks that can affect SMPs or guidance on communication of independence issues.

Should you have any question, please contact avila@icjce, we will be very pleased to clarify any issue regarding the content of this letter

Sincerely,



Javier Quintana

Chief Executive

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:

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?

In our opinion, the quality risk management approach is appropriate because it's in line with ISAs' approach and because it will probably give more flexibility to firms depending on their circumstances and on the services that they provide.

However, we consider that there are a lot of objectives to fulfil and that moving from a requirement approach to a risk approach will require firms to consider their current procedures as responses to risks and to direct them to their firms own risks, so they will need to work in a realistic identification of their risks.

- (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?

When we analyse the leadership issue and how leadership should be used to create a culture of quality in the professional performance, professional skepticism is indirectly addressed. However, we understand that ISA 220, currently under review, already addresses the exercise of professional skepticism at the engagement level.

- (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?

We consider that the scalability objective has been met mainly due to the change of the approach from compliance to risk. This favours the effective application of scalability. Specifically, in ISQM1 the consideration of the nature and circumstances of the firm and of the engagements that it performs (Para 5), is key to that objective.

- 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?

In addition to what we state in our answer to question 1 about the appropriateness of the current firms' internal quality control system to the new requirements, we see in:

- Para. 23 c): to subject firms' strategic decisions to quality will be a challenge for those exerting leadership and general organization.
- Para. 38 a) and b): Retaining personnel with the competence, experience and skills needed becomes a challenge, especially for SMPs if we take into account the incessant regulatory changes, the need for expertise and the lower capacity of attracting and retaining talent.

- Para 38 e) and g) The implementation of technological tools to manage quality and engagements, and having trained staff to use these tools, are challenges for SMPs due to their lower investment capacity and their difficulties to attract and retain the appropriate professional personnel (please see previous paragraph).
- Paras. 33) and A69): Setting policies and procedures and an information system to manage independence risks related to personal situations and services is especially difficult due to the divergent regulatory requirements in different jurisdictions. Analysing the applicable laws and regulations; organising the firm; training the relevant people; and implementing an appropriate information system is a challenge. In Spain, the extension of the applicability of the independence rules to other people related to the engagement partner makes management of independence especially difficult.

Please see our answer to question 3 about the usefulness of further application material and guidance.

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?

Yes, in general, the application material is more descriptive, and the proposals are much more aligned to the reality of the firms that they used to be in ISQC1. However, the proposed application material section is excessively long. There is a substantial difference between the number of paragraphs in ISQM1 and ISQC1 (214 and 75 respectively). In this regard, a simplified version addressed to SMPs or examples or additional guidelines to help putting in place this new Quality Management System, would be desirable.

Regarding those areas that need more examples or further explanations:

- There are no specific considerations addressed to PIE auditors. This would help make the standard more scalable and would help its implementation.
- The preparation of an illustrative list of main quality risks that can affect SMPs would be useful. However, the illustrative character of the list and the fact that every firm is responsible for the identification and assessment of their risks must be clearly stated to avoid confusion.

Specific Questions

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

Yes. We do not have comments on that issue.

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?

Yes. The objective of the standard (Para. 18) is clearly described.

Achievement of the public interest objective through the quality management system is stated in Paragraph 7.

- 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?

Yes. Despite the effort required to appropriately analyse all the risks of the firm, this approach will ease achieving the objective of the standard, since it is more flexible.

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?

Yes. It is reasonable that this approach is applied to the whole standard and therefore it be applicable to other components of the system.

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

Response:

In particular:

- i. Are the required quality objectives appropriate?

Quality objectives defined in Paragraphs 23, 32, 34, 36, 38, 40 and 42 are appropriate to achieve the objective of the standard as described in Paragraph 18.

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

In our opinion it is not clear. We understand that no additional quality objectives will be established to those required by the standard. Probably, only larger firms will voluntarily establish them.

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

Yes. Despite the above stated (question 3 regarding SMPs), criteria to identify and assess quality risks are adequately set.

- (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?

Yes. Adapting those responses in the standard (Para.24, 25, 33, 35, 39, 41 and 44 to 57) to the circumstances of the firm is reasonable.

- 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?

In addition to the responses required by the standard, designing and implementing further measures is not clear. That's why it seems that only larger firms, with a more complex organisation and activities, will implement such additional measures. This will be also because they are already applying them as a part of their policies and procedures established by their network.

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

We believe that governance and leadership responsibilities have been properly addressed and leadership and governance objectives adequately set.

- Culture and promotion of the values of the firm.
- Leader responsibilities.
- Strategic decisions in which quality is first considered, before other considerations.
- Adequate and flexible structure of the organisation with functions to ensure quality management and that is adaptable to the circumstances and engagements of every firm.
- Adequate organisation of resources broadly considered.
- Regular performance evaluations.
- Promotion of a commitment to quality through the establishment of a complaints and allegations channel.

