

Board Meeting Agenda

10 April 2019
9.15 am to 5.00pm

XRB Offices, Level 7, 50 Manners Street, Wellington

Est. Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
B: PUBLIC SESSION					
10.15 am	<i>Morning tea</i>				
10.30 am	3	<u>IAASB's Quality management exposure drafts</u>			
	3.1	Board meeting summary paper	Note	Paper	
	3.2	Issues paper	Consider	Paper	
	3.3	IAASB covering explanatory memorandum	Note	Paper	
	3.4	ED ISQM 1 EM	Note	Paper	
	3.5	ED ISQM 2 EM	Note	Paper	
	3.6	ED ISA 220 (Revised) EM	Note	Paper	
11.45 am	4	<u>Meet with Lyn Provost</u>			
	4.1	IAASB March 2019 meeting report	Note	Late	
12.30 pm	<i>Lunch</i>				
1.15 pm	5	<u>EER Consultation Paper</u>			
	5.1	Board meeting summary paper	Note	Paper	
	5.2	Issues paper	Consider	Paper	
	5.3	IAASB Consultation paper	Note	Paper*	
2.00 pm	6	<u>LCE Consultation Paper (LATE PAPER)</u>			
	6.1	Board meeting summary paper	Note	Late	
	6.2	Issues paper	Consider	Late	
	6.3	IAASB Consultation paper	Note	Late	
2.45 pm	7	<u>Update from the NZASB</u>			
	7.1	Board meeting summary paper	Note	Paper	
3:15 pm	<i>Afternoon tea</i>				
3:30 pm	8	<u>NSS meeting</u>			
	8.1	Board meeting summary paper IESBA NSS	Note	Paper	
	8.2	IESBA NSS matters to discuss	Consider	Paper	
	8.3	Board meeting summary paper IAASB NSS	Consider	Paper	
4.15 pm	9	<u>IAASB Future Strategy</u>			
	9.1	Board meeting summary paper	Note	Paper	
	9.2	Draft submission to IAASB	Consider	Paper	
	9.3	IAASB Strategy 2020-23 and Work Plan 2020-21	Note	Paper	

Est. Time	Item	Topic	Objective		Page
4:45 pm	10	<u>Environmental Scanning</u>			
	10.1	International monitoring update	Note	Paper	
	10.2	Domestic monitoring update	Note	Paper	
	10.3	Academic update	Note	Paper	
C: NON-PUBLIC SESSION					
4.55 pm	11	<u>Closing items</u>			
	11.1	Issues to be reported to the XRB Board and NZASB	Discuss	Verbal	-

** IAASB has locked this PDF. It is attached separately as it can't be combined along with the other papers.*

Next meeting: 5 June 2019, Wellington

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 3.1
Meeting date: 10 April 2019
Subject: Quality management control EDs
Date: 28 March 2019
Prepared By: Sylvia van Dyk



Action Required



For Information Purposes Only

Agenda Item Objectives

For the Board to:

- CONSIDER possible compelling reason amendments for exposure draft (ED) ISQM 1 and to APPROVE development of a NZ ED and invitation to comment (ITC).
- RECEIVE an overview of ED ISQM 2 and ED ISA 220, and PROVIDE initial feedback to include in the submission to the IAASB.

Background

1. The IAASB approved in December 2018 the three Exposure Drafts for quality management at the firm and engagement levels:
 - a) Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance Engagements or Related Services Engagements* (ED ISQM 1).
 - b) Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED ISQM 2).
 - c) Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED 220).
2. The final explanatory memorandums for each of the three exposure drafts, together with an overall explanatory memorandum, were issued in February, for a 150-day period until the end of June.

3. At the previous meeting we provided the board with an overview of the pre-final ED ISQM 1, and our proposed outreach plan.
4. The final issued documents are available at agenda items 3.3 to 3.6. There have been no substantive changes to the documents previously seen by the Board.
5. In addition to issuing the IAASB EDs for consultation in New Zealand, we have arranged the following outreach events.

Workshops		Roundtables	
Auckland	3 April	SMPs follow up	6 May
Tauranga	4 April	Larger firms	27 May
Wellington	11 April		
Christchurch	12 April		

A joint webinar with the AUASB on Monday 1 April. This will cover an overview of the quality management standards.

6. We will provide verbal feedback to the Board on the results of the workshops held in Auckland and Tauranga.
7. We will prepare a draft submission for the Board's consideration at the June meeting.

Matters to Consider

8. The matters for consideration related to possible compelling reason amendments identified for New Zealand are explained in the issues paper at agenda 3.2.
 - We have identified 2 key issues as possible new compelling reason amendments to ED ISQM 1 for the Board to consider. These are NZ specific issues only and are not applicable to the AUASB. We ask the Board to consider the various options presented and to approve the development of a NZ ED and ITC.
 - We have also performed a preliminary analysis on the NZ paragraphs included in PES 3, the New Zealand equivalent to ISQC 1 that will be replaced by ISQM 1, to consider if the NZ paragraphs remain relevant given the proposed IAASB changes. We ask the Board for feedback on our initial thoughts on these NZ paragraphs. A more detailed analysis will be performed for the June meeting if the Board agrees that a NZ ED should be developed.
 - We also ask for feedback on the proposed next steps and timing regarding the development of a NZ ED.
9. We will provide the Board with an overview of ED ISQM 2 and ED ISA 220 at the meeting, where we will ask for initial feedback to include in the submission to the IAASB, and that will provide an opportunity for the Board to consider if there are further compelling reason amendments.

Recommendations

We recommend that the Board consider the issues paper and provide feedback on the questions asked.

Material Presented

Agenda item 3.1	Board Meeting Summary Paper
Agenda item 3.2	Issues Paper
Agenda item 3.3	Covering Explanatory memorandum
Agenda item 3.4	Proposed ISQM1 Explanatory memorandum
Agenda item 3.5	Proposed ISQM 2 Explanatory memorandum
Agenda item 3.6	Proposed ISA 220 (Revised) Explanatory memorandum

Agenda 3.2

ISQM 1: Issues Paper

Proposed compelling reason amendments

We have identified two key issues to consider as New Zealand compelling reason amendments to ED ISQM 1:

1. Proposed scope of engagements subject to an engagement quality review (EQR)
2. How to refer to PART 2 of IESBA Code of Ethics¹

Issue 1: Proposed scope of engagements subject to an EQR

1. ED ISQM 1 proposes an enhanced scope of engagements subject to an EQR which includes entities that the firm determines are of significant public interest and those that are required by law and regulation. The impact of this proposal is that more audits will be required to have an EQR.
2. The proposed scope of entities or engagements subject to an EQR is (with the change to the extant highlighted):
 - All listed entities
 - **Entities the firm determines are of significant public interest**, for example entities operating in the public sector, financial institutions such as certain banks, insurance companies and pension funds, those with a large number and wide range of stakeholders, nature and size of the business, certain not-for-profit entities (NFPs).
 - Audits or **other engagements** for which:
 - **An EQR is required by law or regulation** or
 - The firm determines that an engagement quality review is an appropriate response to assessed quality risks.
3. The IAASB has intentionally used slightly different language, “entities of significant public interest” rather than referring to public interest entities (PIEs) as defined in the Code of Ethics. The reason for this, as highlighted in the explanatory memorandum (para 60), is that there was not extensive support given the lack of a universal definition of PIEs, which could lead to inconsistency in practice. Also, in some jurisdictions, PIEs could include very small or non-complex entities (such as small charities) and performing an EQR for audits of such engagements would be overly burdensome.
4. The concept of a public interest entity (PIE) is only included in the Code of Ethics, and not used in the ISAs. In New Zealand, the definition of a PIE is included in the Code of Ethics and includes all Tier 1 entities but is not included in the ISAs (NZ).

¹ Part 2 of the IESBA Code of Ethics deals with Professional Accountants in Business which is outside the mandate of the NZAuASB

5. We note that the application material (para A101 – A105) included by the IAASB in ED ISQM 1 to assist firms identify entities of significant public interest is very similar to the guidance included in the Code of Ethics.
6. The public interest entities in New Zealand not currently required to have an EQR that may be captured by the increased proposed scope are Tier 1 NFPs and large public sector entities². All other PIEs in New Zealand are already required to have an EQR, as well as the FMC reporting entities in Tier 2. This is because historically in New Zealand ISA references to listed entities have been amended to FMC reporting entities considered to have a higher level of public accountability. Accordingly, PES 3 currently requires an EQR for all FMC reporting entities considered to have a higher level of public accountability. The FMA has extended this to require an EQR for all FMC reporting entities as a condition of being a licensed auditor.
7. The matters arising for the NZAuASB is:
 - a. How to amend the reference to listed entities in para 37(e)(i) of the ED; and
 - b. How any changes to this reference interact with 37(e)(ii) that requires an EQR for entities that the firm determines are of significant public interest

In summary, the NZAuASB is asked whether to leave it to the firms' discretion to determine entities of significant public interest, as contemplated by the IAASB's proposals, or to require an EQR for all PIEs, that is, all Tier 1 entities in New Zealand, as defined in the Code of Ethics.

8. An alternative way to explore these matters is to consider whether, if the firms apply the application material in ED ISQM 1, in New Zealand, would all Tier 1 entities be identified as entities of significant public interest? If so, it may be clearer to be explicit in this regard.
9. We have identified the following different options for the Board to consider:

Option 1

10. Continue to amend the reference to listed in the ED to FMC reporting entities considered to have a higher level of public accountability (and require the firms to determine what other entities are of significant public interest).
11. The FMA's requirement for an EQR for all FMC reporting entities will still be captured as it is an audit for which an EQR is required by law or regulation.

Option 2

12. Amend references to listed in the ED to FMC reporting entities to ensure that there is consistency with the FMA's requirements.
13. Note this option will leave it to the firms' discretion to determine other entities of significant public interest.

Option 3

14. Amend the reference to listed in the ED to PIEs, and align and include the definition of a PIE from the New Zealand Code of Ethics. This will meet the intent of the IAASB (based on the guidance

² AG PES 3 Auditor-General's Statement on Quality Control requires an EQR on all annual public sector audits over 750 budgeted hours, so most large public sector entities are already required to have an EQR.

material to assist an auditor to identify significant public interest entities, which is similar to the entities defined as PIEs in New Zealand)). It will also ensure a consistent approach to identifying PIEs for an EQR.

15. The FMA's requirement for an EQR for all FMC reporting entities will still be captured as it is an audit for which an EQR is required by law or regulation.
16. Under this option, we would suggest retaining the requirement in 37(e)(ii) for an EQR for audits of financial statements of entities that the firm determines are of significant public interest and the attached application material in A101-A107 to avoid have NZ deletions in the standard.

Recommendation:

17. We recommend option 3, as it meets the intent of the IAASB and provide consistent application in New Zealand regarding performing an EQR for all PIEs.
18. The additional entities that will be captured (and in our view should be captured by firms to meet the intent of the IAASB) are Tier-1 entities in the public sector and in the not-for-profit sector. Most of the larger not-for-profits may already be captured as firms may have determined an EQR is an appropriate response to assessed quality risks. Also, most of the larger public sector entities are already subject to an EQR as required by AG PES 3 Auditor-General's Statement on Quality Control.

Question 1 : Does the Board agree with our recommendation?

Future option to consider – for noting only at this point.

19. If the Board agrees with our recommendation to change the reference to listed entities to PIEs in ED ISQM 1, a point to note is that higher risk entities as defined in the ISAs (NZ) for EQR requirements will be closer aligned with the higher risk entities as defined in the Code of Ethics, as both will refer to PIEs. There remains one exception in the ISAs (and the ISAs (NZ) where the most robust audit requirements do not apply to PIEs, i.e. Key audit matters (KAM) reporting requirements. In the ISAs, KAM requirements apply to listed entities, and in New Zealand to FMC Reporting entities considered to have a higher public accountability.
20. The IAASB, as part of its post implementation review, intends to consider extending KAM reporting to PIEs. Given the intent of the IAASB to extend an EQR to PIEs, it is likely that the IAASB may extend KAM reporting to PIEs. Should this happen, an option for the Board to consider at that time would be to amend all references to listed entities in the ISAs to PIEs in the ISAs (NZ), that is, change all references to FMC reporting entities considered to have a higher public accountability to PIEs.
21. The benefit of doing so is that it would create one consistent level of financial reporting requiring the application of the highest financial reporting requirements, and then having those audited using the most robust auditing and independence requirements. These requirements are to be applied by entities that have been determined by the XRB Board to have public accountability in New Zealand. Using the most onerous audit and independence requirements is in the public interest for all entities that have public accountability.

Issue 2 : Reference to relevant ethical requirements.

22. Relevant ethical requirements in ED ISQC 1 include Part 2 of the IESBA Code of Ethics³ which is not included in PES 1. The references to Part 2 of the IESBA Code will therefore need to be amended to include references to CA ANZ's Code.

For example, PAR A70 of ED ISQC 1:

- A70. Various provisions of the relevant ethical requirements may apply only to personnel and not the firm itself. For example, **Part 2 of the IESBA Code** applies to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm. The firm's system of quality management may need to address personnel's compliance with such relevant ethical requirements, for example, the firm may need to establish policies or procedures to facilitate personnel's compliance with **Part 2 of the IESBA Code** (e.g., policies or procedures addressing section 260 of the IESBA Code regarding non-compliance with laws and regulations).

Question 2 : Does the Board see any issues in XRB standards giving effect to CA ANZ's standards?

Other issues to consider

23. We have also performed some preliminary analysis of the existing NZ paragraphs in PES 3. We will perform a more detailed analysis for the Board's consideration at the June meeting. Our preliminary thoughts are noted in red.

NZ para in existing PES 3

- NZ1.1 This Professional and Ethical Standard deals with a firm's responsibilities for its system of quality control for audits and reviews of financial statements, and other assurance engagements. This Professional and Ethical Standard is to be read in conjunction with relevant ethical requirements. **[Retain, as it clarifies the scope of our mandate]**
- NZ3.1 This standard is not intended to detract from responsibilities which may be imposed by law or regulation. **[Retain]**
- NZ4.1 This Professional and Ethical Standard applies to all firms of assurance practitioners in respect of audits and reviews of financial statements, and other assurance engagements. The nature and extent of the policies and procedures developed by an individual firm to comply with this Professional and Ethical Standard will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network. **[Retain as it clarifies mandate—but last sentence could be deleted as this aspect is emphasized in the ED]**

1. Definitions:

- [NZ12.1] Assurance engagement - An engagement in which an assurance practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party

³ Part 2 of the IESBA Code of Ethics deals with Professional Accountants in Business which is outside the mandate of the NZAuASB

about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria).[retain – mandate]

[NZ12.2] Assurance practitioner – A person or an organisation, whether in public practice, industry, commerce or the public sector, appointed or engaged to undertake assurance engagements. [retain – mandate]

[NZ12.3] Engagement – In the context of this Professional and Ethical Standard, an assurance engagement. [retain – mandate]

[NZ] Considerations Specific to the Public Sector

Where a statutory officer (such as the Auditor-General) appoints an employee or other suitably qualified person (appointed auditor) to perform audits or other assurance services on that officer's behalf, for the purposes of this Professional and Ethical Standard it is the appointed auditor who effectively discharges the obligations of the engagement partner. Any reference to the engagement partner should be interpreted accordingly. [retain – NZ specific]

[NZ12.4] Engagement quality control review – A process designed to provide an objective evaluation, on or before the date of the report, of the significant judgements the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is for audits of financial statements of FMC reporting entities considered to have a higher level of public accountability, and those other assurance engagements, if any, for which the firm has determined an engagement quality control review is required. [may no longer be necessary, as scope is clear in the ED, and ED definition is sufficient]

[NZ] Considerations Specific to the Public Sector

Where a statutory officer (such as the Auditor-General) appoints an employee or other suitably qualified person (appointed auditor) to perform audits or other assurance services on that officer's behalf, for the purposes of this Professional and Ethical Standard the term "firm" refers to the combination of the statutory officer, the appointed auditor, and, if applicable, the firm of which the appointed auditor is a partner, member or employee. [retain – NZ specific]

[NZ12.5] FMC reporting entity considered to have a higher level of public accountability – A FMC Reporting Entity or a class of FMC reporting entity that is considered to have a higher level of public accountability than other FMC reporting entities:

- Under section 461K of the Financial Markets Conduct Act 2013; or
- By notice issued by the Financial Markets Authority (FMA) under section 461L(1)(1) of the Financial Markets Conduct Act 2013.[if replaced by reference to PIE may not be needed]

[NZ12.6] Public entity – Has the meaning as defined in section 5 (1) of the Public Audit Act 2001.[retain – NZ specific]

[NZ12.7] Public interest entity – An entity that meets the Tier 1 criteria in accordance with XRB A1⁴ and is not eligible to report in accordance with the accounting requirements of another tier.~~[retain – NZ specific]~~

[NZ12.8] Public sector auditor – The Auditor-General or an auditor appointed by the Auditor-General to perform audits or other assurance services for public entities.~~[retain – NZ specific]~~

(o) Professional standards – ~~[Deleted by the NZAuASB].~~

[NZ12.9] Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Professional and Ethical Standard 1 (Revised), and other applicable law or regulation. ~~[may need to amend to include reference to PART 2 of the Code]~~

[NZ31.1] The firm shall also establish policies and procedures to assign appropriate personnel with the necessary competent, capabilities, and time to: ~~[may no longer be needed, as the ED now includes a requirement for personnel to have sufficient time – see par 38 b of ED ISQM 1]~~

(a) Perform engagements in accordance with standards issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board and applicable legal and regulatory requirements; and

(b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (Ref: Para. A31)

[NZ34.1] The reasons alternative courses of action from consultations were undertaken are documented. (Ref: Para. A36-A40)

NZ35.1 The firm shall establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgements made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures shall: ~~[The NZ paragraph will have to be amended to refer to PIEs if the Board agrees with our recommendation.]~~

(a) Require an engagement quality control review for all audits of financial statements of FMC reporting entities considered to have a higher level of public accountability;

(b) Set out criteria against which all other audits and reviews of historical financial information and other assurance engagements shall be evaluated to determine whether an engagement quality control review should be performed; and (Ref: Para. A41)

(c) Require an engagement quality control review for all engagements, if any, meeting the criteria established in compliance with subparagraph 35(b).

NZ38.1 For audits of financial statements of FMC reporting entities considered to have a higher level of public accountability, the firm shall establish policies and procedures to require the engagement quality control review to also include consideration of the following: ~~[this is now covered in ISQM 2 –to delete and consider if need to include in ED ISQM 2 – may not be needed as the scope is set in ISQM 1 and the procedures to perform in ISQM 2]~~

(a) The engagement team's evaluation of the firm's independence in relation to the specific engagement;

⁴ XRB A1 *Application of the Accounting Standards Framework*.

- (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and
- (c) Whether documentation selected for review reflects the work performed in relation to the significant judgements and supports the conclusions reached. (Ref: Para. A45-A46)

[NZA2.1] The form and content of communication should be explicit to provide firm personnel with a ready source of information concerning those policies and procedures applicable

[communication enhanced in the ED – to consider if can delete]

[NZA10.1] In the case of a statutory officer (such as the Auditor-General) who is bound by this Professional and Ethical Standard in their professional capacity as an assurance practitioner, if the officer does not have the ability to withdraw from, or to decline to accept, an engagement to eliminate a threat to independence of a professional nature, it will be sufficient compliance with this Professional and Ethical Standard for the statutory officer to:

- (a) Introduce safeguards to reduce the threat to independence to the extent that is reasonably possible in the circumstances; and
- (b) Disclose the threat to independence to those responsible for governance of the entity and publicly disclose the matter where a report is required. [there is enhanced guidance in the ED that covers this situation – refer par 35, A89-A90 in ED ISQM 1. To consider if can delete]

[NZA14.1] Professional and Ethical Standard 1 (Revised) recognises that the familiarity threat is particularly relevant in the context of financial statement audits of public interest entities. For these audits, Professional and Ethical Standard 1 (Revised) requires the rotation of the key audit partner⁵ after a pre-defined period, normally no more than seven years, and provides related standards and guidance⁶. [remains appropriate in NZ context]

[NZA14.2] Shorter rotation requirements may be established for particular audit engagements or classes of audit engagement, for example for audits of entities whose securities are quoted or listed on a recognised stock exchange. [remains appropriate in NZ context]

[NZA16.1] There may be other public entities that are not defined as a public interest entity, that are significant due to size, complexity, commercial risk, parliamentary or media interest or public interest aspects, and which consequently have a wide range of stakeholders. There are no fixed objective criteria on which this determination of significance should be based. Such a determination should encompass an evaluation of all factors relevant to the public entity. Therefore, there may be instances when a firm determines, based on its quality control policies and procedures, that a public entity is significant for the purposes of expanded quality control procedures. [remains appropriate in NZ context]

[NZA17.1] In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. Nonetheless, for public entities considered significant, as noted in paragraph A16, it may be in the public interest for public sector auditors to establish policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility. [remains appropriate in NZ context]

NZA41.1 Criteria for determining which engagements other than audits of financial statements of FMC reporting entities considered to have a higher level of public accountability are to be subject to an engagement quality control review may include, for example: [can delete as no need to refer

⁵ Professional and Ethical Standard 1 (Revised), Definitions.

⁶ Paragraph 290.151 of Professional and Ethical Standard 1 (Revised).

to scope for this guidance because of the change in structure in the ED ISQM 1 – see A104 in ED ISQM 1]

- The nature of the engagement, including the extent to which it involves a matter of public interest.
- The identification of unusual circumstances or risks in an engagement or class of engagements.
- Whether laws or regulations require an engagement quality control review.

NZA44.1 The extent of the engagement quality control review may depend, among other things, on the complexity of the engagement, whether the entity is a FMC reporting entity considered to have a higher level of public accountability, and the risk that the report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner. [responsibility of a partner is now emphasized in ED ISA 220 – to consider if remains appropriate and if not to delete]

NZA45.1 Other matters relevant to evaluating the significant judgements made by the engagement team that may be considered in an engagement quality control review of an audit of financial statements of a FMC reporting entity considered to have a higher level of public accountability include: [this is now included in ISQM 2 and can be deleted here – to consider if necessary to include in NZ for ISQM 2 equivalent]

- Significant risks identified during the engagement and the responses to those risks.
- Judgements made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

These other matters, depending on the circumstances, may also be applicable for engagement quality control reviews for audits of the financial statements of other entities as well as reviews of financial statements and other assurance engagements.

NZA46.1 Although not referred to as FMC reporting entities considered to have a higher level of public accountability, as described in paragraph A16, certain public entities may be of sufficient significance to warrant performance of an engagement quality control review. [could be deleted if change scope to PIEs]

NZA46.2 There are no fixed objective criteria on which this determination of significance should be based. However, such a determination should encompass an evaluation of all factors relevant to the public entity. Such factors include size, complexity, commercial risk, parliamentary or media interest and the number and range of stakeholders affected. [could be deleted if change scope to PIEs]

NZA47.1 What constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement. For example, the engagement quality control reviewer for an audit of the financial statements of a FMC reporting entity considered to have a higher level of public accountability is likely to be an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of FMC reporting entities considered to have a higher level of public accountability. [this is now included in ISQM 2 with enhanced requirements –to consider if necessary to include in NZ for ISQM 2 equivalent]

- [NZA67.1] In the public sector, the Office of the Auditor-General performs quality reviews on appointed auditors on a cyclical basis. A quality review by the Office of the Auditor-General would contribute towards the firm's compliance with the monitoring requirements [still applicable]
- [NZA70.1] Complaints and allegations may also be received from relevant professional bodies.[enhanced requirements in the ED to consider all relevant sources – to consider if can delete]
- [NZA75.1] The policies are often simply embedded in the firm's engagements templates in the form of standard communications, questionnaires, checklists, memoranda, and forms. [still applicable]

Question 3 : Does the Board have any feedback on our preliminary analysis?

Next steps

24. We propose to develop a NZ ED and an ITC for the Board's consideration at the June meeting, for exposure in June or further consideration by the Board at the July meeting and exposure thereafter, depending on the feedback received at the June meeting. Issuing a NZ ED at this stage of the process will enable the Board to issue the NZ quality management standards soon after the IAASB issues its final standards. This aligns with our process to issue a NZ ED when we have identified compelling reason amendments.
25. The ITC will request feedback on the New Zealand amendments only and refer constituents to the IAASB's EDs for feedback on the IAASB's proposals. This is similar to the process we followed for Auditor Reporting.
26. When developing a New Zealand ED we will perform a further analysis of the NZ paragraphs included in the extant standards to determine if they remain appropriate, and if further changes may be required. At this stage we have not identified any other key issues than the ones we have discussed above.
27. We are not aware of any compelling reason amendments identified by the AUASB staff at this point other than for Corporation Act requirements. We will continue to liaise with the AUASB staff about this and the outcome of their exposure process (refer the paper at agenda 2.13).
28. We will also further consider what NZ changes are required for the ED ISQM 2 and ISA 220 (Revised) to be consistent with any changes regarding references to the scope of entities subject to EQR and to relevant ethical requirements in ED ISQM 1, as well as any other NZ relevant changes to definitions or application material.
29. One issue that we have identified in ED ISQM 2 relates to the inclusion of guidance regarding a "cooling-off" period as part of the eligibility criteria to be appointed as an EQR. We are not supportive of the inclusion of the application material related to the relevant ethical requirements in ED ISQM 2 and recommend that this should be opposed in developing a response to the IAASB.
30. However, if the IAASB goes ahead with the application material as proposed, the issue arising for the development of a New Zealand ED will be that paragraph A5 of ED ISQM 2 proposes that in the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the EQR until two subsequent audits have been conducted. We do not consider that it would be appropriate to extend this reference to all PIEs in New Zealand, given that we are opposed to this application material, however an alternative may add complexity. We consider that there are two alternative options:

- a. Amend the reference to listed entity to FMC reporting entity considered to have a higher level of public accountability
 - b. Retain the IAASB example of a listed entity so as not to broaden this requirement any further. This would be the first instance in the ISAs (NZ) where the reference to a listed entity would remain but may be appropriate in this specific instance, given that the NZX has a separate auditor rotation requirement (i.e. a 5 year time on limit) for listed entities. This would then require the inclusion of a definition of listed entity.
31. Subject to feedback from the Board about the proposed compelling reason amendments, we intend to raise awareness of the NZ ED and our proposals during our outreach on the IAASB's EDs, and to do further targeted consultation once the ED is published.

Question 4 : Does the Board have any views on whether to amend the reference to listed entities in paragraph A5 of ED ISQM 2?

Question 5 : Does the Board have any comments on our proposed next steps? Specifically, does the Board agree with the proposed timing of a NZ ED?

Exposure Drafts
February 2019

Comments due: July 1, 2019

The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews

IAASB

International Auditing
and Assurance
Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

This Explanatory Memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*, was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Explanatory Memorandum may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: <http://www.iaasb.org>. The approved text is published in the English language.

THE IAASB'S EXPOSURE DRAFTS FOR QUALITY MANAGEMENT AT THE FIRM AND ENGAGEMENT LEVEL, INCLUDING ENGAGEMENT QUALITY REVIEWS

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Section 1 Introduction

1. This memorandum provides background to the IAASB's three Exposure Drafts for quality management at the firm and engagement levels:
 - (a) Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1¹), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1).
 - (b) Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED-ISQM 2).
 - (c) Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220).

The three proposed standards were approved for exposure by the IAASB in December 2018. The IAASB is of the view that the three standards will, individually and collectively, improve the quality of engagements through addressing key public interest issues related to the management of quality at a firm and engagement level and the performance of engagement quality reviews.

2. This memorandum also provides an explanation of the significant issues pervasive to the three exposure drafts, including a discussion of scalability and the interrelationship of the three proposed standards. It also sets out the IAASB's proposals regarding the effective date and the related implementation period for the three proposed standards, as well as the IAASB's planned implementation support activities.
3. This memorandum should be read in conjunction with the explanatory memorandums for each of the three proposed standards, which provide background to each of the exposure drafts, and the key issues considered by the IAASB in developing the exposure drafts. The explanatory memorandums for each of the standards are available at <http://www.iaasb.org/quality-management>.

Section 1-A – Background

4. In March 2009, the IAASB completed its Clarity Project, designed to improve the clarity and understandability of the International Standards on Auditing (ISAs) and ISQC 1. Firms were required to establish a system of quality control in compliance with extant ISQC 1 by December 15, 2009. At the engagement level, extant ISA 220² was effective for audits of financial statements for periods beginning on or after December 15, 2009. Requirements and application material on engagement quality control reviews were included in both ISQC 1 and ISA 220. Following the completion of the Clarity Project, the IAASB developed its Strategy and Work Program for 2009-2011. One of the initiatives in the IAASB's Strategy and Work Program 2009–2011 was the development of a process for assessing the effectiveness of the implementation of the clarified ISAs, including ISQC 1 and ISA 220.
5. The post-implementation review of the clarified ISAs was completed in 2013, and the [findings](#) from this review formed the basis for the [IAASB's Strategy for 2015–2019](#) and the [IAASB Work Plan for 2015–2016: Enhancing Audit Quality and Preparing for the Future](#). Findings with regard to ISQC 1

¹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

² ISA 220, *Quality Control for an Audit of Financial Statements*

and ISA 220 suggested that additional guidance was needed to demonstrate how ISQC 1 could be applied proportionately by small- and medium-sized practitioners (SMPs) and that there were calls to make various aspects of the standards more robust. Accordingly, the Board included planned work on its quality control standards in its Strategy for 2015–2019 and its Work Plan for 2015–2016.

6. As work commenced on the IAASB's quality control standards, the working groups reflected on the issues identified through the post-implementation review of the clarified ISAs, inspection findings and ongoing outreach. The IAASB released the Invitation to Comment (ITC), [*Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*](#), in December 2015 to obtain stakeholder views on key issues regarding quality control, group audits, and professional skepticism. Respondents generally agreed that the IAASB should take action to address the issues presented in the ITC.
7. Recognizing the importance of taking action to respond to the issues identified, in December 2016 the IAASB approved the [project](#) to revise ISQC 1 and ISA 220 and develop other outputs, as necessary. The project proposal included engagement quality reviews as one of the issues to be addressed.

Section 1-B – Key Public Interest Issues

8. The proposed revisions in ED-ISQM 1, ED-ISQM 2 and ED-220 have been made with the public interest at the forefront. The proposed revisions address the most relevant public interest issues related to quality control, including the following issues that were identified in the ITC:
 - (a) Fostering an appropriately independent and challenging skeptical mindset of the auditor.
 - (b) Encouraging proactive quality management at the firm and engagement level.
 - (c) Exploring transparency and its role in audit quality.
 - (d) Focusing more on firms' (including networks') structures and communication processes and their internal and external monitoring and remediation activities.
 - (e) Reinforcing the need for robust communication and interactions during the audit engagement.
9. The explanatory memorandums for each of the standards further explain how the above public interest issues have been addressed.

Section 2 Significant Matters

Section 2-A – Scalability of the Standards and a New Approach to Quality Management

10. The business environment is becoming increasingly complex; expectations of firms' stakeholders are escalating and there is growing pressure for the IAASB's standards to keep pace with these changes to enhance engagement quality. These factors have given rise to challenges in developing international standards that enhance engagement quality and address complex issues. Developing standards in this environment may lead to more detailed and longer standards, but at the same time the IAASB is conscious that the standards need to be able to be effectively applied to a wide range of circumstances, including, in particular, audits of less complex entities. Addressing the scalability of the IAASB's International Standards is a key focus area for the IAASB to make sure that the standards are scalable to all types of engagements. The IAASB is also aware of the need for its standards to be fit-for-purpose for all firms, regardless of their size or complexity.

11. In order to improve the robustness of firms' systems of quality control and address the scalability of extant ISQC 1, the ITC proposed a new approach that encourages proactive management of quality. This approach is intended to be adaptable to the size and nature of a firm or the services it provides. Taking into account the ITC respondents' views on the proposed new approach, the IAASB concluded that ED-ISQM 1 should adopt the new approach, termed quality management, that is focused on how each firm manages its risks to quality. The explanatory memorandum for ED-ISQM 1 provides further explanation of this approach and the IAASB's key considerations in incorporating it into ED-ISQM 1. ED-220 takes this further by embedding the principles of quality management into the engagement level requirements. The explanatory memorandum for ED-ISQM 1 explains that the references to "quality control" have been changed to "quality management." The new terms have also been used in ED-ISQM 2 and ED-220.
12. In addition to the new quality management approach, the IAASB has taken various other steps to address scalability across the standards, which have been further discussed in the explanatory memorandums for each of the standards. In particular, ED-ISQM 1 emphasizes the need for the firm to consider the nature and circumstances of the firm and the engagements it performs in designing, implementing and operating its system of quality management, and the standard is focused on achieving quality objectives that are outcomes-based. Similarly, ED-220 has increased the focus on taking into account the nature and circumstances of the audit engagement in managing quality at the engagement level.
13. Given the importance of the scalability of the IAASB's International Standards, the IAASB is seeking input from respondents, in particular SMPs, on the scalability of each of the standards.

Section 2-B – Interrelationship between the Standards

Relationship Between Quality Management at the Firm and the Engagement Level

14. Although a new quality management approach has been introduced in ED-ISQM 1, the nature and spirit of the relationship between ED-220 and ED-ISQM 1 has not changed. The firm is responsible for establishing its system of quality management, which provides the foundation for managing quality at the engagement level, and the engagement partner is responsible for managing and achieving quality at the engagement level.
15. Although the firm is responsible for establishing its system of quality management, aspects of the system of quality management may be implemented at the engagement level, as illustrated in paragraph A62 of ED-ISQM 1. The extent to which aspects of the firm's system of quality management are implemented at the engagement level will depend on the nature and circumstances of the firm and the engagements it performs. For example, in the case of a sole practitioner, it is possible that much of the firm's system of quality management will operate at the engagement level.
16. Various enhancements have been made to ED-ISQM 1 and ED-220 to clarify the respective responsibilities of the firm and the engagement partner. These include:
 - (a) A new requirement in paragraph 41(b) of ED-ISQM 1 for the firm to communicate the responsibility for implementing the firm's responses to relevant personnel, including engagement teams.
 - (b) An explicit statement in paragraph 4 of ED-220 regarding the responsibility of the engagement team, led by the engagement partner, for implementing the firm's responses to quality risks that are applicable to the audit engagement. This paragraph also explains the engagement

partner's further responsibilities for determining whether to design and implement responses beyond those required by the firm, given the nature and circumstances of the engagement. This is intended to recognize that the firm cannot identify and design and implement responses to address all quality risks that are relevant to the engagement.

Two-Way Communication

17. As highlighted in Section 1–B, one of the most significant public interest issues highlighted in the ITC was reinforcing the need for robust communication and interactions during the audit. Ongoing communication between the firm, its engagement quality reviewers and its engagement teams is necessary for the firm's system of quality management to operate effectively and to support the performance of engagements. The IAASB is of the view the importance of this communication should be emphasized and therefore ED-ISQM 1, ED-ISQM 2 and ED-220 now include various requirements and application material that address the required communications between the various parties.

A New Standard for Engagement Quality Reviews

18. Given the importance and value placed on the role of the engagement quality review by stakeholders, particularly investors and regulators, it was proposed in the ITC that a separate standard be developed for engagement quality reviews. The ITC further explained that doing so may help to address scalability and may provide a simpler mechanism for elaborating the requirements and application material for engagement quality reviews. Respondents to the ITC had mixed views about whether a separate standard for engagement quality reviews would be appropriate.
19. As the IAASB's thinking about the new quality management approach evolved and the revisions to ED-ISQM 1 progressed and as the work advanced on addressing issues relating to engagement quality reviews, the IAASB concluded that it would be better to place the more detailed requirements and related application material for engagement quality reviews in a separate standard, ED-ISQM 2. The explanatory memorandum for ED-ISQM 2 provides further information regarding the IAASB's key considerations in determining that a separate standard should be developed for engagement quality reviews, including how the requirements between ED-ISQM 1 and ED-ISQM 2 have been linked.
20. As a result of the development of a separate standard for engagement quality reviews, the requirements in extant ISA 220 dealing with the responsibilities of the engagement quality control reviewer have been removed from ED-220, and revised and relocated to ED-ISQM 2. The IAASB noted that this approach reinforces the function of the engagement quality review as a firm-level activity that is undertaken by an individual who is acting on behalf of the firm, and results in ISA 220-ED dealing with the responsibilities of the engagement team, including the engagement partner, in relation to managing and achieving quality at the engagement level.

Section 3 Effective Date

21. In finalizing the three standards, the IAASB considered the possible effective dates for each of the standards, recognizing that the effective dates would need to be aligned because of the interrelationships of the standards described previously in this memorandum. The IAASB also considered the appropriate wording of the effective dates of the standards, in particular ED-ISQM 2 given that the standard addresses all types of engagements and some engagements do not relate to a particular period. The proposed wording of the effective date paragraphs are included in each of

the standards (see paragraph 17 of ED-ISQM 1, paragraph 9 of ED-ISQM 2 and paragraph 8 of ED-220).

22. The IAASB is proposing that an implementation period of approximately 18 months following the approval of the standards by the Public Interest Oversight Board,³ would be appropriate for all three proposed standards.
23. In proposing these effective dates, the IAASB noted the concerns of stakeholders that firms' systems of quality control and the management of engagement quality is an area requiring urgent improvement. For example, the [International Forum of Independent Audit Regulators' 2017 Inspection Findings Survey](#) highlights that findings related to firms' systems of quality control continue to occur and that improvements are needed. The IAASB is of the view that the three standards will, individually and collectively, improve the quality of engagements through addressing the key public interest issues mentioned previously in this document. Accordingly, facilitating timely and effective implementation of the three standards such that the intended benefits are realized, is a priority of the IAASB and in the public interest.
24. Establishing an implementation period that allows enough time to effectively implement the standards, including the translation of the standards and the development of implementation guidance and support materials, is important. The new quality management approach in ED-ISQM 1 represents a substantial revision to the extant standard and there are various other new requirements across the three standards that enhance the rigor of the standards. Accordingly, there will be a need for focused and likely substantial effort by firms and engagement teams to implement the new standards. For example, unlike extant ISQC 1 that sets forth discrete requirements for matters that the firm's policies and procedures are required to address, the new quality management approach requires firms to design, implement and operate an integrated system of quality management, including (1) identifying and assessing their quality risks, (2) designing and implementing responses to address the assessed quality risks, and (3) designing processes related to monitoring and remediation. Designing and implementing the new system of quality management will take time and effort and increased levels of coordination and cooperation within the firm, and may also require internal organizational changes and the acquisition and development of resources. For firms that belong to a network, there will be a direct impact on the network given the need for increased cooperation between the firm and the network and a likely desire by some networks for centralized implementation efforts to support the implementation at a member firm level and to improve the consistency and quality of the implementation. Furthermore, firms or networks will likely need time to test aspects of the system to determine that they are appropriate for use across the firm or the network before implementing them. There may also be firms, including SMPs, who will be dependent on guidance and support materials developed by national standard setters or professional accounting organizations to implement the standards.
25. Bearing in mind the perspectives outlined in paragraphs 23–24 above, the IAASB concluded that proposing an 18 month implementation period, supported by appropriate implementation support materials, is both practical and in the public interest. The IAASB notes that a rushed implementation may exacerbate risks to quality, lead to increased inspection findings, and would be inconsistent with

³ When the final standards are approved by the IAASB, their approval is subject to the approval of the Public Interest Oversight Board that an appropriate due process was followed. Typically, the Public Interest Oversight Board approves the standards one quarter after the approval of the standards by the IAASB. For example, if the standards are approved by the IAASB in March 2020, the approval of the Public Interest Oversight Board is likely to be sought in June 2020.

the objectives of the IAASB's project to enhance its quality management standards. Accordingly, the IAASB is interested in respondents' views about whether an 18 month implementation period is appropriate (see question 1).

26. The IAASB proposes to allow early adoption; however, all three standards would need to be early adopted as a package due to the linkages between them and the incompatibility with extant standards that would result from selective early adoption of only one or two of the new standards.

Section 4 Conforming Amendments

27. As a result of the proposals in the three EDs, the IAASB is also proposing conforming amendments to the following IAASB pronouncements: the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*; ISA 200;⁴ ISA 210;⁵ ISA 230;⁶ ISA 250 (Revised);⁷ ISA 260 (Revised);⁸ ISA 300;⁹ ISA 500;¹⁰ ISA 540 (Revised);¹¹ ISA 610 (Revised 2013);¹² ISA 620;¹³ ISA 700 (Revised);¹⁴ ISA 701;¹⁵ ISA 720 (Revised);¹⁶ and IAPN 1000.¹⁷
28. These conforming amendments are included in the Appendix. The conforming amendments do not include:
- Changes for the revised and restructured International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)*; and
 - Conforming and consequential amendments to the assurance and related services standards arising from the quality management standards.

Separate projects will be considered in 2019 to determine the nature and scope of necessary amendments or changes for these matters.

Section 5 Perspectives on Practical Implementation

29. For most firms, the proposals would result in a significant change in practice, in particular the proposals in ED-ISQM 1. The nature and extent of change would however depend on many factors,

⁴ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*

⁵ ISA 210, *Agreeing the Terms of Audit Engagements*

⁶ ISA 230, *Audit Documentation*

⁷ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

⁸ ISA 260 (Revised), *Communication with Those Charged with Governance*

⁹ ISA 300, *Planning an Audit of Financial Statements*

¹⁰ ISA 500, *Audit Evidence*

¹¹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

¹² ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

¹³ ISA 620, *Using the Work of an Auditor's Expert*

¹⁴ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

¹⁵ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

¹⁶ ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

¹⁷ IAPN 1000, *Special Considerations in Auditing Financial Instruments*

such as the nature and circumstances of the firm and the engagements the firm performs, and the extent to which the firm already uses a risk-based approach in managing quality. The IAASB is aware that some firms have already evolved their processes to incorporate a risk-based approach to quality management, and that some have also commenced activities to plan for the implementation of the standards when they are eventually issued. The IAASB is interested in learning about practical challenges and experiences in implementing the proposals and the possible effects of the proposals. This includes the perspectives of SMPs regarding any practical challenges that can be foreseen in implementing the standards.

