

## Summary of potential matters for inclusion in a submission to IAASB

The International Auditing and Assurance Standards Board (IAASB) released Exposure Drafts and Explanatory Memorandums on proposed International quality management standards in early February 2019, with submissions due on 1 July 2019.

Technical Staff support the overall aim of the proposed standards to enhance consistent engagement quality, however there are a number of concerns summarised below.

### Scalability and Implementation of ED-ISQM 1

A focus of the IAASB in developing ED-ISQM 1 was to develop a “*new approach to managing quality that is scalable to deal with differences in the size and nature of firms and the services they provide*”.<sup>1</sup> ED-ISQM 1 seeks to achieve scalability by the development of a tailored approach and that entities do not have to comply with requirements that are not relevant to the nature and circumstances of the firm or its engagements.<sup>2</sup> It moves from the current system of quality control (per *International Standard on Quality Control 1 (ISQC 1)/APES 320 Quality Control for Firms (APES 320)*) to a system of quality management (SQM). This involves a “*transition from policies and procedures that address standalone elements [extant ISQC 1/APES 320] to an integrated approach that reflects the system as a whole*”.<sup>3</sup>

Technical Staff consider this to be a significant shift from extant requirements which may create a compliance burden (most notably for small to medium practitioners (SMPs)) particularly with implementation and in ongoing obligations.

### Implementation of the Risk Assessment Process

The proposed principles-based approach and risk assessment process in ED-ISQM 1 aims to enable firms to design and implement tailored quality management systems, scalable to their circumstances and engagements. However, Technical Staff are concerned about the potential cascading effect of the requirements under ED-ISQM 1 as follows:

- There are 8 components to the standard and Firms are required to establish quality objectives for 7 of these components (excluding the Risk assessment Process), which are stipulated in the standard (approximately 4 on average per component) and possibly others if required to achieve the overall objective of the standard;
- Firms must identify and assess their own quality risks (no risks are prescribed), being risks that may adversely affect the achievement of quality objectives; and
- Responses to address assessed quality risks are required to be designed and implemented beyond the 32 responses stipulated in the standard, as prescribed responses are identified as not being comprehensive and that additional responses will be required.

The IAASB notes “*it would not be possible to comprehensively address all of the responses needed by firms in the standard, given the varying nature and circumstances of firms and the engagements they perform*”<sup>4</sup>. It is unclear how many responses may be required to be designed and implemented by any particular Firm; however, this could be significant and vary greatly between Firms. Even assuming certain quality objectives may not be relevant and/or

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<sup>1</sup> Explanatory Memorandum to ED-ISQM 1, page 28.

<sup>2</sup> ED-ISQM 1, section 21.

<sup>3</sup> Explanatory Memorandum to ED-ISQM 1, page 6.

<sup>4</sup> Explanatory Memorandum to ED-ISQM 1, page 15.

responses may address two or more assessed quality risks, the cascading impact could be substantial. Further, although ED-ISQM 1 requirements only need to be implemented if relevant, the Firm would still likely need to determine all potential quality objectives, quality risks and responses before deciding if any requirements are not applicable.

### Potential Ongoing Impacts

The proposals in ED-ISQM 1 for ongoing monitoring and remediation are intended to improve the robustness of the SQM, including additional or enhanced requirements to those in extant ISQC 1/APES 320 such as<sup>5</sup>:

- More proactive and effective monitoring with emphasis on tailoring activities to the Firm's circumstances and engagements;
- Monitoring all aspects of the SQM not just completed engagements;
- Evaluating findings, identifying deficiencies, investigating root causes and remediating deficiencies;
- Communicating to personnel and externally where required; and
- Annually evaluating the SQM as to whether it provides reasonable assurance of achievement of standard's overall objective.

ED-ISQM 1 is designed to be a "*continual and iterative process responsive to change*"<sup>6</sup>, however, Technical Staff are concerned this may lead to continuous re-evaluations as circumstances or risks change in addition to annually evaluating the effectiveness of the SQM.

