

EXECUTIVE DIRECTOR

Julie Bell Lindsay

GOVERNING BOARD*Acting Chair***Joe Adams**Managing Partner and CEO
RSM US LLP**Brian P. Anderson**

Corporate Director

Wayne BersonUS CEO and Global Chairman
BDO USA LLP**Jeffrey R. Brown**Professor of Business and Dean
University of Illinois at
Urbana-Champaign
Gies College of Business**Lynne M. Doughtie**U.S. Chairman and CEO
KPMG LLP**Kelly Grier**U.S. Chairman and Managing
Partner, Americas Managing Partner
EY**Barry C. Melancon**CEO, Association of International
Certified Professional Accountants
President and CEO, American
Institute of CPAs**James L. Powers**CEO
Crowe LLP**Bradley J. Preber**Interim CEO
Grant Thornton LLP**Timothy F. Ryan**US Chairman and Senior Partner
PricewaterhouseCoopers LLP**Mary Schapiro**Vice Chair for Global Public Policy
and Special Advisor to the Founder
and Chairman
Bloomberg LP**Joseph B. Ucuzoglu**CEO
Deloitte US

July 1, 2019

Mr. Willie Botha

International Auditing and Assurance Standards Board

529 Fifth Avenue

New York, New York 10017

Re: Exposure Drafts, Proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* and Proposed International Standard on Auditing 220 (Revised), *Quality for an Audit of Financial Statements*

Dear Mr. Botha:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs. This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the proposals included in the International Auditing and Assurance Standards Board's (IAASB or the Board) Exposure Drafts, Proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1), Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED-ISQM 2), and Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality for an Audit of Financial Statements* (ED-220), (collectively the "Proposed Standards"). The CAQ is supportive of the IAASB's efforts to consider ways to strengthen auditing practices to continuously improve audit quality.

We note the importance of a firm's system of quality management to audit quality. We support the Board's efforts to substantively enhance firms' management of engagement quality and at the same time incorporate a new quality management approach that focuses on proactively identifying and responding to risks to quality. We recognize that the Board has been working diligently on this project since it began information gathering in 2014 and appreciate its outreach and responsiveness to concerns raised by key stakeholders. We commend the Board for collaborating with other standard setters as we understand that other jurisdictions are contemplating updates to

their quality control standards. We believe that collaboration is important to promote consistency and alignment of the requirements of quality management standards to minimize unnecessary differences or incremental effort that does not benefit audit quality.

Our views in this letter are organized into the following sections:

- I. Responses to Section 7 Request for Comments of the Overall Explanatory Memorandum
- II. Responses to Section 4 Request for Comments of ED-ISQM 1
- III. Responses to Section 4 Request for Comments of ED-ISQM 2
- IV. Responses to Section 3 Request for Comments of ED-220

I. Responses to Section 7 Request for Comments of the Overall Explanatory Memorandum

- 1) *Do you support the approach and rationale for the proposed implementation period of approximately 18 months after the approval of the three standards by the Public Interest Oversight Board? If not, what is an appropriate implementation period?*

Given the importance of the Proposed Standards and their broad impact, firms require sufficient time for thoughtful and careful implementation. Successful implementation and execution is needed to generate the intended transformational benefits. We agree with the comments in paragraph 25 of the Overall Explanatory Memo that a “rushed implementation may exacerbate risks to quality, lead to increased inspection findings, and would be inconsistent with the objectives of the quality management standards.”

As a result, and given the global reach of the Proposed Standards, we strongly believe that an 18-month implementation period is not practical.¹ We believe an implementation period that would allow sufficient time to achieve compliance with the standards is at least 24 months after the approval of the Proposed Standards by the Public Interest Oversight Board (PIOB). As further explained in our response to ED-ISQM 1 Request for Comment Question 2, there are certain aspects of the Proposed Standards that may create challenges for implementation, which include:

- Making necessary organizational changes,
- Designing and implementing the risk assessment approach,
- Designing and implementing the information and communication requirements,
- Designing, piloting, and implementing an enhanced monitoring and remediation process, and
- Designing, piloting, and implementing the overall evaluation of the system of quality management. This requirement in particular will require time for firms to test new processes to ensure the system is operating effectively prior to the effective date of the standard.

We believe at least an additional six-month implementation period from that proposed by the Board would provide additional time for firms to effectively implement the Proposed Standards while at the same time move forward with implementation in a timely manner.

- 2) *In order to support implementation of the standards in accordance with the IAASB’s proposed effective date, what implementation materials would be most helpful, in particular for small- and medium-sized practitioners (SMPs)?*

Additional implementation materials would be beneficial for SMPs, including those that operate as part of a network. To supplement a clear and appropriately principles-based standard, the IAASB should also consider periodic webinars during the transition period to provide the opportunity for firms to ask the IAASB questions and the FAQs should be updated on an on-going basis as new questions arise.

¹ Overall Explanatory Memo, paragraph 25.