Section 6 Implementation Support

30. The IAASB is currently in the [process of developing its strategy for 2020–2023](#), with an increased focus on other mechanisms for addressing issues and challenges on a more timely basis, including implementation support that is of particular importance to SMPs. Recognizing the increasing demand for implementation support, the IAASB plans to develop materials to accompany the standards, in particular ED-ISQM 1, to facilitate an improved understanding of the standards. The IAASB has developed illustrations of the accompanying materials to facilitate input from respondents on the nature of implementation support that is most useful. The illustrative materials include:
- (a) Practical examples that demonstrate how the requirements of ED-ISQM 1 may be scaled according to the nature and circumstances of the firm and its engagements.
 - (b) Frequently asked questions that provide additional explanations and examples of more complex aspects of ED-ISQM 1.
31. In addition, during the exposure period, the IAASB plans to undertake various outreach activities, such as videos and webcasts, that will also provide a mechanism for respondents to further understand the standards, in particular their application to SMPs.

Section 7 Request for Comments

The explanatory memorandums for each of the standards include questions about the key issues considered by the IAASB in developing the exposure drafts, and are available at www.iaasb.org/quality-management. The questions below address key issues pervasive to the three standards. Comments will be most helpful if they include the reasons for any concern about the matters covered in the questions below.

Overall Questions

- 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?
- 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 SMPs?

General Questions

In addition, the IAASB is also seeking comments on the general matters set out below for all three EDs:

- (a) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to

comment on the proposals, in particular, on any foreseeable difficulties in applying it in a developing nation environment.

- (b) *Public Sector*—The IAASB welcomes input from public sector auditors on how the proposed standards affect engagements in the public sector, particularly regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.
- (c) *Translations*—Recognizing that many respondents may intend to translate the final ISQMs and ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed standards.

PROPOSED CONFORMING AMENDMENTS TO THE INTERNATIONAL STANDARDS ON AUDITING ARISING FROM PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 1 AND INTERNATIONAL STANDARD ON AUDITING 220 (REVISED)

Preface to the International Quality ~~Control~~Management, Auditing, Review, Other Assurance, and Related Services Pronouncements

Introduction

1. This preface to the *International Quality ~~Control~~Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* is issued to facilitate understanding of the scope and authority of the pronouncements the International Auditing and Assurance Standards Board (IAASB) issues, as set forth in the IAASB's Terms of Reference.

...

The Authority Attaching to International Standards Issued by the International Auditing and Assurance Standards Board

...

10. International Standards on Quality ~~Control~~Management (ISQCMs) are to be applied for all services falling under the IAASB's Engagement Standards.

...

International Standards on Quality ~~Control~~Management

12. ISQCMs are written to apply to firms in respect of all their services falling under the IAASB's Engagement Standards. The authority of ISQCMs is set out in the introduction to ~~the~~each ISQCM.¹⁸

...

Applicability of the International Standards

...

19. International Standards are relevant to engagements in the public sector. When appropriate, additional considerations specific to public sector entities are included:
 - (a) Within the body of an International Standard in the case of ISAs and ISQCMs; or
 - (b) In a Public Sector Perspective (PSP) appearing at the end of other International Standards. ...

¹⁸ Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 16

ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

...

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

14. The auditor shall comply with relevant ethical requirements, including those ~~pertaining~~related to independence, relating to financial statement audit engagements. (Ref: Para. A16–A19)

...

Application and Other Explanatory Material

...

Definitions

...

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 14)

...

- A19. International Standard on Quality Control~~Management~~ (ISQCM) 1,⁴⁹ or national requirements that are at least as demanding,²⁰ deal with the firm's responsibilities to ~~establish~~design, implement and maintain its operate a system of quality control for audit engagements. ~~ISQC 1 sets out the responsibilities of management that provides the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply~~fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements. As part of its system of quality management, ISQM 1 requires the firm to address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those pertainingrelated to independence.²¹ ISA 220 (Revised) sets out the engagement partner's responsibilities with respect to relevant ethical requirements, including those related to independence.²²~~These include remaining alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team, determining the appropriate action if matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.~~²³ ISA 220

⁴⁹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

²⁰ ISA 220 (Revised), *Quality Control~~Management~~ for an Audit of Financial Statements*, paragraph 23

²¹ ISQCM 1, paragraphs 20–25~~32–33~~

²² ISA 220 (Revised), paragraphs 14–19

²³ ISA 220, paragraphs 9–12

~~recognizes that the engagement team is entitled to rely on a firm's system of quality control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless information provided by the firm or other parties suggests otherwise.~~

...

Professional Judgment (Ref: Para. 16)

...

A27. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as that required by ISA 220 (Revised),²⁴ assist the auditor in making informed and reasonable judgments.

...

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 5 and 17)

Sufficiency and Appropriateness of Audit Evidence

A30. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit²⁵) or through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement~~firm's quality control procedures for client acceptance or continuance~~. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

...

Conduct of an Audit in Accordance with ISAs

...

Contents of the ISAs (Ref: Para. 19)

...

²⁴ ISA 220 (Revised), paragraph 18~~32~~

²⁵ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 9

A64. An ISA may include, in a separate section under the heading “Definitions,” a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms relating to International Standards issued by the International Auditing and Assurance Standards Board in the *Handbook of International Quality ~~Control~~ Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC contains a complete listing of terms defined in the ISAs. It also includes descriptions of other terms found in ISAs to assist in common and consistent interpretation and translation.

...

ISA 210, *Agreeing the Terms of Audit Engagements*

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present. ISA 220 (Revised) deals with those aspects of engagement acceptance that are within the control of the auditor. (Ref: Para. A1)

...

Application and Other Explanatory Material

Scope of this ISA (Ref: Para. 1)

- A1. ISQM 1 deals with the firm’s responsibilities regarding the acceptance and continuance of client relationships and specific engagements. Assurance engagements, which include audit engagements, may only be accepted when the practitioner considers that relevant ethical requirements such as independence and professional competence will be satisfied, and when the engagement exhibits certain characteristics. The auditor’s responsibilities in respect of relevant ethical requirements, including those related to independence, in the context of the acceptance of an audit engagement and in so far as they are within the control of the auditor are dealt with in ISA 220 (Revised).²⁶ This ISA deals with those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity’s management to agree.

...

²⁶ ISA 220 (Revised), paragraphs 9–11 ~~14–19~~

ISA 230, *Audit Documentation*

Introduction

...

Nature and Purposes of Audit Documentation

...

3. Audit documentation serves a number of additional purposes, including the following:
- Assisting the engagement team to plan and perform the audit.
 - Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with ISA 220 (Revised).²⁷
 - Enabling the engagement team to be accountable for its work.
 - Retaining a record of matters of continuing significance to future audits.
 - Enabling the conduct of engagement quality control reviews,²⁸ other engagement reviews and monitoring activities under the firm's system of quality management inspections in accordance with ISQC 1²⁹ ~~or national requirements that are at least as demanding~~.³⁰
 - Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

...

Application and Other Explanatory Material

...

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

...

Form, Content and Extent of Audit Documentation (Ref: Para. 8)

...

Documentation of Compliance with ISAs (Ref: Para. 8(a))

...

- A7. Audit documentation provides evidence that the audit complies with the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in

²⁷ ISA 220 (Revised), *Quality Control for an Audit of Financial Statements*, paragraphs 15–17 ~~27–31~~

²⁸ International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*

²⁹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, paragraphs 32–33, 35–38, and 48

³⁰ ISA 220 (Revised), paragraph 2

a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management or, where appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the ISAs.
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with the ISAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
 - Similarly, that the engagement partner has taken responsibility for the nature, timing and extent of direction, and supervision and performance of the audit in compliance with engagement team and the ISAs review of the work performed may be evidenced in a number of ways within the audit documentation. This may include documentation of that evidences the engagement partner's timely sufficient and appropriate involvement in aspects of the audit, such as participation in the engagement team discussions required by ISA 315 (Revised).³⁴

...

Identification of Specific Items or Matters Tested, and of the Preparer and Reviewer (Ref: Para. 9)

...

A13. ISA 220 (Revised) contains requirements and guidance on the requires the auditor to review the audit work performed through review of the audit documentation.³² The requirement to document who reviewed the audit work performed does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

...

³⁴ — ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 10

³² — ISA 220 (Revised), paragraphs 1728–29

Matters Arising after the Date of the Auditor's Report (Ref: Para. 13)

A20. Examples of exceptional circumstances include facts which become known to the auditor after the date of the auditor's report but which existed at that date and which, if known at that date, might have caused the financial statements to be amended or the auditor to modify the opinion in the auditor's report.³³ The resulting changes to the audit documentation are reviewed in accordance with the review responsibilities set out in ISA 220 (Revised).³⁴ ~~with the engagement partner taking final responsibility for the changes.~~

Assembly of the Final Audit File (Ref: Para. 14–16)

A21. ISQCM 1 (or national requirements that are at least as demanding) requires firms to establish policies ~~and/or procedures that require the engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized for the timely completion of the assembly of audit files.~~³⁵ An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.³⁶

...

A23. ISQCM 1 (or national requirements that are at least as demanding) requires firms to establish policies ~~and/or procedures for the retention of engagement documentation~~ that require the engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards.³⁷ The retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report on the group financial statements, when applicable.³⁸

A24. An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need to clarify existing audit documentation arising from comments received during monitoring ~~inspections performed by internal activities or external parties inspections.~~

Appendix

(Ref: Para. 1)

Specific Audit Documentation Requirements in Other ISAs

This appendix identifies paragraphs in other ISAs that contain specific documentation requirements. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISA 210, *Agreeing the Terms of Audit Engagements* – paragraphs 10–12

³³ ISA 560, *Subsequent Events*, paragraph 14

³⁴ ISA 220 (Revised), paragraph 46~~27~~

³⁵ ISQCM 1, paragraph 45~~37(f)(i)~~

³⁶ ISQCM 1, paragraph A54A110

³⁷ ISQCM 1, paragraph 47~~37(f)(ii)~~

³⁸ ISQCM 1, paragraph A64A111

- ISA 220 (Revised), *Quality Control* ~~Control~~ Management for an Audit of Financial Statements – paragraphs 24–25³⁸

...

ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

...

Application and Other Explanatory Material

...

Audit Procedures When Non-Compliance Is Identified or Suspected

...

Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)

...

A25. In certain circumstances, the auditor may consider withdrawing from the engagement, where permitted by law or regulation, for example when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances or the identified or suspected non-compliance raises questions regarding the integrity of management or those charged with governance, even when the non-compliance is not material to the financial statements. The auditor may consider it appropriate to obtain legal advice to determine whether withdrawal from the engagement is appropriate. When the auditor determines that withdrawing from the engagement would be appropriate, doing so would not be a substitute for complying with other responsibilities under law, regulation or relevant ethical requirements to respond to identified or suspected non-compliance. Furthermore, paragraph A9A49 of ISA 220³⁹ (Revised) indicates that some ethical requirements may require the predecessor auditor, upon request by the proposed successor auditor, to provide information regarding non-compliance with laws and regulations to the successor auditor.

ISA 260 (Revised), *Communication with Those Charged with Governance*

...

Application and Other Explanatory Material

...

Matters to Be Communicated

...

Significant Findings from the Audit (Ref: Para. 16)

³⁹ — ISA 220, *Quality Control for an Audit of Financial Statements*

...

Other Significant Matters Relevant to the Financial Reporting Process (Ref: Para. 16(e))

...

A28. To the extent not already addressed by the requirements in paragraphs 16(a)–(d) and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, ~~in accordance with ISA 220.~~⁴⁰

...

Appendix 1

Specific Requirements in ISQCM 1 and Other ISAs that Refer to Communications with Those Charged With Governance

This appendix identifies paragraphs in ISQCM 1⁴¹ and other ISAs that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISQCM 1, *Quality Control Management for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* – paragraph 30(a)41(c)

...

ISA 300, *Planning an Audit of Financial Statements*

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to plan an audit of financial statements. This ISA is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified.

~~The Role and Timing of Planning~~

2. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate quality management at the engagement level in accordance with ISA 220 (Revised), in conjunction with adequate planning in accordance with this ISA, benefits the audit of financial statements in several ways, including the following: (Ref: Para. A1A0–A3)
 - Helping the auditor to devote appropriate attention to important areas of the audit.
 - Helping the auditor identify and resolve potential problems on a timely basis.

⁴⁰ See paragraphs 19–22 and A23–A33 of ISA 220, *Quality Control for an Audit of Financial Statements*.

⁴¹ ISQCM 1, *Quality Control Management for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by auditors of components and experts.

...

Requirements

...

Preliminary Engagement Activities

6. The auditor shall undertake the following activities at the beginning of the current audit engagement:
 - (a) Performing procedures required by ISA 220 (Revised) regarding the acceptance and continuance of the client relationship and the specific audit engagement,⁴²
 - (b) Evaluating compliance with relevant ethical requirements, including those related to independence, in accordance with ISA 220 (Revised);⁴³ and
 - (c) Establishing an understanding of the terms of the engagement, as required by ISA 210.⁴⁴ (Ref: Para. A5–A7)

...

Planning Activities

...

8. In establishing the overall audit strategy, the auditor shall consider the information obtained from complying with the requirements of ISA 220 (Revised) and:
 - (a) Identify the characteristics of the engagement that define its scope;
 - (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
 - (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
 - (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and

⁴² ISA 220 (Revised), *Quality Control/Management for an Audit of Financial Statements*, paragraphs 12–13 and 20–22

⁴³ ISA 220 (Revised), paragraphs 9–11 and 14–19

⁴⁴ ISA 210, *Agreeing the Terms of Audit Engagements*, paragraphs 9–13

- (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.
 (Ref: Para. A8–A11)

...

- 11. The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work as required by ISA 220 (Revised). (Ref: Para. A16–A17)

...

Additional Considerations in Initial Audit Engagements

- 13. The auditor shall undertake the following activities prior to starting an initial audit:
 - (a) Performing procedures required by ISA 220 (Revised) regarding the acceptance of ~~the client relationships and the specific audit engagements~~⁴⁵ and
 - (b) Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements. (Ref: Para. A22)

...

Application and Other Explanatory Material

A0. ISA 220 (Revised) establishes requirements and provides guidance on the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner. Information obtained from complying with the requirements of ISA 220 (Revised) is relevant to this ISA. For example, in accordance with ISA 220 (Revised), the engagement partner is required to determine that sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, given the nature and circumstances of the audit engagement. Such a determination is directly relevant when describing the nature, timing and extent of resources necessary to perform the engagement in the overall strategy, as required by paragraph 8 of this ISA.

The Role and Timing of Planning (Ref: Para. 2)

- A1. The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement. In planning the audit, the auditor may use project management techniques and tools. ISA 220 (Revised)⁴⁶ describes how such techniques and tools may support the engagement partner and the other members of the engagement team in managing the quality of the engagement.

...

- A3. The auditor may decide to discuss elements of planning with the entity's management to ~~facilitate the conduct and management of the audit engagement~~ inform quality management at the engagement level (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan

⁴⁵ ISA 220 (Revised), paragraphs ~~12–13~~ 20–22

⁴⁶ ISA 220 (Revised), paragraphs A63–A64

remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

...

Preliminary Engagement Activities (Ref: Para. 6)

- A5. Performing the preliminary engagement activities specified in paragraph 6 at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to ~~plan and perform the audit engagement~~manage quality at the engagement level in accordance with ISA 220 (Revised).
- A6. Performing ~~these~~ preliminary engagement activities enables the auditor to plan an audit engagement ~~for which in order to~~, for example:
- ~~The auditor maintains~~Maintain the necessary independence and ability to perform the engagement.
 - ~~There~~Determine that there are no issues with management integrity that may affect the auditor's willingness to continue the engagement.
 - ~~There~~Determine that there is no misunderstanding with the client as to the terms of the engagement.
- A7. ~~The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur.~~ Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often occur shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: Para. 7–8)

- A8. The process of establishing the overall audit strategy ~~assists the auditor to determine~~, subject to the completion of the auditor's risk assessment procedures, may include such matters as:
- The ~~nature of~~ resources (human, technological or intellectual) to ~~deploy~~be deployed for specific audit areas, ~~such as~~. For example, the ~~use~~deployment of appropriately experienced team members for high risk areas, or the ~~involvement~~assignment of experts ~~onto~~to address complex matters;
 - The amount of resources to ~~allocate~~be allocated to specific audit areas, ~~such as~~. For example, the number of team members assigned to ~~observe~~attend the physical inventory count at ~~material~~multiple locations; the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
 - When these resources are to be deployed, such as whether at an interim audit stage or at key cutoff dates; and

- How such resources are ~~managed, directed and~~ supervised, ~~such as~~ or used. For example, when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), ~~and whether to complete engagement quality reviews.~~

A8A. ISA 220 (Revised) contains requirements and guidance on engagement resources and engagement performance (including direction and supervision of the members of the engagement team and the review of the work performed).

...

Direction, Supervision and Review (Ref: Para. 11)

A16. ISA 220 (Revised)⁴⁷ establishes requirements and provides guidance on the engagement partner's responsibility for the nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed. ~~The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:~~

- ~~• The size and complexity of the entity.~~
- ~~• The area of the audit.~~
- ~~• The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).~~
- ~~• The capabilities and competence of the individual team members performing the audit work.~~

~~ISA 220 contains further guidance on the direction, supervision and review of audit work.⁴⁸~~

~~Considerations Specific to Smaller Entities~~

A17. ~~If an audit is carried out entirely by the engagement partner, questions of direction and supervision of engagement team members and review of their work do not arise. In such cases, the engagement partner, having personally conducted all aspects of the work, will be aware of all material issues. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved, and the audit is performed by a sole practitioner, it may be desirable to consult with other suitably experienced auditors or the auditor's professional body.~~

Documentation (Ref: Para. 12)

A18. The documentation of the overall audit strategy is a record of the key decisions ~~considered necessary to properly plan the audit and~~ in managing quality at the engagement level and a means to communicate significant matters to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

⁴⁷ ISA 220 (Revised), paragraphs 27–29

⁴⁸ ~~ISA 220, paragraphs 15–17~~

...

Additional Considerations in Initial Audit Engagements (Ref: Para. 13)

A22. The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Unless prohibited by law or regulation, arrangements to be made with the predecessor auditor, for example, to review the predecessor auditor's working papers.
- Any major issues (including the application of accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances.⁴⁹
- Other procedures required responses designed and implemented by the firm's system of quality control for initial audit engagements (for example, e.g., the firm's system of quality control management may include responses that require the involvement of another partner or senior individual with appropriate authority to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

Appendix

(Ref: Para. 7–8, A8–A11)

Considerations in Establishing the Overall Audit Strategy

This appendix provides examples of matters the auditor may consider in ~~establishing the overall audit strategy~~ managing quality at the engagement level. Many of these matters will also influence the auditor's overall audit strategy and detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. While some of the matters referred to below may be required by other ISAs, not all matters are relevant to every audit engagement and the list is not necessarily complete.

...

Nature, Timing and Extent of Resources

- The ~~selection~~ human, technological and intellectual resources assigned or made available to the engagement (e.g., assignment of the engagement team (including, where necessary, the engagement quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement).

⁴⁹ ISA 510, *Initial Audit Engagements—Opening Balances*

- Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

ISA 500, *Audit Evidence*

...

Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

- A1. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit⁵⁰) or ~~a firm's quality control procedures for client acceptance and continuance~~through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

...

Information to Be Used as Audit Evidence

Relevance and Reliability (Ref: Para. 7)

- A26. As noted in paragraph A1, while audit evidence is primarily obtained from audit procedures performed during the course of the audit, it may also include information obtained from other sources ~~such as, for example, previous audits, in certain circumstances, a firm's quality control procedures for client acceptance and continuance and~~through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement and in complying with certain additional responsibilities under law, regulation or relevant ethical requirements (e.g., regarding an entity's non-compliance with laws and regulations). The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.

...

⁵⁰ ISA 315 (Revised), paragraph 9

ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

...

Application and Other Explanatory Material

...

Risk Assessment Procedures and Related Activities

...

Specialized Skills or Knowledge (Ref: Para. 15)

A61. Matters that may affect the auditor's determination of whether the engagement team requires specialized skills or knowledge, include, for example:⁵¹

- The nature of the accounting estimates for a particular business or industry (for example, mineral deposits, agricultural assets, complex financial instruments, insurance contract liabilities).

...

ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Introduction

Scope of this ISA

...

4. In accordance with ISA 220 (Revised),⁵² the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities, including sufficient time. The group engagement partner is also responsible for the direction, supervision and performance of the group audit engagement.
5. The group engagement partner applies the requirements of ISA 220 (Revised) regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This ISA assists the group engagement partner to meet the requirements of ISA 220 (Revised) where component auditors perform work on the financial information of components.

...

⁵¹ ISA 220 (Revised), *Quality Control/Management for an Audit of Financial Statements*, paragraphs 1423–24 and ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

⁵² ISA 220 (Revised), *Quality Control/Management for an Audit of Financial Statements*, paragraphs 14–15

Requirements

...

Acceptance and Continuance

12. In applying ISA 220 (Revised), the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. (Ref: Para. A10–A12)

...

ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

Introduction

...

Requirements

...

Using Internal Auditors to Provide Direct Assistance

...

34. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220 (Revised).⁵³ In so doing:
- (a) The nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29 of this ISA; and
 - (b) The review procedures shall include the external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors.

The direction, supervision and review by the external auditor of the work performed by the internal auditors shall be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work. (Ref: Para. A40–A41)

...

⁵³ ISA 220 (Revised), *Quality Control/Management for an Audit of Financial Statements*

Application and Other Explanatory Material

...

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used

Evaluating the Internal Audit Function

...

Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

...

A11. Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

- The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
- Whether the internal audit function has appropriate quality control policies and procedures, for example, ~~such as those policies and procedures in ISQC 1~~⁵⁴ that would be applicable to an internal audit function (such as those relating to leadership, human resources and engagement performance) or quality control requirements in standards set by the relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements such as conducting periodic external quality assessments.

...

ISA 620, *Using the Work of an Auditor's Expert*

Introduction

Scope of this ISA

...

2. ISA does not deal with:

- (a) Situations where the engagement team includes a member, or consults an individual or organization, with expertise in a specialized area of accounting or auditing, which are dealt with in ISA 220 (Revised)⁵⁵ or
- (b) The auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the

⁵⁴ ~~International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*~~

⁵⁵ ISA 220 (Revised), *Quality Control Management for an Audit of Financial Statements*, paragraphs A11, A21–A23A56

entity in preparing the financial statements (a management's expert), which is dealt with in ISA 500.⁵⁶

...

Requirements

...

Nature, Timing and Extent of Audit Procedures

8. The nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 9–13 of this ISA will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including: (Ref: Para. A10)
- (a) The nature of the matter to which that expert's work relates;
 - (b) The risks of material misstatement in the matter to which that expert's work relates;
 - (c) The significance of that expert's work in the context of the audit;
 - (d) The auditor's knowledge of and experience with previous work performed by that expert; and
 - (e) Whether that expert is subject to the auditor's firm's system of quality control policies and procedures management. (Ref: Para. A11–A13)

Application and Other Explanatory Material

...

Determining the Need for an Auditor's Expert (Ref: Para. 7)

...

- A6. If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement.⁵⁷ Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement.⁵⁸ The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert.

...

⁵⁶ ISA 500, *Audit Evidence*, paragraphs A35–A49

⁵⁷ ISA 220 (Revised), paragraph 14~~24~~

⁵⁸ ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

Nature, Timing and Extent of Audit Procedures (Ref: Para. 8)

A10. The nature, timing and extent of audit procedures with respect to the requirements in paragraphs 9–13 of this ISA will vary depending on the circumstances. For example, the following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's expert relates to a significant matter that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's expert, and has no prior knowledge of that expert's competence, capabilities and objectivity.
- The auditor's expert is performing procedures that are integral to the audit, rather than being consulted to provide advice on an individual matter.
- The expert is an auditor's external expert and is not, therefore, subject to the firm's system of quality control policies and procedures management.

The Auditor's Firm's System of Quality Control Policies and Procedures Management (Ref: Para. 8(e))

A11. An auditor's internal expert may be a partner or staff, including temporary staff, of the auditor's firm, and therefore subject to the system of quality control policies and procedures management of that firm in accordance with ISQCM 1⁵⁹ or national requirements that are at least as demanding.⁶⁰ ~~Alternatively, an~~ An auditor's internal expert may also be a partner or staff, including temporary staff, of a network firm, which may share common quality control management policies ~~and/or~~ procedures with the auditor's firm.

A12. An auditor's external expert is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with ISQC 1.⁶¹ ~~In some jurisdictions, however, the firm's system of quality management in accordance with ISQM 1.~~⁶² However, ISQM 1 includes requirements for the firm when the firm intends to obtain or use resources provided by a service provider in performing engagements, which includes the use of an external expert.⁶³ Relevant ethical requirements or law or regulation may require that an auditor's external expert be treated as a member of the engagement team, and the external expert may therefore be subject to relevant ethical requirements, including those pertaining related to independence, and other professional requirements, as determined by ~~that~~ the relevant ethical requirements or law or regulation.

A13. ~~Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise.~~⁶⁴ ~~The extent of that reliance will vary with the circumstances, and may affect the nature, timing and extent of the auditor's procedures with respect to such matters as~~ As described in ISA 220 (Revised),⁶⁵ quality management at the

⁵⁹ ISQCM 1, Quality Control Management for Firms that Perform Audits and/or Reviews of Financial Statements, and/or Other Assurance and/or Related Services Engagements, paragraph 1219(f)

⁶⁰ ISA 220 (Revised), paragraph 23

⁶¹ ISQC 1, paragraph 12(f)

⁶² ISQM 1, paragraph 19(f)

⁶³ ISQM 1, paragraphs 64–65

⁶⁴ ISA 220, paragraph 4

⁶⁵ ISA 220 (Revised), paragraph A5

engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. The auditor may be able to depend on the firm's related policies or procedures in respect of:

- Competence and capabilities, through recruitment and training programs.
- Objectivity. Auditor's internal experts are subject to relevant ethical requirements, including those ~~pertaining~~relating to independence.
- The auditor's evaluation of the adequacy of the auditor's expert's work. For example, the firm's training programs may provide auditor's internal experts with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm ~~processes, such as protocols for scoping the work of auditor's internal experts,~~ may affect the nature, timing and extent of the auditor's procedures to evaluate the adequacy of the auditor's expert's work.
- Adherence to regulatory and legal requirements, through monitoring processes.
- Agreement with the auditor's expert.

~~Such reliance~~Matters that the auditor may take into account when determining whether, and if so, the degree to which, the auditor may depend on the firm's policies or procedures are described in ISA 220 (Revised). Dependence on the firm's policies or procedures does not reduce the auditor's responsibility to meet the requirements of this ISA.

The Competence, Capabilities and Objectivity of the Auditor's Expert (Ref: Para. 9)

...

- A15. Information regarding the competence, capabilities and objectivity of an auditor's expert may come from a variety of sources, such as:
- Personal experience with previous work of that expert.
 - Discussions with that expert.
 - Discussions with other auditors or others who are familiar with that expert's work.
 - Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
 - Published papers or books written by that expert.
 - The auditor's firm's system of quality control policies and procedures~~management~~ (see paragraphs A11–A13).
- A18. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may eliminate or reduce such threats, and may be created by external structures (~~for example, e.g.,~~ the auditor's expert's profession, legislation or regulation), or by the auditor's expert's work environment (~~for example, quality control, e.g.,~~ the firm's policies ~~and/or~~ procedures or the external expert's organization's policies or procedures). There may also be safeguards specific to the audit engagement.

...

Agreement with the Auditor's Expert (Ref: Para. 11)

...

A26. When there is no written agreement between the auditor and the auditor's expert, evidence of the agreement may be included in, for example:

- Planning memoranda, or related working papers such as the audit program.
- The policies ~~and/or~~ procedures of the auditor's firm's system of quality management. In the case of an auditor's internal expert, the ~~established policies and procedures~~requirements to which that expert is subject under the firm's system of quality management may include, for example, particular policies ~~and/or~~ procedures in relation to that expert's work. The extent of documentation in the auditor's working papers depends on the nature of such policies ~~and/or~~ procedures. For example, no documentation may be required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an expert is used.

...

ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

...

Application and Other Explanatory Material

...

Auditor's Report (Ref: Para. 20)

...

Auditor's Report for Audits Conducted in Accordance with International Standards on Auditing

...

Name of the Engagement Partner (Ref: Para. 46)

A61. ~~ISQC 1⁶⁶ requires that~~ The objective of the firm establish policies in ISQM 1⁶⁷ is to design, implement and procedures to provide operate a system of quality management that provides the firm with reasonable assurance that engagements are performed;

- The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

⁶⁶ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, paragraph 32

⁶⁷ ISQM 1, *Quality Control for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 18

- Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Notwithstanding ~~these~~ the objective of ISQCM 1 requirements, naming the engagement partner in the auditor's report is intended to provide further transparency to the users of the auditor's report on financial statements of a listed entity.

...

ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

...

Application and Other Explanatory Material

...

Determining Key Audit Matters (Ref: Para. 9–10)

...

Matters that Required Significant Auditor Attention (Ref: Para. 9)

...

A15. Various ISAs require specific communications with those charged with governance and others that may relate to areas of significant auditor attention. For example:

- ISA 260 (Revised) requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.⁶⁸ The ISAs acknowledge potential difficulties in relation to, for example:
 - Related party transactions,⁶⁹ in particular limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's length transaction.
 - Limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.⁷⁰
- ISA 220 (Revised) establishes requirements for the engagement partner in relation to undertaking appropriate consultation on matters where the firm's policies or procedures require consultation, difficult or contentious matters,⁷¹ and other matters that in the engagement

⁶⁸ ISA 260 (Revised), paragraphs 16(b) and A21

⁶⁹ ISA 550, *Related Parties*, paragraph A42

⁷⁰ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 49(d)

⁷¹ ISA 220 (Revised), *Quality Control/Management for an Audit of Financial Statements*, paragraph 48~~32~~

partner's professional judgment, require consultation. For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality ~~control~~ reviewer.⁷²

...

Communication with Those Charged with Governance (Ref: Para. 17)

...

A63. The requirement in paragraph 17(b) to communicate with those charged with governance when the auditor has determined there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality ~~control~~ reviewer, where one has been appointed). These discussions may cause the auditor to re-evaluate the auditor's determination that there are no key audit matters.

...

ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

...

Application and Other Explanatory Material

...

Reading and Considering the Other Information (Ref: Para. 14–15)

...

A24. In accordance with ISA 220 (Revised),⁷³ the engagement partner is required to take responsibility for the ~~direction, supervision and performance of the audit engagement~~ nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed, and be satisfied that such direction, supervision and review is in compliance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements. In the context of this ISA, factors that may be taken into account when determining the appropriate engagement team members to address the requirements of paragraphs 14–15, include:

- The relative experience of engagement team members.
- Whether the engagement team members to be assigned the tasks have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge.

⁷² ISA 220 (Revised), paragraph 19~~33~~

⁷³ ISA 220 (Revised), *Quality Control*~~Management~~ for an Audit of Financial Statements, paragraph 15~~27~~(a)

- The degree of judgment involved in addressing the requirements of paragraph 14–15. For example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members.
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component.

...

IAPN 1000, *Special Considerations in Auditing Financial Instruments*

Contents

International Auditing Practice Note (IAPN) 1000, *Special Considerations in Auditing Financial Instruments*, should be read in conjunction with the *Preface to the International Quality Control Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*. IAPNs do not impose additional requirements on auditors beyond those included in the International Standards on Auditing (ISAs), nor do they change the auditor's responsibility to comply with all ISAs relevant to the audit. IAPNs provide practical assistance to auditors. They are intended to be disseminated by those responsible for national standards, or used in developing corresponding national material. They also provide material that firms can use in developing their training programs and internal guidance.

...

Section II—Audit Considerations Relating to Financial Instruments

...

Planning Considerations⁷⁴

...

*Using Those with Specialized Skills and Knowledge in the Audit*⁷⁵

⁷⁴ ISA 300, *Planning an Audit of Financial Statements*, deals with the auditor's responsibility to plan an audit of financial statements.

⁷⁵ When such a person's expertise is in auditing and accounting, regardless of whether the person is from within or external to the firm, this person is considered to be part of the engagement team and is subject to the requirements of ISA 220 (Revised), *Quality Control Management for an Audit of Financial Statements*. When such a person's expertise is in a field other than accounting or auditing, such person is considered to be an auditor's expert, and the provisions of ISA 620, *Using the Work of an Auditor's Expert*, apply. ISA 620 explains that distinguishing between specialized areas of accounting or auditing, and expertise in another field, will be a matter of professional judgment, but notes the distinction may be made between expertise in methods of accounting for financial instruments (accounting and auditing expertise) and expertise in complex valuation techniques for financial instruments (expertise in a field other than accounting or auditing).

78. A key consideration in audits involving financial instruments, particularly complex financial instruments, is the competence of the auditor. ISA 220 (Revised)⁷⁶ requires the engagement partner to be satisfied that members of the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the ~~appropriate~~ competence and capabilities, including sufficient time, to perform the audit engagement ~~in accordance with professional standards and applicable legal and regulatory requirements and to enable an auditor's report that is appropriate in the circumstances to be issued~~. Further, relevant ethical requirements⁷⁷ require the auditor to determine whether acceptance of the engagement would create any threats to compliance with the fundamental principles, including the professional competence and due care. Paragraph 79 below provides examples of the types of matters that may be relevant to the auditor's considerations in the context of financial instruments.

...

⁷⁶ ISA 220 (Revised), paragraph 1424

⁷⁷ IESBA *Code of Ethics for Professional Accountants* paragraphs 210.1 and 210.6

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Exposure Draft
February 2019
Comments due: July 1, 2019

International Standard on Quality Management

**Proposed International Standard
on Quality Management 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*

IAASB

International Auditing
and Assurance
Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

This Exposure Draft, proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the “[Submit a Comment](#)” link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

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Section 1 Introduction

1. This memorandum provides background to, and an explanation of, the Exposure Draft of proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1¹), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1), which the IAASB approved for exposure in December 2018. The sections that follow describe the key issues considered by the IAASB in developing ED-ISQM 1. The proposed revisions address the most relevant public interest issues related to firms' systems of quality control, including those highlighted in the Invitation to Comment (ITC) released in December 2015, [*Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*](#).
2. ED-ISQM 1 is part of a package of proposed quality management standards on which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, [*The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level*](#). The overall explanatory memorandum includes background to the IAASB's three quality management Exposure Drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

Section 2 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-ISQM 1, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are free to address only questions relevant to them. When a respondent agrees with the proposals in ED-ISQM 1, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

Section 3 Significant Matters

Section 3A – A New Approach Focused on Quality Management

3. An effective system of quality control provides the foundation for the approach to achieving consistent engagement quality, as it sets out what is needed in a firm's system of quality control to manage the quality of engagements performed by the firm. Extant ISQC 1 requires firms to establish and maintain a system of quality control and specifies the policies and procedures that firms are required to establish as part of the system of quality control.
4. In the wake of the financial crisis, many companies responded to the changing environment and emerging corporate governance risks by revisiting their business practices and relevant activities. Questions have arisen about whether extant ISQC 1 remains fit for purpose, given the evolving environment in which firms operate, the intensifying focus on quality and the increasing expectations of firms' stakeholders. Furthermore, the findings from the post-implementation review of the clarified

¹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

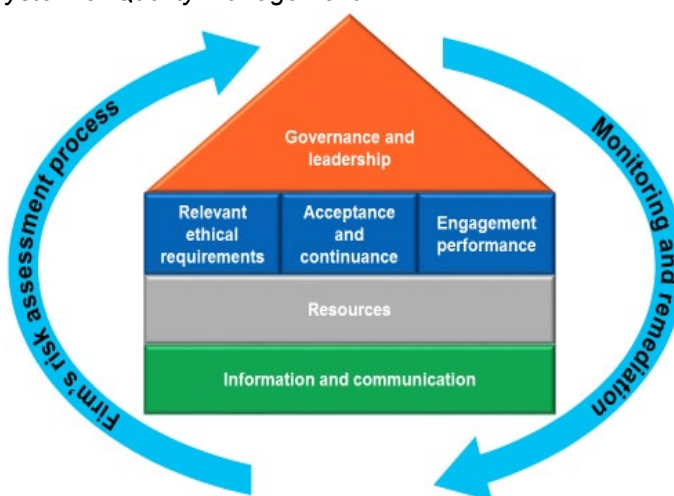
ISAs, inspection findings and ongoing outreach have suggested that several aspects of extant ISQC 1 could be more robust, and that additional action is needed to address the proportional application of the standard by small- and medium-sized practitioners (SMPs).

5. Recognizing these issues, the ITC highlighted several public interest issues, which included the need for proactive management of quality and keeping the standard fit for purpose. The ITC suggested that a new approach to quality control at the firm level is needed that emphasizes the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide. As a result, the ITC proposed a new approach for ISQC 1, the quality management approach.
6. Respondents to the ITC supported the quality management approach because it is more risk-based and proactive, and agreed that the approach could provide benefits for firms' systems of quality control, including that it would likely enhance the ability for firms to proportionately apply the standard. However, some respondents noted that only limited information had been provided in the ITC about the new approach and cautioned that the new approach should not simply result in add-ons to the existing requirements that may result in compliance with the standard becoming unnecessarily onerous, particularly for SMPs. On the other hand, other respondents were concerned that a new approach could diminish the robustness of ISQC 1 because the approach would involve more judgment and some of the requirements of the extant standard may not be adapted to the risk-based approach appropriately.
7. The IAASB concluded that in order to substantively enhance firms' management of engagement quality and at the same time improve the scalability of the standard, ED-ISQM 1 should incorporate the new quality management approach that would be focused on proactively identifying and responding to risks to quality. This approach would include other enhancements to address key issues highlighted in the ITC to improve the robustness of firms' systems of quality management (e.g., enhanced requirements and focus on governance and leadership, monitoring and remediation, and circumstances when a firm belongs to a network).
8. The essence of the new approach is to focus firms' attention on risks that may have an impact on engagement quality. Unlike extant ISQC 1, the new approach requires a firm to customize the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs. The new approach also requires the firm to transition from policies and procedures that address standalone elements, as required by extant ISQC 1, to an integrated approach that reflects upon the system as a whole.
9. The new approach, termed quality management, is expected to generate multiple benefits for firms' systems of quality management that support the consistent performance of quality engagements, including:

The new quality management approach aims to improve the scalability of ED-ISQM 1 because it requires a firm to **customize** the design, implementation and operation of its system of quality management based on the **nature and circumstances of the firm and the engagements it performs**

- (a) A system that is tailored for the nature and circumstances of the firm and the engagements it performs, thereby improving the robustness and effectiveness of activities undertaken by the firm to address engagement quality. A tailored system of quality management may also result in improved utilization of firm resources.
 - (b) Facilitating a proactive response by the firm to changing circumstances and proactively managing or mitigating risks, and promoting continual improvement and responsiveness. This new approach will also aid in keeping the standard fit for purpose and adaptable to a changing environment.
 - (c) Increased emphasis on monitoring the system as a whole and timely and effective remediation, to promote ongoing improvement and consideration of the appropriateness of the system, including whether it is effective in supporting engagement quality.
 - (d) Improved integration of the components of the system, thereby promoting an ongoing process of improvement, and consideration of the effect of decisions across the system.
10. In incorporating the new approach into the standard, the IAASB considered many other risk management and governance frameworks, such as the COSO Integrated Framework (2013).² ED-ISQM 1 has many similarities to these frameworks, where the aim is to achieve objectives or principles through managing risks to achieving those objectives. The IAASB also undertook outreach with firms that have begun to adopt risk-based approaches in their systems of quality control.
11. Given the new references to quality management, the title of the standard and other references to quality control in the requirements and application material have been changed to refer to quality management. The IAASB recognizes that many jurisdictions have law or regulation that requires firms to adopt ISQC 1 or otherwise refer to ISQC 1 in jurisdictional professional standards, and changing the title may create the need for law or regulation or jurisdictional standards to be amended. However, the IAASB notes the introduction of ED-ISQM 2, which may also create the need for amendments to law or regulation or jurisdictional standards. The IAASB is seeking views of respondents as to whether the change in title will create significant difficulties in adopting the standard at a jurisdictional level (see question 15).