The tone and attitude at the top of the organisation towards the quality has also been highlighted. (Para A27

- 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?

We are of the opinion that the responsibility of safeguarding independence relies on the engagement partner and on each member of the staff and individual providing services on behalf of the firm. However, in larger firms, nominating one individual or team as responsible for independence issues to coordinate all the responses to independence risks and to set common policies and procedures may be adequate. Due to the large number of engagements and their complexity, in the larger firms this is a task to perform exclusively.

The standard does not require firms to appoint a specific individual, but this will probably be the response of the larger firms to ethics risks.

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

In Paragraph 33a) the standard requires firms to design the relevant ethics requirements relevant to the network, businesses and service providers.

In Para A71, includes how to consider the application of ethics principles to the individuals or entities mentioned in Para 33 a). Consideration of non-firm staff that may be included in the definition of member of the engagement team and application of ethics principles to them is also mentioned. In Spain, according to Article 67.9 of the BRAC¹, and without prejudice to what is stated in NIA-ES² 620, all who participates in an audit engagement is considered as a member of the engagement team.

In para A143 frequent communications with the network are addressed, including those related to independence.

We are of the opinion that, although the draft includes responses to independence risks linked to being part of a network, more detail would be desirable specially to help SMP regarding procedures to communicate independence issues.

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

Consideration in Para 38 e) and application material in Paras A124 to A131 are new and we believe that are appropriate as a part of the resources that firms need to allow internal quality systems operation and engagement performance.

Application material outlines the circumstances under which technological resources could be used and the need for specialised personnel for the performance of the engagements; and describes what a technological resource is (application, infrastructure and processes) and the risks associated to them.

Providing examples, in the standard or in a separate guidance material, would be desirable, especially for SMPs, since larger firms have already included technology in their quality management systems.

- 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?

Para 40 and Para 149 et seq. about communication requirements with external parties do not promote exchanging information of interest about the quality management system. The most common mean of disclosure is the transparency report. The obligation of reporting and regulatory requirements varies from one jurisdiction to another and the information disclosed about the

¹ BRAC: Draft regulation developing the Law 22/2015 of 20 July on Auditing.

² NIA-ES are national Audit standards, which comprises the translation into Spanish of ISAs adapted for their use in Spain.

quality management system does not contribute to reinforce communication between firms and stakeholders. Since Non-PIE auditors are not required to prepare a transparency report, another transparency mean would be necessary. However, this would also entail an administrative cost to be assessed in relation to benefits obtained

- 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?

Yes. However, the ISQC1 as adapted in Spain, all those paragraphs where reference is made to listed companies apply to PIEs, being one of them the scope of the quality control reviews.

We consider that widening the scope to PIEs, as defined by the local laws and regulations and according to the quality risk assessed at the engagement level by the firm, is appropriate. Application material about engagement high level of complexity in Para A104 is very useful.

- 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?

Actions proposed to design and implement monitoring activities look more effective according to what is provided in Para 44 to 46 and A156 to A158 because monitoring activities are wider than foreseen including not just the annual review, but an ongoing review of the responses that the system provides. This makes the system more flexible. Highlighting that there are different means to test the quality management system, not only the annual monitoring review or under proved selected criteria but depending on the risks and the responses implemented by the firm, would be desirable. Firms must have flexibility to analyse compliance

- (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?

Establishing a mix of monitoring activities as described in Paras 44 and 45 seems appropriate to make monitoring flexible.

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

Yes. The assessment process described in Para 48 including:

- The root cause, and
- The severity and pervasiveness of deficiencies

is appropriate

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

Yes:

In particular:

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

Regarding negative results, factors suggested in Para A175 seem to be flexible to find the root cause of the identified deficiency.

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

Regarding positive results and their impact on the root cause analysis, in our opinion it is not developed enough, especially in relation to the advantages of this analysis.

(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?

As stated in answer 12 a), in our opinion it seems reasonable that monitoring methodology and regularity show certain degree of flexibility, especially if a response to a quality risks is working adequately. On the contrary, if a response does not work properly, increasing the regularity of the monitoring activity might be necessary.

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?

Para 14 and especially Para 58 state the aspects to consider when a firm is part of a network including the network policies; firms' responsibilities and applicable procedures.

We consider that the risk analysis and the responses stem from belonging to a network as proposed in para A192 et sq. are adequate.

14) Do you support the proposals addressing service providers?

Yes, in general. The fact that service providers should be included in the monitoring scope, as it happens with network service providers (Para 63) is not addressed.

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?

No. In fact, in Spain we do not foresee a problem since the Spanish regulator already included the concept "internal organisation" in the Audit law as a firm's management concept. Therefore ISQM 1 is aligned with regulatory changes in force in Spain from 2021.

Editorial Comments on Proposed ISQM 1

[Please include here comments of an editorial nature.]