II. Responses to Section 4 Request for Comments of ED-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 principle of a quality management approach. While we generally support ED-ISQM 1 and the overall approach to quality management, we offer in this letter specific recommendations for the Board's consideration to clarify the Board's intent related to certain requirements. Our comments are also provided to assist the Board in finalizing a standard that can be implemented in a risk-based manner by firms of all sizes.

(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?*

We agree that many aspects of the firm's system of quality management support the exercise of professional skepticism at the engagement level. While we support the emphasis on professional skepticism in paragraph 36(b) of the Engagement Performance component, other components of a firm's system of quality management also contribute to or support the application of professional skepticism. We encourage the Board to consider emphasizing the exercise of professional skepticism in other components.

Further, we believe that greater clarity in ED-ISQM 1 would contribute to more consistency in expectations on how far an auditor needs to go to demonstrate the skeptical mindset. Professional skepticism is defined in ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, which requires "a questioning mind" and a "critical assessment of audit evidence." In the CAQ's view, to be operational, these concepts of a questioning mind and critical assessment need to be supplemented with clear direction and practical application examples on what behaviors, actions, and documentation constitute appropriate professional skepticism in executing an auditor's responsibility across a range of risk scenarios.² This could include, for example, emphasis in ED-ISQM 1 that a firm's methodology and guidance, supported by training and incentives, can promote awareness of possible impediments to the exercise of professional skepticism and how to address such impediments.

(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 believe the flexibility provided to apply ED-ISQM 1 is critically important to its scalability, in particular the acknowledgement that a firm may use different terminology or frameworks to describe

² CAQ comment letter to IAASB dated May 16, 2016, [Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#).

the components of its system of quality management. Each firm may structure their system differently to effectively manage and support quality based on the nature and circumstances of the firm. Should the flexibility provided in ED-ISQM 1 differ in the final standard, the scalability could be negatively impacted.

Prescriptive required responses reduce the overall scalability of ED-ISQM 1. We have provided examples of those instances and recommendations throughout our letter to enhance the overall scalability.

- 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?*

While we support the overall objective of ED-ISQM 1, certain aspects of the proposed standard are likely to create implementation challenges. These implementation challenges further support our comments that an implementation period of at least 24 months after PIOB approval of the Proposed Standards is needed. Some of those challenges may include:

- Implementing changes to the organizational structure of the firm.
 - Designing and validating a risk assessment process that is:
 - appropriately tailored, and
 - capable of being applied across a regional, national, or global network.
 - Designing, developing or enhancing, and implementing policies, procedures, tools, and systems across the organization and global network, if applicable.
 - Enhancing documentation, system capabilities, and reporting to support the requirements of the Proposed Standards and the overall evaluation of the system of quality management. This will involve various functions including human resources, information technology, risk management, and others.
 - Designing and implementing an enhanced monitoring solution, including monitoring of network and member firm responses, performing root cause analyses, and performing remediation.
 - Developing or refining the annual assessment processes, including establishing a framework for evaluating deficiencies.
 - Communicating with and managing expectations of smaller firms within a large international network.
- 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?*

Certain statements and graphics included in the Explanatory Memo section of ED-ISQM 1 are beneficial to assist in understanding the Board's intent or clarifying how the requirements are expected to be implemented. We provide examples throughout our letter of information from the Explanatory Memo to ED-ISQM 1 that we recommend including in the final standard or application material.

Specific Questions

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

Overall, we support the eight components and the structure of ED-ISQM 1. We also believe that firms can achieve the objectives and requirements of ED-ISQM 1 without organizing their system according to these discrete components.³ This flexibility provided within ED-ISQM 1 is critically important to effectively manage and support quality, including from a scalability perspective. For example, a firm may have different names for their components, may combine or have additional components, or may structure their system in a different way (e.g., across functional areas of the firm) and still be able to meet the objectives of ED-ISQM 1. Should the flexibility provided in ED-ISQM 1 differ in the final standard, we would have concerns as the scalability could be negatively impacted.

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 support the objective of ED-ISQM 1, including the objective of the system of quality management. We agree with and support how ED-ISQM 1 explains the firm's role relating to the public interest (i.e., that the public interest is served by the consistent performance of quality engagements). It is clear how achieving the objective of ED-ISQM 1 relates to the firm's public interest role.

We encourage the Board to include paragraphs 16 and 17 (including the graphic) of the Explanatory Memorandum to ED-ISQM 1 in the application material or FAQ materials to support paragraph 18 of ED-ISQM 1.

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 should be applied to the other components of the system of quality management.

(b) *Do you support the approach for establishing quality objectives? In particular:*

i. *Are the required quality objectives appropriate?*

The required quality objectives are appropriate. We suggest the Board consider ways to assess the appropriateness of the required quality objectives through post-implementation review activities.

³ As noted in the Explanatory Memorandum to ED-ISQM 1, paragraphs 13 and 26.