The Components of a System of Quality Management



² Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework* (2013)

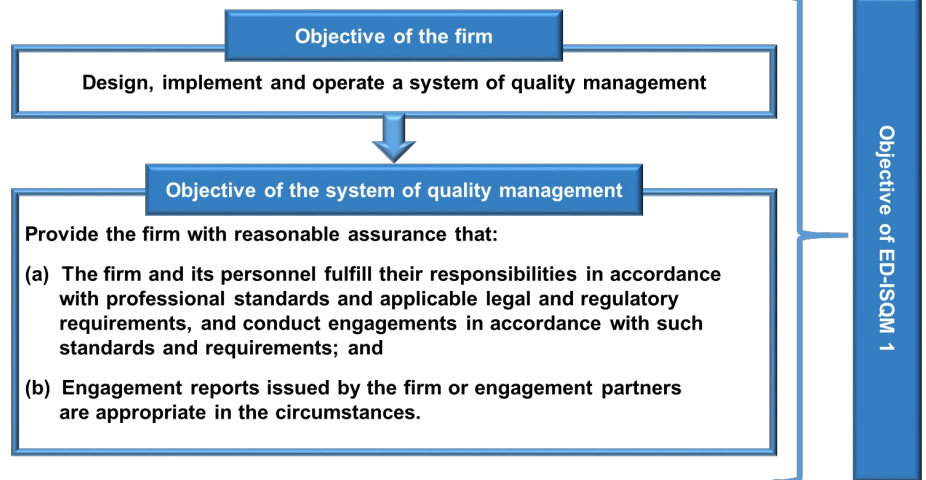
12. In determining the key components of the system of quality management that need to be addressed in ED-ISQM 1, the IAASB considered the organization of the other risk management and governance frameworks highlighted previously and how the elements in extant ISQC 1 should be retained. The IAASB agreed that retaining the elements of extant ISQC 1 is important as they reflect topics that continue to be relevant to a firm's system of quality management and provide a necessary link to the management of quality at the engagement level (i.e., ED-220³). The eight components of the proposed system of quality management, which are depicted in the diagram, are as follows:
- (a) Governance and leadership (adapted from "leadership responsibilities for quality within the firm" in extant ISQC 1);
 - (b) The firm's risk assessment process (new);
 - (c) Relevant ethical requirements;
 - (d) Acceptance and continuance of client relationships and specific engagements;
 - (e) Engagement performance;
 - (f) Resources (adapted from "human resources" in extant ISQC 1);
 - (g) Information and communication (new); and
 - (h) Monitoring and remediation process (adapted from "monitoring" in extant ISQC 1).
13. While ED-ISQM 1 is organized according to the eight components, firms are not required to organize their systems according to these discrete components (see paragraph A5 of ED-ISQM 1). ED-ISQM 1 only requires that a firm meet all of the requirements of the standard in designing, implementing and operating its system of quality management. For example, provided that all of the requirements of the standard are still met, a firm may have different names for the components, may combine the components or may have additional components.
14. Unlike the elements of extant ISQC 1 that appear disconnected from one another, the eight components in ED-ISQM 1 are specifically designed and described as highly integrated. For example, resources and information and communication are essential aspects that enable the operation of each of the other components of the system of quality management. The integration of the components means that the system of quality management does not operate in a linear manner. As a result, many aspects of ED-ISQM 1 would be designed, implemented and operated by the firm in an iterative manner.
15. In order to provide an overall understanding of the integrated nature of the system, the introductory paragraphs of the standard provide a summary explanation of the components (see paragraphs 8–13 of ED-ISQM 1). Additionally, the interrelationships between the components have been emphasized and explained throughout ED-ISQM 1. However, the IAASB agreed that matters that relate to more than one component should not be repeated in each component because that would result in a voluminous standard and be perceived as more prescriptive. For example, communication of independence matters is not specifically required in the relevant ethical requirements component because it is addressed by the broader requirements in the information and communication component.

³ Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

Section 3B – General Considerations

Objective of the Standard

16. The *objective of the firm* in the context of the standard is to design, implement and operate a system of quality management.
17. The system of quality management is designed to achieve the following two objectives, which are similar to the objectives in extant ISQC 1:
- The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
 - Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.
18. An effective system of quality management provides the firm with reasonable assurance regarding the achievement of the two objectives (see paragraph A3 of ED-ISQM 1). A system of quality management cannot be designed to provide absolute assurance, because of the inherent limitations of a system, for example, human error or uncertainty in judgments. The term "reasonable assurance" rather than "absolute assurance" acknowledges that limitations exist in all systems of quality management, and that uncertainties and risks may exist that cannot be predicted. Accordingly, the *objective of the system of quality management* is to provide the firm with reasonable assurance regarding the achievement of the objectives. In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (i.e., in the case of an assurance engagement). Instead, reasonable assurance is obtained through the operation of the system as a whole. This approach is similar to other risk management and governance frameworks.



Public Interest

19. In the ITC, one of the actions proposed to address the culture of the firm and responsibility and accountability of leadership for quality was to emphasize in the introduction or application material the importance of relevant public interest considerations in relation to the design of the firm's system of quality control. Respondents to the ITC had mixed views about this proposal and indicated that there is no common interpretation or understanding of the term "public interest."
20. The International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code) indicates that professional accountants have a responsibility to act in the public interest. The IAASB is of the view that although public interest considerations vary across engagement types, the consistent performance of quality engagements is integral to a firm's responsibility to act in the public interest. As a result, paragraph 23(c) of ED-ISQM 1 describes the firm's role in serving the public interest, and paragraphs 7 and A2 of the standard explain the meaning of this term and its relationship to the Code.

21. Paragraph 7 of ED-ISQM 1 also explains the connection between the public interest and the objective of the standard. However, some Board members were of the view that the firm's role to act in the public interest should be explicitly referred to in the objective of the standard. Others were of the view that without explicit criteria, a reference to acting in the public interest in the objective would result in an objective that is not capable of being consistently measured, observed or attained. The IAASB is seeking the views of respondents on whether it is clear how achieving the objective of the standard relates to the firm's public interest role (see question 5).

Professional Judgment and Professional Skepticism

Professional Skepticism at the Engagement Level

22. One of the most significant public interest issues highlighted in the ITC is fostering an appropriately independent and challenging skeptical mindset of the auditor. The IAASB recognizes that many aspects of the firm's system of quality management support the exercise of professional skepticism at the engagement level. For example:
- (a) The firm's culture and the tone set by leadership should promote the importance of quality, and the need to exercise professional skepticism when performing audit, review or other assurance engagements.
 - (b) Allocating appropriate resources to perform engagements may prevent impediments to professional skepticism, such as limited time, knowledge or experience.

Given the pervasive effect of the system of quality management on supporting professional skepticism at the engagement level, ED-ISQM 1 does not specifically highlight which aspects of the system support professional skepticism. However, an emphasis on professional skepticism at the engagement level has been made in the introductory section and the engagement performance component (see paragraphs 7 and 36(b) of ED-ISQM 1). Furthermore, ED-220 addresses professional skepticism in the context of managing quality at the engagement level through explaining the impediments to the exercise of professional skepticism and actions that the engagement partner may take to deal with such impediments.

Professional Judgment and Professional Skepticism at the Firm Level

23. Unlike extant ISQC 1, ED-ISQM 1 explicitly requires the firm to exercise professional judgment in applying the requirements of the standard. Doing so is necessary so that a firm's system of quality management is appropriately tailored to the nature and circumstances of the firm and the engagements it performs. The need to exercise professional judgment is reinforced throughout the standard and a definition of professional judgment has been introduced (see, for example, paragraphs 7, 8, 19(n) and 22 of ED-ISQM 1).
24. The IAASB considered whether the concept of professional skepticism is relevant to professional judgments made about the system, and agreed that professional skepticism is a concept that is relevant to judgments made in performing engagements. Nevertheless, the IESBA's project addressing the [role, mindset and behavioral characteristics expected of all professional accountants when performing their professional activities](#) may be relevant to professional judgments made about the system of quality management, and the IAASB will continue to coordinate with IESBA in considering the impact of that project on ED-ISQM 1.

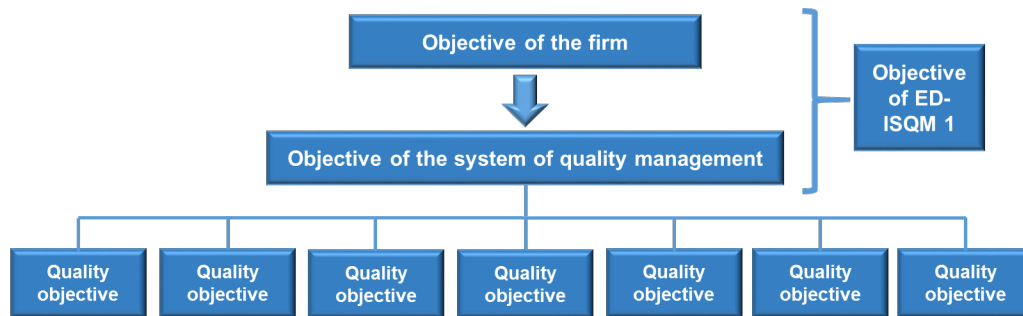
Section 3C – The Firm’s Risk Assessment Process

25. As explained in Section 3A, ED-ISQM 1 includes a new approach that focuses firms’ attention on risks that may have an impact on engagement quality. ED-ISQM 1 includes a component, the firm’s risk assessment process, which comprises the process the firm is required to follow in implementing the risk-based approach to quality management. The firm’s risk assessment process is applied to the other seven components of the system of quality management, i.e., the firm is required to use this process in establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses for the other seven components.
26. As explained previously in this explanatory memorandum, ED-ISQM 1 does not require that firms organize their systems according to the components. Accordingly, firms may perform the firm’s risk assessment process in a variety of ways, for example, the process may be applied to the firm as a whole for all components together, the process may be applied individually to each component, or the process may be applied to individual business units or service lines (see paragraph A48 of ED-ISQM 1).



Establish Quality Objectives

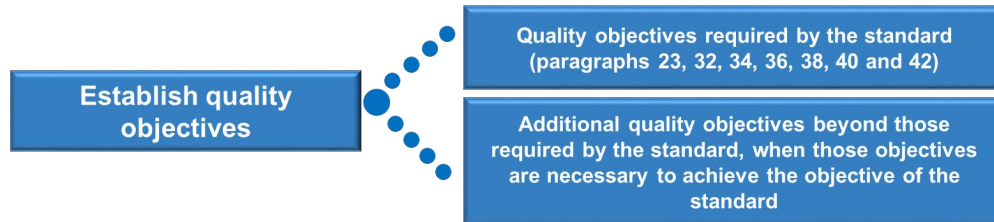
27. The quality objectives established by the firm consist of objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved (see paragraph 19(p) of ED-ISQM 1). The relationship between the quality objectives, the objective of the system of quality management and the objective of the standard is as follows:



28. ED-ISQM 1 includes quality objectives that all firms are required to establish (see paragraphs 23, 32, 34, 36, 38, 40 and 42 of ED-ISQM 1). The quality objectives are outcome-based and how they are achieved is determined by the firm, thereby improving the scalability of the standard. The quality objectives required by the standard comprise important aspects of extant ISQC 1 that have been retained⁴ as well as objectives that have been introduced to address key issues highlighted in the ITC or elements the IAASB considers necessary for a system of quality management.

⁴ In developing the quality objectives, the IAASB identified that there was an inconsistent level of granularity across the requirements in extant ISQC 1. As a result, some of the requirements transposed from extant ISQC 1 are less specific in ED-ISQM 1 to ensure a consistent level of granularity across the quality objectives.

29. The IAASB is of the view 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. However, the IAASB recognizes that the nature and circumstances of firms and the engagements they perform will vary, which may give rise to the need for the firm to establish additional quality objectives beyond those set out in the standard in order to achieve the objective of the standard. Accordingly, the firm is required to establish additional quality objectives beyond those required by the standard, when those objectives are necessary to achieve the objective of the standard (see paragraph 26 of ED-ISQM 1). This requirement will also aid in keeping the standard fit for purpose and adaptable to a changing environment. A description of the purpose of each component has been included in each lead-in to the requirement to establish quality objectives.⁵



30. The IAASB debated whether there should also be a requirement for firms to establish more granular quality objectives than those required by the standard in order to facilitate the identification and assessment of quality risks, i.e., a requirement for the firm to break down the quality objectives required by the standard into more specific quality objectives. The IAASB agreed that such a requirement would not be necessary, as some firms may identify high-level objectives that may be as effective in providing a basis for the identification and assessment of quality risks as firms that choose to establish more granular quality objectives. Accordingly, establishing more granular quality objectives is not required (see paragraph A49 of ED-ISQM 1).

Identify and Assess Quality Risks

31. A risk-based approach supports the firm in focusing its efforts and resources on areas where they are needed the most. ED-ISQM 1 recognizes that it is not reasonable or practicable for firms to identify and assess every possible risk, and to design and implement responses for every risk (see paragraph A54 of ED-ISQM 1). Accordingly, ED-ISQM 1 includes a process for identifying and assessing quality risks that includes a threshold for identifying quality risks and a requirement to assess those risks identified, such that the nature, timing and extent of the responses designed and implemented by the firm are appropriately focused on what is important for the system of quality management. The threshold for identifying quality risks is those risks for which (a) there is a reasonable possibility of the risk occurring; and (b) if the risk were to occur, it may individually or in



⁵ For example, paragraph 38 of ED-ISQM 1 describes the resources component as "appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management."

combination with other quality risks, have a significant effect on the achievement of a quality objective(s).

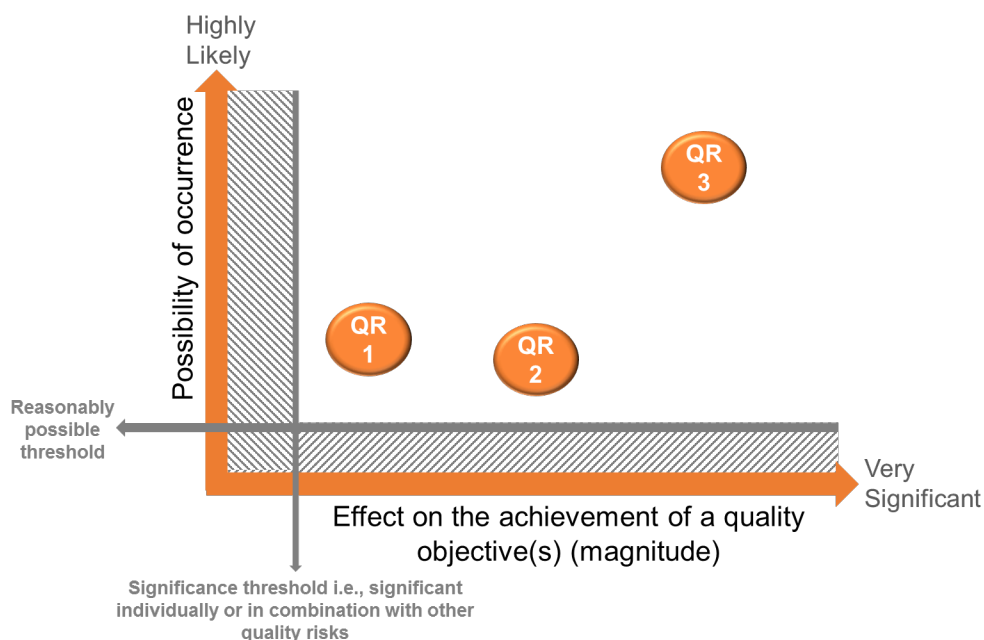
32. The IAASB is of the view that a consistent approach to identifying and assessing risks across the IAASB's standards helps to reinforce key concepts of a risk-based approach. Accordingly, the approach for identifying and assessing quality risks in ED-ISQM 1 echoes the principles in the IAASB's recently published Exposure Draft, ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* (ED-315).⁶
33. The process in ED-ISQM 1 consists of two steps:
- Identifying the quality risks that meet the threshold described in paragraph 31, based on a preliminary consideration of the possibility of the quality risks occurring and their effect on the achievement of the quality objectives (see paragraph 28 of ED-ISQM 1); and
 - Assessing the identified quality risks, which involves a more detailed consideration of the degree of the likelihood of the quality risks occurring and the significance of the effect of the identified quality risks on the achievement of the quality objectives (see paragraph 29 of ED-ISQM 1). The purpose of assessing the quality risks is to assist the firm in designing and implementing responses, because the reasons for the assessment of the quality risks affect the nature, timing and extent of the responses.

The IAASB acknowledges that in some instances, the two steps may be undertaken concurrently by the firm. However, the firm is not expected to assess every quality risk; the firm is only expected to assess those risks that reach the threshold criteria. The process for identifying quality risks and the further assessment is depicted as follows:



⁶ The IAASB plans to consider the feedback from respondents on ED-315 as it relates to the concepts incorporated in ED-ISQM 1, including whether the threshold of "a reasonable possibility of occurring" is appropriate.

34. As explained above, the assessment of the identified quality risks involves a more detailed consideration of the possibility of occurrence and effect on the achievement of a quality objective(s), and may entail an analysis such as the following:



35. Unlike the quality objectives, ED-ISQM 1 does not identify quality risks that are applicable for all firms. The firm is expected to identify and assess its own quality risks for the quality objectives set forth in the standard and any additional quality objectives that the firm has established, taking into account the nature and circumstances of the firm and the engagements it performs. As a result, the quality risks identified and assessed by the firm are customized and tailored for the firm. The IAASB is of the view that specifying quality risks in the standard would result in less tailored quality risks and would likely drive a checklist-based approach to implementing the standard, contrary to the new quality management approach.

Design and Implement Responses

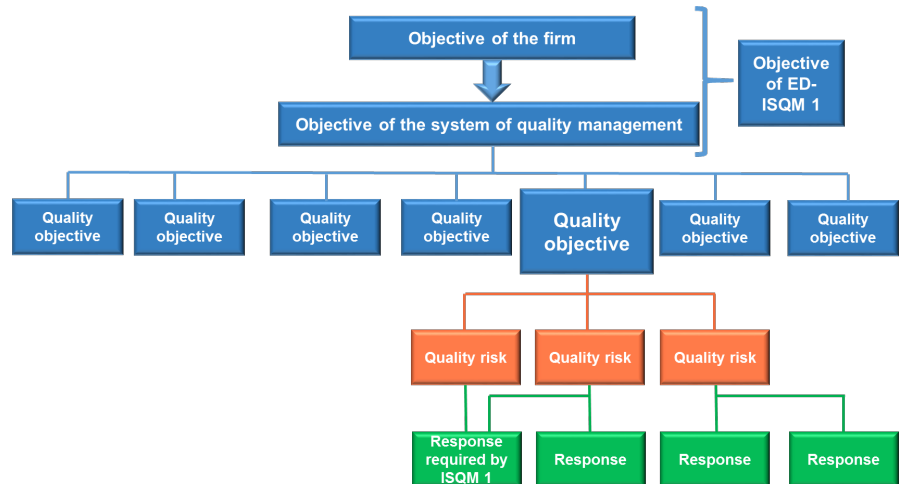
Definition of Responses

36. The definition of controls in ED-315 refers to policies or procedures, consistent with the COSO Integrated Framework (2013).⁷ The IAASB is of the view that responses to quality risks are analogous to controls, and therefore the definition of responses in ED-ISQM 1 has been aligned to the definition of controls in ED-315 (see paragraph 19(t) of ED-ISQM 1). This definition recognizes that policies or procedures may include aspects of governance, for example, tone at the top and other aspects of the firm's system which are established but are not formally documented policies or procedures. The IAASB used the term responses instead of controls or policies or procedures because it emphasizes the importance of responding to the quality risks and the proactive nature of the new quality management approach.

⁷ The COSO Integrated Framework (2013) describes control activities as the actions established by policies and procedures to help ensure management directives to mitigate risks to the achievement of objectives are carried out.

The Requirement to Design and Implement Responses

37. ED-ISQM 1 requires the firm to design and implement responses to address the quality risks, in order that the quality objectives are achieved (see paragraph 30 of ED-ISQM 1). As explained previously, the standard includes quality objectives that are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved. ED-ISQM 1 includes some responses that all firms are required to design and implement, however these responses are not comprehensive (see paragraphs 24, 25, 33, 35, 37, 41 and 43 of ED-ISQM 1). For example, the resources component does not include any required responses. As a result, the standard is explicit that the firm is required to design and implement responses to address the assessed quality risks, in addition to the responses required by the standard (see paragraphs 10(c) and A59 of ED-ISQM 1). In the view of the IAASB, this approach promotes a tailored and scalable approach to managing quality.



38. The responses in ED-ISQM 1 that all firms are required to design and implement include:
- (a) Important aspects of extant ISQC 1 that need to be retained in order to preserve the robustness of the extant standard;
 - (b) New matters that have been introduced to address key issues, for example, issues highlighted in the ITC (e.g., undertaking periodic performance evaluations of firm leadership); or
 - (c) Responses needed for consistency with, or linkage to, other professional standards, including relevant ethical requirements and ED-220.

Although these responses are required by the standard, the firm would tailor them taking into account the assessed quality risks that the responses address, as well as the nature and circumstances of the firm and the engagements it performs. For example, paragraph 33(d) of ED-ISQM 1 requires the firm to obtain, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent. The firm may tailor this response by adapting its frequency (e.g., obtaining the confirmation twice a year), or by adding specificity as to how the firm's personnel will evidence the confirmation (e.g., a manual signature on a hard copy or a digital signature through an IT application).

39. The IAASB explored including more prescriptive responses in the standard, but agreed that doing so would deter firms from identifying and assessing the quality risks in a proper manner and result in firms only implementing the responses required by the standard, contrary to the new quality management approach. Furthermore, the IAASB noted that 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.

Changes in the Nature and Circumstances of the Firm or its Engagements

40. A key aspect of the quality management approach is continuous improvement. ED-ISQM 1 sets forth two instances when the quality objectives, quality risks or responses may need to be revised to improve the system:
- (a) As a result of information arising from the firm's monitoring activities. The revisions to the monitoring and remediation component in ED-ISQM 1 have improved the focus on ongoing, or more real-time, monitoring. In responding to identified deficiencies, which may be identified through the firm's own monitoring activities, external inspections or other information sources, paragraph 49 of ED-ISQM 1 requires the firm to determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate, and modify them, as appropriate.
 - (b) As a result of changes in the nature and circumstances of the firm or its engagements. Paragraph 31 of ED-ISQM 1 requires the firm to take actions to identify these changes and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes.

Section 3D – Governance and Leadership

41. The ITC noted that extant ISQC 1 does not specifically address firm governance, or contain much detail as to what is expected from firm leadership in relation to firm governance, and therefore included various suggestions to address firm governance and enhance the role of firm leadership in sustaining and continually improving audit quality. Respondents to the ITC overall supported the various suggestions to strengthen firm governance and leadership, although emphasized that any actions would need to be flexible to accommodate different jurisdictions and firm structures.
42. The IAASB is of the view that a firm's governance and leadership is of paramount importance to engagement quality, as it is the way in which the firm embeds its culture and ethics and self-regulates, and serves as the framework for how the firm's decisions are made. Accordingly, the governance and leadership component has been placed first in ED-ISQM 1. A firm's governance also affects the public's perception of the firm; a firm without effective governance may be regarded as one that does not operate in the public interest.
43. In developing the various quality objectives and responses for this component, the IAASB considered numerous global resources addressing governance and leadership in general for all entities, and those more specific to the governance of audit firms. ED-ISQM 1 has been substantially enhanced to improve the robustness of firms' governance and leadership. In particular, it addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations. The standard also now addresses the effect of the firm's strategic actions, including financial and operational decisions,⁸ on engagement quality and the firm's public interest role, as well as firm leadership's ability to influence decisions about the firm's resources.
44. In developing the requirements, the IAASB considered who in the firm should be ultimately responsible for the system of quality management, and whether that responsibility should be extended to quality more broadly. The IAASB resolved to retain the requirement of extant ISQC 1, which assigns this role to the firm's chief executive officer (or equivalent) or, if appropriate, the firm's

⁸ The IAASB is of the view that commercial considerations are the same as financial and operational decisions, and preferred the latter term as it provides a more accurate description of what is meant.

managing board of partners (or equivalent) (see paragraph 24(a) of ED-ISQM 1). However, recognizing that SMPs may not have these types of roles in their leadership structures, outreach feedback suggested that an additional option should be added to acknowledge SMPs (i.e., the firm's managing partner). The IAASB further agreed that leadership cannot be responsible and accountable for quality broadly, but is responsible and accountable for the system of quality management that supports the consistent performance of quality engagements. The accountability of leadership is reinforced by the new requirement for the firm to undertake performance evaluations of those assigned leadership roles.

45. In developing ED-ISQM 1, the IAASB undertook various outreach activities across many stakeholder groups. The IAASB heard concerns that SMPs may experience practical challenges in implementing certain proposals related to governance and leadership. The IAASB is of the view that the requirements in this component are universally applicable to firms of all sizes, in particular since the quality objectives have been established as outcomes. The nature and extent of the actions taken in achieving those objectives may be more simple for an SMP. For example, paragraph A28 of ED-ISQM 1 explains that a smaller firm may be able to establish the desired culture of the firm through the direct interaction of firm leadership with other personnel, which is not always possible in the case of a larger firm. Furthermore, paragraph 21 of the standard recognizes that not all requirements are relevant in all circumstances, and paragraph A20 of ED-ISQM 1 provides examples of when the requirements might not be relevant, which includes aspects of governance and leadership in certain circumstances.

Operational Responsibility for Compliance with Independence Requirements

46. In the ITC the IAASB had included a proposal to specifically require a firm to identify appropriate personnel within the firm's leadership to be responsible and accountable for independence matters. This proposal was included in response to calls from certain regulatory stakeholders to the IESBA to more clearly and robustly address the issue of responsibility for independence within a firm. Although respondents to the ITC expressed mixed views about this proposal, the IAASB is of the view that independence is critical to the performance of engagements for which independence is required. Accordingly, requiring firms to assign responsibility for independence emphasizes that independence is an important consideration in a firm's system of quality management (see paragraph 24(a)(iii) of ED-ISQM 1). This new requirement operates in conjunction with many other enhanced requirements of the standard, for example, the firm may need resources to support its activities to determine compliance with independence requirements.
47. In developing ED-ISQM 1, the IAASB coordinated with the IESBA on many matters of mutual interest, including responsibility for independence. Through this engagement, the IESBA suggested that the requirement in ED-ISQM 1 should more broadly capture responsibility for relevant ethical requirements. In general, the IAASB is of the view that doing so would reduce the focus on the importance of independence. However, the IAASB is interested in respondents' views as to whether there should be an individual assigned responsibility for relevant ethical requirements, and if so, whether this should be in addition to assigning responsibility for compliance with independence requirements (see question 8(a)). The IAASB recognizes that an individual within the firm could fulfill both roles, particularly in the case of an SMP.

Responsibility for Understanding ED-ISQM 1

48. In order to improve leadership's responsibility for the system of quality management, paragraph 20 of ED-ISQM 1 is more explicit about who is responsible for understanding ED-ISQM 1. However, through its outreach in developing the standard, the IAASB heard that while these individuals may have ultimate responsibility for the system, responsibilities for aspects of the system are delegated to other individuals within the firm who support leadership (this is particularly the case in large firms). As a result, the IAASB heard concerns that requiring those with ultimate or operational responsibility for the system to have an in-depth understanding of the standard would be impractical. Accordingly, paragraph 20 of ED-ISQM 1 has been adjusted from extant ISQC 1 and requires these individuals to have an understanding of ED-ISQM 1 that is relevant to their responsibilities.

Section 3E – Resources

Technological Resources

49. The IAASB recognizes that firms are increasingly using technology in performing engagements, which may be developed by the firm or obtained from the firm's network or an external service provider. Firms are also increasing their use of technology in facilitating the operation of their systems of quality management, for example, technology may be used to continually monitor the permissibility of financial investments recorded by personnel as part of the firm's independence responses.
50. As part of the modernization of the standard, the IAASB has introduced a new requirement addressing the use of technological resources, both in the performance of engagements and the operation of the system of quality management (see paragraph 38(e) of ED-ISQM 1). The requirement is principles-based because the IAASB is mindful that the types of technologies, and the extent to which they are being used, are continually evolving. It is noted that the application material includes IT-related concepts that have been explained in a manner consistent with ED- 315.⁹

Intellectual Resources

51. The IAASB noted that intellectual resources are essential to enabling the performance of quality engagements, and are not addressed in extant ISQC 1. For example, in performing an audit of financial statements, engagement teams ordinarily depend on the firm's methodology to perform their work, which is based on professional standards and addresses applicable law or regulation. Accordingly, a new principles-based requirement addressing intellectual resources has been introduced in ED-ISQM 1, designed to be adaptable to the variety of intellectual resources that may be utilized within the firm (see paragraph 38(f) of ED-ISQM 1).

Section 3F – Information and Communication

52. Extant ISQC 1 does not address the broader need for information and communication across the system and the communication of information with engagement teams, which is essential for the effective operation of the system of quality management and the performance of engagements. It also does not acknowledge the two-way nature of communication. As a result, ED-ISQM 1 includes

⁹ ED-315 includes new material to address how automated tools and techniques are being used in performing audits. ED-315 also includes significant clarifications and enhancements to address the auditor's understanding of an entity's IT environment, and provides greater clarity on IT-related concepts. The IAASB is mindful that the explanations and descriptions in ED-315 need to be principles-based, given that rapid changes in IT and the terms in which it is described could outdate the standard within a short period of time.

a new component, information and communication, which includes requirements for the firm to establish an information system¹⁰ and emphasizes the need for effective two-way communication within the firm, as well as the responsibility of all personnel for communication (see paragraphs 40 and 41 of ED-ISQM 1). The new component also supports the firm in addressing the need for robust communication and interactions during the performance of engagements, a key public interest issue highlighted in the ITC.

53. The IAASB considered whether the requirements in the information and communication component should further specify with whom communication should take place and the type of information that should be obtained, generated and communicated. The IAASB is of the view that specifying the information and communication needs for each component would result in lengthy requirements and could inadvertently omit information or communication needs. Furthermore, such an approach would be prescriptive and contrary to the principles-based nature of the standard. Accordingly, the requirements do not include this specificity and in designing the system of quality management, the firm would need to understand the integration of the components and the information that needs to be obtained, generated or communicated to support the firm in achieving the requirements of each of the components.

Communication with External Parties

54. The ITC recognized that some firms are increasingly issuing publicly available reports that provide transparency regarding certain elements of the firm and its operations, commonly referred to as transparency reports. Accordingly, the ITC explored various actions for the IAASB to take. Respondents to the ITC were generally supportive of further actions but cautioned that any actions should not stifle developments or innovation related to transparency reporting at a jurisdictional level. However, certain respondents, mostly investors, called for the IAASB to more specifically address transparency reports in the IAASB's standards.
55. Transparency reports are required in many jurisdictions, largely for firms that perform audits of public interest entities or certain listed entities, and are commonly prepared by firms in certain other jurisdictions on a voluntary basis. However, the IAASB observed that there are still many jurisdictions where transparency reporting is not required or common practice, largely because there is a lack of demand from stakeholders in those regions for such information. Furthermore, firms that tend to prepare transparency reports perform audit engagements of public interest entities or listed entities; there is low demand for transparency reporting for smaller firms that do not perform these types of engagements.
56. The IAASB recognizes that firms communicate with external parties in a variety of ways and the communication is continually evolving. For example, firms may provide information on their website or through a publication other than a transparency report or may have a mechanism to engage directly with external parties. The IAASB is of the view that specifically requiring firms to prepare transparency reports may discourage the exchange of valuable and insightful information with external parties through alternative means that may be more appropriate or effective than a transparency report given the circumstances of the firm. The IAASB further noted that other means of communication with external parties are just as relevant and important as transparency reports.

¹⁰ Paragraphs A137 and A138 of ED-ISQM 1 explain that the information system may include the use of manual or IT elements, and in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

57. Accordingly, the requirements in ED-ISQM 1 for communication with external parties address all forms of communication with external parties and have been developed in a manner that is adaptable to the circumstances of the firm (see paragraph 41(c) of ED-ISQM 1). The requirements aim to promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders without stifling innovation or other developments at the jurisdictional level. Although the requirements explicitly recognize transparency reports so that firms are encouraged to consider whether a transparency report is appropriate, the preparation of a transparency report is not required. However, if jurisdictional law, regulation or professional standards require the firm to prepare a transparency report, this is addressed by the requirement in paragraph 41(c)(i) of ED-ISQM 1.

Section 3G – Engagement Quality Reviews

58. An engagement quality review is a firm-level response to an assessed quality risk(s) that is implemented by the engagement quality reviewer on behalf of the firm. As explained in the explanatory memorandum for ED-ISQM 2, the IAASB agreed that since the engagement quality review is a response to an assessed quality risk(s), ED-ISQM 1 should address the engagements for which an engagement quality review is to be performed. The specific criteria for an individual to be eligible to perform the engagement quality review and requirements for the performance and documentation of the review are located in ED-ISQM 2.
59. The ITC proposed several enhancements to address engagement quality reviews, given the need to keep the standard fit for purpose and enhance support for exercising professional skepticism at the engagement level. Among the proposals, the IAASB explored whether the requirements for engagements that should be subject to an engagement quality review should be strengthened by requiring an engagement quality review for audits of entities other than listed entities. The ITC considered whether it would be appropriate to require an engagement quality review to be performed for audits of public interest entities (PIEs), as this term is used in the Code. However, the IAASB recognized in the ITC the difficulty of defining the term on a global basis, given the various definitions and interpretations across different jurisdictions.
60. Respondents to the ITC supported strengthening the requirement; however, there was not extensive support for requiring the performance of an engagement quality review for audits of PIEs. Respondents who did not support this proposal noted that the lack of a universal definition of PIEs could lead to inconsistent application in practice. Further, they noted that in many jurisdictions PIEs could include very small or non-complex entities (such as small charities) and performing an engagement quality review for audits of such entities would be overly burdensome.
61. However, the IAASB recognizes the need to enhance the scope of engagements subject to an engagement quality review, because there are audits of certain entities for which engagement quality reviews would be appropriate. These entities may include, for example, some entities operating in the public sector, and financial institutions such as certain banks, insurance companies and pension funds. Accordingly, paragraph 37(e)(ii) of ED-ISQM 1 includes a new requirement for the firm's policies or procedures to require an engagement quality review for audits of financial statements of entities that the firm determines are of significant public interest. ED-ISQM 1 also provides application material that describes the characteristics of such entities, to support firms in fulfilling this requirement. "Entities that are of significant public interest" is a term that is used elsewhere in the

IAASB's standards, such as ISA 700 (Revised)¹¹ and ISA 260 (Revised),¹² to describe those entities that may have characteristics that give rise to similar public interest issues as listed entities. Although the IAASB has determined that this term continues to be suitable for its purposes, there may be questions as to how the term relates to "public interest entity" as defined in the Code. If respondents have views on this topic, it would be helpful for these views to be included in their responses to Question 11.

62. The IAASB is of the view that in addition to audits of listed entities or entities that the firm determines are of significant public interest, an engagement quality review may be an appropriate response to an assessed quality risk(s) for other engagements. Accordingly, paragraph 37(e)(iii)(b) of ED-ISQM 1 requires the firm to establish policies or procedures to require an engagement quality review for engagements for which the firm determines that an engagement quality review is an appropriate response, based on the reasons for the assessments given to the assessed quality risk(s). However, the IAASB recognizes that an engagement quality review is not always an appropriate response to an assessed quality risk(s) and paragraph A95 of ED-ISQM 1 explains that other types of responses may be more appropriate or effective to address the assessed quality risk(s).

Section 3H – Monitoring and Remediation Process

63. The ITC highlighted the need for greater focus on internal and external monitoring and remediation activities as one of the key public interest issues, and an area where the extant standard is in need of modernization. The improvements proposed in the ITC for monitoring and remediation were in general supported by respondents. As a result, ED-ISQM 1 has various new and improved requirements for monitoring and remediation, in particular:
- (a) The requirements promote more proactive and effective monitoring activities and have increased the emphasis on tailoring the monitoring activities to provide a sufficient basis for the firm to evaluate the system. The IAASB is of the view that this approach may encourage firms to develop innovative monitoring techniques to further enhance quality management.
 - (b) The requirements focus on monitoring all aspects of the system. Extant ISQC 1 is largely focused on inspections of completed engagements, which only address monitoring responses that are implemented at the engagement level.
 - (c) The requirements acknowledge that there may be a variety of information sources that provide the firm with information about the operation of the system of quality management, including external inspection findings.
 - (d) The requirements have been clarified to differentiate between findings and deficiencies, so that it is clear that not all findings are deficiencies for which further action is needed.
 - (e) The firm is now required to investigate the root causes of deficiencies so that appropriate action can be taken to remediate the deficiencies effectively.
 - (f) The responsibilities of firm leadership have been enhanced, and include a requirement to determine the effectiveness of remedial actions, and an evaluation, at least annually, of whether there is reasonable assurance that the objective of the system has been achieved.

¹¹ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*. See also paragraphs 54–61 of the [Basis for Conclusions to Reporting on Audited Financial Statements](#).

¹² ISA 260 (Revised), *Communication with Those Charged with Governance*

64. While the monitoring and remediation process has been set up in ED-ISQM 1 in a logical order, the IAASB is of the view that the monitoring and remediation process is iterative, as opposed to being purely linear. For example, the firm may adjust the nature, timing or extent of the monitoring activities based on the severity and pervasiveness of the deficiencies identified.

Monitoring Activities, Including Inspection of Engagements

65. The IAASB recognizes that the nature, timing and extent of the firm's monitoring activities should vary from firm to firm. Accordingly, the new requirements have been designed to emphasize factors that the firm would consider in designing its monitoring activities, rather than prescribing all of the monitoring activities that need to be performed (see paragraph 44 of ED-ISQM 1).
66. The IAASB debated the retention of the requirement in extant ISQC 1 for the firm to inspect at least one completed engagement for each engagement partner on a cyclical basis. The IAASB noted the need to retain the robustness of the extant standard in this regard but at the same time address concerns that the extant requirement is inflexible and consumes resources that could be used to perform more effective monitoring activities. The IAASB resolved to retain the requirement (see paragraph 45 of ED-ISQM 1), but has taken the following steps to improve its scalability and place emphasis on other types of monitoring activities that may be more effective:
- (a) The requirement explicitly recognizes inspections of in-progress engagements (these may also be referred to as in-process reviews). It is noted that in some cases, in-process reviews may be a monitoring activity, but in other cases they may be a response to a quality risk in another component (e.g., a quality risk related to judgments made in the performance of engagements). Whether an in-process review is a monitoring activity depends on how the firm has designed the review, including how the results of the review are considered and addressed by the firm.
 - (b) The requirement emphasizes that in determining the nature, timing and extent of the inspection of engagements, the firm takes into account various factors set out in the standard, such as changes in the system.
 - (c) 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.

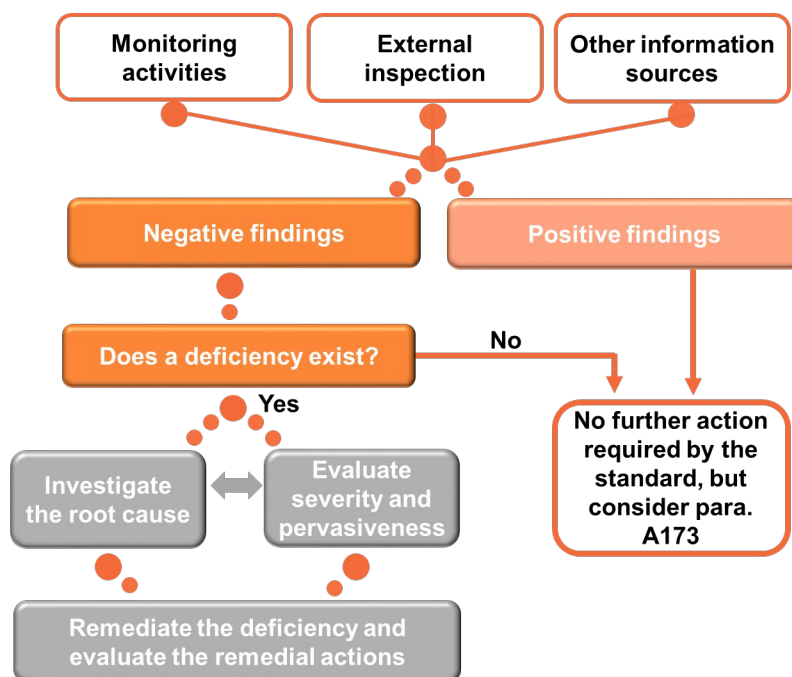
Monitoring the Monitoring and Remediation Process

67. The monitoring and remediation process needs to be designed appropriately and operating effectively, because without an effective monitoring and remediation process, the firm would not be able to determine whether deficiencies exist and remediate them. The IAASB is of the view that monitoring of the monitoring and remediation component may be accomplished in a variety of ways including through understanding external information (e.g., the results of external inspections may highlight deficiencies not detected by the firm's monitoring activities) or in undertaking the root cause analysis (e.g., the investigation of a deficiency may reveal further deficiencies not detected by the firm's monitoring activities) (see paragraph A177 of ED-ISQM 1). Paragraph 47 of ED-ISQM 1 requires the firm to identify deficiencies through evaluating the findings arising from monitoring

activities, results of external inspections, and other information. The identification of deficiencies may include deficiencies in the monitoring and remediation process.