### **Mapping of Extant Requirements to ED-ISQM 1**

Technical Staff understand that at this stage IAASB have not developed a mapping of extant requirements to the new requirements in ED-ISQM 1 or how existing systems of quality control could be adapted to comply with SQM requirements. There is a significant concern as without such mapping, Firm's may discard current systems or not understand the differences in requirements, potentially adding to the cost of implementation. The responses in the new framework require policies and procedures to address quality risks and the Firms may have these already developed under the existing quality control framework.

### **Cost/Benefit Analysis**

As detailed above, there will be significant additional costs for implementation and ongoing compliance with ED-ISQM 1. However, Technical Staff understand that IAASB has not undertaken an analysis to date which compares the expected improvements to quality from the introduction of the proposed standards to potential additional implementation costs to be incurred by a Firm and in particular a SMP.

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<sup>5</sup> Explanatory Memorandum to ED-ISQM 1, page 21.

<sup>6</sup> ED-ISQM 1, section 8.

## Professional Judgement and Potential Subjectivity of ED-ISQM 1

Technical Staff note that ED-ISQM 1 includes a significant amount of professional judgment to be exercised, including in relation to<sup>7</sup>:

- Appropriate organisational structure and assignment of roles, responsibilities and authority that support commitment to quality;
- Establishing where necessary additional quality objectives are required in addition to the examples in the standard;
- Identification and assessment of quality risks;
- Appropriate nature, timing and extent of responses to address assessed quality risks;
- Resources, information and communication appropriate to enable the design, implementation and operation of the components of the SQM;
- Evaluation of whether the SQM provides reasonable assurance objectives of the standard have been achieved; and
- The effect of the network requirements or network services on the SQM.

Whilst the use of professional judgement is intended to enable the SQM to be tailored to the Firm and to promote scalability, this could lead to subjectivity and disparity in the design, implementation and operation of SQMs. Different firms may have very different risk appetites and even firms with the same nature, circumstances and engagements will likely result in different SQMs due to different views. Further, there is potential for regulators or professional bodies to conclude differently to Firms.

## Networks and Service Providers

ED-ISQM 1 acknowledges that quality control systems of networks can enhance quality for the Firms in the network. However, the ultimate responsibility for achievement of the standard's objective fall on the individual firm. The standard is also clear that when a firm uses a service provider it is responsible to understand the provider, nature and scope of services, the resource is appropriate and again that the firm remains responsible for the SQM. This approach is consistent with APES GN 30 *Outsourced Services* (originally issued 2013 and revised 2015) which provides guidance on the professional and ethical obligations when dealing with outsourced services.

## Separation of ED-ISQM 1 and ED-ISQM 2

Technical Staff support the approach taken by IAASB to have ED-ISQM 1 address the engagements for which an Engagement Quality Review (EQR) is required and for ED-ISQM 2 to address eligibility criteria and performance and documentation requirements for EQRs<sup>8</sup>. The separation improves scalability because if a Firm determines under ED-ISQM 1 that an EQR is not a required response, there is no requirement to consider ED-ISQM 2.

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<sup>7</sup> ED-ISQM 1, section A4.

<sup>8</sup> Explanatory Memorandum to ED-ISQM 1, page 20.

### **Use of Terminology – Entities of Significant Public Interest**

Technical Staff are not supportive of the introduction of new terminology “*significant public interest*” in the proposed standards in relation to EQRs, which is inconsistent with Public Interest Entity (PIE).<sup>9</sup> When undertaking the development of the proposed standards the IAASB noted difficulty in defining the term due to jurisdictional differences.<sup>10</sup> However, Technical Staff consider that the introduction of additional terminology may create further confusion with the Code’s definition and it is unclear whether there is any significant difference between the terms.

### **Volume of Application and Other Explanatory Material**

ED-ISQM 1 includes a significant amount of application and other explanatory material, consisting of 44 pages and 212 paragraphs (compared to approximately 70 application paragraphs in ISQC 1/APES 320). Some of the content repeats requirements, is often descriptive without providing information on how to apply requirements and at times is more akin to guidance and/or a basis for conclusions. There is a concern that this voluminous material may also confuse or detract from the standard’s requirements.

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<sup>9</sup> As defined in the *International Code of Ethics for Professional Accountants (including International Independence Standards)* and *APES 110 Code of Ethics for Professional Accountants (including Independence Standards)*

<sup>10</sup>Explanatory Memorandum to ED-ISQM 1, page 20.