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

We agree with the Board's view expressed in paragraph 29 of the Explanatory Memo to ED-ISQM 1 that "the quality objectives in ED-ISQM 1 are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved." We strongly encourage the Board to include this language in paragraphs A49-51 of the application material and add the concept into FAQ #3.

While we understand firms are expected to establish additional quality objectives beyond those required by the standard in certain circumstances, we would expect those circumstances to be limited. It may be useful to add this statement to the application material to clarify the Board's expectations.

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

We generally support the principle of identifying and assessing quality risks. This is an important part of the system of quality management that will require sufficient time to implement effectively. However, we question whether it is necessary for the process of identifying and assessing quality risks to align with the principles in the IAASB's recently published Exposure Draft, ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatements* as noted in paragraph 32 of the Explanatory Memorandum to ED-ISQM 1. While we support a risk-based approach in both proposed standards, we believe the approach to identifying and assessing quality risks may differ compared with identifying and assessing risks of material misstatement in the context of an audit.

As it relates to paragraphs 28 and 29 of ED-ISQM 1,⁴ firms may not undertake these requirements in two separate steps. Further, the identification and assessment of quality risks is likely to be an iterative process. We believe firms will benefit from having flexibility in developing an approach to meet the requirements of these paragraphs. Therefore, we encourage the Board to strengthen the language used in A53 to state "~~In some circumstances,~~ The identification and assessment of quality risks may be undertaken concurrently."

- (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?*

We support the approach that requires the firm to design and implement responses to address the assessed quality risks. If a firm appropriately defines its quality objectives and risks, this would promote the design of responses that are appropriately tailored to the assessed risks, including, where applicable, additional responses that are necessary to

⁴ ED-ISQM 1 states:

28. Based on the understanding obtained in paragraph 27, the firm shall identify those quality risks, before consideration of any responses, that:

(a) Have a reasonable possibility of occurring; and
(b) If they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective(s).

29. The firm shall assess the quality risks identified in paragraph 28 to provide a basis for the design and implementation of the related responses.

address risks identified by the firm. This is an important part of the risk assessment process that will require sufficient time to implement effectively.

We find the concept included in paragraph 36 of the Explanatory Memo to ED-ISQM 1 that analogizes responses to controls useful. We encourage the Board to reflect this concept in paragraphs A59-64 of the application material. We believe that providing this information in the application material will better enable firms to design and implement responses to assessed quality risks that can be effectively monitored.

- 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?*

Paragraph 10 is clear which states, “However, the responses required by this ISQM alone will not be sufficient to address all the firm’s assessed quality risks for the quality objectives that are required to be established by this ISQM.” Paragraph A59 is also clear on this point. We believe it would be useful for paragraph 30 to state explicitly that additional responses are required for consistency and completeness. Suggested revisions that might make the requirement more clear are as follows:

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.

- 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 support the revisions to the standard related to this component.

- 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 support the proposed requirements in ED-ISQM 1. While assigning responsibility for compliance with independence requirements to an individual is arguably prescriptive, we recognize the importance and complexity of independence rules. Further, we believe this already occurs in practice and therefore we do not object to this requirement. We do not believe any further responsibilities for relevant ethical requirements should be assigned as these requirements are broad and firms may operationalize oversight of compliance with such requirements differently.

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

We agree ED-ISQM 1 appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons within the network.

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

ED-ISQM 1 adequately deals with the modern auditing environment, including the use of different audit delivery models and technology. As currently written, the standard and related application guidance neither inhibit nor mandate the use of technology on an audit and is sufficiently flexible.

However, the standard should be clarified to state that the technological resources that are to be evaluated and documented as part of the system of quality management are limited to those that are **designed** to enable the system of quality management and the performance of engagements.

We believe that, by indicating that the scope is those resources designed to enable the system of quality management and the performance of engagements, this clarifies which technological resources are in scope of ISQM 1 and that the scope does not include applications such as email, as mentioned in the FAQ materials. This change should be appropriately reflected in the supporting application materials and FAQs as appropriate.

- 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?*

We support the principle that the firm should determine when it is appropriate to communicate with external parties. A principles-based approach that provides flexibility is important. The needs of external parties vary, and firms should have the ability to tailor communications based on the demand of such parties. While the CAQ advocates for transparency in general, we suggest deleting the reference to "transparency reports" in ED-ISQM 1 paragraph 41(c)(iv) as it could be construed that these types of reports are required, which would be a change from current practice.

We encourage the Board to consider including the language from paragraph 57 of the Explanatory Memorandum to ED-ISQM 1 in the application material, which states that transparency reports are not required.

- 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?*

Overall, we are supportive of the proposals addressing the scope of engagements that should be subject to an engagement quality review. However, we recommend the following:

- To reduce ambiguity and maintain flexibility, consider providing additional clarity in the application material of example characteristics that could be used to distinguish a 'public interest entity' from 'entities that the firm determines are of significant public interest.' An entity that is of 'significant public interest' is not defined and the application guidance is not clear. Firms may develop tools or a framework to implement this requirement; therefore, additional clarity would be helpful to promote consistent application.