Evaluating Findings and Identifying Deficiencies

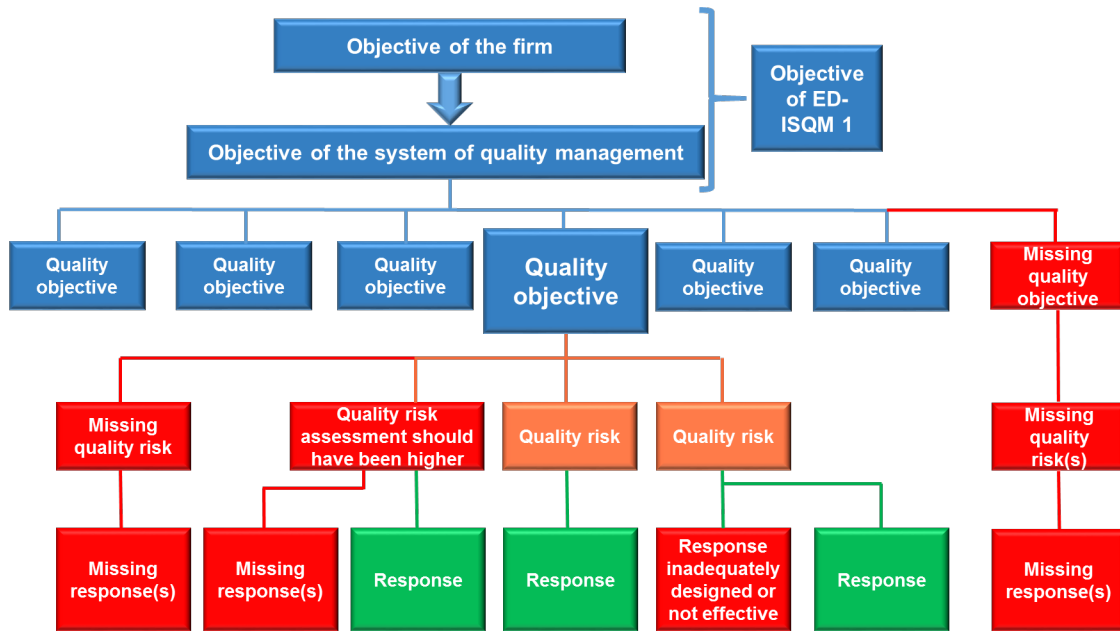
68. Findings may be positive or negative in nature, and the severity and pervasiveness of negative findings will vary. The IAASB is of the view that findings that do not rise to the level of a deficiency do not need to be subject to additional actions, such as investigating the root cause of the finding or remediating the finding. As a result, the IAASB identified the need for a clear definition of a deficiency in ED-ISQM 1¹³ (see paragraph 19(a) of ED-ISQM 1) and a supporting framework that sets out the process for evaluating negative findings and identifying deficiencies (see paragraphs 47–48 of ED-ISQM 1). The illustration sets out the framework in ED-ISQM 1, and the application material in ED-ISQM 1 provides further guidance to support the firm in working through the framework.



69. The definition of deficiencies was developed taking into consideration how other standards and frameworks, such as ISA 265¹⁴ and the COSO Integrated Framework (2013), describe deficiencies. The diagram that follows depicts examples of deficiencies that may arise in the firm's system of quality management in red. This includes circumstances when a response that is necessary to address a quality risk has not been appropriately designed or implemented because the quality objective or quality risk was missing, or the quality risk was not appropriately assessed.

¹³ Extant ISQC 1 requires the firm to take certain actions for deficiencies noted in the system of quality control. The term deficiencies is not defined in extant ISQC 1.

¹⁴ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*



Root Cause Analysis

70. Recognizing the increased demand from regulators and audit oversight bodies for firms to take action to understand the causal factors of inspection findings as a means of improving audit quality, the ITC proposed introducing a new requirement for firms to obtain an understanding of the causal factors of audit deficiencies identified by inspections and other reviews. Respondents in general supported this proposal, and therefore ED-ISQM 1 includes a new requirement for firms to investigate the root cause of deficiencies (see paragraph 48(a) of ED-ISQM 1).
71. In developing the new requirement, the IAASB debated the threshold of matters on which the root cause analysis should be performed, including whether the root cause analysis would be undertaken before determining whether a finding is a deficiency. The IAASB is of the view that determining the root cause of every finding would be onerous and consume important resources that should focus on more significant issues in the system of quality management. Therefore, the IAASB concluded that firms should be expected to determine the root cause only of identified deficiencies. However, the IAASB recognizes that in some cases the process may be iterative, i.e., in order to determine whether a finding is a deficiency, the firm may need to have some understanding of the root cause of the finding.
72. ED-ISQM 1 acknowledges that the nature and extent of the firm's process to determine the root cause of a deficiency would vary depending on the nature and possible severity of the deficiency. For example, the causes of some deficiencies may be more obvious and immediately identifiable, whereas other deficiencies may need a more rigorous process to understand the underlying causes. In ED-ISQM 1, the requirement to determine the severity and pervasiveness of the deficiency follows the requirement to investigate the root cause of the deficiency, however investigating the root cause of the deficiency and determining the severity and pervasiveness of the deficiency is likely to be iterative.
73. The IAASB concurred with views expressed by some respondents to the ITC that determining the root cause of positive findings is valuable because it may reveal opportunities for the firm to improve the system of quality management and may assist the firm in determining the root causes of

deficiencies and how to remediate such deficiencies. Despite these benefits, the IAASB in general is of the view that ED-ISQM 1 should not require firms to determine the root cause of positive findings because the priority is for firms to remediate deficiencies, such that the objective of the standard is achieved. Furthermore, the nature of the positive findings that may enhance the system of quality management would vary and it would therefore be difficult to establish criteria in the standard for determining positive findings that should be subject to root cause analysis. The application material of ED-ISQM 1 discusses the benefits of investigating the root cause of positive findings to encourage firms to include this as part of their policies or procedures addressing the evaluation of the findings (see paragraph A178 of ED-ISQM 1). Nevertheless, the IAASB is interested in the views of respondents regarding how firms currently deal with positive findings and whether this should be more explicitly addressed in the requirements of the standard, or otherwise be more prominently highlighted (see question 12(d)(ii)).

Leadership Evaluation of the System of Quality Management

74. As explained previously, various enhancements have been made to ED-ISQM 1 to enhance the role of firm leadership as it relates to the system of quality management. Paragraph 55 of ED-ISQM 1 is a new requirement for the individual(s) assigned ultimate responsibility and accountability for the system of quality management to evaluate whether the system of quality management provides the firm with reasonable assurance that the objectives of the system have been achieved. In circumstances when it is determined that the system does not provide reasonable assurance that the objectives have been achieved, leadership is responsible for taking appropriate action. The IAASB is of the view that the new requirements reinforce the responsibility and accountability of leadership for the system of quality management. Furthermore, the requirement implicitly creates the need for the firm to collate all of the information about the system of quality management, and for leadership to evaluate this information in forming an overall view about the system.
75. The IAASB envisages that the evaluation would involve a determination of whether the system provides reasonable assurance that the objectives are achieved at the point in time the evaluation is undertaken. The IAASB debated how often the evaluation should be undertaken and agreed that undertaking the evaluation of the system at least annually would be appropriate (see paragraph 56 of ED-ISQM 1), given the requirement in extant ISQC 1 to communicate the results of the monitoring at least annually. However, the IAASB noted that in some instances the evaluation may need to be undertaken more frequently, particularly in circumstances when there is an indication that the system is not effective.

Section 3I – Networks and Service Providers

Networks

76. The IAASB is of the view that in circumstances when networks share common elements related to the system of quality management (e.g., a common methodology or policies or procedures), such common elements can be instrumental in enhancing engagement quality across the firms that belong to the network. For example, in circumstances when a firm is subject to common policies or procedures established by the network, the network may hold the firm accountable for

What is a network?

Some firms operate internationally through a consortium of network firms, referred to as “a network.” Each firm that forms part of the consortium is referred to as “a network firm.”

The extent to which the network firms share common elements varies. For example, some networks may only share a brand name, while

complying with such policies or procedures. A network may also fulfill functions that the firm would otherwise have to perform, for example, the development of a methodology in accordance with international standards.

77. However, as highlighted in the ITC, concerns have been raised that firms place undue reliance on network requirements or network services (e.g., methodologies, policies or procedures, IT applications or monitoring). Accordingly, new requirements have been introduced in ED-ISQM 1 addressing network requirements or network services (see paragraphs 58–63 of ED-ISQM 1). The aim of the new requirements is to improve the robustness of the firm's responsibilities for the network requirements or network services, so that the firm understands the network requirements or network services and the effect they have on the firm's system of quality management. Given the varying structure of networks and the nature of the network requirements or network services, the new requirements are principles-based so that they can be adapted to a variety of circumstances. The IAASB is of the view that the new requirements emphasize that the firm is responsible for its own system of quality management, thereby addressing the issue that firms may place undue reliance on network requirements or network services.
78. The IAASB is of the view that although the new requirements are focused on the firm, they are likely to have an effect on the network. The requirements are structured such that the network would likely need to provide information to all network firms so that the firms are able to fulfill their responsibilities under ED-ISQM 1. This is expected to improve the communication and transparency between the network and network

other networks may share common methodologies or policies or procedures. In some circumstances, the network firms may be monitored by the network for compliance with the methodology or policies or procedures. The network functions (i.e., developing and maintaining the methodology or performing monitoring) may be undertaken by a standalone body established by the network to perform the various network functions.

The structure of the network may also vary. For example, within a network there may be a consortium of network firms that form a cluster within a region. Such clusters may share common policies or procedures specific to that region or there may be services used across the cluster (e.g., training).

The network firms are responsible for the engagements they perform and the reports that are issued on behalf of the network firm, i.e., the network does not perform engagements or issue engagement reports. A firm's responsibility is established in the IAASB's Standards,¹⁵ and may be further reinforced by a jurisdictional, professional, legal or regulatory body that specifies who has the appropriate authority to perform an engagement and issue the related report.

The network itself is not responsible for the engagements undertaken by network firms or the reports issued by network firms. Furthermore, as the network is a consortium of network firms, it is not usually regulated or subject to inspection at the network level. The individual firms within the network will most likely be regulated and inspected by the regulators and audit oversight bodies within their jurisdictions or who have

¹⁵ The ISAs apply to "the auditor" or "engagement partner." ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, defines the auditor as "the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm." ISQC 1 defines the engagement partner as "the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body." ISQC 1 also defines the firm as "a sole practitioner, partnership or corporation or other entity of professional accountants."

firms, and it may encourage improvements in communication across the network.

oversight of the engagements performed by the firm.

79. In developing ED-ISQM 1, the IAASB considered establishing requirements for the network instead of, or in addition to, the new requirements for the firm. The IAASB notes that the firm is responsible for the engagements it performs and the reports that are issued on behalf of the firm, and regulatory oversight occurs at the level of the firm. The network does not perform engagements and is generally not subject to regulatory inspections or overseen by oversight authorities.¹⁶ Therefore, the IAASB is of the view that the firm needs to remain solely responsible for the system of quality management, i.e., requirements for networks may have the unintended effect of diluting the firm's responsibility for the system of quality management.
80. The IAASB recognizes that some stakeholders do not have an accurate understanding of the responsibilities of the network and network firms, including the relationship between networks and the network firms, and this has given rise to expectation gaps. As a result, ED-ISQM 1 includes application material to encourage firms to provide transparency about their relationships with the network and the responsibilities of the firm and the network in order to enhance stakeholders' understanding of these relationships and responsibilities (see paragraph A152 of ED-ISQM 1).

Network Firm Independence

81. In the IAASB's coordination with the IESBA, the IESBA questioned whether there should be more direct requirements in ED-ISQM 1 regarding compliance with independence requirements within the network. The IAASB is of the view that network firm independence is appropriately addressed in ED-ISQM 1 through the principles-based requirements addressing relevant ethical requirements.¹⁷ Therefore, including more direct requirements for independence within the network would result in duplicative requirements, and the specificity of the requirement would be in contrast to other requirements in the standard. However, the IAASB is interested in respondents' views as to whether there should be more specific requirements addressing independence within the network (see question 8(b)).

Service Providers

82. Firms may use service providers in the system of quality management, for example, engagement software may be obtained from a service provider or the firm may use a service provider to perform engagement quality reviews. The IAASB is of the view that a service provider provides a resource, and therefore the firm needs to determine that it is appropriate to use that resource in the system of quality management. Accordingly, ED-ISQM 1 includes new requirements addressing the use of service providers in the firm's system of quality management (see paragraphs 64–65 of ED-ISQM 1). The IAASB is of the view that although the new requirements are a responsibility of the firm, they are

¹⁶ Regulators are a critical element in the financial reporting supply chain and the requirements of professional standards are most effective if they are properly enforced through the legal status of standards, inspection of engagements, the investigation of allegations of failure, and when appropriate, disciplinary action being taken.

¹⁷ For example, paragraph 33(a) of ED-ISQM 1 requires the firm to identify the relevant ethical requirements and determine the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, personnel in the network or other network firms, or service providers (this is further supported by application material that provides examples specific to networks). The firm is further required by paragraphs 33(b) and 33(c) to establish policies or procedures to address threats to compliance with relevant ethical requirements and breaches of the relevant ethical requirements, which would need to address other firms or persons within the network when there are relevant ethical requirements applicable to them.

likely to have an effect on service providers, given the need for service providers to provide information to firms to enable the fulfillment of the new requirements.

83. The IAASB noted that in some cases, a service provider may be obtained through the firm's network, for example, the network may mandate that engagement software has to be acquired from a specific service provider. In such cases, the requirements for service providers would apply to the use of those resources.

Section 3J – Other

84. Many other enhancements have been made to ED-ISQM 1 that although not explicitly highlighted in this memorandum, are also intended to enhance the robustness of the standard. For example, the documentation requirements of the standard have been enhanced from extant ISQC 1, with the introduction of an overarching principles-based requirement (which has similarities to the documentation principles established in ISA 230¹⁸) and more specific requirements for matters that firms are expected to document.

Section 3J – Scalability

85. The scalability of ED-ISQM 1 has been at the forefront of the IAASB's deliberations throughout the project. The ITC highlighted the need for a new approach to managing quality that is scalable to deal with differences in the size and nature of firms or the services they provide. As discussed previously, the new quality management approach drives firms to think about the nature and circumstances of the firm and the engagements it performs in designing, implementing and operating its system of quality management, and the approach is focused on achieving quality objectives that are outcome-based. While this approach is expected to generate multiple benefits for engagement quality, one of the most important benefits is a tailored system of quality management that is suitable for the nature and circumstances of the firm and the engagements it performs.
86. The IAASB recognizes that the quality management approach in ED-ISQM 1 is more complex than the approach in extant ISQC 1, and has added to the overall length of the standard. However, the IAASB is of the view that the approach in extant ISQC 1 is no longer fit for purpose and adaptable to the changing environment, given that it is more prescriptive in nature, and does not promote a scalable and tailored system of quality management that focuses on areas of risk. The IAASB acknowledges that firms will need to invest time and resources to implement the revised standard initially, however it is of the view that over time a more tailored and focused system of quality management will result in more effective use of firm resources and improvements in engagement quality.
87. Adding to the length of the standard are various new requirements that have been introduced to enhance the rigor of the standard, in particular to address key issues highlighted in the ITC (e.g., governance and leadership, monitoring and remediation, and network requirements or network services) and essential elements needed for a system of quality management (e.g., information and communication). The IAASB acknowledges that the new requirements increase the responsibilities of firms, however they address important issues that are necessary for improvements in engagement quality.

¹⁸ ISA 230, *Audit Documentation*

88. While the new quality management approach is the fundamental change introduced in the standard to address scalability, the IAASB has addressed or emphasized the scalability of ED-ISQM 1 in other ways, including:
- (a) An explicit discussion about the scalability of the standard in paragraphs 5 and 6 of ED-ISQM 1.
 - (b) A requirement to exercise professional judgment in paragraph 22 of ED-ISQM 1 and increased emphasis on professional judgment throughout the standard.
 - (c) Numerous references throughout the standard to consider the nature and circumstances of the firm and the engagements it performs.
 - (d) An explicit requirement in paragraph 21 of ED-ISQM 1 that indicates that there may be circumstances when a requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements.
 - (e) Application material that provides examples for SMPs, for example, paragraphs A28 and A42 of ED-ISQM 1.
89. The IAASB debated whether to retain the sections in extant ISQC 1 titled “Considerations Specific to Smaller Firms.” However, the IAASB is of the view that given the integrated nature of the standard, an understanding of the entire standard is needed to facilitate the implementation of a system of quality management that is tailored to the circumstances of the firm. As highlighted above, where considered useful and appropriate, the IAASB has included examples specific for SMPs. In addition, the IAASB is developing support materials to show how the standards can be applied in a scalable manner by smaller firms.

Application Material in ED-ISQM 1

90. Throughout the development of ED-ISQM 1, the IAASB has heard mixed views through its outreach about examples and explanations in the standard. While examples and explanations provide useful information to support implementation of the standard, they add extensive content that has resulted in an increase in the length of the standard. The IAASB is interested in respondents’ views as to the usefulness of the application material in ED-ISQM 1, in particular areas where the examples or explanations are not useful, and areas where additional examples or explanations would be helpful.

Section 4 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-ISQM 1. In this regard, comments will be most helpful if they are identified with specific aspects of ED-ISQM 1 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

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?
 - (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?
 - (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?
- 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?
- 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?

Specific Questions

- 4) Do you support the eight components and the structure of ED-ISQM 1?
- 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?
- 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?
 - (b) Do you support the approach for establishing quality objectives? In particular:
 - i. Are the required quality objectives appropriate?
 - ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?
 - (c) Do you support the process for the identification and assessment of quality risks?

- (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?
 - 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?
- 7) Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?
- 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?
 - (b) Does the standard appropriately address 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?
- 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?
- 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?
- 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?
 - (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?
 - (c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?
 - (d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:
 - i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?
 - ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?

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

PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 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

(Effective as of TBD)

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Appendix 1: The Components of a System of Quality Management

Proposed International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

Scope of this ISQM

1. This International Standard on Quality Management (ISQM) deals with a firm's responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements. ISQM 2¹⁹ deals with the responsibility of the firm and engagement quality reviewers relating to engagement quality reviews. This ISQM is to be read in conjunction with relevant ethical requirements.
2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) include requirements for engagement partners and other personnel regarding quality management at the engagement level. ISA 220 (Revised),²⁰ for example, deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. (Ref: Para. A1)
3. Law, regulation or relevant ethical requirements may establish responsibilities for the firm's management of quality beyond those described in this ISQM.
4. This ISQM applies to all firms performing audits or reviews of financial statements, or other assurance or related services engagements (i.e., if the firm performs any of these engagements, this ISQM applies).

Scalability

5. This ISQM requires the firm to apply a risk-based approach in the design, implementation and operation of the system of quality management, taking into account:
 - (a) The nature and circumstances of the firm, including whether it is part of a network or uses service providers; and (Ref: Para. A22)
 - (b) The nature and circumstances of the engagements performed by the firm, including the types of engagements performed by the firm and the types of entities for which such engagements are performed. (Ref: Para. A23)

Accordingly, the complexity and formality of firms' systems of quality management will vary. For example, a firm that performs different types of engagements for a wide variety of entities, including audits of financial statements of listed entities or entities that are of significant public interest, will likely need to have a more complex and more formal system of quality management than a firm that performs only reviews of financial statements or compilation engagements.

6. The nature and circumstances of the firm and its engagements may change over time. This ISQM requires the firm to identify such changes and respond appropriately.

The Firm's System of Quality Management

7. The purpose of a system of quality management is to support the consistent performance of quality engagements, by providing the firm with reasonable assurance that the objectives of the system, stated in paragraph 18(a) and (b), are achieved. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and

¹⁹ Proposed ISQM 2, *Engagement Quality Reviews*

²⁰ Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism. (Ref: Para. A2–A4)

8. This ISQM requires professional judgment to be exercised in designing, implementing and operating the firm's system of quality management. A system of quality management is a continual and iterative process and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. However, for the purposes of this ISQM, a system of quality management addresses the following eight components, which are highly integrated: (Ref: Para. A4–A5)
- (a) Governance and leadership;
 - (b) The firm's risk assessment process;
 - (c) Relevant ethical requirements;
 - (d) Acceptance and continuance of client relationships and specific engagements;
 - (e) Engagement performance;
 - (f) Resources;
 - (g) Information and communication; and
 - (h) The monitoring and remediation process.

A further description of each of the eight components and their interrelationships is included in Appendix 1.

9. The firm's governance and leadership component establishes the environment in which the system of quality management operates because this component addresses the firm's culture, decision-making process, actions, organizational structure and leadership. This standard requires that the firm's leadership demonstrate a commitment to quality through their actions and behaviors and establish the expected behavior of personnel within the firm.
10. In taking a risk-based approach to quality management, the firm applies the firm's risk assessment process to the other components. The firm's risk assessment process consists of:
- (a) Establishing quality objectives. The quality objectives established by the firm consist of objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management, stated in paragraph 18(a) and (b), are achieved. The firm is required to establish the quality objectives set out in this ISQM and additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
 - (b) Identifying and assessing risks to the achievement of the firm's quality objectives (referred to in this standard as quality risks). The firm is required to identify and assess quality risks to provide a basis for designing and implementing responses.
 - (c) Designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the firm's responses to address the assessed quality risks will be based on, and responsive to, the reasons for the assessments given to the quality risks. The firm is

required to include the responses required by this ISQM, which are organized by component, in its responses to its assessed quality risks. The responses required by this ISQM are relevant to every firm's system of quality management, and are therefore applicable to all firms. However, the responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks for the quality objectives that are required to be established by this ISQM.

11. This ISQM includes components that address specific topics that are fundamental for the performance of audits or reviews of financial statements, or other assurance or related services engagements (i.e., relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, and engagement performance). In addition, it includes components for resources and information and communication, which are necessary to enable the operation of all the other components of the system of quality management.
12. This ISQM requires the firm to evaluate the design, implementation and operation of its system of quality management through a monitoring and remediation process, which involves:
 - (a) Designing and performing monitoring activities and evaluating the findings from such activities, the results of external inspections and other relevant information to determine whether deficiencies exist in the system of quality management;
 - (b) Investigating the root cause(s) of the identified deficiencies and evaluating the severity and pervasiveness of the identified deficiencies; and
 - (c) Remediating the identified deficiencies.

The findings arising from the monitoring may also highlight positive practices that the firm uses to enhance its system of quality management. The monitoring and remediation process provides information that is the basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

13. All of the components of the system of quality management operating together enable the consistent performance of quality engagements and contribute to the firm achieving the objective of this ISQM. Accordingly, other pronouncements of the IAASB, such as ISA 220 (Revised),²¹ are premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding.

Networks

14. In some circumstances, the firm may belong to a network. This ISQM includes requirements for firms that operate as part of a network, in recognition that networks may establish requirements regarding the firm's system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation and operation of its system of quality management. Network requirements or network services are further described in paragraph 58 of this ISQM. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that operate as part of the network. Notwithstanding the firm's compliance with the network requirements or use of the network services, the firm remains responsible for its system of quality management.

²¹ Proposed ISA 220 (Revised), paragraph 3

Service Providers

15. This ISQM also includes requirements for circumstances when the firm intends to obtain or use resources provided by a service provider in its system of quality management.

Authority of this ISQM

16. This ISQM contains the objective of the firm in following this ISQM, and requirements designed to enable the firm to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. (Ref: Para. A6–A9)

Effective Date

17. Systems of quality management in compliance with this ISQM are required to be established by TBD.

Objective

18. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:
- (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
 - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Definitions

19. In this ISQM, the following terms have the meanings attributed below:
- (a) Deficiency in the firm’s system of quality management (referred to as “deficiency” in this ISQM) – This exists when:
 - (i) A quality objective required to achieve the objective of this ISQM is not established;
 - (ii) A quality risk has not been appropriately identified or assessed, such that a response that addresses that risk has not been appropriately designed or implemented; or
 - (iii) A response to address an assessed quality risk is not properly designed, implemented or operating effectively. (Ref: Para. A10)
 - (b) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as “working papers” or “work papers” are sometimes used).
 - (c) Engagement partner²² – The partner or other individual, appointed by the firm, who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

²² “Engagement partner” and “partner” should be read as referring to their public sector equivalents where relevant.

- (d) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.
- (e) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.
- (f) Engagement team – All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an external expert engaged by the firm or by a network firm, and also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).²³
- (g) External inspections – Inspections or investigations undertaken by an external oversight authority related to the firm’s system of quality management or engagements performed by the firm. (Ref: Para. A11)
- (h) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A12)
- (i) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
- (j) Network firm – A firm or entity that belongs to a network.
- (k) Network²⁴ – A larger structure: (Ref: Para. A13–A14)
 - (i) That is aimed at cooperation, and
 - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (l) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (m) Personnel – Partners and staff.
- (n) Professional judgment – The application of relevant training, knowledge and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation and operation of the firm’s system of quality management.

²³ ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistances is restricted to situations where it is permitted.

²⁴ As defined in the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

- (o) Professional standards – IAASB Engagement Standards, as defined in the IAASB's *Preface to the International Quality Management, Auditing, Review, Other Assurance and Related Services Pronouncements*, and relevant ethical requirements.
- (p) Quality objectives – The objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved.
- (q) Quality risks – Risks arising from conditions, events, circumstances, actions or inactions that may adversely affect the achievement of a quality objective(s).
- (r) Reasonable assurance – In the context of the ISQMs, a high, but not absolute, level of assurance.
- (s) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking engagements that are audits or reviews of financial statements or other assurance or related services engagements. Relevant ethical requirements ordinarily comprise the provisions of the IESBA Code related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive. (Ref: Para. A15–A16, A67)
- (t) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address an assessed quality risk: (Ref: Para. A17–A18, A62)
 - (i) Policies are statements of what should, or should not, be done to address an assessed quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
 - (ii) Procedures are actions to implement policies.
- (u) Staff – Professionals, other than partners, including any experts the firm employs.
- (v) System of quality management – A system designed, implemented and operated by a firm to provide reasonable assurance that:
 - (i) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
 - (ii) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Requirements

Applying, and Complying with, Relevant Requirements

20. The individual(s) assigned ultimate responsibility and accountability, and the individual(s) assigned operational responsibility, for the firm's system of quality management shall have an understanding of this ISQM relevant to their responsibilities, including the application and other explanatory material, to understand the objective of this ISQM and to apply its requirements properly. (Ref: Para. A19)
21. The firm shall comply with each requirement of this ISQM unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: Para. A20)

System of Quality Management

22. The firm shall design, implement and operate a system of quality management that complies with the requirements of this ISQM. The requirements are designed to enable the firm to achieve the objective stated in this ISQM. The proper application of the requirements in this ISQM is expected to provide a sufficient basis for the achievement of the objective of this standard. In applying the requirements of this ISQM, the firm shall exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements, such that the objective of this ISQM is achieved. (Ref: Para. A21–A24)

Governance and Leadership

23. The firm shall establish the following quality objectives that address the aspects of the firm's environment that support the design, implementation and operation of the other components of the system of quality management, including the firm's culture, decision-making process, actions, organizational structure and leadership:
- (a) The firm's culture promotes a commitment to quality, including recognizing and reinforcing the importance of professional ethics, values and attitudes throughout the firm and emphasizing the responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A26–A28)
 - (b) The firm has leadership who is responsible and accountable for quality. (Ref: Para. A36)
 - (c) The firm's strategic decisions and actions, including financial and operational priorities, demonstrate a commitment to quality and to the firm's role in serving the public interest, by consistently performing quality engagements. (Ref: Para. A29–A30)
 - (d) The firm has an organizational structure with appropriate assignment of roles, responsibilities and authority that supports the firm's commitment to quality and the design, implementation and operation of the firm's system of quality management. (Ref: Para. A31–A32)
 - (e) The firm plans for its resource needs, including financial resources, and obtains, allocates or assigns resources in a manner that supports the firm's commitment to quality and enables the design, implementation and operation of the firm's system of quality management. (Ref: Para. A33–A35)
 - (f) The firm fulfills its responsibilities in accordance with law, regulation and professional standards that relate to the governance and leadership of the firm, if applicable. (Ref: Para. A25)
24. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the governance and leadership quality objectives, the firm shall include the following responses:
- (a) Assigning ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer or the firm's managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The individual(s) to whom such responsibility and accountability is assigned shall: (Ref: Para. A36)
 - (i) Have the appropriate experience and knowledge to fulfill the assigned responsibility.
 - (ii) Demonstrate a commitment to quality through their actions and behaviors, including recognizing and reinforcing the importance of professional ethics, values and attitudes,

- and establishing the expected behavior of personnel relating to the performance of engagements and activities within the system of quality management. (Ref: Para. A26–A28)
- (iii) Establish structures, reporting lines, and appropriate authorities and responsibilities, including assigning operational responsibility for the following matters to personnel who fulfill the requirements in paragraph 25: (Ref: Para. A37–A39)
- a. The system of quality management as a whole; and
 - b. Specific aspects of the system of quality management, as appropriate to the nature and circumstances of the firm, which shall include operational responsibility for compliance with independence requirements and the monitoring and remediation process.
- (b) Establishing policies or procedures for periodic performance evaluations of the individual(s) assigned ultimate responsibility and accountability for the firm’s system of quality management, and the individual(s) assigned operational responsibility for the matters set out in paragraph 24(a)(iii), in order to hold individuals accountable for the responsibilities assigned to them. (Ref: Para. A40–A43)
- (c) Establishing policies or procedures for dealing with complaints and allegations about the commitment to quality of the firm or its personnel, including clearly defining channels within the firm that enable reporting by personnel or external parties to appropriate individual(s) without fear of reprisal and enabling the investigation and resolution of the complaints and allegations. (Ref: Para. A44–A47)
25. The personnel assigned operational responsibility for the matters set out in paragraph 24(a)(iii) shall have: (Ref: Para. A39)
- (a) The appropriate experience and knowledge and sufficient time to fulfill their assigned responsibility;
 - (b) A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management; and
 - (c) An understanding of their assigned responsibilities and accountability for such responsibilities.

The Firm’s Risk Assessment Process

26. The firm shall establish the quality objectives required by this ISQM. The firm shall also establish additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM. (Ref: Para. A48–A51)
27. The firm shall understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of its quality objectives, taking into account the nature and circumstances of the firm and its engagements, to provide the basis for the identification and assessment of quality risks. (Ref: Para. A48, A52)
28. Based on the understanding obtained in paragraph 27, the firm shall identify those quality risks, before consideration of any responses, that: (Ref: Para. A48, A53–A54)
- (a) Have a reasonable possibility of occurring; and (Ref: Para. A55)

- (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). (Ref: Para. A56–A57)
- 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. (Ref: Para. A48, A58)
- 30. The firm shall design and implement responses to address the assessed quality risks, including the 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. (Ref: Para. A48, A59–A64)

Changes in the Nature and Circumstances of the Firm or its Engagements

- 31. The firm shall identify changes in the nature and circumstances of the firm or its engagements and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes. (Ref: Para. A48, A65–A66)

Relevant Ethical Requirements

- 32. The firm shall establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, which, as defined, include the principles of professional ethics: (Ref: Para. A67)
 - (a) The firm, its personnel and others subject to relevant ethical requirements understand the relevant ethical requirements, including those related to independence.
 - (b) The firm, its personnel and others subject to relevant ethical requirements fulfill their responsibilities in relation to the relevant ethical requirements, including those related to independence.
 - (c) The firm, its personnel and others subject to relevant ethical requirements identify and appropriately respond to breaches of the relevant ethical requirements, including those related to independence, in a timely manner.
- 33. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the relevant ethical requirements quality objectives, the firm shall include the following responses: (Ref: Para. A68–A69 and A75)
 - (a) Identifying the relevant ethical requirements and determining the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, network firms, personnel in the network or network firms, or service providers. (Ref: Para. A15, A70–A71)
 - (b) Establishing policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed. (Ref: Para. A72)
 - (c) Establishing policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches. (Ref: Para. A73–A74)
 - (d) Obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.

Acceptance and Continuance of Client Relationships and Specific Engagements

34. The firm shall establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances: (Ref: Para. A76)
- (a) The firm obtains sufficient appropriate information about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) and based on such information makes appropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A77–A82)
 - (b) The firm makes appropriate judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements when determining whether to accept or continue a client relationship or specific engagement, including that the firm has: (Ref: Para. A83)
 - (i) Resources to perform the engagement; and (Ref: Para. A84)
 - (ii) Access to information to perform the engagement, or to the persons who provide such information.
 - (c) The firm's financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A85–A86)
 - (d) The firm responds appropriately in circumstances when the firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement. (Ref: Para. A87–A88)
35. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the acceptance and continuance quality objectives, the firm shall include policies or procedures that address circumstances when the firm is obligated by law or regulation to accept the client relationship or specific engagement, if applicable. (Ref: Para. A89–A90)

Engagement Performance

36. The firm shall establish the following quality objectives that address the performance of quality engagements:
- (a) Personnel understand and fulfill their responsibilities in connection with the engagement, including, as applicable:
 - (i) The engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement; and (Ref: Para. A91)
 - (ii) The appropriate direction and supervision of the engagement team and review of the work performed. (Ref: Para. A92–A93)

- (b) Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism, in planning and performing engagements such that conclusions reached are appropriate. (Ref: Para. A94–A97)
 - (c) The engagement documentation is appropriately assembled and retained.
37. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the engagement performance quality objectives, the firm shall include the following responses:
- (a) Establishing policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members. (Ref: Para. A92–A93)
 - (b) Communicating to engagement teams their responsibility for planning and performing the engagement in accordance with professional standards and applicable legal and regulatory requirements.
 - (c) Establishing policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. (Ref: Para. A95, A98–A99)
 - (d) Establishing policies or procedures addressing differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation. (Ref: Para. A95, A100)
 - (e) Establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2, and that require an engagement quality review for: (Ref: Para. A101–A107)
 - (i) Audits of financial statements of listed entities;
 - (ii) Audits of financial statements of entities that the firm determines are of significant public interest; and
 - (iii) Audits or other engagements for which:
 - a. An engagement quality review is required by law or regulation; or
 - b. The firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.
 - (f) Establishing policies or procedures addressing assembly and retention of documentation that require:
 - (i) The engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized; and (Ref: Para. A108)
 - (ii) The engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards. (Ref: Para. A109–A112)

Resources

38. The firm shall establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management: (Ref: Para. A113–A116)
- (a) The firm hires, develops and retains personnel, including engagement partners, who have the competence and capabilities to: (Ref: Para. A117–A119)
 - (i) Consistently perform quality engagements, including knowledge or experience regarding professional standards and applicable law or regulation relevant to the engagements the firm performs; or
 - (ii) Perform activities or carry out responsibilities in relation to the operation of the firm's system of quality management.
 - (b) The firm assigns an engagement partner and other human resources to each engagement who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. (Ref: Para. A120)
 - (c) The firm assigns human resources to perform activities within the system of quality management who have appropriate competence and capabilities, including sufficient time, to perform such activities. (Ref: Para. A120)
 - (d) Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable through timely evaluations, compensation, promotion and other incentives. (Ref: Para. A121–A123)
 - (e) The firm obtains or develops, implements and maintains appropriate technological resources to enable the operation of the firm's system of quality management and the performance of engagements. (Ref: Para. A124–A131)
 - (f) The firm obtains or develops, implements and maintains appropriate intellectual resources to enable the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: Para. A132–A133)
 - (g) Personnel appropriately use the firm's technological and intellectual resources. (Ref: Para. A134)
39. The firm shall design and implement responses to address the quality risks identified and assessed by the firm relating to the resources quality objectives.

Information and Communication

40. The firm shall establish the following quality objectives that address obtaining, generating or using information regarding the system of quality management, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the system of quality management: (Ref: Para. A135)

- (a) The firm has an information system that supports the system of quality management by identifying, capturing, processing and maintaining relevant and reliable information, whether from internal or external sources. (Ref: Para. A136–A138)
 - (b) 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 relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A139)
 - (c) The firm’s culture promotes and emphasizes the responsibility of personnel to exchange information with the firm and with one another. (Ref: Para. A139)
 - (d) Personnel communicate relevant and reliable information to the firm when performing engagements or activities within the system of quality management. (Ref: Para. A139)
 - (e) The firm communicates relevant and reliable information to external parties regarding the firm’s system of quality management, as the firm determines appropriate. (Ref: Para. A142–A153)
41. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the information and communication quality objectives, the firm shall include the following responses:
- (a) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated by the firm with engagement teams. (Ref: Para. A140)
 - (b) Communicating the responsibility for implementing the firm’s responses to relevant personnel, including engagement teams. (Ref: Para. A141)
 - (c) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated with external parties, including:
 - (i) Communication to external parties in accordance with law, regulation or professional standards. (Ref: Para. A142)
 - (ii) Communication with the network. (Ref: Para. A143)
 - (iii) Communication with service providers. (Ref: Para. A144)
 - (iv) Other communication to external parties about the firm’s system of quality management, in a transparency report or otherwise, when the firm determines it appropriate to do so, taking into account: (Ref: Para. A145, A149–A153)
 - a. Whether there are external parties who may use such information to support their understanding of the quality of the engagements performed by the firm; and (Ref: Para. A146–A147)
 - b. The nature and circumstances of the firm, including the nature of the firm’s operating environment. (Ref: Para. A148)

Monitoring and Remediation Process

42. The firm shall establish the following quality objectives that address the firm’s monitoring and remediation process that enable the evaluation of the design, implementation and operation of the

components of the system of quality management to determine whether the quality objectives have been achieved: (Ref: Para. A154–A155)

- (a) The firm's monitoring and remediation process provides relevant, reliable and timely information about the design, implementation and operation of the components of the system of quality management.
 - (b) The firm takes appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.
 - (c) The individual(s) assigned ultimate responsibility and accountability for the system of quality management evaluates whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
43. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the monitoring and remediation quality objectives, the firm shall include the responses in paragraphs 44–57.

Designing and Performing Monitoring Activities

44. The firm shall determine the nature, timing and extent of the monitoring activities, including the appropriate combination of ongoing and periodic monitoring activities. In designing and implementing the monitoring activities, the firm shall take into account: (Ref: Para. A156–A159)
- (a) For a response, the related assessed quality risk(s), the reasons for the assessments given to the quality risk(s) and the design of the response; (Ref: Para. A160–A161)
 - (b) For monitoring activities over the firm's risk assessment process, the design of that process;
 - (c) Changes in factors that have affected the firm's system of quality management or changes in the system of quality management; (Ref: Para. A162)
 - (d) Previous monitoring activities and remedial actions, including whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management; and (Ref: Para. A163–A164)
 - (e) Other relevant information, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A165–A167)
45. 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: (Ref: Para. A168–A170)
- (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.
46. The firm shall establish policies or procedures that:
- (a) Require those performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and

- (b) Address the objectivity of the individuals performing the monitoring activities. Such policies or procedures shall prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: Para. A171)

Evaluating Findings and Identifying Deficiencies

- 47. 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. (Ref: Para. A165, A172–A177)

Evaluating Identified Deficiencies

- 48. The firm shall establish policies or procedures addressing:
 - (a) The investigation of the root cause(s) of the identified deficiencies, including that the nature, timing and extent of the procedures to be performed to investigate the root cause(s) take into account the nature of the identified deficiencies and their possible severity; and (Ref: Para. A178–A182)
 - (b) The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole. (Ref: Para. A183)

Responding to Identified Deficiencies

- 49. The firm shall design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. In doing so, the firm shall determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate and modify them, as appropriate. (Ref: Para. A184)
- 50. The individual(s) assigned operational responsibility for monitoring and remediation shall evaluate whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s) and determine whether they have been implemented. The individual shall also evaluate whether the remedial actions implemented to address previously identified deficiencies are effective. (Ref: Para. A163)

Findings About a Particular Engagement

- 51. In circumstances when a finding relates to an in-process or completed engagement and there is an indication that procedures required were omitted during the performance of the engagement or the report issued may be inappropriate, the firm shall: (Ref: Para. A185)
 - (a) Take appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements; and
 - (b) When the report is considered to be inappropriate, consider the implications and take appropriate action, including considering whether to obtain legal advice.

Ongoing Communication Related to Monitoring and Remediation

- 52. The individual(s) assigned operational responsibility for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability

for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A186)

- (a) A description of the monitoring activities performed;
 - (b) The identified deficiencies, including the severity and pervasiveness of such deficiencies; and
 - (c) The remedial actions to address the identified deficiencies.
53. The firm shall communicate the matters described in paragraph 52 to personnel to the extent that the information is relevant to their responsibilities to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. (Ref: Para. A187)
54. The firm shall communicate information about the results of the firm's monitoring and remediation process to external parties on a timely basis, in accordance with paragraph 41(c).

Evaluating the System of Quality Management

55. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved. This evaluation shall take into account: (Ref: Para. A188–A189)
- (a) The severity and pervasiveness of identified deficiencies; and
 - (b) The evaluation in paragraph 50 regarding whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s), and have been implemented.
56. The evaluation in paragraph 55 shall be undertaken at least annually, or more frequently when the identified deficiencies are of a severity and pervasiveness that indicate that the system may not be providing reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
57. If the evaluation indicates that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, the individual(s) assigned ultimate responsibility and accountability for the system of quality management shall:
- (a) Take prompt and appropriate action in accordance with their responsibilities; and
 - (b) Communicate to: (Ref: Para. A190–A191)
 - (i) Personnel to the extent that it is relevant to their responsibilities; and
 - (ii) External parties in accordance with the firm's policies or procedures required by paragraph 41(c).

