Swedish National Audit Office 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

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?

    Response:

    We are supportive of the risk-based approach, however we find the revised standard to be two-folded. It is intended to be risk-based but at the same time IAASB defines several quality objectives, requirements for defining additional quality objectives, risk-assessments and responses to the risks and above that mandatory policies and procedures. This becomes quite overwhelming and we question whether the standard is entirely risk-based or if it could be understood as providing more detailed and specific demands than intended?

    We also find it to be a bit contradictive and confusing. As we have understood the process is that audit firms need to:

    - implement the quality objectives specified by the IAASB and identify any additional,

    - identify any quality risks for not fulfilling these quality objectives mentioned above and also assess the probability before designing response

    - design responses for the identified risks.

But at the same time the requirements specify that firms need to implement mandatory responses (example in §24). Are these mandatory responses to be considered as mandatory irrespective of the risk for not fulfilling the quality objectives?

We believe this needs to be clarified.

Other comments:

- **Quality objectives**. There are several quality objectives defined by the IAASB in the standard. Objectives which would be part of the strategic and operational internal management workplans. We would like to raise the question whether this is consistent with how the structure is within the public sector, and more specific for the supreme audit institutions. This could be interpreted as interfering with the strategic management of a supreme audit institution. The audit supreme institutions (SAI) are independent and their mandates are objectives are specified in the constitution and additional laws and regulations. The management of the SAIs are then responsible for defining and operationalizing the mandate and objectives.

  In our view the identification of more specific quality objectives should be a prerogative and responsibility of each SAI. To ensure that the SAI addressed quality objectives our suggestion would be that revised standard include an overall criteria to be fulfilled for each component. Based on this and their mandates the SAI would identify additional and more specific quality objectives. The suggested quality objectives (in the revised ISQM1) could be part of the application material.

  If the more specific quality objectives are kept within the standard, we suggest additional application material for public sector auditors (supreme audit institutions). That application material could refer to the independency of supreme audit institutions and the management of the SAIs must evaluate and analyze wither their mandates, laws and regulations and whether the specified quality objectives are relevant for the SAI. If not and they should define their own based on the overall criteria (objective) for each component.

- **Scalability.** The number of quality objectives would make it rather difficult apply scalability and in addition the mandatory processed and procedures that needs to be produced.

> (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:

In our view the proposals generate benefit for engagement quality as intended but not specifically for supporting the appropriate exercise of professional skepticism at the engagement level. This would mainly depend on the culture and tone-at-the top, created by the management and how the firm actively promotes ethics and professional skepticism.

To further strengthen the "professional skepticism" component in ISQM 1 we suggest to address it more specific, for example under

- §9

- Definitions (define professional skepticism)
- §23 a) Component Governance and leadership.

The exercise of professional skepticism would most efficiently be addressed by ensuring that the requirements in the specific audit standard are robust.

(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:

See question 1. We find it challenging to visualize the scalability considering the requirements related to quality objectives, mandatory risk response and development of policies and procedures in addition to firm-specific quality objectives and response etc. Full scalability would only be imposed if the firms are able to identify their own quality objectives, risk assessments related to those objectives and measures to address the specific risks.

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:

Yes, we believe that implementing the standard will be challenging in practice. The process for establishing a quality management system based on the requirements will be quite time consuming when implemented for the first time. It is also very difficult to identify the appropriate level for the risks identified. The application material does not give any specific guidance in this area. There is a risk that the risk identification may be very detailed in some cases and on a very high level for others. But that will depend on the environment for each audit 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:

In general, yes. Though we would suggest moving some of the material from the requirements to the application section. See our responses to specific questions.

Specific Questions

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

Response:

Our suggestion is to exclude risk assessment and monitoring from the components. These both components are more related to the process of QM itself while the other components are more substantially oriented.

We suggest a specific section that prescribes the whole process for identifying objectives, risk identification etc. Thereafter a section on the components. This would provide a clearer overview of the process and perhaps also a shorter Introduction (as some of the paragraphs could be moved to that "process section", §10-12)

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.

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:

In general yew, but we also think that the standard could be more risk-based than it is now. The standard "serves" the firms with generic audit quality objectives and that is not always a good thing.

One way to strengthen the standard objective would be to further guide the firms in defining qualitative objectives for quality. IAASB sets a number of objectives and mandatory responses. The question is whether this drives a "lean back position" by the firms? It woud be tempting to just settle with the basics instead for identifying objectives and responses more relevant for the circumstances. We also believe that this approach would stimulate more proactive work. Though we would support if IAASB set an overall quality objective for each component in the ISQM.

	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:

Se above and in our overall comment (question 1).

In particular:

i. Are the required quality objectives appropriate?

Response:

We find them to be too detailed, for example within the components; Resources, Information and Communication.

For the component Ethics and Independence, the objective could be shortened as a-c are repetitive.

We suggest having an overall quality objective (or general criteria) for each component followed by a requirement to identify firm-specific quality objectives. The more detailed quality objectives specified in the revised ISQM could be moved to application material to demonstrate examples of specific quality objectives.

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.

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

Response:

In general yes. Though the application material is quite repetitive and could be shortened.

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

Response:

Yes.

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:

Not necessary.

There is a risk that the firm settles with the "standardized" quality objectives and also settle with the mandatory responses required by the standard. There is also a risk that the firms may "tailor" the risk to fit the already identified quality objectives and mandatory responses.

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.

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 addition we would like to emphasize the importance of the leadership responsibility to ensure that professional skepticism is applied in all aspects of the audit.

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:

No

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

Response:

No comment.

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

Response:

The issue of technology may not be the most important aspect in the ISQM. It would be more relevant to address technology in other standards, like 315, 330, 520 etc.

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. We also believe that this would enhance **the trust** in the work of auditors.

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:

Yes.

Public sector perspective. Application guidance for significant engagements from a public interest perspective could be the size of fund, requirements in law and regulations, impact on the state/government budget etc.

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

Response:

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:

In general yes, but the requirements could be simplified by moving some of the material to application material.

(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:

Yes.

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

Response:

In general, yes, with a few comments.

1. The definition of deficiency. The definition does not include lack of proper monitoring and follow up procedures, we believe that this also refer to a deficiency.

2. The application material (A. 174 – 177) on the correlation between negative findings and deficiency is a bit confusing and not totally consistent with the definition of deficiency. For example, the negative finding as stated in A175: a finding that indicates that personnel have not adhered to the firm's policies or procedures may be indicative of a deficiency in the culture of the firm.

   We are unsure which of the partial definitions in 19 this refers to?

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

Response:

Yes.

In particular:

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

    Response:

    Yes. But the timing and extend would depend on the type of deficiency identified.

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

    Response:

    Yes.

(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:

Yes, it could be a time issue but this would depend on the overall quality system and the size of the firm.

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:

No comment

14)   Do you support the proposals addressing service providers?

Response:

No comment.

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:

Not relevant for or office.