- In addition, there could be unintended independence consequences in jurisdictions where an entity is identified as one of ‘significant public interest’ for the purposes of ED-ISQM 2 but not defined as a public interest entity for the purposes of the independence requirements. We understand and agree with the Board’s intent not to assume that all public interest entities require an engagement quality review because of the variation in the definition of this term globally. However, we recommend the IAASB coordinate with the International Ethics Standards Board for Accountants (IESBA) to determine whether this requirement may be viewed to be imposing additional independence requirements.
- Consider deleting the sentence in paragraph A102, which states “Entities that the firm determines to be of significant public interest may include entities such as financial institutions (e.g., **certain** (*emphasis added*) banks, insurance companies, and pension funds), and other entities such as **certain** (*emphasis added*) not-for-profit organizations”. We suggest this deletion to avoid the implication that all insurance companies and pension funds are of “significant public interest,” as it is unclear to which category of entity the adjective “certain” applies. Further, in some jurisdictions, application guidance is interpreted to be requirements and this language could trigger unintentional de facto requirements causing inconsistency in implementation and incremental effort by some firms without a corresponding benefit.

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?*

As a whole, we believe the proposals will promote proactive and effective monitoring activities. However, the proposal likely will create significant implementation challenges from the perspective of the time it could take to design and implement a redesigned monitoring and remediation process, which is one reason we strongly recommend an effective date for the Proposed Standards of at least 24 months after approval by the PIOB.

- (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?*

- Monitoring completed portions of in-process engagements often may be more proactive and preventive than monitoring completed engagements. Inspecting completed engagements is one of many tools available to firms to monitor the system of quality management. The requirement of paragraph 45(b), although in place today, is prescriptive and not sufficiently risk-based when compared to the objectives of a quality management approach.⁵ It may dissuade

⁵ ED-ISQM 1 paragraph 45(b) states:

The firm’s monitoring activities shall include the inspection of engagements to determine whether the responses that are required to be implemented at the engagement level have been implemented. Engagement inspections may include the inspection of in-process or completed engagements. In determining the nature, timing and extent of the inspection of engagements, the firm shall:

firms from evolving to enhanced real-time ways of monitoring. Therefore, we would support eliminating this requirement. If the Board determines it is important to keep this requirement, we strongly support retaining the proposed language “on a cyclical basis determined by the firm.” We believe the ability for the firm to determine the cyclicality improves the flexibility and scalability of this requirement. Paragraph 66(c) of the Explanatory Memorandum to ED-ISQM 1 explains well the Board’s thinking related to determining the length of the cycle. We recommend this language be included in the final standard to help practitioners understand the flexibility intended.⁶

- As it relates to ED-ISQM 1 Application and Other Explanatory Material paragraph A169, we recommend:
 - The Board refer to the *risk* of the engagement performed and not necessarily the *category* of engagement performed when determining the basis for the cycle length. While there may be a correlation between risk and category, we believe focusing on risk is more appropriate. Therefore, we suggest deleting the references to the “audit” and “compilation” categories.
 - We suggest deleting the reference in the application guidance to “every three years” for audits of financial statements as this could be viewed as more prescriptive than intended given its placement in the application guidance, which may detract from the flexibility the Board intends.

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

- We do not believe the definition of deficiencies, included in ED-ISQM 1 paragraph 19(a), is clear. The proposed definition varies from those commonly used in other frameworks such as the American Institute of CPAs Standards for Performing and Reporting on Peer Reviews.⁷ Having common and well understood definitions could contribute to the consistent application of the standard.
- It is unclear in the ED-ISQM 1 how to evaluate deficiencies in determining whether the system of quality management provides reasonable assurance that the objectives of the standard have been achieved. While we believe it is appropriate for firms to apply professional judgment in reaching an overall determination, additional guidance would promote consistency in

(a) Take into account the relevant factors in paragraph 44; and

(b) Include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.

⁶ As noted on page 22 of ED-ISQM 1, paragraph 66(c) states: Although the firm is still required to inspect one completed engagement per engagement partner on a cyclical basis, more emphasis has been given to the fact that the firm determines the length of the cycle. The application material provides examples of factors that the firm may consider in determining the length of the cycle, which includes the extent to which the firm performs other monitoring activities (e.g., inspections of in-process engagements) and the nature and circumstances of the engagements. The application material also acknowledges that the cycle may vary across engagement partners, for example, the cycle may be more frequent for engagement partners who perform audits of financial statements of listed entities.

⁷ See American Institute of CPAs Standards for Performing and Reporting on Peer Reviews, [Section 1000](#).

application. For example, when evaluating the effectiveness of a company's internal control over financial reporting, there is a framework for assessing the severity and impact of exceptions. There is defined terminology such as significant deficiency and material weakness that aids in the evaluation of exceptions.