Network Requirements or Network Services

58. When the firm operates as part of a network, the firm shall understand, when applicable:
- (a) The requirements established by the network regarding the firm's system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (i.e., network requirements); (Ref: Para. A192)

- (b) Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation or operation of the firm's system of quality management (i.e., network services); and (Ref: Para. A193)
- (c) The firm's responsibilities for any actions that are necessary to implement the network requirements or use network services. (Ref: Para. A194)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation and operation of the system of quality management. The firm shall not allow compliance with the network requirements or use of network services to contravene the requirements of this ISQM. (Ref: Para. A13, A195–A196)

The Firm's Risk Assessment Process

59. In complying with the requirements in paragraphs 26–30, the firm shall evaluate the effect of the network requirements or network services on the firm's system of quality management, including determining whether they need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management. (Ref: Para. A197–A198)

Monitoring and Remediation Process

60. In circumstances when the network performs monitoring activities relating to the firm's system of quality management, the firm shall:
- (a) Determine the effect of the monitoring activities performed by the network on the nature, timing and extent of the firm's monitoring activities performed in accordance with paragraphs 44–45; (Ref: Para. A199)
 - (b) Determine the firm's responsibilities in relation to the monitoring activities, including any related actions by the firm; and
 - (c) As part of evaluating findings and identifying deficiencies in paragraph 47, obtain the results of the monitoring activities from the network in a timely manner. (Ref: Para. A200)
61. The firm shall, at least annually, obtain information from the network, about the overall scope and results of the monitoring activities across the network firms' systems of quality management and:
- (a) Consider the effect of such information on the nature, timing and extent of the monitoring activities that need to be undertaken by the firm; and (Ref: Para. A201–A202)
 - (b) Communicate the information to personnel to the extent that it is relevant to their responsibilities such that personnel take prompt and appropriate action in accordance with their responsibilities (including as it relates to the performance of engagements).
62. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the network requirements or network services, the firm shall communicate to the network relevant information about the identified deficiencies. (Ref: Para. A203)
63. As part of designing and implementing remedial actions in paragraph 49, for identified deficiencies related to the network requirements or network services the firm shall: (Ref: Para. A204)
- (a) Understand the planned remedial actions by the network;
 - (b) Understand whether the network's remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s); and

- (c) Determine the supplementary remedial actions needed by the firm, if any.

Service Providers

64. When the firm intends to obtain or use resources provided by a service provider in its system of quality management, the firm's responses for resources shall include: (Ref: Para. A205–A207)
- (a) Obtaining an understanding of the service provider, including determining that the reputation, competence and capabilities of the service provider are appropriate in the context of the intended use of the resource; (Ref: Para. A208)
 - (b) Establishing the nature and scope of the resources provided by the service provider, including the firm's responsibilities for any actions that are necessary in using the resources; and (Ref: Para. A209)
 - (c) Determining whether the resource is appropriate for use in the system of quality management in the context of the quality risks identified and assessed by the firm and the reasons for the assessments given to the quality risks, including when changes are made to the resources provided. (Ref: Para. A210)

Notwithstanding the firm's use of a service provider(s), the firm remains responsible for its system of quality management.

65. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the resources provided by the service provider, the firm shall communicate to the service provider relevant information about the identified deficiencies. The firm shall also:
- (a) Understand the planned remedial actions by the service provider and consider whether the service provider's remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s);
 - (b) Determine the supplementary remedial actions needed by the firm, if any; and
 - (c) Consider whether to continue using the services provided by the service provider.

Documentation

66. The firm shall prepare documentation of its system of quality management that is sufficient to: (Ref: Para. A211–A213)
- (a) Support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the firm's system of quality management;
 - (b) Support the consistent implementation and operation of the responses; and
 - (c) Provide evidence of the design, implementation and operation of the responses, such that the firm is able to evaluate the system of quality management.
67. The firm shall prepare documentation that includes: (Ref: Para. A214)
- (a) The firm's quality objectives and assessed quality risks;
 - (b) A description of the responses and how the firm's responses address the assessed quality risks; and

- (c) Regarding the monitoring and remediation process:
 - (i) Evidence of the monitoring activities performed;
 - (ii) The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information, including the identified deficiencies and their related root cause(s);
 - (iii) Remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions;
 - (iv) Communications about monitoring and remediation; and
 - (v) The basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
- 68. The firm shall document the matters in paragraph 67 as they relate to network requirements or network services or resources provided by service providers and:
 - (a) The evaluation of the effect of the network requirements or network services in accordance with paragraph 59 and the conclusions reached.
 - (b) The firm's basis for determining that it is appropriate to use the resources from a service provider in its system of quality management.
- 69. The firm shall establish a period of time for the retention of documentation for the system of quality management that is sufficient to permit those performing monitoring procedures to evaluate the firm's system of quality management, or for a longer period if required by law or regulation.

Application and Other Explanatory Material

Scope of this ISQM (Ref: Para. 2)

- A1. Other pronouncements of the IAASB, including ISRE 2400 (Revised)²⁵ and ISAE 3000 (Revised),²⁶ also establish requirements for the engagement partner for the management of quality at the engagement level.

The Firm's System of Quality Management (Ref: Para. 7–8)

- A2. The IESBA Code contains requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance as described in this ISQM, the consistent performance of quality engagements forms part of the professional accountant's responsibility to act in the public interest.
- A3. Reasonable assurance is obtained when the firm's system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph 18(a) and (b) are not achieved. Reasonable assurance is not an absolute level of assurance, because there are inherent limitations

²⁵ International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

²⁶ International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

of a firm's system of quality management. Such limitations include reality that human judgment in decision making can be faulty and that breakdowns in the firm's system of quality management may occur, for example, due to human error or behavior or failures in the firm's IT applications.

- A4. The design, implementation and operation of the system of quality management involves the exercise of professional judgment, including when making decisions about:
- The appropriate organizational structure and assignment of roles, responsibilities and authority that support the firm's commitment to quality.
 - Establishing additional quality objectives beyond those required by this ISQM when those objectives are necessary to achieve the objective of this standard.
 - The identification and assessment of the quality risks.
 - The appropriate nature, timing and extent of the responses to address the assessed quality risks.
 - The resources and information and communication that are appropriate to enable the design, implementation and operation of the components of the system of quality management.
 - The evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
 - The effect of the network requirements or network services on the firm's system of quality management.
- A5. The firm may use different terminology or frameworks to describe the components of its system of quality management.

Authority of this ISQM (Ref: Para. 16)

- A6. The objective of this ISQM provides the context in which the requirements of this ISQM are set, establishes the desired outcome of this ISQM and is intended to assist the firm in understanding what needs to be accomplished and, where necessary, the appropriate means of doing so.
- A7. The requirements of this ISQM are expressed using "shall."
- A8. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:
- Explain more precisely what a requirement means or is intended to cover; and
 - Include examples that illustrate how the requirements might be applied.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this ISQM. Where appropriate, additional considerations specific to public sector audit organizations are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in this ISQM. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this ISQM.

- A9. This ISQM includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of this ISQM. These definitions are provided to assist in the consistent

application and interpretation of this ISQM, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the *Handbook of International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC includes the terms defined in this ISQM. The Glossary of Terms also includes descriptions of other terms found in the ISQMs to assist in common and consistent interpretation and translation.

Definitions

Deficiencies (Ref: Para. 19(a))

A10. A response to address an assessed quality risk is not:

- Properly designed when a response necessary to address an assessed quality risk is absent or a response is not properly designed in a manner that effectively addresses an assessed quality risk, such that a quality objective may not be achieved. A deficiency in the design of a response may also arise from a quality objective or assessed quality risk not being appropriately specific, given the nature and circumstances of the firm and its engagements.
- Operating effectively when a response that is properly designed does not operate as designed, which results in the related quality risk not being effectively addressed such that a quality objective may not be achieved.

External Inspections (Ref: Para. 19(g))

A11. In some circumstances, an external oversight authority may undertake other types of reviews, for example, reviews of specific areas of focus that contribute to the improvement of engagement quality. Paragraph A165 describes such reviews as part of other relevant information considered by the firm in the monitoring and remediation component.

Firm (Ref: Para. 19(h))

A12. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISQM.

Network (Ref: Para. 19(k), 58)

A13. Networks and the firms within the network may be structured in a variety of ways; however, in all cases networks are external to the firm. In some instances, network firms may provide services (e.g., resources) that are used by the firm in its system of quality management. There may also be circumstances when the network includes other structures or organizations that establish requirements for the firm related to its system of quality management, or provides services. For the purposes of this ISQM, any requirements established by the network regarding the firm’s system of quality management or services or resources provided by the network that the firm chooses to implement or use in its system of quality management that are obtained from the network, network firms or another structure or organization in the network are considered “network requirements or network services.”

A14. The IESBA Code provides guidance in relation to the terms “network” and “network firm.”

Relevant Ethical Requirements (Ref: Para. 19(s), 33(a))

- A15. The relevant ethical requirements that are applicable in the context of a system of quality management may vary, depending on the nature and circumstances of the firm and its engagements. The term “professional accountant” may be defined in relevant ethical requirements. For example, the IESBA Code defines the term “professional accountant” and further explains the scope of provisions in the IESBA Code that apply to individual professional accountants in public practice and their firms.
- A16. The IESBA Code addresses circumstances when law or regulation precludes the professional accountant from complying with certain parts of the IESBA Code. It further acknowledges that some jurisdictions might have provisions in law or regulation that differ from or go beyond those set out in the IESBA Code and that professional accountants in those jurisdictions need to be aware of those differences and comply with the more stringent provisions, unless prohibited by law or regulation.

Response (Ref: Para. 19(t))

- A17. Policies are implemented through the actions of personnel and other individuals whose actions are subject to the policies, or through their restraint from taking actions that would conflict with the firm’s policies.
- A18. Procedures may be mandated, through formal documentation or other communications, or may be effected by behaviors that are not mandated but are rather conditioned by the firm’s culture. Procedures may be enabled through the application of IT, for example, the firm may use an IT application to facilitate obtaining a documented confirmation of compliance with independence requirements from personnel.

Applying, and Complying with, Relevant Requirements (Ref: Para. 20–21)

- A19. The individual(s) assigned ultimate responsibility and accountability for the system of quality management may also assume operational responsibility for the system of quality management, for example, in smaller firms.
- A20. Examples of when a requirement of this ISQM may not be relevant to the firm include:
- When the firm is a sole practitioner. For example, the requirements addressing the organizational structure and assigning roles, responsibilities and authority within the firm, appropriate direction, supervision and review and addressing differences of opinion may not be relevant.
 - When the firm only performs engagements that are related services engagements. For example, if the firm is not required to maintain independence for the related services engagements, the requirement to obtain a documented confirmation of compliance with independence requirements from all personnel would not be relevant.

System of Quality Management (Ref: Para. 22)

- A21. Paragraph 55 requires the individual(s) assigned ultimate responsibility and accountability for the system of quality management to evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
- A22. The nature and circumstances of the firm may include consideration of matters such as:

- The size and operating characteristics of the firm, including the geographical dispersion and the extent to which the firm concentrates or centralizes its processes or activities.
- The firm's strategic decisions and actions, including those about financial and operational matters.
- External factors, for example, law or regulation, economic stability, stakeholder expectations and social factors.
- In the case of a firm that belongs to a network, the nature of the network, how the network is organized and the nature and extent of the requirements established by the network regarding the firm's system of quality management or services or resources provided by the network that the firm chooses to implement or use in the design, implementation and operation of the firm's system of quality management.
- The extent to which the firm uses service providers in its system of quality management and the nature of such services.

A23. The nature and circumstances of the engagements performed by the firm may include consideration of matters such as:

- The types of engagements performed by the firm, for example, whether the firm performs only compilation engagements or performs a variety of engagements, including audits of financial statements.
- The types of entities for which such engagements are undertaken, for example, the industries in which the entities operate and whether the entities are owner-managed, listed or of significant public interest. An entity may be of significant public interest because it has a large number and wide range of stakeholders or due to the nature and size of its business.
- External factors, such as relevant professional standards and law or regulation.

A24. The quality of professional judgments exercised by the firm is enhanced when personnel making such judgments demonstrate an attitude that includes a questioning mind, critical assessment of information in formulating decisions, and being alert to changes in the nature and circumstances of the firm or its engagements.

Governance and Leadership (Ref: Para. 23–25)

A25. Law, regulation or other professional standards may prescribe additional matters related to the governance or leadership of the firm, for example, the firm may be required to follow an audit firm governance code that may incorporate specific governance principles and require adherence by the firm to specific provisions.

***Culture* (Ref: Para. 23(a), 24(a)(ii))**

A26. The firm's culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics, and are further addressed in the relevant ethical requirements component of this ISQM. Professional values and attitudes may include, for example:

- Professional manner, for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability;

- A commitment to teamwork;
- Maintaining an open mind to new ideas or different perspectives in the professional environment;
- Pursuit of excellence;
- A commitment to continual improvement (e.g., setting expectations beyond the minimum requirements); and
- Social responsibility.

A27. A culture that promotes a commitment to quality is likely to involve clear, consistent, frequent and effective actions, including communications, at all levels within the firm, that emphasize the firm's commitment to quality. The tone at the top and the attitude towards quality, including reinforcing the importance of professional ethics, values and attitudes, are set by the individual(s) assigned ultimate responsibility and accountability for the system of quality management through their personal conduct, communication and actions. The attitude towards quality is further shaped and reinforced by other personnel who are expected to embed or demonstrate the behaviors that reflect the firm's commitment to quality.

A28. The nature and extent of the actions of the individual(s) assigned ultimate responsibility and accountability for the system of quality management in establishing the firm's culture may depend on factors such as the size, structure, geographical dispersion and complexity of the firm. For example, a smaller firm may be able to establish the desired culture through the direct interaction of firm leadership with other personnel. For a larger firm in which personnel are dispersed across many geographical locations, more formal communication may be necessary. Other actions that may be taken to establish the expected behavior of personnel include creating a code of conduct.

Strategic Decisions and Actions (Ref: Para. 23(c))

A29. It is important that the firm's strategic decision-making process, which may include establishing a business strategy, takes into consideration how the firm's decisions about financial and operational matters (e.g., the firm's profitability or strategic focus, such as growth of the firm's market share, industry specialization or new service offerings) affect the performance of quality engagements.

Public Sector Considerations

A30. In the public sector, although the firm's strategic decisions and actions may be less influenced by matters such as profitability or strategic focus areas, they are nevertheless affected by financial and operational priorities, for example, the allocation of financial resources.

Organizational Structure (Ref: Para. 23(d), 24(a)(iii))

A31. The organizational structure of the firm may include operating units, operational processes, divisions or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, for example, engagement teams may include human resources from service delivery centers who perform specific tasks that are repetitive or specialized in nature.

A32. How the firm assigns roles, responsibilities and authority within the firm may vary. For example, the leadership structure of a smaller firm may comprise a single managing partner with sole responsibility

for the oversight of the firm. Larger firms may have multiple levels of leadership, such as a chief executive officer (or equivalent) and a managing board of partners (or equivalent), and further levels that reflect the organizational structure of the firm. Some firms may also have an independent governing body that has non-executive oversight of the firm. At a jurisdictional level, law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities.

Resources (Ref: Para. 23(e))

- A33. The quality objective in this component for resources addresses all categories of resources. The resources component includes quality objectives that address specific aspects of human resources, technological resources and intellectual resources. Financial resources are necessary for obtaining, developing, using and maintaining human resources, technological resources and intellectual resources. The quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources.
- A34. The individuals(s) assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are in most cases able to influence the nature and extent of resources that the firm obtains, develops, uses and maintains, and how those resources are allocated or assigned, including the timing of when they are used. The firm's strategic decisions and actions may affect decisions about obtaining, allocating or assigning resources. Paragraph 23(c) requires that the strategic decisions and actions, including the firm's financial and operational priorities, demonstrate a commitment to quality, including not leading to inappropriate decisions about obtaining, allocating or assigning resources for the system of quality management.
- A35. Resource needs may change over time as a result of changes in the nature and circumstances of the firm (e.g., the emergence of new or advanced technology or evolution in the firm's business model) and the engagements performed by the firm. The firm's resource planning involves determining the resources currently required and forecasting the firm's future resource needs. However, given the continual changes in the nature and circumstances of the firm and its engagements, it may not be practicable for the firm to anticipate all possible resource needs or changes to the resource needs and therefore, in most cases, the firm's resource planning includes processes to deal with resource needs that cannot be anticipated as and when they arise.

Firm Leadership Responsibility and Accountability (Ref: Para. 23(b), 24(a))

- A36. Paragraph A32 explains the various leadership structures that may exist in a firm. Ordinarily the person with ultimate responsibility and accountability for the system of quality management is the chief executive officer (or equivalent), or the firm's managing partner (e.g., in the case of a smaller firm). However, some firm management structures may share the responsibility and accountability for the system of quality management among the firm's managing board of partners (or equivalent).

Operational Responsibility (Ref: Para. 24(a)(iii), 25)

- A37. The individual(s) assigned ultimate responsibility and accountability for the system of quality management is responsible and accountable for the firm achieving the objective of this ISQM. The individual(s) assigned operational responsibility for the system of quality management as a whole is responsible and accountable for the design, implementation and operation of the firm's system of quality management. In some instances, operational responsibility for the matters in paragraph

24(a)(iii) may be assigned to one individual, particularly in the case of a smaller firm. These responsibilities may also be fulfilled by the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

- A38. In some instances, the individual assigned operational responsibility for the system of quality management may further assign specific roles, procedures, tasks or actions to other individuals within the firm. For example, in addition to assigning responsibility for compliance with independence requirements and the monitoring and remediation process, the individual may assign responsibility for technological resources.
- A39. In some circumstances, the firm may establish additional criteria for the eligibility of the individual(s) assigned operational responsibility for the matters set out in paragraph 24(a)(iii).

Performance Evaluations (Ref: Para. 24(b))

- A40. Periodic performance evaluations of individual(s) within the firm are a required response to promote the accountability of such individual(s) for their assigned responsibilities. In considering the performance of individuals, the firm may take into account:
- The results of the firm's monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. For example, the firm may set targets for the individual and measure the results of the firm's monitoring activities against those targets.
 - The actions taken by the individual(s) in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.
- A41. A positive performance evaluation may be rewarded through compensation, promotion and other incentives that focus on the individual's commitment to quality, and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm's achievement of its quality objectives.
- A42. Given the unique position of the individual(s) assigned ultimate responsibility and accountability for the system of quality management, the performance evaluations may be undertaken by an independent non-executive member of the firm's governing body, or a special committee overseen by the firm's governing body, or the firm may engage a service provider to perform the evaluation. In the case of smaller firms, it may not be practicable to perform performance evaluations; however, in such cases, the results of the firm's monitoring activities may provide an indication of the performance of the individual(s).

Public Sector Considerations

- A43. In the case of the public sector, it may not be practicable to perform a performance evaluation of the individual assigned ultimate responsibility and accountability for the system of quality management, or to take actions to address the results of the performance evaluation, given the nature of the individual's appointment. Nevertheless, performance evaluations may still be undertaken for other individuals in the firm who are assigned operational responsibility for aspects of the system of quality management.

Complaints and Allegations (Ref: Para. 24(c))

- A44. Establishing policies or procedures for dealing with complaints and allegations supports the firm's commitment to quality. Complaints and allegations may originate from within or outside the firm and

they may be made by personnel or external parties, such as clients or others within the firm's network. Complaints and allegations may relate to the failure to perform work in accordance with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm's policies or procedures. A complaint or allegation may indicate that there is a deficiency in the firm's system of quality management, which would be other relevant information considered by the firm as part of its monitoring and remediation process, as required by paragraph 44(e).

- A45. Law, regulation or relevant ethical requirements may establish responsibilities for the firm or its personnel in circumstances when complaints or allegations arise, such as an obligation on the firm or its personnel to report the matter to an authority outside the firm. For example, sections 260 and 360 of the IESBA Code address the approach to be taken by the firm or its personnel in responding to non-compliance or suspected non-compliance with laws or regulations, which may include communications external to the firm that are addressed through the firm's policies or procedures for external communication in paragraph 41(c).
- A46. In identifying an appropriate individual(s) to whom complaints and allegations are to be communicated, the firm may consider whether the individual(s) has:
- The experience, knowledge, time and appropriate authority within the firm needed to assume the role; and
 - A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

The firm may use a service provider to facilitate the reporting of complaints and allegations.

- A47. The firm may also identify an individual(s) to be responsible for supervising the investigation of complaints and allegations and may consider:
- The factors described in paragraph A46; and
 - Whether the individual(s) is not otherwise involved in the engagement to which a complaint or allegation pertains or has sufficient objectivity from the area or personnel subject to the investigation.

The individual(s) supervising an investigation may involve legal counsel as necessary. In the case of a smaller firm, it may not be practicable to identify an individual to supervise an investigation of an allegation or complaint who is not involved in the related engagement or area of the investigation. As a result, such firms may use a service provider to carry out the investigation into complaints and allegations, for example, legal counsel or a suitably qualified consultant.

The Firm's Risk Assessment Process (Ref: Para. 26–31)

- A48. The approach that the firm takes to the risk assessment process may vary according to many factors, including how the firm is structured and organized. For example, the firm's risk assessment process may be centralized (e.g., the quality objectives, quality risks and responses are established centrally for all business units, functions and service lines) or may be decentralized (e.g., the quality objectives, quality risks and responses are established at a business unit, function or service line level, with the outputs combined at the firm level). Although this ISQM is organized by components, the firm's risk assessment process may be undertaken for the system of quality management as a whole.

Establish Quality Objectives (Ref: Para. 26)

A49. The quality objectives that the firm is required to establish are set out in paragraphs 23, 32, 34, 36, 38, 40 and 42. In addition, given the nature and circumstances of the firm and its engagements the firm:

- Is required to establish additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
- May decide that more granular quality objectives than those set out in this ISQM are appropriate. Establishing more granular quality objectives may enhance the firm's identification and assessment of quality risks.

A50. Given the iterative nature of the firm's risk assessment process, the firm may determine that additional quality objectives are necessary to achieve the objective of this ISQM at any stage in the process of establishing quality objectives, identifying and assessing quality risks and designing and implementing responses. The results of the firm's monitoring and remediation process may also highlight that additional quality objectives are necessary to achieve the objective of this ISQM, including in circumstances when it is determined that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

A51. Although the quality objectives set out in this ISQM are organized by component, an objective in one component may overlap, be related to, support or be supported by a quality objective in another component. For example, the quality objective in information and communication addressing the communication of relevant and reliable information in a timely manner to personnel supports the quality objective in the relevant ethical requirements component addressing the understanding of relevant ethical requirements by the firm, its personnel and others subject to relevant ethical requirements.

Conditions, Events, Circumstances, Actions or Inactions That May Affect the Achievement of the Quality Objectives (Ref: Para. 27)

A52. In understanding the conditions, events, circumstances, actions or inactions that may affect the achievement of its quality objectives, the firm may consider what could go wrong in relation to the matters identified in paragraphs A22–A23 that could affect the achievement of such objectives. Such consideration may also assist with identifying quality risks.

Identify and Assess Quality Risks (Ref: Para. 28–29)

A53. The firm exercises professional judgment in identifying and assessing quality risks. The process for identifying and assessing quality risks may involve a combination of ongoing and periodic risk identification and assessment procedures. In some circumstances, the identification and assessment of quality risks may be undertaken concurrently.

A54. Under this ISQM, not every quality risk needs to be identified and further assessed. The firm identifies which quality risks need to be further assessed based on a preliminary consideration of the possibility of the quality risks occurring and the effect on the achievement of the quality objectives. Only those quality risks that meet both of the criteria in paragraph 28(a) and (b) need to be identified and further assessed. The further assessment of the quality risks involves a more detailed consideration of the

degree of the likelihood of the quality risks occurring and the significance of the effect of the quality risks on the achievement of the quality objectives.

- A55. There is a reasonable possibility of a quality risk occurring when the likelihood of its occurrence is more than remote.
- A56. The significance of the effect of a quality risk on the achievement of a quality objective(s) is judged in the context of the underlying conditions and events that gave rise to the quality risk, as well as the nature and circumstances of the firm and its engagements, which are further described in paragraphs A22–A23.
- A57. The firm may determine that a quality risk that has a reasonable possibility of occurring does not, on its own, have a significant effect on the achievement of a quality objective(s). However, a quality risk is required to be identified and further assessed in circumstances when the quality risk, in combination with other quality risks that have a reasonable possibility of occurring, have a significant effect on the achievement of a quality objective(s).
- A58. The assessment of identified quality risks need not comprise formal ratings or scores, and may involve taking into consideration:
- The expected frequency of the quality risk occurring.
 - The rate at which the effect of the quality risk would take place, or the amount of time that the firm has to respond to the quality risk.
 - The duration of time of the effect of the quality risk after it has occurred.

Design and Implement Responses to Assessed Quality Risks (Ref: Para. 19(t), 30)

- A59. The responses required by this ISQM are set out in paragraphs 24, 25, 33, 35, 37, 41 and 43 and represent responses that are relevant to every firm's system of quality management and are therefore applicable to all firms. However, the responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks, as explained in paragraph 10(c). Accordingly the firm is required to design and implement responses in addition to those required by this ISQM. For example, paragraph A69 identifies additional responses that may be appropriate to address quality risks for relevant ethical requirements.
- A60. The firm exercises professional judgment in designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the responses are affected by the reasons for the assessment given to the assessed quality risks, which includes:
- The likelihood of the assessed quality risk occurring. For example, a more robust response may be needed for an assessed quality risk that has a higher likelihood of occurring.
 - The significance of the effect on the achievement of the quality objectives. For example, a more robust response may be needed for an assessed quality risk that has a more significant effect on the achievement of a quality objective.
 - The conditions, events, circumstances, actions or inactions that give rise to the assessed quality risks. For example, if the assessed quality risk relates specifically to engagements performed for a category of entities (e.g., audits of financial statements of listed entities), the responses may require specific actions for entities in that category, rather than all engagements performed by the firm.

- A61. The nature and circumstances of the firm and its engagements affect the reasons for the assessment given to the assessed quality risks, and the nature, timing and extent of the responses designed and implemented to address the assessed quality risks. For example, in demonstrating a commitment to quality through their actions and behaviors, as required by paragraph 24(a)(ii), leadership of a smaller firm may engage in direct and frequent interactions with personnel throughout the firm. However, in the case of a larger firm, frequent and direct interactions by leadership with all personnel may not be practicable and therefore the actions taken to demonstrate a commitment to quality may involve multiple actions, including establishing firm values in a code of conduct that all personnel are required to comply with and a series of formal communications from firm leadership that emphasize the importance of quality.
- A62. The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level in order for a response to operate as designed. For example, the firm may appoint suitably qualified and experienced personnel to provide technical advice to engagement teams and, in doing so, may prescribe specific matters for which consultation by the engagement team is required. The engagement team may have a responsibility to identify when such matters occur and to initiate such consultation as required by the firm's policies or procedures. Communicating to engagement teams about their responsibilities for the implementation of the responses is therefore important for the functioning of the system of quality management, and is a response required by paragraph 41(b).
- A63. The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.
- A64. In some cases, the response designed and implemented by the firm may address multiple assessed quality risks across multiple components of the system of quality management. Furthermore, the responses designed and implemented to address an assessed quality risk in one component may affect the assessed quality risks and responses of another component. For example, engaging a service provider to manage all aspects of the firm's IT environment may create new quality risks for relevant ethical requirements (e.g., the service provider may have access to confidential information).

Changes in the Nature and Circumstances of the Firm or Its Engagements (Ref: Para. 31)

- A65. In some circumstances, changes in the nature and circumstances of the firm's engagements may affect the design, implementation and operation of the system of quality management. For example, the firm may accept an engagement to perform an audit of financial statements for an entity involved in an industry for which the firm has not previously performed audit engagements that may create new quality risks (e.g., personnel do not have the knowledge or experience relevant to the engagement).
- A66. Quality objectives, quality risks or responses may also need to be modified as a result of:
- Changes that affect specific components of the system of quality management, for example, changes in the firm's resources.
 - Information from the firm's monitoring and remediation, including identified deficiencies from monitoring activities, external inspections or other relevant information.

Relevant Ethical Requirements (Ref: Para. 32–33)

A67. The IESBA Code sets out the fundamental principles of ethics that establish the standard of behavior expected of a professional accountant and establishes the International Independence Standards. The fundamental principles are integrity, objectivity, professional competence and due care, confidentiality and professional behavior. The IESBA Code also specifies the approach that a professional accountant is required to apply to comply with the fundamental principles and the International Independence Standards and addresses specific topics relevant to complying with the fundamental principles. Law or regulation in a jurisdiction may also contain provisions addressing ethical requirements, including independence, for example, privacy laws affecting the confidentiality of information.

A68. In some cases, the firm may determine that it is appropriate to design and implement responses that are more specific than the provisions of relevant ethical requirements. For example, having regard to the nature and circumstances of the firm and its engagements, a firm may:

- Prohibit the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- Set rotation periods for the engagement partner and other senior personnel for all engagements performed by the firm, including other assurance or related services engagements.

A69. Other components include responses that may affect or relate to the relevant ethical requirements component. For example, the following are examples of responses for information and communication and resources that may address assessed quality risks for relevant ethical requirements:

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
- Providing training for personnel on relevant ethical requirements.
- Establishing manuals and guides (i.e., intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
- Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.
- Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner related to:
 - Personal or firm situations that may create threats to independence, for example, financial interests, loans, employment relationships or personal appointments.
 - Client engagements, including non-assurance engagements. For example, this may include the scope of services, fees or information about long association.
 - Business relationships.
 - Any breaches of the relevant ethical requirements, including those related to independence.

- Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

Furthermore, the individual in the firm assigned operational responsibility for compliance with independence requirements is ordinarily responsible for the oversight of all matters related to independence, including the policies or procedures addressing communication of breaches of independence requirements and determining that appropriate actions have been taken to address the causes and consequences of the breach.

- A70. Various provisions of the relevant ethical requirements may apply only to personnel and not the firm itself. For example, Part 2 of the IESBA Code applies to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm. The firm's system of quality management may need to address personnel's compliance with such relevant ethical requirements, for example, the firm may need to establish policies or procedures to facilitate personnel's compliance with Part 2 of the IESBA Code (e.g., policies or procedures addressing section 260 of the IESBA Code regarding non-compliance with laws and regulations).
- A71. The applicability of the relevant ethical requirements to others (i.e., the network, network firms, personnel in the network or network firms, or service providers) depends on whether those requirements contain specific provisions addressing others, and how the firm uses others in its system of quality management. For example:
- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms.
 - The definition of engagement team under relevant ethical requirement may include any individuals engaged by the firm who perform assurance procedures on the engagement (e.g., a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team may also be relevant to such individuals.
 - The principle of confidentiality may apply to a network, network firm or service provider, given that they may have access to client information obtained by the firm.
- A72. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the IESBA Code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third party test.
- A73. The policies or procedures addressing breaches of the relevant ethical requirements, including those related to independence, may address matters such as:
- The communication of breaches of the relevant ethical requirements to appropriate individual(s) within the firm;
 - The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements;
 - The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable;
 - Determining whether to report a breach to external parties; and

- Determining the appropriate actions to be taken in relation to the individual(s) responsible for the breach.

A74. Relevant ethical requirements may specify how the firm is required to respond to a breach. The IESBA Code sets out requirements for the firm in the event of a breach of the IESBA Code and includes specific requirements addressing breaches of the International Independence Standards, which includes requirements for communication with external parties.

Public Sector Considerations

A75. Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may still exist regardless of any statutory measures designed to protect the firm's independence that will require an appropriate response by the organization.

Acceptance and Continuance of Client Relationships and Specific Engagements (Ref: Para. 34–35)

A76. Other components include responses that may affect or relate to the acceptance and continuance of client relationships and specific engagements component. For example:

- The information necessary to support the firm's decisions about the acceptance and continuance of client relationships and specific engagements is identified, captured, processed and maintained through the information and communication component, and may include intellectual resources such as databases of client information or access to external information databases.
- The firm may use technological resources in the form of IT applications to facilitate the approval of client relationships or specific engagements at appropriate levels within the firm.
- Governance and leadership addresses the responsibility of the firm with respect to appropriate resource planning and obtaining, allocating or assigning resources.

The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client (Ref: Para. 34(a))

A77. The information obtained about the nature and circumstances of the engagement may include:

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors;
- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model and how it is financed; and
- The nature of the underlying subject matter and the criteria to be applied in the preparation of the subject matter information, for example, in the case of integrated reporting, the underlying subject matter may include social, environmental and health and safety information and the criteria may be performance measures established by a recognized body of experts.

A78. In some circumstances the firm may establish policies or procedures that specify, or prohibit, the types of engagements that may be performed by the firm, for example, the firm may prohibit the performance of assurance engagements over a certain subject matter. The policies or procedures may also prohibit the performance of engagements for certain types of entities, for example, the firm may prohibit the performance of engagements in certain industries.

A79. The information obtained to support the firm's judgments about the integrity and ethical values of the client may include the identity and business reputation of the client's principal owners, key management, and those charged with its governance. The nature and extent of information obtained may depend on factors such as:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of a client-imposed limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The identity and business reputation of related parties.

A80. The firm may obtain the information from a variety of internal and external sources, for example:

- In the case of an existing client, consideration of matters that have arisen during the current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.
- In the case of a new client, inquiry of existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel and industry peers.
- Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

A81. Information that is obtained during the firm's acceptance and continuance process about the nature and circumstances of the engagement and the integrity and ethical values of the client's management, and, when appropriate, those charged with governance is in most cases relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, ISA 220 (Revised)²⁷ requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of ISA 220 (Revised).

A82. Professional standards or legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an

²⁷ Proposed ISA 220 (Revised), paragraph 21

engagement. For example, when there has been a change of auditors, ISA 300²⁸ requires the auditor, prior to starting an initial audit, to communicate with the predecessor auditor in compliance with relevant ethical requirements. The IESBA Code also includes requirements for the consideration of conflicts of interests in accepting or continuing a client relationship or specific engagement and communication with the existing or predecessor firm when accepting an engagement that is an audit or review of financial statements.

The Firm's Ability to Perform Engagements (Ref: Para. 34(b))

- A83. The consideration of whether the firm is able to perform engagements in accordance with professional standards and applicable legal and regulatory requirements includes determining that the firm, its personnel and others are able fulfill their responsibilities in relation to the relevant ethical requirements.
- A84. The judgments about whether the firm has the resources to perform the engagement may involve reviewing the specific circumstances of the engagement and considering whether the firm has the resources to perform the engagement within the reporting deadline, including whether there are:
- Human resources with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes:
 - Personnel to direct and supervise the engagement and take overall responsibility; and
 - Human resources with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements.
 - Experts that are available, if needed.
 - Engagement quality reviewers who meet the eligibility requirements in ISQM 2, if applicable.
 - Technological resources, for example, IT applications that enable the engagement team to perform procedures on the entity's data.
 - Intellectual resources, for example, a methodology, industry or subject matter-specific guides, or access to information sources.

The Firm's Financial and Operational Priorities (Ref: Para. 34(c))

- A85. Financial priorities may focus on the profitability of the firm, and fees obtained for the performance of engagements have an effect on the firm's financial resources. Operational priorities may include strategic focus areas, such as growth of the firm's market share, industry specialization or new service offerings. There may be circumstances when the firm is satisfied with the fee quoted for an engagement but, notwithstanding the firm's operational and financial priorities, it is not appropriate for the firm to accept or continue the engagement or client relationship (e.g., when the client lacks appropriate integrity and ethical values).
- A86. There may be other circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The IESBA Code addresses fees and other types of remuneration, including

²⁸ ISA 300, *Planning an Audit of Financial Statements*, paragraph 13(b)

circumstances that may create a threat to compliance with the fundamental principle of professional competence and due care if the fee quoted for an engagement is too low.

Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement (Ref: Para. 34(d))

A87. Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may:

- Have existed at the time of the firm's decision to accept or continue the client relationship or specific engagement and the firm was not aware of such information; or
- Relate to new information that has arisen since the decision to accept or continue the client relationship or specific engagement.

The information may come to the attention of the firm in a variety of ways, including through the engagement partner or engagement team. For example, ISA 220 (Revised)²⁹ requires the engagement partner to communicate information to the firm that the engagement partner obtains that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement.

A88. The firm's response to address circumstances when information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm's decision to accept or continue a client relationship or specific engagement may include policies or procedures that set out the actions to be taken, including:

- Undertaking appropriate consultation within the firm or with legal counsel.
- Considering whether there is a professional, legal or regulatory requirement for the firm to continue the engagement.
- Discussing with the appropriate level of the client's management and with those charged with governance or the engaging party the appropriate action that the firm might take based on the relevant facts and circumstances, and when it is determined that withdrawal is an appropriate action, informing them of this decision and the reasons for the withdrawal.
- If the firm withdraws from the engagement, considering whether there is a professional, legal or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- If the firm does not withdraw from the engagement, considering the effect of the information on the performance of the engagement and the additional actions to be taken by the firm or the engagement partner in managing quality at the engagement level (e.g., assigning more experienced personnel to the engagement, requiring an engagement quality review or increasing the extent and frequency of the engagement partner's direction and supervision of engagement team members and review of their work).

²⁹ Proposed ISA 220 (Revised), paragraph 22

Circumstances When the Firm is Obligated to Accept or Continue a Client Relationship or Specific Engagement (Ref: Para. 35)

- A89. There may be circumstances when the firm is obligated to accept or continue a client relationship or specific engagement. For example, jurisdictional law or regulation may impose an obligation on the firm to accept or continue a client engagement, or in the case of the public sector, the firm may be appointed through statutory provisions. In such circumstances, when the firm becomes aware of information that would otherwise have caused the firm to decline or discontinue the engagement, the firm may design and implement additional responses to address the assessed quality risk(s) arising from the performance of such engagements. For example, the firm may assign more experienced personnel to the engagement or may require that an engagement quality review be performed in respect of the engagement. There may also be actions at the engagement level to manage quality when performing such engagements, for example, increasing the extent and frequency of the engagement partner's direction and supervision of engagement team members and review of their work.
- A90. In some circumstances, a threat to the firm's integrity may arise as a result of being associated with the subject matter of the engagement. Relevant ethical requirements may include requirements addressing circumstances when the firm becomes associated with information that is false or misleading. For example, the IESBA Code contains requirements addressing circumstances when the professional accountant becomes associated with information that contains a materially false or misleading statement, contains statements that have been provided recklessly or omits or obscures required information where such omission or obscurity would be misleading.

Engagement Performance (Ref: Para. 36–37)

- A91. ISA 220 (Revised)³⁰ requires the engagement partner to take overall responsibility for managing and achieving quality on the audit engagement.

Direction, Supervision and Review (Ref: Para. 36(a)(ii), 37(a))

- A92. The firm's policies or procedures addressing engagement supervision may include responsibilities for:
- Tracking the progress of the engagement;
 - Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement;
 - Addressing matters arising during the engagement, considering their significance and modifying the planned approach appropriately; and
 - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
- A93. The policies or procedures addressing the review of the work of engagement teams may address matters such as the reviewer's consideration of whether:

³⁰ Proposed ISA 220 (Revised), paragraph 11

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have been undertaken and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

Judgments and Conclusions (Ref: Para. 36(b))

- A94. The system of quality management creates an environment that supports engagement teams in making informed decisions about the courses of action that are appropriate given the nature and circumstances of the engagement. For example, the responses designed and implemented by the firm to establish a culture that promotes a commitment to quality or the responses addressing the hiring, development, retention and assignment of personnel with the competence and capabilities to perform engagements are important in supporting the engagement team in exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism.
- A95. The firm's policies or procedures for consultation and differences of opinion and the performance of engagement quality reviews may also address assessed quality risks related to exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism in planning and performing engagements. The firm may also design and implement other types of responses, including other forms of engagement reviews that are not engagement quality reviews. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures on significant risks or reviews of certain matters by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.
- A96. Professional skepticism supports the quality of judgments made on the engagement and, through these judgments, the overall effectiveness of the engagement team in performing the engagement. Other pronouncements of the IAASB may address the exercise of professional judgment or professional skepticism at the engagement level. For example, ISA 220 (Revised)³¹ explains the impediments to the exercise of professional skepticism at the engagement level and actions that the engagement partner may take to deal with such impediments.
- A97. In performing related services engagements, a practitioner is not required to gather evidence to express an opinion or conclusion on the information. However, the practitioner may form conclusions related to the performance of the engagement, for example, in a compilation engagement the practitioner may conclude that the compiled financial information is misleading and be required to take the appropriate actions set out in ISRS 4410 (Revised).³²

³¹ Proposed ISA 220 (Revised), paragraphs A27–A29

³² International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, paragraphs 34–36

Consultation (Ref: Para. 37(c))

- A98. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. While the firm establishes policies or procedures regarding the matters on which consultation is required, the engagement team may identify other matters that require consultation.
- A99. In considering its resource needs, the firm may consider the resources needed to enable consultation, for example, appropriate access to intellectual resources to facilitate research and personnel with the competence and capabilities to provide consultations. In some instances, such as a smaller firm, human resources to support consultation may only be available externally, for example, other firms, professional and regulatory bodies, or commercial organizations that provide such services. In such cases, paragraphs 64–65 apply.

Differences of Opinion (Ref: Para. 37(d))

- A100. The policies or procedures addressing differences of opinion may be established in a manner that encourages identification of differences of opinion at an early stage. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

Engagements Subject to an Engagement Quality Review (Ref: Para. 37(e))

- A101. The categories of engagements for which an engagement quality review is required are not mutually exclusive. For example, many listed entities may be considered to be of significant public interest based on the characteristics described in paragraph A102. In addition, law or regulation may require engagement quality reviews to be performed for certain types of entities (e.g., entities with public accountability as defined in certain jurisdictions), or may include different criteria or characteristics that firms may use in determining whether an entity is of significant public interest.
- A102. In determining whether an entity is of significant public interest, the firm may take into account, for example, whether the entity has a large number and wide range of stakeholders, and the nature and size of the business. The firm also may consider the relative significance of factors such as these in the context of the jurisdiction or region in which the entity operates. Entities that the firm determines to be of significant public interest may include entities such as financial institutions (e.g. certain banks, insurance companies, and pension funds), and other entities such as certain not-for-profit organizations.
- A103. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:
- Are characterized as public interest entities;
 - Operate in the public sector or which are recipients of government funding;
 - Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
 - Meet a specified asset threshold; or
 - Are under the management of a court or judicial process (e.g., liquidation).