- We suggest the Board add the definition of the term "finding" included in A172 to ED-ISQM 1 paragraph 19.
- We recommend the Board emphasize positive findings in the proposed requirements of ED-ISQM 1 paragraph 47, which states, "The firm shall establish policies or procedures addressing the evaluation of the findings arising from the monitoring activities, the results of external inspections and other relevant information to determine whether deficiencies exist, including in the monitoring and remediation process."

As the Board noted in A173, we agree that positive findings "may be useful to the firm as they indicate practices that the firm can support or apply more extensively, for example, across all engagements." We believe the proposed standard would be strengthened if the term "positive" findings is included in paragraph 47 and not only included in the application guidance.

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

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

We agree with the new requirement for the firm to investigate the root cause of deficiencies and believe the nature, timing and extent of the procedures to investigate the root cause is sufficiently flexible. It may be useful for the Board to clarify in the application material that findings do not require a root cause analysis, as noted in the Explanatory Memo to ED-ISQM 1, paragraph 71.

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

We agree with the IAASB's approach to describe the benefits of investigating the root cause of positive findings in the application guidance rather than to require firms to determine the root cause of positive findings. This approach provides firms with the flexibility to identify the number and types of positive findings to explore further.

(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?*

We encourage the Board to provide more guidance related to what might trigger a need to complete an evaluation more frequently than annually. Further, we suggest clarifying in the application material that the Board contemplated the annual evaluation to be "at the point in time the evaluation is undertaken" as noted in the Explanatory Memo to ED-ISQM 1, paragraph 75. In other words, the annual evaluation is expected to be "as of" a specified date and not for a specific period ended. Lastly, as noted above in our response to Question 12(c), it is unclear how to evaluate deficiencies

in determining whether the system of quality management provides reasonable assurance that the objectives of the standard have been achieved. While we believe it is appropriate for firms to apply professional judgment in reaching an overall determination, additional guidance such as a principles-based evaluation framework could promote consistency in application.

- 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 believe addressing networks is important to achieving the objectives of the ED-ISQM 1 and support the proposed requirements. We expect firms will develop policies and procedures to comply with these requirements that may include obtaining information at an aggregate level. ED-ISQM 1 is sufficiently flexible.

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

We generally support how the proposal addresses service providers. However, we encourage the Board to consider providing additional guidance to help firms appropriately scale this requirement based on various characteristics of the service provider, including the scope of services it provides. For example, including a discussion about how firms might be expected to apply the requirement to a well-known and reputable service provider compared to a newer, lesser-known service provider could be instructive.

Further, it may be challenging for firms to obtain certain information from service providers as described in the application material. We recommend that the IAASB perform outreach to service providers of technological resources to determine what is reasonable for firms to obtain (i.e., operations manual, service organization control reports) and update the standard and implementation materials accordingly.

- 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 do not object to the change in title to “ISQM.”

III. Responses to Section 4 Request for Comments of ED-ISQM 2

1) *Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?*

- We support creating a separate quality management standard that focuses on the engagement quality reviewer's (EQR) roles and responsibilities. The consolidation of the EQR responsibilities that currently reside in extant ISA 220, *Quality Control for an Audit of Financial Statements* and the eligibility and selection requirements from extant *International Standard on Quality Control 1, Quality Control for Firms that Perform Audits or Reviews, of Financial Statements, or Other Assurance or Related Services Engagements* makes logical sense.
- The interrelationship between ED-ISQM 1 (which outlines the requirements of when an EQR's review is performed) and ED-ISQM 2 (which details the roles and responsibilities of the EQR) emphasizes the importance of the EQR's review as part of a system of quality management – an engagement quality review is one type of response that a firm can use to address the risks of achieving quality at the engagement level.
- Because ED-ISQM 2 addresses requirements for both the firm and the EQR, we recommend expanding the objective in paragraph 10 of ED-ISQM 2 to describe the objectives of the EQR in performing his or her review. For example, the Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) 1220, *Engagement Quality Review* (AS 1220), paragraph .02 states:

The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.

2) *Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?*

Overall, the linkage is clear as this is highlighted in paragraph 2 of ED-ISQM 2; however, in certain instances, the linkage could be strengthened. For example, ED-ISQM 1 paragraph 38(b) refers to the engagement partner (and staff) "**being given** (*emphasis added*) sufficient time" to perform the review, while ED-ISQM 2 paragraph 16(a) states that "policies and procedures shall require that the engagement quality reviewer... **have** (*emphasis added*)... sufficient time." In ED-ISQM 2, the firm's responsibility to ensure the EQR has "sufficient time" is not acknowledged.

3) *Do you support the change from "engagement quality control review/reviewer" to "engagement quality review/reviewer?" Will there be any adverse consequences of changing the terminology in respondents' jurisdictions?*

We support the change and do not foresee any adverse consequences to changing the terminology.

- 4) *Do you support the requirements for eligibility to be appointed as an EQR or an assistant to the EQR as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?*

We support the requirements for eligibility to be appointed as an EQR or an assistant to the EQR.

- (a) *What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?*

We recommend additional clarity related to the “cooling off” period. The guidance should include any relevant distinctions among “cooling off” periods for different types of entities subjected to audit services provided by accounting firms which require an engagement quality review as outlined in ED-ISQM 1 paragraph 37(e) (e.g., listed entities versus those determined by the firm would have varying degrees of risk resulting in varied cooling off periods). This will help firms develop risk-based, scalable policies and procedures to comply with the requirements.

- (b) *If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?*

We support that such guidance should be updated and located in ED-ISQM 2 and to the extent possible, the IESBA Code also should be updated and align with ED-ISQM 2. Most importantly, guidance in ED-ISQM 2 and the IESBA Code should not be contradictory.

- 5) *Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in ED-220?*

Overall, we support the requirements related to the nature, timing, and extent of the EQR’s procedures and that they are appropriate; however, we recommend the following:

- In paragraph 22(c), the phrase “identifying significant judgments” could be viewed as expanding the role of the EQR beyond what is intended. Consider replacing “identifying” with “evaluating” consistent with PCAOB AS 1220, paragraphs .02 and .10a.
- Paragraph 22(f) requires the EQR to “evaluate the basis for the engagement partner’s conclusion” on the achievement of audit quality on the engagement. The requirements and application guidance of ED ISQM-2 do not provide a sufficient framework to execute this requirement effectively. We recommend the following:
 - Delete paragraph 22(f) and update paragraph 23 as follows:

~~If the~~The engagement quality reviewer shall notify the engagement partner if the engagement quality reviewer has concerns that:

(a) the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate, or

(b) for audits of financial statements, that the basis for the engagement partner’s conclusion that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement is not appropriate.

If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer shall notify an appropriate individual(s) in the firm that the engagement quality review cannot be completed.

- Regardless of whether the Board finds it appropriate to collapse the requirement in 22(f) into paragraph 23, we recommend deleting the current application guidance in ED-ISQM 2 paragraphs A33-34. Currently, it is a reference to the engagement partner's responsibilities as outlined in ED-220 and other pronouncements which could imply that the EQR is required to re-perform the responsibilities of the engagement partner. The application guidance should provide a framework for the EQR to determine whether the engagement partner's conclusion that (s)he has taken overall responsibility for managing and achieving quality on the audit engagement is appropriate.

- 6) *Do you agree that the engagement quality reviewer's evaluation of the engagement team's significant judgments includes evaluating the engagement team's exercise of professional skepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?*

Overall, we support the enhanced discussion around professional skepticism as this further reinforces the requirement that the EQR must maintain objectivity in his or her role; however, we recommend the following:

- The emphasis with respect to professional skepticism should be refined to highlight that the EQR's responsibility is to consider whether the engagement team appropriately exercised professional skepticism. While all auditors, including the EQR, are required to be professionally skeptical, the EQR uses professional judgment when making his or her assessment of the significant judgments made by the engagement team and the engagement team's related conclusions reached in forming the overall conclusion on the engagement as a whole.
- While acknowledging in certain, although likely rare, cases that the objectivity of the EQR may be affected by extensive interaction with the engagement team, we recommend including application guidance that emphasizes the benefits of such interaction such as not to discourage collaborative discussions between the EQR and the engagement team that would support audit quality.

- 7) *Do you agree with the enhanced documentation requirements?*

Overall, we support the enhanced documentation requirements; however, we recommend the following:

- The use of the term "complete" in paragraph 24 of ED-ISQM 2 to describe the fulfillment of the EQR's requirements may not be consistently applied. There is a risk that "complete" may not indicate that open issues have been appropriately resolved. We suggest clarifying in paragraph 24 that the EQR is required to provide the engagement partner "concurring approval for issuance only if, after performing with due professional care the review required by the standard, he or she is not aware of a significant engagement deficiency."⁸
- The requirement proposed above to obtain "concurring approval for issuance..." (or as revised based on the Board's final determination) from the EQR should be clarified as a responsibility of

⁸ We note this is consistent with PCAOB requirements included in AS 1220.12.

the engagement partner in both ED-ISQM 2 and ED-220 and the language in ED-220 paragraph 33(d) and ED-ISQM 2 paragraph 24 should conform as appropriate.

- 8) *Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?*

We support the requirements and guidance establishing a scalable system to implement the policies and procedures used to determine eligibility requirements and selection of the EQR reviewers assigned to an engagement.

Other Recommendation

The term impairment is used broadly in paragraph 19 of ED-ISQM 2. To give prominence and provide clarity, consider including in the requirements of the standard the factors detailed in paragraph A20 that may be relevant in considering whether the eligibility of an EQR has been impaired. Further, paragraph A20 should state that the factors listed are examples or indicators of impairment but do not automatically mean impairment exists.