A104. Audits or other engagements for which the firm may determine that an engagement quality review is an appropriate response to assessed quality risks may include, for example, engagements:

- That involve a high level of complexity or judgment, such as:
 - An audit of financial statements for an entity operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g., certain large financial institutions or mining entities), or for which uncertainties exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
 - An assurance engagement that requires specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (e.g., a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein).
- Where issues have been encountered on the engagement, for example, audit engagements with recurring internal or external inspection findings, unremediated deficiencies in internal control, or a material restatement of comparative information in the financial statements.
- For entities in emerging industries or that involve emerging technologies, or for which the firm has no previous experience.
- For which unusual circumstances are identified during the firm's acceptance and continuance of client relationships and specific engagements (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- That involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.
- For entities for which concerns were expressed in communications from securities or prudential regulators.

A105. In some cases, there may be no engagements for which an engagement quality review is required to be performed (e.g., when a firm does not perform audits of listed entities or entities of significant public interest and other responses to assessed quality risks are determined by the firm to be appropriate).

Considerations Specific to Public Sector Audit Organizations

A106. Public sector entities may be of significant public interest due to their size and complexity, the range of their stakeholders and the nature of the services they provide. Factors to consider in determining whether a public sector entity is of significant public interest may include whether the entity is a national, regional or local government, or whether an opinion is being expressed on the entire entity or only certain units. Other factors to consider may include whether the entity is a corporation that is state owned or in which the state has a controlling stake or a stake with significant influence. Larger public sector entities may be determined to be of significant public interest due to their social or economic influence on the community or region in which the entity operates.

A107. The firm may determine that an engagement quality review is an appropriate response to a quality risk for engagements in the public sector for which law or regulation establishes additional reporting requirements (e.g., a separate report on instances of non-compliance with law or regulation to the

legislature or other governing body or communicating such instances in the auditor's report on the financial statements).

Engagement Documentation (Ref: Para. 37(f))

A108. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. Where no such time limits are prescribed in law or regulation, the firm ordinarily establishes an appropriate time limit. In the case of an audit of financial statements, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.

A109. The retention and maintenance of engagement documentation includes managing the safe custody, integrity, accessibility or retrievability of the underlying data. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation may be compromised if it is altered, supplemented or deleted without the appropriate authorization to do so, or if it is permanently lost or damaged. The firm's responses may therefore include actions to prevent unauthorized access and create audit trails that indicate access and changes to engagement documentation.

A110. Relevant ethical requirements generally include provisions relating to confidentiality of client information, unless specific client authority has been given to disclose information, or there is a legal or professional duty or right to disclose the information. Specific law or regulation may impose additional obligations on personnel to maintain client confidentiality, particularly where data of a personal nature is concerned. Accordingly, the firm's responses for relevant ethical requirements may include responses for the retention and maintenance of engagement documentation. The firm's responses to address the confidentiality of client information may need to address all possible locations of client information, including engagement documentation, emails, firm servers or hard copy.

A111. Law or regulation may prescribe the retention period for engagement documentation, or there may be generally accepted retention periods. If the retention periods are not prescribed in law or regulation, the firm may, in determining an appropriate retention period, consider the nature of the engagements performed by the firm and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of audits of financial statements, the retention period would ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the auditor's report on the group financial statements, when applicable.

A112. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Resources (Ref: Para. 38–39)

A113. Resources for the purposes of the resources component include:

- Human resources.
- Technological resources, for example, IT applications.
- Intellectual resources, for example, written policies or procedures, a methodology or guides.

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing and maintaining the firm's human resources, technological resources and intellectual resources. The governance and leadership component addresses appropriate resource planning for all resources. Given the nature of financial resources, the quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources. This component addresses specific aspects of human resources, technological resources and intellectual resources.

A114. Resources are pervasive to all components of the system of quality management and therefore the firm's responses for resources will address assessed quality risks specific to resources, as well as assessed quality risks for other components. Such responses may be designed and implemented individually for each component, or they may be designed and implemented for all components holistically.

A115. Resources may be internal to the firm, or may be obtained externally from a network, network firm or service provider. In such circumstances, in addition to complying with the requirements for resources set out in this component, the firm is also required to comply with paragraphs 58–63 addressing network requirements or network services or paragraphs 64–65 addressing the use of resources from a service provider.

A116. Other components include responses that may affect or relate to the resources component. For example, the information necessary to facilitate the appropriate assignment of personnel or the evaluation of personnel is identified, captured, processed and maintained through the information and communication component.

Human Resources (Ref: Para. 38(a)–38(d))

A117. Competence is the ability of the individual to perform a role to a defined standard and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values and attitudes. Competence can be developed through a variety of methods, including professional education, continuing professional development, training, work experience or coaching of less experienced engagement team members by more experienced engagement team members.

A118. Professional standards, law or regulation may establish requirements addressing competence and capabilities. For example, law or regulation of a jurisdiction may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.

A119. The firm's responses that relate to the hiring, development and retention of personnel may include:

- Recruitment strategies that focus on selecting individuals who have the ability to develop the competence necessary to consistently perform quality engagements or activities in relation to the operation of the system of quality management.
- Training programs, which may form part of the firm's intellectual resources, to develop personnel's competence to enable them to perform their roles and responsibilities.
- Policies addressing the continuing professional development of personnel, including personnel's responsibility to maintain an appropriate level of continuing professional development, and training resources and other assistance provided by the firm.

- Evaluation mechanisms that establish competency areas and other performance measures, and facilitate the evaluation of personnel at appropriate intervals.
- Compensation, promotion and other incentives, appropriate to the nature and circumstances of the firm, for all personnel, including engagement partners, the individuals assigned ultimate responsibility and accountability for the firm's system of quality management, and the individual(s) assigned operational responsibility the firm's system of quality management or other aspects of the system of quality management.

A120. Human resources assigned to engagements or other roles may include personnel in a service delivery center, human resources engaged by the firm (i.e., a service provider) or human resources from a network or network firm.

A121. Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, for example, in the case of smaller firms with fewer personnel.

A122. Evaluations of personnel may be used by the firm in determining the compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

A123. The firm may take action for personnel who demonstrate actions or behaviors that negatively affect quality, including failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role or implement the firm's responses as designed (e.g., an individual breaches the firm's policies or procedures related to independence). The consequences or actions taken by the firm may depend on the severity of the failure and the frequency of occurrence and may include, for example:

- Training or other professional development;
- Considering the effect of the matter on the evaluation, compensation, promotion or other incentives of the individual(s); or
- Taking disciplinary action against the individual(s), if appropriate, depending on the severity of the failure and the frequency of occurrence.

Technological Resources (Ref: Para. 38(e))

A124. Technological resources, which are typically IT applications, form part of the firm's IT environment. The firm's IT environment also includes the supporting IT infrastructure and the IT processes and human resources involved in those processes that the firm uses in the operation of its system of quality management:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.
- The IT processes are the firm's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations, which includes monitoring the IT environment.

A125. An IT application, IT infrastructure or IT process may serve multiple purposes within the firm and some of the purposes may be unrelated to the system of quality management. Only IT applications, IT infrastructure or IT processes that support the firm's system of quality management are relevant for the purposes of this ISQM.

A126. In some cases, the network may require the firm to use an IT application, the firm may choose to use an IT application provided by the network, or the firm may purchase an IT application from a service provider. The firm may also use the network or a service provider to manage certain aspects of the IT processes.

A127. Paragraph 40(a) addresses the firm's responsibility to establish an information system that supports the system of quality management, which may include the use of IT elements and records in the form of digital information. The firm may also use certain IT applications to enable the operation of various aspects of its system of quality management, for example, IT applications used to monitor compliance with relevant ethical requirements and record and maintain information about independence. Other IT applications may be implemented by the firm for use by engagement teams in performing engagements, for example, the firm may mandate the use of an IT application that facilitates the documentation of work performed or the firm may offer an IT application to perform analyses of the client's information that engagement teams may choose to use.

A128. The IT environment for a larger firm may be comprised of customized or integrated IT applications, with dedicated human resources to manage the IT infrastructure and IT processes. The IT environment for smaller firms may comprise IT applications that are commercial software, and the IT processes may involve authorizing access to the IT applications and processing updates to the IT applications.

A129. The use of IT applications or other aspects in the IT environment may give rise to quality risks, for example:

- Inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorized access to data that may result in breaches in confidentiality of information contained in the data, destruction of data or improper changes to data.
- Potential loss of data or inability to access data or IT applications as required.
- Unauthorized changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.

The nature and significance of these quality risks may vary based on whether, and the extent to which, the firm relies on IT, including automated controls, to enable the design, implementation and operation of the system of quality management. General IT controls may be part of the responses designed and implemented by the firm to address quality risks identified and assessed by the firm.

A130. When implementing an IT application, particularly a customized IT application that has been developed specifically for the firm, it is necessary for the firm to determine that the IT application operates appropriately. This determination may involve consideration of whether:

- The data inputs are appropriate and confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.

- The outputs of the IT application achieve the purpose for which they will be used.
- It is clear how users are required to interact with and use the IT application and users have appropriate support.
- The general IT controls necessary to support the IT application's continued operation as designed are appropriate.

The firm may specifically prohibit the use of IT applications or features of IT applications, until such time that it has been determined that they operate appropriately and have been approved for use by the firm.

A131. Engagement teams may need training on how to use the IT applications appropriately. Furthermore, for certain IT applications, specialized skills may be needed to utilize the IT application effectively and the firm may need to specify procedures that set out how the engagement team operates the IT application. For example, in some instances the firm's IT application for the performance of engagements may require that the engagement team complete certain information about the client and the circumstances of the engagement in order to generate an appropriate engagement file template for the circumstances of the engagement.

Intellectual Resources (Ref: Para. 38(f))

A132. Intellectual resources include the information the firm uses to promote consistency in the performance of engagements, for example, written policies or procedures, a methodology, industry or subject matter-specific guides, accounting guides, standardized documentation or access to information sources (e.g., subscriptions to websites that provide in-depth information about entities or other information that is typically used in the performance of engagements).

A133. The intellectual resources may be made available to personnel through technological resources, for example, the firm's audit methodology may be embedded in the audit IT application that facilitates the planning and performance of the engagement. The firm may also need human resources to develop, implement and maintain its intellectual resources. Intellectual resources may also be dependent on relevant and reliable information that is identified, captured, processed and maintained through the firm's information and communication component.

Personnel's Use of Technological and Intellectual Resources (Ref: Para. 38(g))

A134. The firm may establish policies or procedures regarding the use of the firm's technological and intellectual resources. Such policies or procedures may:

- Require the use of certain IT applications or intellectual resources in performing engagements, for example, engagement teams may be required to use the firm's methodology when performing the engagement. They may also be required to use IT applications that facilitate the performance of the engagement and the archival of the engagement file.
- Specify the qualifications or experience of personnel that are needed to use the IT application, for example, the firm may specify the qualifications or expertise needed to use an IT application for the performance of automated techniques and to interpret the results.
- Set out how the technological or intellectual resources are to be used.

Information and Communication (Ref: Para. 40–41)

A135. Obtaining, generating or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication is pervasive to all components of the system of quality management and therefore the firm's responses for information and communication address assessed quality risks specific to information and communication, as well as assessed quality risks for the other components. Such responses may be designed and implemented individually for each component, or for all components holistically. Paragraphs A51, A69, A76 and A116 explain and provide examples of how the information and communication component supports the design, implementation and operation of the other components of the system of quality management.

The Firm's Information System (Ref: Para. 40(a))

A136. Reliable information includes information that is accurate, complete, timely and valid to enable the proper functioning of the firm's system of quality management and to support decisions regarding the system of quality management.

A137. The information system in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

A138. The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained and communicated. The procedures to identify, capture, process, maintain and communicate information may be enforced through IT applications, and in some cases may be embedded within the firm's responses for other components. For example, the firm's responses for monitoring and remediation may define how information from the results of the firm's monitoring activities is captured, processed, maintained and communicated. In addition, digital records may replace or supplement physical records. For example, the firm may use an IT application to obtain a documented confirmation of compliance with independence requirements from personnel.

Communication Within the Firm (Ref: Para. 40(b)–(d), 41(a)–(b))

A139. The firm and its personnel share relevant information to enable the proper functioning of the firm's system of quality management. For example:

- The firm communicates information to engagement teams, such as information that is obtained during the firm's acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.
- Engagement teams communicate information to the firm, for example, information about:
 - The client obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement.
 - The operation of the firm's responses to assessed quality risks (e.g., concerns about the firm's processes for assigning personnel to engagements).

In some cases, the information communicated by the engagement team may indicate a deficiency in the firm's system of quality management.

- Personnel performing activities within the firm's system of quality management share information. For example, the individual(s) assigned operational responsibility for compliance with independence requirements may communicate to the person with ultimate responsibility for the system of quality management changes in the independence requirements and how the firm's policies or procedures have been updated in response to such changes.

Two-way communication may also be among the various parties, for example, engagement teams may communicate information directly to the personnel performing activities within the firm's system of quality management.

A140. Matters communicated by the firm to engagement teams or other personnel performing activities within the firm's system of quality management may include changes to the system of quality management, to the extent that the changes are relevant to their responsibilities and enables the personnel to take prompt and appropriate action in accordance with their responsibilities.

A141. Responsibility for operating the responses designed and implemented by the firm may be assigned to:

- The engagement team, as described in paragraph A62;
- Personnel performing activities within the firm's system of quality management (e.g., assigning responsibility for the performance of an engagement quality review to an engagement quality reviewer); or
- A combination of the engagement team and personnel performing activities within the firm's system of quality management.

The firm may also use human resources external to the firm to assist in operating the responses.

Communication with External Parties (Ref: Para. 40(e), 41(c))

Communication Required by Law or Regulation (Ref: Para. 41(c)(i))

A142. Law, regulation or professional standards may require the firm to communicate information to external parties. For example:

- In circumstances when the firm becomes aware of non-compliance with laws and regulations by a client, relevant ethical requirements may require the firm to report the non-compliance with laws and regulations to an appropriate authority outside the client entity, or to consider whether such reporting is an appropriate action in the circumstances.
- Law, regulation or professional standards may require the firm to publish a transparency report and may specify the nature of the information that is required to be included in the transparency report.

Communication with the Network (Ref: Para. 41(c)(ii))

A143. When the firm belongs to a network, frequent communication with the network supports the network in establishing network requirements and providing network services that promote the consistent performance of quality engagements. Furthermore, the network's communication of relevant information supports the firm in the design, implementation and operation of its system of quality management. Such communication may include matters related to independence, for example, in

circumstances when relevant ethical requirements include requirements for independence that apply to network firms or employees of network firms.

Communication with Service Providers (Ref: Para. 41(c)(iii))

A144. When the firm uses a service provider, the service provider's communication of relevant information to the firm that affects the firm's system of quality management supports the firm in the design, implementation and operation of its system of quality management.

Communication to External Parties About the Firm's System of Quality Management (Ref: Para. 41(c)(iv))

A145. The firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective two-way communication between the firm and its stakeholders. For example, stakeholders' perception of the quality of engagements performed by the firm may be improved when the firm is transparent about the activities that it has undertaken to address quality, and the effectiveness of those activities.

External parties who may use information about the firm's system of quality management
(Ref: Para. 41(c)(iv)(a))

A146. External parties may include management or those charged with governance of the firm's clients, the firm's network or network firms, external oversight authorities, other firms who use the work of the firm in the performance of engagements (e.g., in relation to a group audit) or service providers. External parties may also include users of the firm's engagement reports, for example, current shareholders and credit providers of the entities for whom the firm performs engagements.

A147. The firm exercises professional judgment when taking into account whether there are external parties who may use information about the firm's system of quality management. Whether there are such external parties may depend on the nature of the engagements the firm performs and the types of entities for which such engagements are performed. For example, for a firm that performs audits of financial statements of listed entities or entities that may be of significant public interest described in paragraph A23, external parties such as shareholders of such entities may use a transparency report or similar publication to inform their understanding of the quality of engagements performed by the firm. On the other hand, for a firm that only performs compilation engagements, external parties who may use information about the firm's system of quality management may be limited, and they may obtain such information through discussions and direct interaction with the firm.

Nature and circumstances of the firm (Ref: Para. 41(c)(iv)(b))

A148. Factors that may affect the firm's operating environment include the nature and circumstances of the financial markets in which the firm operates and the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm's processes in performing the engagements.

Nature, timing, extent and content of communications to external parties about the system of quality management (Ref: Para. 41(c)(iv))

A149. The form of communication to external parties may include a publication such as a transparency report or audit quality report, webpage, targeted communication to specific stakeholders (e.g.,

information about the results of the firm's monitoring and remediation process), or direct conversations with the external party.

A150. The information that is communicated to external parties about the firm's system of quality management may depend on a variety of factors, including the form of the communication, the nature and circumstances of the firm and the external parties with whom the communication is being undertaken. For example, the communication may contain information about:

- The nature and circumstances of the firm, such as the organizational structure and operating environment and whether it is part of a network.
- The firm's governance and leadership, such as its culture and commitment to quality and information about the individuals responsible for the leadership of the firm.
- Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with appropriate narrative to explain the indicators.
- The results of the firm's monitoring activities and external inspections, and how the firm has remediated identified deficiencies or is otherwise responding to them.
- The evaluation undertaken in accordance with paragraph 55 of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, including the basis for the judgments made in undertaking the evaluation.
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes.

A151. Information that is communicated to external parties about the firm's system of quality management that has the following attributes contributes to an enhanced understanding of the quality of the engagements performed by the firm:

- The information is specific to the circumstances of the firm and is prepared and presented in a timely manner. Relating the matters in the firm's communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time.
- The information is presented in a clear and understandable manner that is neither misleading nor would inappropriately influence the users of the communication (e.g. the information is appropriately balanced towards positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources, for example, information located on the firm's website.

A152. In circumstances when the firm is part of a network, it may be useful to provide information about the relationship between the firm and the network in certain external communications, such as a transparency report. Such information helps facilitate an understanding of the responsibilities of the firm and the network, and clarifies how the network requirements or network services promote the consistent performance of quality engagements across the network firms. Such information may include:

- The nature of the relationship between the firm and the network and the overall structure of the network.
- Requirements established by the network for the firm or network services that are used by the firm in its system of quality management.
- Information about the overall scope and results of network monitoring activities across the network firms that the network has provided to the firm in accordance with paragraph 61, if applicable.

In some circumstances, the network may provide external communication about the above matters, for example, in the form of a network transparency report, which may support the firm in communicating the information.

A153. In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. For example, certain information may be subject to privacy or secrecy laws or regulations or the firm may be precluded from communicating certain information because of the duty of confidentiality under law, regulation or relevant ethical requirements.

Monitoring and Remediation Process (Ref: Para. 42–57)

A154. In addition to enabling the firm's evaluation of the system of quality management, the monitoring and remediation process facilitates the improvement of engagement quality and the system of quality management.

A155. Professional judgment is exercised in making various decisions within the monitoring and remediation process, including decisions about:

- The nature, timing and extent of the monitoring activities, including the scope of inspection of engagements.
- The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information to determine whether deficiencies exist.
- How to respond to the findings from the monitoring activities, results of external inspections and other relevant information.
- The evaluation of the severity and pervasiveness of the identified deficiencies.
- Whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

Designing and Performing Monitoring Activities (Ref: Para. 44–46)

A156. The firm's monitoring activities may comprise ongoing monitoring activities, periodic monitoring activities or a combination of both. Ongoing monitoring activities are generally routine activities, built

into the firm's processes and performed on a real-time basis, reacting to changing conditions, for example:

- An IT application that continually monitors the permissibility of financial investments recorded by personnel as part of the firm's independence responses.
- Inspection of in-process engagements that are focused on specific aspects of completed work.

Periodic monitoring activities are conducted at certain intervals by the firm, for example, inspection of training records to determine that personnel have attended training in accordance with the firm's policies or procedures or inspection of completed engagements. In most cases, ongoing monitoring activities identify deficiencies in the system of quality management in a timelier manner.

A157. The purpose of a monitoring activity is to monitor the responses in the system of quality management. The system of quality management may include responses that are similar in nature to a monitoring activity but have a different purpose (e.g., responses that are designed to detect failures or shortcomings in the system of quality management so that they can prevent an assessed quality risk from occurring). For example, in some circumstances, an in-process review of engagement documentation may be designed as a monitoring activity as part of paragraph 45, in which case the findings from that review are subject to the requirements in paragraph 47. In other circumstances, an in-process review may be designed as a response to address an assessed quality risks in the engagement performance component or other components. Determining the purpose of the response is necessary in determining its design and implementation, and where it fits within the system of quality management (i.e., whether it is a response in monitoring and remediation or a response in another component).

A158. The nature, timing and extent of the monitoring activities may be affected by factors such as:

- The size, structure and organization of the firm.
- The involvement of the network in monitoring activities.
- The resources that the firm intends to use to enable monitoring activities, for example, the use of IT applications in addition to human resources.
- The design of the response subject to monitoring. For example, the response may comprise in-process reviews of engagement documentation of selected engagements by personnel who are not members of the engagement team. The extent of the review of the engagement documentation, the nature of the matters considered in the review, and how the results of the review are collated may affect the nature, scope and frequency of the monitoring activities over the in-process review.

A159. When performing monitoring activities, the firm may determine that changes to the nature, timing and extent of the monitoring activities are needed. For example, the firm may identify findings that indicate the need for more extensive monitoring activities.

The Design of the Response and the Assessed Quality Risks (Ref: Para. 44(a))

A160. The nature, timing and extent of the firm's monitoring activities may be more robust for areas of the system of quality management where the assessed quality risks are greater and the related responses are more extensive or rigorous. For example, the firm may perform more extensive monitoring activities over compliance with independence requirements for audits of financial statements than for other types of engagements.

A161. The reasons for the assessments given to the assessed quality risks may include characteristics associated with certain engagements, for example:

- Engagements performed in respect of certain entities (e.g., a listed entity or entity that may be of significant public interest).
- Engagements where the firm or engagement partner are inexperienced, for example, a new industry, a new service offering or new engagement partner.
- Engagements that have been subject to external inspection and which had negative findings, or engagements where the findings of previous monitoring activities resulted in identified deficiencies.
- Engagements where the firm's engagement acceptance and continuance procedures indicated that matters may exist that may increase the engagement risk.

Changes in Factors That Have Affected the System of Quality Management or Changes in the System of Quality Management (Ref: Para. 44(c))

A162. Changes in factors that have affected the firm's system of quality management include changes in the nature and circumstances of the firm and its engagements (e.g., a new service offered by the firm or changes in the firm's environment). Changes in the system of quality management include:

- Changes to address an identified deficiency in the system of quality management.
- Changes to the responses, for example, because they have become obsolete over time or more effective responses are designed and implemented, such as the use of IT applications to replace manual processes.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm's monitoring activities may include monitoring of those areas of change.

Previous Monitoring Activities (Ref: Para. 44(d), 50)

A163. The findings from the firm's previous monitoring activities may indicate areas of focus for the monitoring activities, for example, monitoring activities may need to continue to be undertaken in certain areas where there is a history of deficiencies. Furthermore, the monitoring activities may need to evaluate the effectiveness of the remedial actions that have been implemented to address deficiencies previously identified.

A164. Although areas of the system of quality management may not have changed, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of areas that have not changed, for example, because of the time that has elapsed since the monitoring activities were undertaken.

Other Relevant Information (Ref: Para. 44(e), 47)

A165. Examples of sources of other relevant information may include:

- Information communicated by the network in accordance with paragraphs 60(c) and 61 about the firm's system of quality management, including the network requirements or network services that the firm has included in its system of quality management.

- Information communicated by a service provider about the resources the firm uses in its system of quality management.
- Concerns about the commitment to quality of the firm or its personnel, communicated in accordance with paragraph 24(c).
- The results of industry-wide reviews undertaken by an external oversight authority of focus areas related to systems of quality management or the performance of engagements.
- Other reviews undertaken by an external oversight authority, for example, informal reviews undertaken by an external oversight authority to assess a firm's preparation for the implementation of a new professional standard, or reviews of specific areas of focus that contribute to the improvement of engagement quality.
- Information from regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider.
- A material restatement of financial statements, an engagement report that required reissuance or litigation against the firm.

A166. The results of external inspections or other relevant information may indicate findings or deficiencies in previous monitoring activities undertaken by the firm, which may affect the firm's consideration of whether the nature, scope and frequency of previous monitoring activities were appropriate.

A167. External inspections are not a substitute for the firm's internal monitoring activities. Nevertheless, the results of external inspections may inform the nature, timing and extent of the monitoring activities.

Engagement Inspections (Ref: Para. 45)

A168. The relevant factors in paragraph 44 affect the extent and frequency of selection of in-process or completed engagements or engagement partners for inspection. Other factors that may also affect the extent and frequency of selection of in-process or completed engagements or engagement partners for inspection include:

- The nature, timing and extent of other monitoring activities undertaken by the firm at the engagement level.
- The varying nature of the engagements performed by the firm.
- The size of the firm, including the number and geographic location of offices and the nature and complexity of the firm's practice and organization.

A169. The firm may establish different cyclical periods for inspecting engagement partners according to the categories of engagements they perform, for example, the firm may determine that the cyclical period for an engagement partner performing audits of financial statements is every three years, whereas a longer period may be appropriate for engagement partners performing only compilation engagements. The cycle of the inspection may be based on time (i.e., every three years as illustrated) or another factor, such as the number of engagements performed. The cyclical period may also be affected by the nature, timing and extent of inspection of in-process engagements and the results thereof.

A170. The purpose of an inspection of an in-process or completed engagement depends on how the inspection has been designed by the firm. Ordinarily, the inspection of an in-process or completed engagement includes determining that responses designed to be implemented at the engagement

level have been implemented, for example, the firm may determine whether engagement teams have applied the firm's methodology appropriately.

Individuals Performing the Monitoring Activities (Ref: Para. 46)

A171. As described in paragraph A65, objectivity is a fundamental principle of the IESBA Code, and the provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. For example, a self-review threat may arise when an individual who performs:

- An inspection of an engagement was:
 - In the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period; or
 - For all other engagements, an engagement team member or the engagement quality reviewer of that engagement.
- Another type of monitoring activity had participated in designing, executing or operating the response being monitored.

Evaluating Findings and Identifying Deficiencies (Ref: Para. 47)

A172. Findings represent the information accumulated from the performance of monitoring activities and may also include the results of external inspections and other relevant information about the firm's system of quality management. Findings may be positive or negative in nature.

Positive Findings

A173. 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. They may also highlight opportunities for the firm to enhance the system of quality management.

Negative Findings

A174. Negative findings are considered by the firm in accordance with paragraph 47 to determine whether there are deficiencies in the system of quality management. Not all negative findings are a deficiency in the system of quality management.

A175. Factors that a firm may consider in determining whether a finding is a deficiency include:

- The nature of the finding, for example, 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.
- The design of the monitoring activity from which the finding arose, for example, the firm may consider the tolerable error rate of the activity and whether it was designed to focus on specific areas of risk or the whole population.
- The extent of the monitoring activity from which the finding arose, including the size of sample selected relative to the size of the entire population.
- The extent of the findings in relation to the sample of the population covered by the monitoring activity.

- If the finding relates to a response:
 - The nature of the assessed quality risk to which the response relates, and the extent to which the finding indicates that the assessed quality risk has not been addressed.
 - Whether there are other responses that address the same assessed quality risk and whether there are findings for those responses.
- Whether the finding, in combination with other findings, indicate a trend or systemic issue.

A176. A finding may affect multiple responses across different components. For example, a finding that suggests that personnel assigned to an engagement were not knowledgeable about the procedures they performed in the engagement may indicate deficiencies in responses related to human resources (i.e., inappropriate competence and capabilities) as well as those related to engagement performance (i.e., inappropriate direction, supervision and review).

A177. The effectiveness of the monitoring and remediation process may be evaluated through considering the findings arising from the monitoring activities, the results of external inspections and other relevant information source (e.g., network monitoring activities or complaints and allegations). For example, external inspection findings may indicate deficiencies in the system of quality management that have not been identified by the firm's monitoring and remediation process, which highlight a deficiency in that process.

Root Cause of the Identified Deficiencies (Ref: Para. 48(a))

A178. This ISQM requires the firm to investigate the root cause(s) of identified deficiencies. As highlighted in paragraph A174, not all negative findings from the performance of monitoring activities, results of external inspections and other relevant information are a deficiency in the system of quality management. Although not required by this ISQM, investigating the root cause of positive findings may reveal opportunities for the firm to improve, or further enhance, the system of quality management. Identifying the root cause of positive findings on engagements where identified deficiencies did not exist may also help the firm to identify the root causes of identified deficiencies that existed in other engagements and may assist the firm in determining how to remediate identified deficiencies.

A179. The objective of investigating the root cause(s) of identified deficiencies is to understand the underlying circumstances that caused the deficiencies. An improved understanding of the underlying cause(s) of identified deficiencies may:

- Facilitate the design and implementation of more effective actions to address identified deficiencies.
- Directly contribute to the improvement of quality at the engagement level through the participation of engagement teams in the root cause analysis process.
- Enable those assigned ultimate responsibility and accountability or operational responsibility for the system of quality management to proactively monitor actions taken to address identified deficiencies.
- Facilitate more effective communication to personnel by explaining the actual root cause(s) of identified deficiencies, rather than the deficiencies themselves.

A180. Performing a root cause analysis generally involves those performing the assessment exercising professional judgment based on the evidence available. The firm's policies or procedures for the nature, timing and extent of the procedures to investigate the root cause(s) of identified deficiencies are required to take into account the nature of the deficiencies and their possible severity which may include:

- The nature and extent of the deficiency, for example, a deficiency that results in an engagement report being inappropriate has greater severity than a deficiency that resulted in the firm's policies or procedures not being followed but the engagement report was still appropriate.
- Whether the deficiency, in combination with all other identified deficiencies, indicates a trend or systemic issue, for example, there are multiple engagement reports affected by the same deficiency or certain policies or procedures appear to have high rates of non-compliance.

The procedures undertaken to understand the root cause(s) of an identified deficiency may be simple, for example, in circumstances when the possible severity of the deficiency is not significant, the root cause is apparent or, in the case of a smaller firm, those performing the root cause analysis are familiar with a variety of information to inform their understanding.

A181. There may be multiple root cause(s) of an identified deficiency, the root cause(s) may be complex and interrelated, and the root cause(s) may exist across various components of the firm's system of quality management. Furthermore, a root cause of an identified deficiency may relate to more than one identified deficiency or affect multiple components, for example, in circumstances when the root cause relates to an aspect of the firm's risk assessment process. There may also be circumstances when a single root cause relates to multiple identified deficiencies.

A182. Identifying a root cause(s) that is appropriately specific may support the firm's process for remediating identified deficiencies. For example, it may be identified that an engagement team did not exercise sufficient professional skepticism in complex areas of management judgment. However, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to challenge individuals with greater authority or insufficient direction, supervision and review on the engagement.

Evaluating the Severity and Pervasiveness of Identified Deficiencies (Ref: Para. 48(b))

A183. Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include:

- The nature of the identified deficiency, including whether it relates to a quality objective, quality risk or a response;
- The root cause(s) of the identified deficiency;
- The frequency with which the underlying finding occurred; and
- The magnitude of the identified deficiency, the rate at which it occurred and the duration of time that it existed.

Responding to Identified Deficiencies (Ref: Para. 49–50)

A184. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The root cause(s), for example, whether it relates to an individual engagement, a certain category of engagements, or is more pervasive throughout the firm.

- The severity and pervasiveness of the identified deficiency and therefore the urgency in which it needs to be addressed.
- The effectiveness of the remedial actions in addressing the root cause(s), for example, the firm may need to implement more than one remedial action in order to effectively address the root cause(s), or may need to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions.

Findings About a Particular Engagement (Ref: Para. 51)

A185. In circumstances when procedures were omitted or the report issued is inappropriate, the action taken by the firm may include:

- Consulting with appropriate individuals within the firm regarding the appropriate action.
- Discussing the matter with management of the entity or those charged with governance.
- Performing the omitted procedures.

The actions taken to correct the work performed for a specific engagement does not relieve the firm of the responsibility to investigate the root cause(s) of the identified deficiency related to the engagement.

Ongoing Communication Related to the Monitoring and Remediation (Ref: Para. 52–54)

A186. The information communicated about the monitoring and remediation to the individual(s) assigned ultimate responsibility and accountability for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management provides the basis for the evaluation of the system of quality management, as required by paragraph 55.

A187. In determining the information to be communicated to personnel, including the nature and extent of such communication, the firm may consider the type of information that is relevant to the particular recipients, including the information needs of the recipients, as a result of their defined roles and responsibilities. For example:

- Information communicated to engagement teams may be focused on deficiencies that have been identified at an engagement level and therefore are likely to be relevant. It may also include positive findings that indicate practices that engagement teams could apply more extensively. In considering the information needs of the engagement team, the firm may take into account the responsibilities of the engagement team regarding such information. For example, proposed ISA 220 (Revised)³³ requires the engagement team to determine the relevance and effect on the audit of the results of the monitoring and remediation process, and to take appropriate action.
- Information communicated to all personnel may relate to matters relevant to compliance with the firm's independence policies or procedures as such policies or procedures may apply to all personnel.

Communicating the root cause(s) of identified deficiencies may increase awareness and understanding of why deficiencies occurred, which may influence the behavior of engagement teams

³³ Proposed ISA 220 (Revised), paragraph 36(b)

and personnel. Communicating remedial actions may enable the implementation of such actions in a more proactive manner.

Evaluating the System of Quality Management (Ref: Para. 55–57)

A188. An effective system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

A189. The individual(s) assigned ultimate responsibility and accountability for the system of quality management uses the information obtained in accordance with paragraph 52 in evaluating the effectiveness of the system of quality management. The nature and extent of the information, including how the information is communicated, will vary based on the nature and circumstances of the firm. For example, in a smaller firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and will therefore be aware of the information that supports the evaluation of the system of quality management. However, in a larger firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may not have direct involvement in the monitoring and remediation process. Therefore, the individuals assigned operational responsibility for various aspects of the system of quality management may need to collate, summarize and present the information that supports the evaluation of the system of quality management in a manner that enables the individual(s) assigned ultimate responsibility and accountability for the system of quality management to form an appropriate conclusion.

A190. Prompt and appropriate action when the evaluation indicates that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved may include:

- Taking steps to determine whether the reports already issued by the firm were appropriate.
- Taking measures to confirm that reports not yet issued by the firm are appropriate in the circumstances.
- Obtaining legal advice.

A191. Circumstances when it may be appropriate for the firm to communicate to external parties that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved include:

- When the firm belongs to a network and the information is relevant to the network or other firms within the network who use the work performed by the firm, for example, in the case of a group audit.
- When a report issued by the firm is determined to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed.

In some circumstances, the firm may be required by law or regulation to communicate to an oversight authority or a regulatory body that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

Network Requirements or Network Services (Ref: Para. 58–63)

A192. Network requirements may include, for example:

- Requirements for the firm to include quality objectives or identified quality risks in the firm's system of quality management that are common across the network firms.
- Requirements for the firm to include responses, including resources, in the firm's system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, network developed methodologies for the performance of engagements or IT applications.
- Requirements that the firm be subject to the network's monitoring activities. These monitoring activities may relate to network requirements (e.g., monitoring that the firm has implemented the network's methodology appropriately), or to the firm's system of quality management in general.

A193. Examples of network services include services or resources that are optional for the firm to use as a response in its system of quality management, such as voluntary training programs, or a service delivery center established at the network level, or by another firm or group of firms within the same network.

A194. The network may establish responsibilities for the firm in implementing the network requirements or network services. For example, in the case of implementing an IT application developed by the network, the firm may need to have the appropriate IT infrastructure and IT processes in place.

A195. The firm's understanding of the network requirements or network services and the firm's responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as:

- The network's governance and leadership.
- The procedures undertaken by the network in designing, implementing and, if applicable, operating, the network requirements or network services.
- How the network identifies and responds to changes that affect the network requirements or network services or other information, for example, changes in the professional standards or information that indicates a deficiency in the network requirements or network services.
- How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms' monitoring activities, and the network's processes for remediating identified deficiencies.

A196. Paragraph 41(c) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the network, for example, the matters described in paragraphs 58 and A195.

The Firm's Risk Assessment Process (Ref: Para. 59)

A197. The network requirements or network services may affect the firm's system of quality management in the following ways:

- The firm may need to identify and assess quality risks for quality objectives provided by the network.
- The firm may need to design and implement responses to address quality risks provided by the network, or the firm may need to assess the quality risks provided by the network.
- The firm may identify additional quality risks arising from responses provided by the network, for example, quality risks may arise from the implementation of a network IT application.

A198. The network requirements or network services may need to be adapted or supplemented by the firm to appropriately address the nature and circumstances of the firm and its engagements, for example:

- The quality objectives provided by the network may not be at a sufficient level of granularity for the firm, or additional quality objectives may need to be established.
- The firm may identify additional quality risks that have not been identified by the network.
- The responses provided by the network may not be designed to address the assessed quality risks and the reasons for the assessments given to the quality risks.

Monitoring and Remediation Process (Ref: Para. 60–63)

A199. The monitoring activities undertaken by the network may affect the nature, timing and extent of the firm's monitoring activities. For example, the network may undertake cyclical inspections of completed engagements of the firm, which may affect the extent of inspections of in-process or completed engagements undertaken by the firm.

A200. The results of the network's monitoring activities of the firm's system of quality management may include information such as:

- A description of the monitoring activities, including their nature, timing and extent;
- Findings from the monitoring activities and deficiencies identified; and
- The network's evaluation of the root cause(s) of the identified deficiencies, the assessed effect of the deficiencies and recommended remedial actions.

A201. The information about the overall scope and results of the monitoring activities across the network firms' systems of quality management may highlight trends and common areas of identified deficiencies across the network, or examples of quality that may be replicated across the network. Such information may be used by the firm to determine the nature, timing and extent of its monitoring activities. It may also indicate deficiencies in network requirements or network services used by the firm in its system of quality management.

A202. In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm's system of quality management that affects the firm, for example, when the network firm performs work for the firm's engagements, such as in the capacity of a component auditor. The network may also gather information from the network firms regarding the results of external inspections over the network firms' systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other firms within the network or may restrict the specificity of such information.

A203. Paragraph 42 requires the firm to evaluate the design, implementation and operation of the components of the system of quality management, which includes the network requirements or

network services used by the firm. The network requirements or network services may be monitored by the network, the firm, or a combination of both. For example, the network may undertake monitoring activities at a network level for a common methodology, however various monitoring activities at a firm level may support the evaluation of the methodology, including engagement inspections.

A204. In some cases the firm may determine that the remedial actions by the network are inadequate, or such remedial actions may take time to effectively address the identified deficiency. In such cases, the firm may need to implement its own remedial actions to address the identified deficiency until such time as the network has effectively addressed the deficiency.

Service Providers (Ref: Para. 64–65)

A205. The firm may use human resources, technological resources or intellectual resources that are obtained from a service provider. The service providers used by the firm include individuals or organizations that are external to the firm, excluding networks, network firms or other structures or organizations in the network. Examples of resources from a service provider include:

- Human resources used to perform the firm's monitoring activities or engagement quality reviews, or to provide consultation on technical matters.
- A commercial IT application used to perform audit engagements.
- Human resources used in the performance of engagements, for example, to attend a physical inventory count or inspect physical fixed assets at a remote location.
- External experts used in the performance of engagements. In such cases, there may be requirements in the other IAASB standards that address the competence, capabilities and objectivity of the external expert, understanding of the expert and agreement with the expert which apply in conjunction with the requirements of this ISQM.³⁴
- The use of resources from a service provider does not include using the work of an entity's internal audit function in the performance of engagements, in accordance with ISA 610 (Revised 2013).³⁵

A206. The determination of whether the matters described in paragraph 64 are relevant for a service provider depends on a variety of factors including:

- The nature of the resources provided by the service provider, including how and the extent to which it will be used within the firm.
- The reasons for the assessments given to the assessed quality risks to which the resource relates.
- Whether the resource itself gives rise to quality risks. For example, when the firm uses human resources from a service provider in the performance of engagements, there may be a quality risk that such resources do not have the competence and capabilities to perform the engagement, exercise inappropriate judgment when performing the engagement, do not implement the firm's responses at the engagement level or do not fulfill their responsibilities in accordance with relevant ethical requirements. Such quality risks may also affect the

³⁴ See, for example, ISA 620, *Using the Work of an Auditor's Expert*.

³⁵ ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

management of quality at the engagement level. For example, in circumstances when the firm uses human resources from a service provider to assist in the performance of engagement procedures, there may be a need for the engagement partner to have greater oversight on a more frequent basis and perform more in-depth reviews of work performed by the individual.

A207. The firm may establish policies or procedures that address circumstances when a service provider is used in the performance of engagements that set out the responsibility of the engagement team when engaging a service provider, which may include responsibility for certain matters in paragraph 64.