IV. Responses to Section 3 Request for Comments of ED-220

- 1) *Do you support the focus on the sufficient and appropriate involvement of the engagement partner, as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?*

Overall, we support the focus on sufficient and appropriate involvement of the engagement partner as part of taking overall responsibility for managing quality on the engagement, but certain requirements would significantly increase the amount of work required to be performed, without a commensurate increase to audit quality. In our view, the level of prescription in certain requirements is in direct conflict with the fundamental premise in paragraph A30 of ED-220 that it will generally not be possible or practicable for all of the requirements in ED-220 to be dealt with solely by the engagement partner. As a result, we recommend the following:

- Paragraphs 13(a) and 13(b) are overly prescriptive for a principles-based standard. We propose the following:
 - Remove paragraphs 13(a) and 13(b).⁹
 - Elevate the concept of delegating authority from the application guidance in A30 into the requirements or introductory section of ED-220 and consider whether it is clear in each requirement and related application material what responsibilities can or cannot be delegated.
 - Anchor the requirements of the engagement partner’s “monitoring” responsibilities in a risk-based framework that ensures “adequate involvement” by the engagement partner.
 - Provide additional examples of performing an effective and efficient review to supplement the new guidance proposed in ED-220 paragraph A30.
- The Board has commenced a project to revise and enhance ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*. Given the potential impact that the principles in ED-220 have on those that govern a group audit, we recommend that the Board align these standards where appropriate to achieve its intended objectives. We are concerned that the practical implications of the proposed revised responsibilities of the engagement partner when applied to group audits conducted in accordance with ISA 600 have not been sufficiently evaluated. Further, we recommend that supplemental guidance be issued in the interim period between the issuance of ED-220 and the issuance of revised ISA 600. This interim guidance should highlight that the engagement partner’s responsibilities for group

⁹ ED-220 paragraphs 13(a) and 13(b) state:

13. If the engagement partner assigns procedures, tasks or actions to other members of the engagement team to assist the engagement partner in complying with the requirements of this ISA, the engagement partner shall continue to take overall responsibility for managing and achieving quality on the audit engagement. When assigning procedures, tasks or actions to other members of the engagement team, the engagement partner shall:
- (a) Appropriately inform assignees about the nature of their responsibilities and authority, the scope of the work being assigned, the objectives thereof and any other necessary instructions and relevant information; and
 - (b) Monitor the performance of the work of assignees and review selected related documentation in order to evaluate the conclusions reached.

audits will continue to be in accordance with extant ISA 600 as the requirements in ED-220, as currently written, may not align with the requirements in extant ISA 600.

- 2) *Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm's policies and procedures and the material referring to when the engagement partner may depend on the firm's policies or procedures?*

Overall, we support the linkage with the ISQMs to emphasize the importance of the engagement partner's and engagement team's role in promoting audit quality; however, we recommend the following:

- As written, the application guidance outlined in ED-220 paragraph A8 states “the engagement partner **may depend** (*emphasis added*) on the firm's policies or procedures in complying with the requirements of this ISA” which understates the process outlined in ED-ISQM 1. ED-ISQM 1 requires the firm to inform, communicate, and monitor the design, implementation, and operation of the system of quality management, which encompasses the adherence to policies and procedures. Specifically, paragraph 40(b) in ED-ISQM 1 states that “the firm communicates relevant and reliable information to personnel, the nature, timing and extent of which is sufficient to enable personnel to understand and carry out their responsibilities related to the performance of engagement or activities within the system of quality management.”

Based on this understanding of the requirements of ED-ISQM 1, it is not clear if A8 is intended to require all engagement partners to determine whether the engagement partner can depend on the firm's policies and procedures in complying with the requirements of ED-220. We believe ED-220 paragraph A8 should be written to clarify that compliance with ED-220 paragraph 4(a) entitles an engagement partner to rely on the firm's policies and procedures, unless information provided by the firm or other parties suggests otherwise, consistent with extant ISA 220.

- In instances where the engagement partner has been made aware of issues around the design, implementation, and operation of the system of quality management, we recommend providing additional guidance in ED-220 paragraph A9. The guidance should include factors for the engagement partner to consider in determining the extent of procedures necessary and the level of documentation required to evidence the conclusions reached. We believe this would increase scalability and reduce the risk of a one-size-fits-all approach to meeting the requirements.
- 3) *Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level?*

Overall, we support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level; however, we recommend the following:

- In certain jurisdictions, application guidance is interpreted to be de facto requirements. In paragraphs A27 and A29, the list of impediments to the exercise of professional skepticism and possible actions that engagement partners may take to deal with such impediments, respectively, could be interpreted as a list of instances that always give rise to an impediment of professional skepticism and a checklist of required actions when such instances are encountered, respectively.