A208. Obtaining an understanding of the service provider may include understanding the conditions of the service, for example, how often updates will be provided for an IT application, limitations on the use of the IT application and how the service provider addresses confidentiality of data. Paragraph 41(c)(iii) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the service provider, for example, information to support the firm's understanding of the service provider and use of the resource (e.g., updates or changes to the resource or deficiencies in the resource).

A209. The firm's responsibilities in using the service provider may include matters such as the actions the firm needs to take in order to implement the resource or information the firm needs to communicate to the service provider in order that the resource can function effectively. For example, in the case of an IT application, the firm may need to have appropriate supporting IT infrastructure and IT processes in place.

A210. In determining whether the resource is appropriate, the firm may make inquiries of the service provider or request documentation from the service provider about matters such as:

- For human resources, the qualifications, experience and location of the individuals, including professional licenses or membership obligations, and how they develop and maintain the appropriate competence to perform the services.
- For technological or intellectual resources, the procedures undertaken by the service provider in designing, implementing and operating the resources.
- How the service provider identifies and responds to changes that affect the resources, for example, changes in the professional standards or information that indicates a deficiency in the resources;
- How the resource will be evaluated, monitored or remediated by the service provider.

There may be circumstances when the service provider supplies the firm with an assurance report on the description and design of their controls over the resource, and in some circumstances, it may also include assurance on the operating effectiveness of such controls.

Documentation (Ref: Para. 66–69)

A211. Documentation provides evidence that the firm complies with this ISQM, as well as law, regulation or relevant ethical requirements. It may also be useful for training personnel, ensuring the retention of organizational knowledge and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this ISQM may be evidenced by the firm through its information and communication

component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

A212. Documentation may take the form of formal written manuals, checklists and forms, may be informally documented (e.g., e-mail communication or postings on websites), or may be held in IT applications or other digital forms (e.g., in databases). Factors that may affect the firm's judgments about the form, content and extent of documentation may include:

- The size of the firm and the number of offices;
- The nature and complexity of the firm's practice and organization;
- The types of services the firm provides and the nature of the clients to whom services are provided; and
- The nature and complexity of the matter being documented, for example, whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk.

In a smaller firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may be effective. Nevertheless, the firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

A213. In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the IESBA Code requires documentation of particular matters, including certain situations related to conflicts of interest, non-compliance with laws and regulations and independence.

A214. In some circumstances, it may be appropriate for the firm to document its process and analyses for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks, to provide a history of the basis for decisions made by the firm about its system of quality management.

Appendix 1

The Components of a System of Quality Management

1. This appendix describes the eight components of a firm's system of quality management. The components in this ISQM have similarities to the components of internal control described in the Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework*. For example, the governance and leadership component is similar to the entity's control environment and the firm's risk assessment process is similar to the entity's risk assessment process.

Governance and Leadership

2. The governance and leadership component creates the environment in which the other components of the system of quality management operate because it addresses the firm's culture, decision-making process, actions, organizational structure and leadership. The governance and leadership component also provides the basis for the system of quality management because the firm needs to establish structures, reporting lines and appropriate authority and responsibility in order that the other components of the system of quality management can be developed. For example, in order to establish a system of quality management, the firm needs to identify the individual(s) responsible for its development. Accordingly, the governance and leadership component has a pervasive effect on the system of quality management and the other components cannot be effective if the environment in which they operate is not appropriate.

The Firm's Risk Assessment Process

3. The firm's risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, which consists of establishing quality objectives, identifying and assessing quality risks to the achievement of the quality objectives and designing and implementing responses to address the assessed quality risks.
4. The firm is required to establish the quality objectives set out in this ISQM and additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
5. Quality risks arise from conditions, events, circumstances, actions or inactions that affect the achievement of the quality objectives, and which are associated with the nature and circumstances of the firm and its engagements. For example:
 - (a) *Nature and circumstances of the firm*: The firm may have a service delivery center that includes personnel who perform specific tasks for engagement teams. This may create, or increase the likelihood of, the quality risks for the appropriate direction and supervision of the engagement team and review of the work performed because the personnel may not be in the same location as the engagement partner or the engagement team.
 - (b) *Nature and circumstances of the engagements*: The firm may only perform related services engagements and because of the nature of such engagements, the firm may not identify any quality risks relating to compliance with independence requirements, because independence may not be relevant. In relation to the types of entities for which engagements are undertaken,

the firm may perform engagements for entities in a particular industry, such as banks, insurance companies and pension funds. This may create the quality risk that personnel do not have the appropriate knowledge of the industry to perform the engagement.

The nature and circumstances of the firm and its engagements also affect the assessment of the likelihood of the identified quality risks occurring and the significance of the effect of the identified quality risk on the achievement of the quality objectives.

6. The responses designed and implemented by the firm consist of:

- (a) The responses required by this ISQM, which are organized by component; and
- (b) Additional responses determined by the firm.

The responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks for the quality objectives that are required to be established by this ISQM.

7. The responses designed and implemented by the firm, including the responses required by this ISQM, are affected by the nature and circumstances of the firm and its engagements. For example:

- (a) *Nature and circumstances of the firm:* In circumstances when the firm has a service delivery center that includes personnel who perform specific tasks for engagement teams, the firm may obtain technology to facilitate interaction between the engagement partner and personnel located in the central location, to support appropriate direction and supervision.
- (b) *Nature and circumstances of the engagements:* In circumstances when the firm performs engagements in a particular industry, the firm may provide training for personnel on matters unique to that industry, or recruit personnel with experience in the industry.

8. The firm's processes for establishing quality objectives, identifying and assessing quality risks and designing and implementing responses includes identifying changes in the nature and circumstances of the firm or its engagements and modifying the quality objectives, quality risks or responses, as appropriate, for changes in the matters described above.

Relevant Ethical Requirements

9. The relevant ethical requirements component comprises the firm's processes for managing compliance with relevant ethical requirements, in order that the firm, its personnel and others subject to relevant ethical requirements, as applicable, fulfill their responsibilities in accordance with relevant ethical requirements. The processes include how threats to complying with relevant ethical requirements are identified, assessed and addressed and the firm's responses to breaches of the relevant ethical requirements. Relevant ethical requirements include those related to independence.

Acceptance and Continuance of Client Relationships and Specific Engagements

10. The acceptance and continuance of client relationships and specific engagements comprises the firm's processes for consideration of matters in determining whether to accept or continue a client relationship or specific engagement. Such matters include the nature and circumstances of the engagement, the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance and the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. This component also requires that the firm's financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

Engagement Performance

11. The engagement performance component comprises the firm's actions to promote and support the consistent performance of quality engagements in accordance with professional standards and legal and regulatory requirements. This includes how the firm supports engagement teams in exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism. Matters addressed in this component include the responsibilities of the engagement team, including in relation to direction, supervision and review, consultation, differences of opinion, the assembly and retention of documentation and engagement quality reviews.

Resources

12. The resources component comprises the firm's processes for obtaining, developing, using, maintaining, allocating or assigning resources to enable the design, implementation and operation of the system of quality management. The resources relevant to the firm's system of quality management include human resources, technological resources and intellectual resources. Furthermore, financial resources are needed for obtaining, developing and maintaining the other types of resources. The firm may have competing priorities that affect the allocation or assignment of resources, however, the firm is required to have resource planning, and obtain, allocate or assign resources in a manner that supports the firm's commitment to quality and enables the design, implementation and operation of the firm's system of quality management.

Information and Communication

13. The information and communication component comprises the firm's actions to obtain, generate or use relevant information to enable the design, implementation and operation of the system of quality management. This includes establishing an information system, whether through the use of manual or automated elements, to identify, capture, process and maintain relevant and reliable information.
14. The information and communication component also comprises two-way communication within the firm and communication with external parties, such as information about the firm's system of quality management. Such communication assists external parties in understanding the firm's activities to address quality through its system of quality management and the effectiveness of the firm's system.

Monitoring and Remediation Process

15. Monitoring comprises the firm's processes for evaluating the design, implementation and operation of the system of quality management. It involves undertaking ongoing and periodic monitoring activities, and identifying and evaluating deficiencies in the system of quality management based on the findings from the monitoring activities, results of external inspections or other information sources (e.g., through the firm's complaints and allegations process). In order to understand how the deficiencies arose, this ISQM also requires the firm to understand the root cause of the identified deficiencies.
16. Remediation comprises the firm's actions for responding to identified deficiencies, which includes designing and implementing remedial actions and monitoring those actions to determine whether they appropriately address the identified deficiency. Remediation may also involve addressing the specific engagement, for example, when the identified deficiency indicates that the engagement report is inappropriate. Communication of the results of monitoring and remediation within the firm

also forms part of the firm's remedial actions, since personnel often need to be aware of the results in order to fulfill their roles and responsibilities.

17. This component also includes the responsibilities of the individual(s) assigned ultimate responsibility and accountability for the system of quality management to determine whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

Interrelationship of the Components

18. The firm's risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, and in doing so the firm is required to include the quality objectives and responses set out in each of the components of this ISQM.
19. The governance and leadership component is important to the design, implementation and operation of the other components of the system of quality management because it provides the basis for the system of quality management and also creates the environment in which the other components of the system of quality management operate.
20. Other components such as information and communication and resources have quality objectives that enable the design, implementation and operation of the system of quality management, and therefore such components may include responses that affect or relate to the other components of the system of quality management. For example, the information and communication component contains the information system that provides the information needed for the operation of the other components or the resources component addresses the establishment of human resources that are needed to operate the various aspects of the system of quality management. There may be interrelationships within the components as well, for example, human resources are needed for the development of intellectual resources.
21. There are also relationships between components because there are matters that relate to each other, for example, aspects of the relevant ethical requirements component may be relevant when accepting and continuing client relationships and specific engagements.
22. The monitoring and remediation process monitors the entire system of quality management, and therefore the monitoring activities are undertaken over all of the components of the system of quality management.

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International Standard on Quality Management

Proposed International Standard on Quality Management 2

Engagement Quality Reviews

IAASB

International Auditing
and Assurance
Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

This Exposure Draft, proposed ISQM 2, *Engagement Quality Reviews*, was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the “[Submit a Comment](#)” link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

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Section 1 Introduction

1. This memorandum provides background to, and an explanation of, the exposure draft of International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews* (ED-ISQM 2), which the IAASB approved for exposure in December 2018. The sections that follow describe the key issues considered by the IAASB in developing ED-ISQM 2. The proposed revisions address the most relevant public interest issues related to engagement quality reviews, including those highlighted in the Invitation to Comment (ITC) released in December 2015, [*Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*](#).
2. ED-ISQM 2 is part of a package of proposed quality management standards for which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, [*The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level*](#). The overall explanatory memorandum includes background to the IAASB's three quality management¹ exposure drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

Section 2 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-ISQM 2, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are free to address only questions relevant to them. When a respondent agrees with proposals in ED-ISQM 2, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

Section 3 Significant Matters

Section 3-A – Overall Matters

Public Interest Matters

3. The proposals in ED-ISQM 2 and the aspects of ED-ISQM 1² regarding engagement quality reviews are made with the public interest in the forefront. The IAASB noted in the ITC the public interest importance ascribed to engagement quality reviews by certain stakeholders, such as regulators. The overall explanatory memorandum describes the overarching public interest matters the IAASB has considered in developing the quality management exposure drafts. The IAASB also sought to explore the following possible actions identified in the ITC to address the public interest issues relevant to engagement quality reviews:

¹ The IAASB has changed the terms “quality control” and “engagement quality control review” to “quality management” and “engagement quality review,” respectively. In addition, the name of the standards has been changed from “International Standard on Quality Control” to “International Standard on Quality Management”. As explained in paragraph 11 of the explanatory memorandum for ED-ISQM 1, these changes were made to reflect the new quality management approach proposed for the firm's system of quality management in ED-ISQM 1, 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*.

² Paragraph 37(e) and related application material in proposed ISQM 1 address engagement quality reviews.

- Extending the requirement for an engagement quality review to engagements in addition to audits of financial statements.
 - Enhancing the eligibility criteria for an individual to be appointed as an engagement quality reviewer.
 - Enhancing the requirements and application material regarding the engagement quality reviewer's responsibilities, including the nature, timing and extent of the engagement quality review procedures performed.
 - Consideration of the effect of engagement quality reviews, and other forms of engagement reviews, on the appropriate exercise of professional skepticism by engagement teams.
4. The IAASB considered the importance of engagement quality reviews in the overall context of quality management and sought to address these public interest matters, as further discussed in this explanatory memorandum.

Professional Judgment and Professional Skepticism

5. The IAASB recognizes that engagement quality reviews support the exercise of professional skepticism at the engagement level by providing an objective evaluation of engagement teams' significant judgments made in performing an engagement. ED-ISQM 2 addresses the importance of this objective evaluation by requiring that firm policies or procedures set forth criteria for the eligibility of an individual to be appointed as an engagement quality reviewer. Such criteria include compliance with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer are eliminated or reduced to an acceptable level.
6. Further, ED-ISQM 2 requires firm policies or procedures to include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. This limitation is necessary to make sure that the engagement quality reviewer is in a position to objectively evaluate and, where appropriate, challenge the significant judgments made and the exercise of professional skepticism by the engagement team. The IAASB believes that this separation from the previous role as engagement partner is necessary for the engagement quality review to be an appropriate response to the assessed quality risk(s) for the engagement.
7. The IAASB also considered whether the concept of professional skepticism is relevant to professional judgments made by an engagement quality reviewer. Professional skepticism is generally described in the context of obtaining and evaluating audit evidence. ED-ISQM 2 notes that the engagement quality reviewer is not a member of the engagement team and is not required to obtain evidence to support the opinion or conclusion on the engagement. However, because the role of the engagement quality reviewer is to evaluate the significant judgments made by the engagement team, some might argue that, at least indirectly, the engagement quality reviewer also exercises professional skepticism in reviewing selected engagement documentation supporting those significant judgments and the conclusions reached thereon. Accordingly, the IAASB is seeking respondents' views on how ED-ISQM 2 addresses professional judgment and professional skepticism by the engagement quality reviewer, and whether additional guidance would be helpful in this area.
8. The IAASB also notes that the International Ethics Standards Board for Accountants' (IESBA's) project addressing the [role, mindset and behavioral characteristics expected of all professional accountants when performing their professional activities](#) may be relevant to professional judgments

made by the engagement quality reviewer. Therefore, the IAASB will continue to coordinate with IESBA in considering the effects of that project on ED-ISQM 2.

Scalability for Firms of Different Sizes

9. ED-ISQM 2 is intended to be applied by firms of all sizes based on the nature and circumstances of the engagements performed by the firm. The Appendix to this explanatory memorandum lists paragraphs that highlight how the proposed ISQM is scalable to the nature and circumstances of engagements that the firm performs.

Section 3-B – The Interrelationship Between Proposed ISQM 2 and Proposed ISQM 1 and Proposed ISA 220 (Revised)³

10. The explanatory memorandum for ED-ISQM 1 explains the firm's responsibility for establishing a system of quality management, including the new quality management approach. An engagement quality review is a response, among others, that is designed and implemented by a firm to address its assessed quality risks. Although the performance of an engagement quality review is undertaken at the engagement level, it is a response that is implemented by the engagement quality reviewer on behalf of the firm.

Basis for Developing a Separate Standard for Engagement Quality Reviews

11. The requirements for engagement quality reviews currently reside in extant ISQC 1⁴ and ISA 220.⁵ The IAASB concluded that having a separate standard for engagement quality reviews would provide a number of benefits, including:
 - (a) Placing emphasis on the importance of the engagement quality review.
 - (b) Facilitating the enhancement of the robustness of the requirements for the eligibility of engagement quality reviewers and the performance and documentation of the review.
 - (c) Providing a mechanism to more clearly differentiate the responsibilities of the firm and the engagement quality reviewer.
 - (d) Increasing the scalability of ED-ISQM 1 because there may be circumstances when a firm determines that there are no engagements for which an engagement quality review should be performed (e.g., a firm that performs only compilation engagements).
12. ED-ISQM 2 has been designed to operate as part of the firm's system of quality management, and therefore the IAASB observed the need for the requirements in ED-ISQM 1 and ED-ISQM 2 to be organized in a manner that provides appropriate linkages between the standards. The IAASB agreed that since the engagement quality review is a response to an assessed quality risk(s), ED-ISQM 1 should address the circumstances in which an engagement quality review should be performed. ED-ISQM 2 addresses the specific requirements for the appointment and eligibility of the engagement quality reviewer and the performance and documentation of the review. The explanatory memorandum for ED-ISQM 1 discusses the IAASB's considerations regarding the scope of

³ Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

⁴ International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

⁵ ISA 220, *Quality Control for an Audit of Financial Statements*

engagements that are required to be subject to an engagement quality review in accordance with paragraph 37(e) of proposed ISQM 1.

13. Although there will no longer be requirements for the performance of engagement quality reviews in proposed ISA 220 (Revised), ED-220 contains requirements regarding the engagement partner's responsibilities relating to the engagement quality review, which largely focus on how the engagement partner and the engagement team interact with the engagement quality reviewer.

Section 3-C – Objective of the Standard

14. ED-ISQM 2 is a unique standard because it addresses the responsibilities of multiple parties, i.e., the firm and the engagement quality reviewer. However, since the engagement quality reviewer is acting on behalf of the firm, the IAASB is of the view that the objective of the standard should be framed as the objective of the firm.
15. In its deliberations on the objective of ED-ISQM 2, the IAASB recognized that the objectives in the IAASB's International Standards are intended to be outcome-oriented (i.e., the desired outcome of applying the requirements in the standard, and not an "executive summary" of those requirements). Accordingly, the objective of ED-ISQM 2 reflects the intended outcome (i.e., the performance of an engagement quality review).

Section 3-D – Appointment and Eligibility of Engagement Quality Reviewers

16. The IAASB recognized in the ITC concerns that had been expressed regarding the selection of the engagement quality reviewer, including the qualifications, experience and objectivity of the individual selected to perform the engagement quality review. Respondents to the ITC believed that the independence, integrity and objectivity of the engagement quality reviewer should be addressed. There was also a suggestion that the ability of the engagement quality reviewer to challenge the engagement team's judgments with confidence should be addressed, as well as the authority of the engagement quality reviewer. It was also highlighted that the engagement quality reviewer role should not be restricted to partners. Respondents also cautioned that the requirements should not be so onerous that the availability of suitable engagement quality reviewers is limited or non-existent, especially for small- and medium-sized practices (SMPs). The ITC also explored whether a cooling-off period should be required for an engagement quality reviewer who had previously been involved in the engagement.
17. In response to feedback from the ITC, the requirements in ED-ISQM 2 for the appointment and eligibility of the engagement quality reviewer (whether internal to the firm or external) are more robust than those in extant ISQC 1, as described in the subsections below. In addition, requirements and application material have been added to address:
 - The eligibility of the individual(s) within the firm responsible for the appointment of engagement quality reviewers.
 - The eligibility of individuals to assist the engagement quality reviewer in performing the engagement quality review.
 - The engagement quality reviewer taking responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate.
 - Limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement for which the individual previously served as the engagement partner.

Competence and Capabilities, Including Sufficient Time

18. Extant ISQC 1 includes requirements regarding the criteria for eligibility of engagement quality reviewers that focus on technical qualifications, including necessary experience and authority, and maintaining the reviewer's objectivity. ED-ISQM 2 expands the eligibility requirements and describes competence and capabilities of the engagement quality reviewer in a manner similar to other roles described in ED-ISQM 1. The application material provides further explanation of considerations in determining whether an individual has the competence and capabilities needed to perform the engagement quality review for a particular engagement.
19. The IAASB highlighted in the ITC that the timing of the performance of the engagement quality review is important with respect to both when the engagement quality reviewer becomes involved in the engagement quality review and the time allocated to the engagement quality reviewer for the performance of the review. Respondents supported the importance of the reviewer being involved at the right time. The IAASB agreed and has included a new explicit requirement in paragraph 16(a) of ED-ISQM 2 that the firm's policies or procedures require that the engagement quality reviewer has sufficient time to perform the review.

Appropriate Authority

20. Although extant ISQC 1 refers to having the necessary authority to perform the review, it does not provide further information about how such authority is attained.
21. The IAASB is of the view that authority may be established through different means, not only through having a particular title or position within the firm. ED-ISQM 2 highlights that the firm's culture, which is addressed in ED-ISQM 1, can enhance the authority of the engagement quality reviewer by creating a culture of respect for the role of the engagement quality reviewer, which also reduces the likelihood that the engagement quality reviewer is inappropriately influenced in a way that would compromise the reviewer's evaluation of significant judgments made by the engagement team. In addition, ED-ISQM 2 notes that the firm's policies or procedures addressing differences of opinion, which are required by ED-ISQM 1, may also enhance the authority of the engagement quality reviewer by providing a mechanism for the engagement quality reviewer to resolve issues when differences of opinion arise.

Relevant Ethical Requirements, Including Objectivity

22. In order to improve the focus on the objectivity of the engagement quality reviewer and address the more specific threats that may arise, ED-ISQM 2 requires that the engagement quality reviewer comply with relevant ethical requirements, and specifically highlights in the application material the threats to objectivity that may arise in relation to the engagement or the engagement team.

Appointment as the Engagement Quality Reviewer After Serving as the Engagement Partner ("Cooling-off" Period)

23. In the ITC, the IAASB recognized concerns regarding the need to address circumstances when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner. The IAASB noted that relevant ethical requirements, such as the IESBA *International Code of Ethics for Professional Accountants (including International Independence Standards)*, may not specifically address threats to objectivity that may arise in these circumstances. For example, a self-review or self-interest threat may arise, particularly in circumstances when judgments made by the individual in the previous engagement continue to have an effect on

subsequent periods, as is often the case in an audit of financial statements. Accordingly, the ITC suggested that this concern could be addressed through a mandatory cooling-off period.

24. Respondents to the ITC had mixed views regarding whether the IAASB should address the cooling-off period, including whether the IAASB should prescribe a cooling-off period or require firms to determine the period; whether it should be addressed by the IESBA; or whether there should be collaboration between the two Boards.
25. Given the varying views of respondents, and the need to ensure appropriate consideration of the IESBA Code, a joint working group was formed between the IAASB and IESBA to provide suggestions to the respective Boards about an appropriate way forward, recognizing each Board's mandate. Paragraphs 26-28 below further explain how the issue has been addressed in ED-ISQM 2. The IESBA is continuing to explore whether a specific provision or application material is also needed in the IESBA Code and respondents are asked to provide further input to assist the IESBA in determining its appropriate course of action.
26. The IAASB is of the view that when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner, there are no safeguards or other actions that would eliminate the threats to the individual's objectivity or reduce them to an acceptable level. This view recognizes that the engagement quality reviewer is responsible for objectively evaluating the significant judgments made by the engagement team. In the case of an audit of financial statements, significant judgments made in prior periods often affect judgments made in subsequent periods, albeit that the facts and circumstances may change over time. The ability of the engagement quality reviewer to objectively evaluate the significant judgments is affected by previous involvement with those judgments.
27. Accordingly, ED-ISQM 2 includes a new requirement for the firm to establish policies or procedures that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as the engagement partner. Furthermore, the application material in ED-ISQM 2 suggests such limitations may be accomplished by establishing a cooling-off period and notes that determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation and relevant ethical requirements. The application material further notes that, for an audit of a listed entity, it is unlikely that an engagement partner would be able to serve as the engagement quality reviewer until two subsequent audits have been conducted. The IAASB believes this application material recognizes that audits of listed entities generally involve more complex judgments by engagement teams and that a cooling-off period would be in the public interest. The IAASB considered, but rejected, the view that including such guidance would result in a de facto cooling-off requirement. Rather, the IAASB was of the view that including a guideline will help to support consistent application in practice.
28. The IAASB recognizes that circumstances may differ for engagements other than audits of listed entities and therefore the firm may determine that no cooling-off period is necessary for certain types of engagements, or the firm's policies or procedures may specify a different cooling-off period. The IAASB is of the view that ED-ISQM 2 provides appropriate flexibility because it places the onus on the firm to establish policies or procedures that are appropriate to address the issue.

Discussions with the Engagement Team

29. The IAASB recognizes the importance of encouraging discussions between the engagement partner and the engagement quality reviewer to support an effective and timely review, but also recognizes

that a potential threat to the engagement quality reviewer's objectivity could arise in some circumstances, for example, when the nature, timing or extent of the discussions create a perception that the engagement quality reviewer is making, or perceived to be making, decisions on behalf of the engagement team. Accordingly, ED-ISQM 2 requires the firm's policies or procedures to address, and sets forth appropriate actions to take in, these circumstances.

Use of External Resources to Perform the Engagement Quality Review

30. The IAASB noted in the ITC that SMPs may need to use third-party resources as engagement quality reviewers. Respondents to the ITC cautioned that the requirements should not be so onerous that the availability of suitable engagement quality reviewers is limited or non-existent, especially for SMPs. Accordingly, the application material supporting the appointment and eligibility requirements in paragraph 16 of ED-ISQM 2 clarifies that the same eligibility requirements apply to any individual to be appointed as engagement quality reviewer, whether within the firm or external (as may be the case when there is not a partner or other individual within the firm who is eligible to perform the engagement quality review).

Section 3-E – Performance and Documentation of the Engagement Quality Review

31. In the ITC, the IAASB identified issues regarding the nature, timing and extent of the procedures in performing an engagement quality review, including at what point in the engagement the engagement quality review is performed and the depth and focus of the review. Respondents to the ITC supported enhancing the requirements and application material addressing the nature, timing and extent of the procedures in performing an engagement quality review.
32. The IAASB agreed it was necessary to clarify and improve the requirements addressing the performance of the engagement quality reviews to enhance their robustness. The IAASB acknowledges the concerns raised by some respondents regarding the appropriate balance of responsibilities between the engagement quality reviewer and the engagement partner, i.e., that the responsibilities of the engagement quality reviewer should not outweigh those of the engagement partner. Recognizing the proposals in ED-220 that have enhanced the responsibilities of the engagement partner, the IAASB is seeking respondents' views on whether the requirements imposed on the engagement quality reviewer in ED-ISQM 2 are appropriate in light of the responsibilities of the engagement partner.

Timing of the Engagement Quality Review

33. The IAASB is of the view that an effective engagement quality review is achieved when the engagement quality reviewer is involved at appropriate points in the engagement, consistent with when significant judgments are being made by the engagement team, because doing so facilitates the resolution of issues in a timely manner. Accordingly, ED-ISQM 2 includes a new requirement addressing the engagement quality reviewer's responsibility to perform the procedures at appropriate points in time during the engagement.

Significant Judgments and Significant Matters

34. In the ITC, the IAASB recognized concerns regarding the extent to which the engagement quality reviewer evaluates the assessment of, and response to, areas of significant risk or significant judgment made by the engagement partner and the engagement team. The IAASB affirmed its view in extant ISQC 1 that the engagement quality review provides an objective evaluation of the significant

judgments made by the engagement team, which in the case of audits of financial statements, include significant risks.

35. The IAASB noted that extant ISQC 1 requires the engagement quality reviewer to discuss significant matters with the engagement partner, and there sometimes is confusion between the population of matters that would be considered “significant matters” versus those that are “significant judgments.” The IAASB further noted that significant judgments could include those that are not related to significant matters. The IAASB agreed that significant judgments are identified through reading and understanding the information obtained from the engagement team and the firm about the engagement, and discussing the significant matters with the engagement partner, and if applicable, other members of the engagement team.
36. The IAASB observed that the concept of “significant matters” is addressed in ISA 230.⁶ The concept of “significant judgments,” which is integral to the definition of an engagement quality review, is addressed in proposed ISA 220 (Revised). The IAASB concluded that the engagement quality reviewer’s review of the engagement team’s significant judgments in ED-ISQM 2 needed to be consistent with the approach taken in relation to the engagement partner’s review of audit documentation in ED-220. As a result, ED-ISQM 2 includes application material to draw attention to these standards. The concepts of significant judgments and significant matters are not explicitly addressed in the standards for other types of engagements; however, the engagement quality reviewer would take into account the nature and circumstances of the engagement in identifying significant matters and significant judgments made by the engagement team. In doing so, the descriptions of those terms in ED-220 and ISA 230 may serve as useful guidance.

Documentation

37. In the ITC, the IAASB recognized concerns regarding the robustness of the documentation of the engagement quality review, including the issues raised as part of the review and the disposition of those issues.
38. ED-ISQM 2 includes a specific requirement for the engagement quality reviewer to take responsibility for documentation of the engagement quality review, and also adds a requirement that the documentation be filed with the engagement documentation. The IAASB also added an overarching requirement in ED-ISQM 2 for the documentation to be sufficient to enable an experienced practitioner, having no previous connection to the engagement, to understand the nature, timing and extent of the engagement quality review procedures performed.

⁶ ISA 230, *Audit Documentation*

Section 4 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material in ED-ISQM 2. Comments are most helpful if they are identified with specific aspects of ED-ISQM 2 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

- 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?
- 2) Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?
- 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?
- 4) Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?
 - (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?
 - (b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?
- 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 proposed ISA 220 (Revised)?
- 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?
- 7) Do you agree with the enhanced documentation requirements?
- 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?

Appendix

Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ

Note: This Appendix includes the relevant references to the material located within proposed ISQM 1 and ISQM 2 that incorporates scalability for firms of different sizes and for engagements where the nature and circumstances differ.

How Proposed ISQM 1 and ISQM 2 Address Scalability for Engagement Quality Reviews	Reference
<ul style="list-style-type: none"> Engagement quality reviews are not required for all of a firm's engagements, but only for specified engagements in accordance with ED-ISQM 1. ED-ISQM 1 sets forth the engagements for which engagement quality reviews are required. Those requirements apply if the firm's portfolio includes audits of financial statements of listed entities or audits or other engagements for which an engagement quality review is required by law or regulation. In addition, engagement quality reviews are required for engagements for entities the firm determines are of significant public interest, and engagements for which an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks. 	<ul style="list-style-type: none"> Proposed ISQM 1 Engagement Performance – Paragraph 37(e). Proposed ISQM 2 Scope of this ISQM – Paragraph 2.
<ul style="list-style-type: none"> Engagement quality reviews are not an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements, or with the firm's policies or procedures. 	<ul style="list-style-type: none"> The Firm's System of Quality Management and Role of Engagement Quality Reviews – Paragraph 6.
<ul style="list-style-type: none"> Certain requirements may not be relevant depending on the nature and circumstances of the engagement. 	<ul style="list-style-type: none"> Applying, and Complying with, Relevant Requirements – Paragraph 13. Performance of the Engagement Quality Review – Paragraphs 22 and A25–A28.
<ul style="list-style-type: none"> Explicit acknowledgment of circumstances of smaller firms or different types of engagements, including: 	Appointment and Eligibility of Engagement Quality Reviewers

How Proposed ISQM 1 and ISQM 2 Address Scalability for Engagement Quality Reviews	Reference
<ul style="list-style-type: none"> ○ Obtaining the services of external individuals to perform the engagement quality review; ○ Firm policies or procedures to determine limitations on an individual being appointed as engagement quality reviewer immediately after serving as the engagement partner, for example, specifying a suitable cooling-off period; ○ Consideration of the reasons for the assessments given to the quality risks in determining competence and capabilities required for an engagement; and ○ Impact of firm culture on authority of the engagement quality reviewer. 	<ul style="list-style-type: none"> • Assignment of Responsibility for the Appointment of Engagement Quality Reviewers – Paragraphs A2–A3. • Eligibility of the Engagement Quality Reviewer, Including Limitations on the Eligibility to be Appointed as the Engagement Quality Reviewer – Paragraphs A4–A5. • Eligibility Criteria for the Engagement Quality Reviewer – Paragraphs A7–A8.
<ul style="list-style-type: none"> • Relevant ethical requirements depend on the nature and circumstances of engagements subject to an engagement quality review. 	<ul style="list-style-type: none"> • Relevant Ethical Requirements – Paragraphs A13–A14.
<ul style="list-style-type: none"> • Recognition that it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer in certain circumstances. 	<ul style="list-style-type: none"> • Assignment of Responsibility for the Appointment of Engagement Quality Reviewers – Paragraph A3.
<ul style="list-style-type: none"> • Use of assistants in performing the engagement quality review is permitted. 	<ul style="list-style-type: none"> • Circumstances when the Engagement Quality Reviewer is Assisted by Other Individuals – Paragraphs 17 and A18.
<ul style="list-style-type: none"> • The nature, timing and extent of engagement quality review procedures may vary depending on the firm's policies or procedures or the nature and circumstances of the engagement. 	<ul style="list-style-type: none"> • Performance of the Engagement Quality Review – Paragraph 21. • Procedures Performed by the Engagement Quality Reviewer – Paragraphs A25–A27. • Significant Matters and Significant Judgments – Paragraphs A29–A31.
<ul style="list-style-type: none"> • The form, content and extent of the documentation of the engagement quality review may vary. • The engagement quality review may be documented in a number of ways. 	<ul style="list-style-type: none"> • Documentation – Paragraphs A37 and A38.

PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 2 – ENGAGEMENT QUALITY REVIEWS

(Effective as of TBD)

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Proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*, should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

Scope of this ISQM

1. This International Standard on Quality Management (ISQM) deals with:
 - The appointment and eligibility of the engagement quality reviewer; and
 - The engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review.
2. This ISQM applies to all engagements for which an engagement quality review is required to be performed in accordance with proposed ISQM 1.⁷ This ISQM is premised on the basis that the firm is subject to proposed ISQM 1 or to national requirements that are at least as demanding.

The Firm's System of Quality Management and Role of Engagement Quality Reviews

3. Proposed ISQM 1 establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to assessed quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with this ISQM.
4. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:
 - (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and
 - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.⁸
5. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism.
6. An engagement quality review is an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached thereon. The engagement quality reviewer's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements. However, an engagement quality review is not intended to be an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements, or with the firm's policies or procedures.
7. The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not reduce the responsibilities of the engagement partner for

⁷ Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 37(e)

⁸ Proposed ISQM 1, paragraph 21

managing and achieving quality on the engagement, nor does it change the nature, timing and extent of procedures that need to be performed by the engagement team. The engagement quality reviewer is not required to obtain evidence to support the opinion or conclusion on the engagement, but the engagement team may obtain further evidence through its responses to matters raised in the engagement quality review.

Authority of this ISQM

8. This ISQM contains the objective for the firm in following this ISQM, and requirements designed to enable the firm and the engagement quality reviewer to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. Proposed ISQM 1 explains the terms objective, requirements, application material and other explanatory material, introductory material, and definitions.

Effective Date

9. This ISQM is effective for:
- (a) Audits and reviews of financial statements for periods beginning on or after TBD; and
 - (b) Other engagements beginning on or after TBD.

Objective

10. The objective of the firm is to perform an engagement quality review for the engagement.

Definitions

11. In this ISQM, the following terms have the meanings attributed below:
- (a) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.
 - (b) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.
 - (c) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to a professional accountant when undertaking an engagement quality review. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive.

Requirements

Applying, and Complying with, Relevant Requirements

12. The firm and the engagement quality reviewer shall have an understanding of this ISQM, including the application and other explanatory material, to understand the objective of this ISQM and to properly apply the requirements relevant to them.

13. The firm or the engagement quality reviewer, as applicable, shall comply with each requirement of this ISQM, unless the requirement is not relevant in the circumstances of the engagement.
14. The proper application of the requirements is expected to provide a sufficient basis for the achievement of the objective of this standard. However, if the firm or the engagement quality reviewer determines that the application of the relevant requirements does not provide a sufficient basis for the achievement of the objective of this standard, the firm or the engagement quality reviewer, as applicable, shall take further actions to achieve the objective.

Appointment and Eligibility of Engagement Quality Reviewers

15. The firm shall establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual(s) with the competence, capabilities and appropriate authority within the firm to fulfill the responsibility. Those policies or procedures shall require such individual(s) to appoint the engagement quality reviewer. (Ref: Para. A1–A3)
16. The firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer and that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. Those policies or procedures shall require that the engagement quality reviewer not be a member of the engagement team, and: (Ref: Para. A4–A5)
 - (a) Have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review; (Ref: Para. A6–A12)
 - (b) Comply with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer related to the engagement or the engagement team are eliminated or reduced to an acceptable level; and (Ref: Para. A13–A16)
 - (c) Comply with requirements of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: Para. A17)
17. The firm shall establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer. Those policies or procedures shall require that such individuals not be members of the engagement team, and:
 - (a) Have the competence and capabilities, including sufficient time, to perform the duties assigned to them; and
 - (b) Comply with relevant ethical requirements and, if applicable, the requirements of law and regulation. (Ref: Para. A18–A19)
18. The firm shall establish policies or procedures that require the engagement quality reviewer to take responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate.
19. The firm shall establish policies or procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances. (Ref: Para. A20)
20. When the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility, the engagement quality reviewer shall notify the appropriate individual(s)

in the firm, and: (Ref: Para. A21)

- (a) If the engagement quality review has not commenced, decline the appointment to perform the engagement quality review; or
- (b) If the engagement quality review has commenced, discontinue the performance of the engagement quality review.

Performance of the Engagement Quality Review

21. The firm shall establish policies or procedures regarding the performance of the engagement quality review that address:

- (a) The engagement quality reviewer's responsibilities to perform procedures in accordance with paragraphs 22–23 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon;
- (b) The responsibilities of the engagement partner in relation to the engagement quality review, including prohibiting the engagement partner from dating the engagement report until the completion of the review; and (Ref: Para. A22–A23)
- (c) Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer, and appropriate actions to take in these circumstances. (Ref: Para. A24)

22. In performing the engagement quality review, the engagement quality reviewer shall: (Ref: Para. A24–A34)

- (a) Read and understand information:
 - (i) Obtained from the engagement team about the nature and circumstances of the engagement; and
 - (ii) Provided by the firm about the results of its monitoring and remediation, in particular about identified deficiencies that may relate to, or affect, the areas involving significant judgments by the engagement team.
- (b) Discuss significant matters with the engagement partner and, if applicable, other members of the engagement team. (Ref: Para. A29)
- (c) Based on the information obtained in (a) and (b), identify the areas involving significant judgments made by the engagement team, including those related to: (Ref: Para. A30–A31)
 - (i) The overall strategy and plan for performing the engagement;
 - (ii) The performance of the engagement; and
 - (iii) Forming an opinion or conclusion, when applicable, and reporting on the engagement.
- (d) Review selected engagement documentation that supports the significant judgments made by the engagement team and the conclusions reached thereon and evaluate:
 - (i) The engagement team's basis for making the significant judgments, including when applicable, the appropriate exercise of professional skepticism;
 - (ii) Whether the engagement documentation supports the conclusions reached; and

- (iii) Whether the conclusions reached are appropriate.
 - (e) Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations. (Ref: Para. A32)
 - (f) For audits of financial statements, evaluate 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. (Ref: Para. A33–A34)
 - (g) Review:
 - (i) For an audit of financial statements, the financial statements and the auditor's report thereon, including, if applicable, the description of the key audit matters; or
 - (ii) For an assurance or related services engagement, the engagement report, and when applicable, the subject matter information.
23. If the engagement quality reviewer has concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate, the engagement quality reviewer shall notify the engagement partner. 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. (Ref: Para. A35)

Completion of the Engagement Quality Review

24. The engagement quality reviewer shall determine whether the requirements in this ISQM with respect to the performance of the engagement quality review have been fulfilled, and whether the engagement quality review is complete. If so, the engagement quality reviewer shall notify the engagement partner that the engagement quality review is complete.

Documentation

25. The firm shall establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review. (Ref: Para. A36–A39)
26. The firm shall establish policies or procedures that require documentation of the engagement quality review in accordance with paragraph 27, and that such documentation be included with the engagement documentation.
27. The engagement quality reviewer shall determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing and extent of the procedures performed by the engagement quality reviewer and, when applicable, individuals who assisted the reviewer, and the conclusions reached in performing the review. The engagement quality reviewer also shall determine that the documentation of the engagement quality review includes:
- (a) The names of the engagement quality reviewer and individuals who assisted with the engagement quality review;
 - (b) An identification of the engagement documentation reviewed;
 - (c) The engagement quality reviewer's determination in accordance with paragraph 24;
 - (d) The notifications required in accordance with paragraphs 23 and 24; and

- (e) The date of completion of the engagement quality review.

Application and Other Explanatory Material

Appointment and Eligibility of Engagement Quality Reviewers

Assignment of Responsibility for the Appointment of Engagement Quality Reviewers (Ref: Para. 15)

- A1. Competence and capabilities that are relevant to an individual's ability to fulfill responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about:
- The responsibilities of an engagement quality reviewer;
 - The criteria in paragraph 16 regarding the eligibility of engagement quality reviewers; and
 - The nature and circumstances of the engagement subject to an engagement quality review (e.g., the nature of the entity and the composition of the engagement team).
- A2. The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm's policies or procedures may specify a different process for appointing engagement quality reviewers for audits of listed entities than for audits of non-listed entities or other engagements.
- A3. In certain circumstances, it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer, for example, in the case of a smaller firm or a sole practitioner.