- Consider clarifying that paragraph A27 lists examples of potential impediments and does not necessarily indicate that professional skepticism cannot be exercised when such impediments exist.
 - Consider additional application guidance in paragraph A29 that identifies factors for the engagement partner to consider when evaluating the extent of procedures performed when impediments to professional skepticism are identified. We believe this would increase scalability and reduce the risk of a one-size-fits-all approach.
 - The application guidance in paragraph A103 should be elevated into the standard such that documentation “when dealing with circumstances that may pose risks to... the exercise of professional skepticism” is required.
- 4) *Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?*

Overall, we agree that ED-220 adequately deals with the modern auditing environment, including the use of different audit delivery models and technology. As currently written, the standard and related application guidance in A56–58 do not inhibit nor mandate the use of technology on an audit and is sufficiently flexible; however, we propose the following:

- The phrase “engagement resources” in paragraph 23 of ED-220 is vague. We encourage the Board to consider including the types of resources outlined in A52 in the requirements of the standard to highlight that “engagement resources” include “technological resources,” as well as “intellectual resources.”
- The definition of “engagement team” based on the Explanatory Memorandum to ED-220 has been expanded to recognize the evolving organization of engagement teams. There are potential unintended consequences with respect to this expansion. We propose that the overall definition of the “engagement team” be re-assessed to ensure it is consistent across all ISAs. For example, as the modern auditing environment evolves, new types of specialists such as data specialists could be employed by a firm and current ISAs such as ISA 620, *Using the Work of an Auditor’s Expert*, may need to evolve.
- Paragraph 26 of ED-220 should be further enhanced to more clearly state that specific technological resources used by the engagement team that are not addressed within the firm’s policies and procedures are the responsibility of the engagement partner. For such technological resources, the engagement partner should have a responsibility to determine that such technological resources have been designed, implemented, and maintained properly, taking into account how the resources are intended to be used on the engagement.

5) *Do you support the revised requirements and guidance on direction, supervision and review?*

Overall, we support the revised requirements and guidance on direction, supervision and review; however, we recommend the following:

- Please see response to question 1 related to ED-220 detailing comments on the documentation required to be reviewed by the engagement partner when (s)he assigns procedures, tasks, or actions to other members of the team.
- Paragraph 31 requires the engagement partner to review “any formal written communications to management, those charged with governance, or regulatory authorities.” In a group audit situation, this requirement would significantly increase the work required from current practice, as it implies that the group engagement partner is required to review all communications from all component teams to component management, the component audit committee and others. We believe clarification of the intent of this requirement is necessary, including whether such reviews can be assigned to others (e.g., the engagement partner at the component).

6) *Does ED-220, together with the overarching documentation requirements in ISA 230, Audit Documentation, include sufficient requirements and guidance on documentation?*

Overall, we support the documentation requirements in ED-220 together with the overarching documentation requirements in ISA 230; however, please see response to question 2 related to ED-220 detailing comments on the documentation required to support the audit partner’s reliance on the firm’s policies and procedures and the following recommendation:

- The use of the term “completion” in paragraph 33(d) of ED-220 to describe the engagement partner’s responsibility over the work performed by the EQR may not be consistently applied. There is a risk that “completion” may not indicate that open issues have been appropriately resolved. We suggest clarifying in paragraph 24 that the EQR is required to provide the engagement partner “concurring approval for issuance only if, after performing with due professional care the review required by the standard, he or she is not aware of a significant engagement deficiency.”¹⁰
- The requirement proposed above to obtain “concurring approval for issuance...” (or as revised based on the Board’s final determination) from the EQR should be clarified as a responsibility of the engagement partner in both ED-ISQM 2 and ED-220 and the language in ED-220 paragraph 33(d) and ED-ISQM 2 paragraph 24 should conform as appropriate.

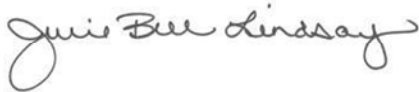
7) *Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?*

Overall, for smaller engagements, complying with the review requirements in ED-220 as outlined are achievable, but as engagements and engagement team structures increase in complexity and size, compliance becomes increasingly challenging. Please see responses throughout this letter highlighting areas where scalability will be challenging to achieve on audits of increasing complexity and size (e.g., group audits, multi-location audits).

¹⁰ We note this is consistent with PCAOB requirements included in AS 1220.12.

We appreciate the opportunity to comment on the Proposed Standards. As the IAASB gathers feedback from other interested parties, we would be pleased to discuss our comments or answer any questions that the IAASB may have regarding the views expressed in this letter.

Sincerely,



Julie Bell Lindsay
Executive Director
Center for Audit Quality

cc:

IAASB

Thomas R. Seidenstein, Chairman

SEC

Sagar Teotia, Acting Chief Accountant
Marc A. Panucci, Deputy Chief Accountant

PCAOB

William D. Duhnke III, Chairman
J. Robert Brown, Jr., Board Member
Duane M. DesParte, Board Member
Kathleen M. Hamm, Board Member
James G. Kaiser, Board Member
Megan Zietsman, Chief Auditor and Director of Professional Standards