Eligibility of the Engagement Quality Reviewer, Including Limitations on the Eligibility to be Appointed as the Engagement Quality Reviewer (Ref: Para. 16)

- A4. In some circumstances, there may not be a partner or other individual within the firm who is eligible to perform the engagement quality review and the firm may therefore contract with, or obtain the services of, external individuals to perform the engagement quality review. An external individual may be a partner or an employee of another firm within the firm's network or a service provider. When using such an external individual, the firm is subject to the requirements for network requirements or network services in paragraphs 59–60 of proposed ISQM 1, or the requirements for service providers in paragraph 65 of proposed ISQM 1, respectively.
- A5. An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level. In recurring engagements, the matters on which significant judgments are made and the facts and circumstances around those significant judgments are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period. Accordingly, this ISQM requires the firm to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the

engagement, and applicable provisions of law or regulation or relevant ethical requirements. In the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

Eligibility Criteria for the Engagement Quality Reviewer

Competence and Capabilities, Including Sufficient Time (Ref: Para. 16(a))

- A6. Competence refers to the integration and application of technical competence, professional skills, and professional ethics, values and attitudes, and the appropriate experience relevant to the nature and circumstances of the engagement, including:
- An understanding of professional standards and applicable legal and regulatory requirements and of the firm's policies or procedures relevant to the engagement;
 - Knowledge of the entity's industry;
 - An understanding of, and experience relevant to, engagements of a similar nature and complexity; and
 - An understanding of the responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review, which may be attained or enhanced by receiving relevant training from the firm.
- A7. An engagement quality review is a response to assessed quality risks relating to engagement performance. Accordingly, an understanding of the reasons for the assessments given to the quality risks may be an important consideration in the firm's determination of the competence and capabilities required to perform the engagement quality review for that engagement. Other factors to consider in determining whether the engagement quality reviewer has the competence and capabilities, including sufficient time, needed to evaluate the significant judgments made by the engagement team and the conclusions reached thereon include, for example:
- The nature of the entity.
 - The specialization and complexity of the industry or regulatory environment in which the entity operates.
 - The extent to which the engagement relates to matters requiring specialized expertise (e.g., with respect to information technology or specialized areas of accounting or auditing), or scientific and engineering expertise, such as may be needed for certain assurance engagements. Also see paragraph A18.
- A8. In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (e.g., findings from the inspection of in-process or completed engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.
- A9. A lack of appropriate competence or capabilities may affect the ability of the engagement quality reviewer to exercise appropriate professional judgment in performing the review. For example, an engagement quality reviewer who lacks relevant industry experience may not possess the ability or confidence necessary to evaluate and, where appropriate, challenge significant judgments made, and the exercise

of professional skepticism, by the engagement team on a complex, industry-specific accounting or auditing matter.

Appropriate Authority (Ref: Para. 16(a))

A10. Actions at the firm level help to establish the authority of the engagement quality reviewer. For example, by creating a culture of respect for the role of the engagement quality reviewer, the engagement quality reviewer is less likely to experience pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In some cases, the engagement quality reviewer's authority may be enhanced by the firm's policies or procedures to address differences of opinion, which may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.

A11. The authority of the engagement quality reviewer may be diminished when:

- The culture within the firm promotes respect for authority only of individuals at a higher level of hierarchy within the firm.
- The engagement quality reviewer has a reporting line to the engagement partner, for example, when the engagement partner holds a leadership position in the firm or is responsible for determining the compensation of the engagement quality reviewer.

Public Sector Considerations

A12. In the public sector, an auditor (e.g., an Auditor General, or other suitably qualified individual appointed on behalf of the Auditor General) may act in a role equivalent to that of the engagement partner with overall responsibility for public sector audits. In such circumstances, when applicable, the selection of the engagement quality reviewer may include consideration of the need for independence and the ability of the engagement quality reviewer to provide an objective evaluation.

Relevant Ethical Requirements (Ref: Para. 16(b))

A13. The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of engagements subject to an engagement quality review. Various provisions of relevant ethical requirements may apply only to individual professional accountants, such as an engagement quality reviewer, and not the firm.

A14. Relevant ethical requirements may establish requirements addressing threats created by the long association of the engagement quality reviewer with an audit client. For example, in relation to audits of public interest entities, the IESBA Code contains requirements for an engagement quality reviewer to serve a required cooling-off period after that individual has served in that role, or any combination of engagement partner, engagement quality reviewer or any other key audit partner role, for specified periods.

Threats to the Objectivity of the Engagement Quality Reviewer

A15. Threats to the engagement quality reviewer's objectivity may be created by a broad range of facts and circumstances. For example:

- A familiarity or self-interest threat may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team.

- An intimidation threat (either implicit or explicit) may be created when pressure is exerted on the engagement quality reviewer (e.g., when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner).

A16. Relevant ethical requirements may include requirements and guidance to identify, evaluate and address threats to objectivity. For example, the IESBA Code specifically addresses intimidation threats in certain circumstances.

Law or Regulation Relevant to Eligibility of the Engagement Quality Reviewer (Ref: 16(c))

A17. Law or regulation may prescribe additional requirements regarding the eligibility of the engagement quality reviewer. For example, in some jurisdictions, the engagement quality reviewer may need to possess certain qualifications or be licensed to be able to perform the review.

Circumstances when the Engagement Quality Reviewer is Assisted by Other Individuals (Ref: Para. 17)

A18. In certain circumstances, it may be appropriate for the engagement quality reviewer to be assisted by an individual or team of individuals, either internal or external, with the relevant expertise. For example, highly specialized knowledge, skills or expertise may be useful for understanding certain transactions undertaken by the entity to help the engagement quality reviewer evaluate the significant judgments made by the engagement team related to those transactions.

A19. When the engagement quality reviewer is assisted by an external individual, the assistant's responsibilities, including those related to compliance with relevant ethical requirements, may be set out in the contract or other agreement between the firm and the assistant.

Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review (Ref: Para. 19–20)

A20. Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review is impaired include:

- Whether changes in the circumstances of the engagement result in the engagement quality reviewer no longer having the appropriate competence and capabilities to perform the review;
- Whether changes in the other responsibilities of the engagement quality reviewer indicate that the individual no longer has sufficient time to perform the review; or
- Notification from the engagement quality reviewer in accordance with paragraph 20.

A21. In circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review becomes impaired, the firm's policies or procedures may set out a process by which alternative eligible individuals are identified or may specify the period of time after notification within which the firm is required to appoint a replacement.

Performance of the Engagement Quality Review (Ref: Para. 21–23)

Engagement Partner Responsibilities in Relation to the Engagement Quality Review (Ref: Para. 21(b))

A22. Proposed ISA 220 (Revised)⁹ establishes the requirements for the engagement partner¹⁰ in audit engagements for which an engagement quality review is required, including:

- Being satisfied that an engagement quality reviewer has been appointed;
- Cooperating with the engagement quality reviewer and informing members of the engagement team of their responsibility to do so;
- Discussing significant matters arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
- Not dating the auditor's report until the completion of the engagement quality review.

A23. ISAE 3000 (Revised)¹¹ also establishes requirements for the engagement partner in relation to the engagement quality review.

Discussions Between the Engagement Quality Reviewer and the Engagement Team (Ref: Para. 21(c))

A24. Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may assist in facilitating an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created depending on the timing and extent of the discussions with the engagement team about a significant judgment. The firm's policies or procedures may set forth the actions to be taken by the engagement quality reviewer or the engagement team to avoid situations in which the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team. For example, in these circumstances the firm may require consultation about such significant judgments with other relevant personnel in accordance with the firm's consultation policies or procedures.

Procedures Performed by the Engagement Quality Reviewer (Ref: Para. 21–24)

A25. The firm's policies or procedures may specify the nature, timing and extent of the procedures performed by the engagement quality reviewer and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.

A26. The timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement, including the nature of the matters subject to the review. Timely review of the engagement documentation by the engagement quality reviewer at appropriate points in time throughout all stages of the engagement (e.g., planning, risk assessment, performance, completion, reporting) allows matters to be promptly resolved to the engagement quality reviewer's satisfaction, on or before the date of the engagement report. For example, the engagement quality reviewer may perform procedures in relation to the overall strategy and plan for the engagement at the completion of the planning phase. In other circumstances, it may be appropriate for the engagement quality reviewer to perform the

⁹ Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 33

¹⁰ Similar requirements exist in paragraph 36 of International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

¹¹ ISAE 3000 (Revised), paragraph 36

procedures near the end of the engagement (e.g., when the engagement is not complex and is completed within a short period of time). Timely performance of the engagement quality review also may reinforce the exercise of professional judgment and, as applicable, professional skepticism, by the engagement team in planning and performing the engagement.

A27. The nature and extent of the engagement quality reviewer's procedures for a specific engagement may depend on, among other factors:

- The reasons for the assessments given to quality risks, for example, engagements performed for entities in emerging industries or with complex transactions.
- The findings arising from the firm's monitoring activities, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer.
- The complexity of the engagement.
- The nature and size of the entity, including whether the entity is a listed entity.
- Other information relevant to the engagement, such as the results of inspections undertaken by an external oversight authority in a prior period, or concerns raised about the commitment to quality of the firm or its personnel.
- The firm's acceptance and continuance of client relationships and specific engagements, which may indicate new risks to achieving quality for an engagement.
- Whether members of the engagement team have cooperated with the engagement quality reviewer. The firm's policies or procedures may address the actions the engagement quality reviewer takes in circumstances when the engagement team has not cooperated with the engagement quality reviewer, for example, informing an appropriate individual in the firm so appropriate action can be taken to resolve the issue.
- For assurance engagements, the engagement team's consideration of, and responses to, areas of risks of material misstatement in the engagement.

A28. The nature, timing and extent of the engagement quality reviewer's procedures may need to change based on circumstances encountered in performing the engagement quality review.

Significant Matters and Significant Judgments (Ref: Para. 22(b)–(d))

A29. For audits of financial statements, proposed ISA 220 (Revised) requires the engagement partner to review audit documentation relating to significant matters¹² and other areas involving significant judgments, especially those relating to difficult or contentious matters identified during the course of the engagement, and the conclusions reached.¹³

A30. For audits of financial statements, proposed ISA 220 (Revised) provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team.¹⁴

¹² ISA 230, *Audit Documentation*, paragraph A8

¹³ Proposed ISA 220 (Revised), paragraph 29

¹⁴ Proposed ISA 220 (Revised), paragraph A80

A31. For engagements other than audits of financial statements, the engagement quality reviewer may consider the nature and circumstances of the engagement in identifying significant matters, and significant judgments made by the engagement team. For example, in an assurance engagement performed in accordance with ISAE 3000 (Revised), the engagement team's determination of whether the criteria to be applied in the preparation of the subject matter information are suitable for the engagement may involve or require significant judgment. The examples in proposed ISA 220 (Revised)¹⁵ also may be useful to the engagement quality reviewer in identifying significant judgments in engagements other than audits of financial statements.

Whether Consultation Has Taken Place on Difficult or Contentious Matters or Matters Involving Differences of Opinion (Ref: Para. 22(e))

A32. Proposed ISQM 1¹⁶ sets out requirements for the firm to establish policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. Proposed ISQM 1¹⁷ also sets out requirements for the firm to establish policies or procedures to address differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing duties within the firm's system of quality management, including those who provide consultation.

Overall Responsibility of the Engagement Partner for Managing and Achieving Quality on the Engagement (Ref: Para. 22(f))

A33. Proposed ISA 220 (Revised) requires the engagement partner to determine, prior to dating the auditor's report, that:

- The engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
- The firm's policies or procedures, and the nature and circumstances of the audit engagement, and any changes thereto, have been taken into account in complying with the requirements of proposed ISA 220 (Revised).¹⁸

A34. Other pronouncements of the IAASB, including ISRE 2400 (Revised),¹⁹ ISAE 3000 (Revised),²⁰ and ISRS 4410 (Revised)²¹ also require the engagement partner to take responsibility for the overall quality on the engagement.

¹⁵ Proposed ISA 220 (Revised), paragraph A80

¹⁶ Proposed ISQM 1, paragraph 40(c)

¹⁷ Proposed ISQM 1, paragraph 40(d)

¹⁸ Proposed ISA 220 (Revised), paragraph 37

¹⁹ International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*, paragraph 25

²⁰ ISAE 3000 (Revised), paragraph 33

²¹ International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, paragraph 23

The Engagement Quality Reviewer's Evaluation (Ref: Para. 23)

A35. The firm's policies or procedures may specify the individual(s) in the firm to be notified if the engagement quality reviewer has unresolved concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate. Such individual(s) may include the individual assigned the responsibility for the appointment of engagement quality reviewers.

Documentation (Ref: Para. 25–27)

A36. Paragraphs 67 and 68 of proposed ISQM 1 require the firm to prepare documentation of the firm's system of quality management. Engagement quality reviews performed in accordance with this proposed ISQM are one response, among others, to a firm's quality risks related to the performance of engagements, and are therefore subject to those documentation requirements.

A37. The form, content and extent of the documentation of the engagement quality review may depend on factors such as:

- The nature and complexity of the engagement;
- The nature of the entity;
- The nature and complexity of the matters subject to the engagement quality review; and
- The extent of the engagement documentation reviewed.

A38. The engagement quality review may be documented in a number of ways. For example, the engagement quality reviewer may document the review of engagement documentation electronically in the IT application for the performance of the engagement. Alternatively, the engagement quality reviewer may document the review through means of a memorandum. The engagement quality reviewer's procedures may also be documented as part of other engagement documentation, for example, minutes of the engagement team's discussions where the engagement quality reviewer was present.

A39. Paragraph 21(b) requires that the firm's policies or procedures preclude the engagement partner from dating the engagement report until the completion of the engagement quality review, which includes resolving matters raised by the engagement quality reviewer. The documentation of the engagement quality review may be completed after the date of the engagement report, but before the assembly of the final engagement file.

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International Standard on Auditing

Proposed International Standard on Auditing 220 (Revised)

Quality Management for an Audit of Financial Statements



International Auditing
and Assurance
Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

This Exposure Draft, proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

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Introduction

1. This memorandum provides background to, and an explanation of, the Exposure Draft of proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220), which was approved for exposure by the IAASB in December 2018.
2. ED-220 is part of a package of proposed quality management standards in respect of which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, [The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level](#). The overall explanatory memorandum includes background to the IAASB's three quality management Exposure Drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

Section 1 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-220, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are also free to address only questions relevant to them. When a respondent agrees with proposals in ED-220, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not stated.

Section 2 Significant Matters

Section 2-A – Overall Matters

Public Interest Matters

3. In revising ISA 220, the IAASB sought to address public interest considerations by encouraging proactive management of quality at the engagement level, emphasizing the importance of the exercise of professional skepticism, enhancing the documentation of the auditor's judgments, keeping ISA 220 fit for purpose in a wide range of circumstances and in a complex environment, and reinforcing the need for robust communications during the audit.¹
4. In support of these goals, the IAASB agreed to:
 - Highlight the importance of the public interest role of audits, and improve the emphasis on the importance of the appropriate application of professional judgment and exercise of professional skepticism (see paragraphs 5–6 below);
 - Clarify the role and responsibilities of the engagement partner, particularly the required involvement of the engagement partner throughout the audit, and retain the emphasis on the engagement partner's responsibility for managing and achieving quality at the engagement level (see Section 2-B below);

¹ The public interest issues that the IAASB was seeking to address are explained further in the [Project Proposal](#), paragraph 21.

- Modernize ISA 220 for an evolving environment, including changes in audit delivery models and the use of technology (see paragraphs 7–9 below); and
- Clarify the relationship between ED-220 and the ISQMs, including additional clarification of the engagement partner's and engagement team's interaction with the firm, and the engagement team's, ability to depend on the firm's quality management policies or procedures (see paragraphs 10–11 below).

The Public Interest Role of Audits and the Exercise of Professional Skepticism

5. The IAASB believes that it is important to emphasize that the public interest is served by the consistent performance of quality engagements. Accordingly, ED-220 highlights that the public interest is served by the consistent performance of quality audit engagements (see paragraph 6 of ED-220 and paragraphs 19–21 of the explanatory memorandum in ED-ISQM 1).
6. In addition, the IAASB has included new introductory material on the importance of the use of professional skepticism and professional judgment in performing audit engagements (see paragraph 7 of ED-220). This introductory material is further supported by application material that describes impediments to professional skepticism, auditor biases, and actions the engagement partner can take to deal with impediments to the exercise of professional skepticism.

Modernizing ISA 220 for an Evolving Environment

7. The [Invitation to Comment \(ITC\), *Enhancing Audit Quality in the Public Interest*](#), noted that the project to revise ISA 220 could acknowledge the evolving use of audit delivery models² and emphasize the need for appropriate policies and procedures for these structures as part of the firm's system of quality control and at the engagement level. Respondents to the ITC were supportive of this suggestion.
8. ED-220 now recognizes that engagement teams may be organized in a variety of ways including being located together or across different geographic locations, or organized by the activity they are performing. ED-220 also recognizes that individuals who are involved in the audit engagement may not necessarily be engaged or employed directly by the firm. Importantly, the change recognizes that, regardless of the location or employment status of such individuals, if they are performing audit procedures, then their work needs to be appropriately directed, supervised and reviewed. As a consequence, changes have been made to the definition of the engagement team to recognize different and evolving engagement team structures (see Section 2-E below).
9. ED-220 also highlights the growing role of technology in audits of financial statements. The requirements in the Resources section have been enhanced and cover not only the human resources involved in an audit engagement, but also the technology and intellectual resources. Paragraphs A56–A58 explain how technological resources may be used in the audit (see also Section 2-D below). The ED also notes the role of specialized skills or knowledge in the use of automated tools. In proposing amendments to the ISA, the IAASB took into account the learnings of the IAASB's Data Analytics Working Group, which is exploring the use of technology on audits.

² See paragraph 117 of the ITC for an explanation of audit delivery models.

The Interaction Between ED-220 and Proposed ISQM 1 and Proposed ISQM 2

10. ED-220 is designed to operate as part of the broader system of quality management established by ISQM 1.³ Under ED-ISQM 1, the firm establishes quality objectives, identifies and assesses quality risks, and designs responses to address the quality risks in relation to the components of the firm's system of quality management. The responses may be implemented at the firm level or at the engagement level, depending on the nature and circumstances of the firm and the engagement.⁴ Accordingly, ED-ISQM 1 requires the firm to communicate information to the engagement team about their responsibilities regarding the firm's responses that are required to be implemented at the engagement level.
11. Extant ISA 220 includes requirements and guidance on the performance of an engagement quality review (formerly known as an engagement quality control review) of the audit, including requirements directed at the engagement quality reviewer. These requirements and guidance are now proposed to be moved to proposed ISQM 2⁵ and, therefore, ED-220 is focused only on the responsibilities of the engagement partner in this regard, including how the engagement partner and engagement team interact with the engagement quality reviewer.

The role of the firm's policies or procedures at the engagement level

12. Extant ISA 220 notes that engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. The IAASB has proposed removing this material, and replacing it with application material that explains that in certain circumstances, the engagement partner may "depend on the firm's policies or procedures" in complying with the requirements of ED-220. This approach is intended to avoid the risk that the engagement team blindly relies on the firm's system of quality management without taking into account whether the firm's quality management policies or procedures are "fit-for-purpose" in the specific circumstances of the engagement. To assist the engagement partner in making the determination as to whether, and the degree to which, the engagement partner may depend on the firm's policies or procedures, the IAASB has also proposed application material that provides examples of 'matters' that the engagement partner may take into account when determining whether it is appropriate to depend on the firm's policies or procedures (see paragraphs A7–A8 of ED-220).
13. In certain places in ED-220, the engagement partner or engagement team is required to comply with the firm's policies or procedures in addressing the requirements of ED-220. This is because in such cases the firm's policies or procedures are considered integral to the fulfillment of the requirements of ED-220. For example, paragraph 16 of ED-220 requires the engagement partner to evaluate threats to compliance with relevant ethical requirements through complying with the firm's policies or procedures. Complying with the firm's policies or procedures in these circumstances is considered necessary because the engagement partner would likely not have the necessary information or tools to evaluate the threats, and would therefore need to draw upon the firm's resources to assist in this regard. The IAASB concluded that the requirements that reference the firm's policies and procedures are aligned with requirements in proposed ISQM 1 for the firm to establish responses to risks to

³ See [ED-ISQM 1](#).

⁴ See the [overall explanatory memorandum](#) for an explanation of how the quality management approach can be implemented in a scalable manner and the implementation support tools available.

⁵ See [ED-ISQM 2](#).

engagement quality⁶ and this approach is consistent with extant ISA 220. In addition, understanding and complying at the engagement level with applicable firm policies and procedures is critical to establishing and maintaining the relationship between quality management at the firm level and quality management at the engagement level.

14. In ED-220, the phrase “shall be satisfied” has been used in requirements that refer to the engagement partner’s responsibility in relation to actions that occur (or should have occurred) at the firm level, but which are relevant to managing and achieving quality at the engagement level. The phrase “shall determine” has been used in requirements that refer directly to actions that the engagement partner is required to take.

Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ

15. ED-220 is intended to be applied by firms of all sizes and circumstances and it is intended to be scalable based on the nature and circumstances of the audit engagement. The Appendix to this Explanatory Memorandum lists paragraphs that highlight how the proposed ISA can be applied in the different circumstances. In addition, the IAASB is developing support materials to show how certain aspects of proposed ISA 220 (Revised) and ISQM 1 (Revised) can be applied together in a scalable manner in smaller firms.⁷

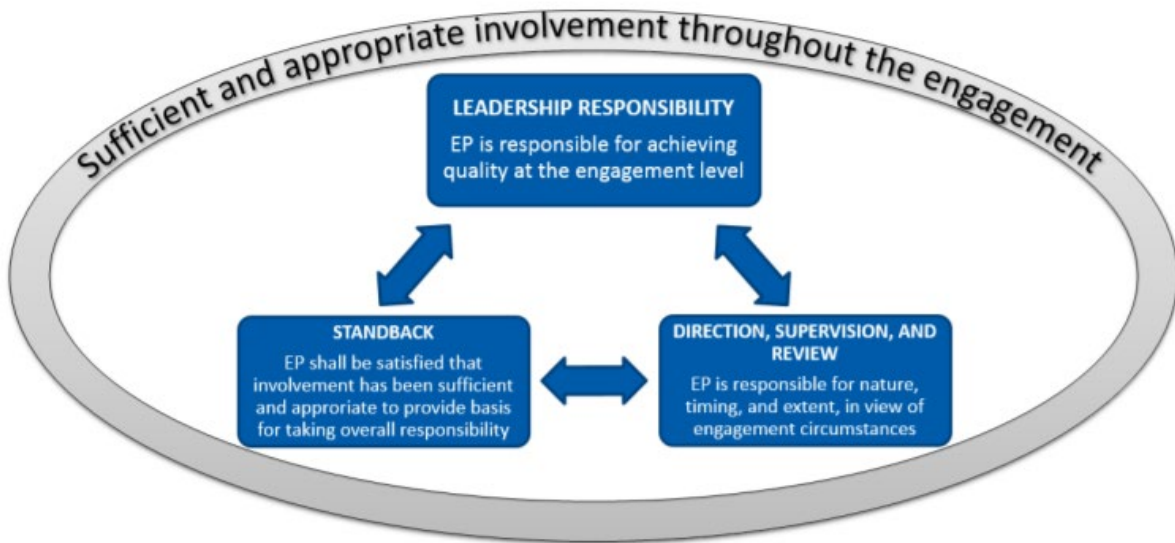
Section 2-B – The Engagement Partner’s Overall Responsibility for Managing and Achieving Quality on Audits, Including Engagement Performance and Standing Back

16. Extant ISA 220 requires the engagement partner to take responsibility for the overall quality of each audit engagement to which that partner is assigned and provides guidance on the actions and messages to emphasize. The ITC noted that the project to revise ISA 220 may result in updating requirements and application material in ISA 220 to make the engagement partner’s responsibilities for leadership and project management (including the assessment of the competence and objectivity of the engagement team) more explicit.
17. The IAASB believes that the engagement partner needs to be sufficiently and appropriately involved throughout the engagement as this is fundamental to providing the engagement leadership required to achieve high quality audits and, therefore, to meeting the objective of ISA 220. The diagram below illustrates how the engagement partner’s overall responsibility to manage and achieve quality on the engagement is demonstrated through sufficient and appropriate involvement throughout the engagement, such that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the audit. This overall responsibility includes:
 - a) **Fulfilling leadership responsibilities**, including taking actions to create an environment for the engagement that emphasizes the firm’s culture and the expected behavior of engagement team members, and assigning procedures, tasks or actions to other members of the engagement team;
 - b) **Supporting engagement performance**, including taking responsibility for the nature, timing and extent of direction, supervision and review of the work performed; and

⁶ See Section 6 of the Explanatory Memorandum, *The IAASB’s Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*.

⁷ The support materials will be available at www.iaasb.org during the public exposure period for ED-220.

- c) **Standing back**, to determine whether the engagement partner has taken overall responsibility for managing and achieving quality, including determining that the engagement partner's involvement has been sufficient and appropriate throughout the engagement and that the nature and circumstances of the engagement have been taken into account.



Fulfilling Leadership Responsibilities (Paragraphs 11–13 of ED-220)

18. In clarifying the role and responsibilities of the engagement partner, the IAASB determined that ED-220 needed to highlight early in the ISA that achieving quality on the audit engagement requires the engagement partner to demonstrate sufficient and appropriate involvement in the engagement, which includes being responsible for creating an environment that emphasizes the firm's culture and expected behavior of engagement team members (see paragraph 11 of ED-220). The engagement partner is also required to take clear, consistent and effective actions that reflect the firm's commitment to quality and communicate the expected behavior of engagement team members (see paragraph 12 of ED-220). The focus on the link between the firm's culture and the tone set by leadership is aligned with the requirements of ED-ISQM 1 (see, for example, paragraph 22 of the explanatory memorandum of ED-ISQM 1).
19. Another aspect of leadership responsibilities is assigning responsibilities to other engagement team members. ED-220 recognizes that the engagement partner may assign procedures, tasks or actions to other members of the engagement team to assist the engagement partner in complying with the requirements, but that the engagement partner is still required to take overall responsibility for the quality of the engagement. The engagement partner is therefore required to inform assignees about their responsibilities, to monitor the performance of the assignees' work, and to review related documentation (see paragraph 13 of ED-220). The IAASB discussed whether the leadership requirements, collectively, placed too much emphasis on the role of the engagement partner, but concluded that the public interest was best served by requirements that continue to emphasize the importance of overall responsibility for managing and achieving quality being in the hands of the engagement partner.

Supporting Engagement Performance (Paragraphs 27–31 of ED-220)

20. The IAASB revised the engagement performance section extensively to improve the quality of audits by enhancing the requirements and emphasizing the importance of taking the nature and circumstances of the audit into account in addressing them. To this end:
- The requirements and application material on direction, supervision and review have been strengthened and include greater specificity on how the engagement partner needs to be involved. In addition, the revised requirements include linkages with other requirements in ED-220 (e.g. the requirements on engagement resources) and with other ISAs (e.g. the guidance in ISA 230 on significant matters). The proposed standard also includes new guidance on these requirements, including guidance on matters that may constitute a significant judgment, and which matters therefore need to be reviewed by the engagement partner.
 - New requirements require the engagement partner to review the financial statements and the auditor's report prior to dating the auditor's report and, prior to their issuance, to review formal written communications to management, those charged with governance, or regulatory authorities.
 - The proposed ISA includes improved links with proposed ISQM 1 and ISQM 2, for example:
 - Requiring the engagement partner to take responsibility for the engagement team consulting on matters where the firm's policies or procedures require consultation.
 - Aligning the requirement to cooperate with the engagement quality reviewer with proposed ISQM 2.
 - Referring in paragraph A29 of ED-ISQM 2 to the new focus and guidance on significant judgments in ED-220, which provides assistance to the engagement quality reviewer in addressing the requirements of ISQM 2
 - A new requirement on addressing differences of opinion has been included to provide greater specificity on the engagement partner's role in handling differences of opinion. This requirement is supported by guidance on how to handle differences of opinion.

Standing Back (Paragraph 37 of ED-220)

21. Paragraph 37 of ED-220 requires the engagement partner to “stand-back” and, prior to forming an opinion, determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. The IAASB concluded that it was appropriate for the engagement partner to determine that the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement and that the nature and circumstances of the engagement (and any changes thereto) have been taken into account in complying with the proposed ISA. The IAASB believes that including such a stand-back requirement would also assist in supporting the exercise of professional skepticism by the engagement partner and other members of the engagement team. Paragraph A100 of ED-220 provides guidance that appropriate consideration of the requirements of ED-220, and how the audit documentation evidences the engagement partner's involvement in the audit, would provide the basis for whether the engagement partner has taken overall responsibility for managing and achieving quality.

Section 2-C – Relevant Ethical Requirements

22. Extant ISA 220 requires that the engagement partner remain alert for non-compliance with relevant ethical requirements by members of the engagement team, determine the appropriate action if non-compliance comes to the engagement partner's attention, and conclude on compliance with independence requirements. The ITC noted that ISA 220 could include further material on the responsibilities of the engagement partner in relation to relevant ethical requirements for members of the engagement team.
23. In response to the ITC and the comments thereon, the IAASB determined that the requirements should be strengthened regarding relevant ethical requirements and the engagement partner's role in dealing with relevant ethical requirements. Accordingly, in addition to enhancing the extant requirements, ED-220 includes requirements regarding:
- Understanding of the relevant ethical requirements and whether other members of the engagement team are aware of those requirements and the firm's related policies or procedures;
 - Threats to compliance with relevant ethical requirements; and
 - Determining whether relevant ethical requirements, including those related to independence, have been fulfilled.
24. ED-220 also includes new application material that links with the firm level requirements in proposed ISQM 1, describes possible appropriate actions if non-compliance is indicated, and links to the requirement in ISA 700 (Revised)⁸ for the auditor's report to include a statement regarding the auditor's independence.

Section 2-D – Engagement Resources

25. Extant ISA 220 contains requirements and guidance about the assignment of the engagement team, but does not otherwise address the engagement level resources. In paragraph 78 of the ITC, it was noted that extant ISA 220 does not explicitly address the need for the engagement partner to be satisfied that sufficient time and resources are available to the engagement team such that it will be possible to perform the necessary work to obtain sufficient appropriate audit evidence before the reporting deadline.
26. Consistent with the approach taken in ED-ISQM 1, proposed ISA 220 addresses this gap through a new section on human, technological and intellectual resources (see paragraphs 23–26 of ED-220). The engagement partner is responsible for determining that there are sufficient and appropriate resources assigned or made available on a timely basis. The engagement partner is also responsible for taking appropriate action when insufficient or inappropriate resources in the context of the audit engagement are provided by the firm, and for the appropriate use of resources by the engagement team. New application material describes how human, technological, and intellectual resources may be used to support the performance of audit engagements, how project management skills can assist in managing the quality of the audit engagement, and the appropriate actions if the engagement partner determines that the resources are insufficient or inappropriate.

⁸ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 28(c)

Section 2-E – Other Matters

27. Other improvements in ED-220 include that:

- Information learned in the acceptance and continuance process is required to be taken into account in planning and performing the audit engagement in accordance with the ISAs (see paragraph 21 of ED-220). For example, ED-220 now explicitly recognizes that information obtained in the acceptance and continuance process will be relevant to the auditor's risk assessment process.
- The monitoring and remediation requirement has been enhanced and clarified. The IAASB has also aligned ED-220 with the new requirements in proposed ISQM 1, and are premised on the basis that the engagement partner is responsible for dealing with the relevant aspects of the monitoring and remediation process as communicated by the firm, including, as applicable, the results of the monitoring and remediation process of the network or network firms (see paragraph 36 of ED-220). In addition, the engagement partner is also required to be satisfied that the engagement team is aware of the results of the firm's monitoring and remediation process, and to remain alert throughout the engagement for information that may be relevant to the monitoring and remediation approach.

28. Regardless of how the engagement team is organized, the IAASB has also emphasized the engagement partner's overall responsibility for managing and achieving quality on the engagement (see Section 2-B above). In light of this, the role and responsibilities of the engagement partner and engagement team in a group audit are also a key focus for the IAASB. The IAASB is currently undertaking a project to revise ISA 600,⁹ which may result in minor amendments to ED-220 in due course as the project progresses.

Section 3 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-220. In this regard, comments will be most helpful if they are identified with specific aspects of ED-220 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

- 1) Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), 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?
- 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?
- 3) Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)
- 4) Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?
- 5) Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

⁹ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

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

Appendix**Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ**

Note: This Appendix includes the relevant references to the material located within ED-220 that incorporates scalability for firms of different sizes and for engagements where the nature and circumstances differ.

How ED-220 Covers Scalability	Reference to ED-220
<ul style="list-style-type: none"> In larger firms, responsibility for elements of the system of quality management is dispersed throughout the firm and the engagement partner may not have direct involvement or detailed knowledge of those elements. In such cases, the engagement partner may use information provided by the firm and personal knowledge, supplemented with additional inquiries or other procedures, to have the necessary basis to depend on the firm's policies and procedures. In a smaller firm, the engagement partner may have more direct involvement in the firm's processes, which may provide the basis for depending on the firm's policies or procedures in certain circumstances. For example, if the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will therefore be aware of the information obtained, or used by the firm, in reaching the related conclusions. Such involvement may also therefore provide a basis for the engagement partner being satisfied that the firm's policies or procedures have been followed and that the conclusions reached are appropriate. 	<ul style="list-style-type: none"> The Firm's System of Quality Management and Role of Engagement Teams – Paragraphs A7–A8. Acceptance and Continuance of Client Relationships and Audit Engagements – Paragraph A45. Engagement Resources – Paragraphs A52 and A61.

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How ED-220 Covers Scalability	Reference to ED-220
<ul style="list-style-type: none"> • In a smaller firm, the design and implementation of many responses to the firm's quality risks may be most effectively dealt with by the engagement partner at the engagement level. • The firm's responses to quality risks, including policies or procedures, may be less formal in a smaller firm (e.g., in a very small firm with a relatively small number of audit engagements, firm leadership may determine that there is no need to establish a firm-wide system to monitor independence, and rather, independence would be monitored at the engagement level by the engagement partner). 	<ul style="list-style-type: none"> • The Firm's System of Quality Management and Role of Engagement Teams – Paragraph A14.
<ul style="list-style-type: none"> • Some requirements of ED-220 may not be relevant if the audit is carried out entirely by the engagement partner because they are conditional on the involvement of other members of the engagement team (e.g., requirements related to direction, supervision, and review). 	<ul style="list-style-type: none"> • The Firm's System of Quality Management and Role of Engagement Teams – Paragraph A15.
<ul style="list-style-type: none"> • For a smaller engagement team that consists of only a few engagement team members, the engagement partner's actions influence the desired culture through direct interaction and conduct, which may be sufficient to reflect the firm's commitment to quality. For a larger engagement team that is dispersed over many locations, more formal communications may be necessary. 	<ul style="list-style-type: none"> • Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraph A23.
<ul style="list-style-type: none"> • The requirements relating to nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed are required to be responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement (i.e., the direction, supervision and review is to be specifically 	<ul style="list-style-type: none"> • Engagement Performance – Paragraphs 27–29.

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How ED-220 Covers Scalability	Reference to ED-220
tailored or scaled for each engagement, depending on its size and complexity).	
<ul style="list-style-type: none"> For larger engagements, the engagement partner may assign certain procedures, tasks or other actions to other members of the engagement team to assist the engagement partner in complying with the requirements of ED-220. 	<ul style="list-style-type: none"> Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraphs 13 and A30.
<ul style="list-style-type: none"> In situations where there are many engagement team members, for example on larger or more complex audit engagements, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, for a smaller engagement team with fewer engagement team members, project management may be achieved through less formal means. 	<ul style="list-style-type: none"> Engagement Resources – Paragraph A63–A64.
<ul style="list-style-type: none"> Explicit acknowledgement of a tailored approach to quality management at the engagement level that is responsive to the nature and circumstances of the audit engagement. 	<ul style="list-style-type: none"> Scope of this ISA – Paragraph A2. The Firm’s System of Quality Management and Role of Engagement Teams – Paragraphs 4(b), 7, A5, A9, and A14. Relevant Ethical Requirements, Including Independence Requirements – Paragraphs 14–15, 18, and A32–A33. Acceptance and Continuance of Client Relationships and Audit Engagements – Paragraph A49. Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraphs 11, A23–A24, and A66. Engagement Resources – Paragraphs 23, 25, A52, A60, and A11D. Direction, Supervision and Review – Paragraphs 27(b), A69, A81, and A84. Monitoring and Remediation – Paragraph A97.

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How ED-220 Covers Scalability	Reference to ED-220
	<ul style="list-style-type: none"> • Taking Overall Responsibility for Managing and Achieving Quality – Paragraph 37.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 220 (REVISED) QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS

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Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner. This ISA is to be read in conjunction with relevant ethical requirements. (Ref: Para. A1–A2)

The Firm's System of Quality Management and Role of Engagement Teams

2. The firm is responsible for the system of quality management. Under proposed ISQM 1, the objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:
 - (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
 - (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.¹⁰ (Ref: Para. A3, A14–A15)
3. This ISA is premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding. (Ref: Para. A4)
4. The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this ISA, for:
 - (a) Implementing the firm's responses to quality risks (i.e., the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm; (Ref: Para. A5–A8)
 - (b) Given the nature and circumstances of the audit engagement, determining whether to design and implement responses beyond those set forth in the firm's policies or procedures; and (Ref: Para. A9–A10)
 - (c) Providing the firm with information from the audit engagement to support the design, implementation, and operation of the firm's system of quality management that is required to be communicated in accordance with the firm's policies or procedures. (Ref: Para. A11)
5. Complying with the requirements in other ISAs may provide information that is relevant to quality management at the engagement level. (Ref: Para. A12)
6. The public interest is served by the consistent performance of quality audit engagements. Quality audit engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law

¹⁰ Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 21

or regulation involves exercising professional judgment and exercising professional skepticism. (Ref: Para. A13)

7. In accordance with ISA 200,¹¹ the engagement partner and other members of the engagement team are required to plan and perform an audit with professional skepticism and to exercise professional judgment. In doing so, the engagement partner and engagement team exercise professional judgment and professional skepticism in meeting the objective and requirements of this ISA. Professional judgment is applied in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement partner and other members of the engagement team. Such actions and communications may include specific steps to deal with impediments that may impair the appropriate exercise of professional skepticism, such as unconscious bias or resource constraints. (Ref: Para. A27–A29)

Effective Date

8. This ISA is effective for audits of financial statements for periods beginning on or after [Date].

Objective

9. The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that:
- (a) The auditor has fulfilled the auditor's responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements; and
 - (b) The auditor's report issued is appropriate in the circumstances.

Definitions

10. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) Engagement partner¹² – The partner, or other individual appointed by the firm, who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
 - (b) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon that is completed on or before the date of the engagement report.
 - (c) Engagement quality reviewer – A suitably qualified partner or other individual appointed by the firm to be responsible for the performance of the engagement quality review.

¹¹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraphs 15–16

¹² "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

- (d) Engagement team – All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an auditor's external expert engaged by the firm or a network firm,¹³ and also excludes individuals within the client's internal audit function who provide direct assistance on an engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).¹⁴ (Ref: Para. A16–A19)
- (e) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A20)
- (f) Network firm – A firm or entity that belongs to a network. (Ref: Para. A21)
- (g) Network – A larger structure: (Ref: Para. A21)
 - (i) That is aimed at cooperation, and
 - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (h) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (i) Personnel – Partners and staff.
- (j) Professional standards – International Standards on Auditing (ISAs) and relevant ethical requirements.
- (k) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking the audit engagement. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to audits of financial statements, together with national requirements that are more restrictive.
- (l) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address a quality risk:
 - (i) Policies are statements of what should, or should not, be done to address a quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
 - (ii) Procedures are actions to implement policies.
- (m) Staff – Professionals, other than partners, including any experts the firm employs.

¹³ ISA 620, *Using the Work of an Auditor's Expert*, paragraph 6(a), defines the term "auditor's expert."

¹⁴ ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

Requirements

Leadership Responsibilities for Managing and Achieving Quality on Audits

11. The engagement partner shall take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the engagement such that the engagement partner has the basis for determining whether the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. (Ref: Para. A22–A29)
12. In creating the environment described in paragraph 11, the engagement partner, and others to whom supervisory roles are assigned, shall take clear, consistent and effective actions that reflect the firm's commitment to quality and establish and communicate the expected behavior of engagement team members, including:
 - (a) Emphasizing that all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;
 - (b) Reinforcing the importance of professional ethics, values, and attitudes to the members of the engagement team;
 - (d) Encouraging open and robust communication within the engagement team, and supporting the ability of engagement team members to raise concerns without fear of reprisal; and
 - (e) Emphasizing the importance of each engagement team member exercising professional skepticism throughout the audit engagement.
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: (Ref: Para. A30)
 - (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.

Relevant Ethical Requirements, Including Those Related to Independence

14. The engagement partner shall have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: Para. A31–A35, A41)
15. The engagement partner shall determine that other members of the engagement team have been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that deal with: (Ref: Para. A33–A35)

- (a) Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence;
 - (b) Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and their responsibilities when they become aware of actual or suspected breaches; and
 - (c) Their responsibilities when they become aware of an instance of actual or suspected non-compliance with laws and regulations.¹⁵
16. If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner shall evaluate such threats through complying with the firm's policies or procedures, using relevant information from the firm, the engagement team, or other sources and take appropriate action. (Ref: Para. A36–A37)
17. The engagement partner shall remain alert throughout the audit engagement, through observation and making inquiries as necessary, for actual or suspected breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: Para. A38)
18. If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the audit engagement have not been fulfilled, the engagement partner, in consultation with others in the firm, shall take appropriate action. (Ref: Para. A39)
19. Prior to dating the auditor's report, the engagement partner shall determine whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: Para. A40)

Acceptance and Continuance of Client Relationships and Audit Engagements

20. The engagement partner shall be satisfied that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A42–A45, A51)
21. The engagement partner shall take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of this ISA. (Ref: Para. A46–A49)
22. If the engagement partner obtains information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: Para. A50)

Engagement Resources

23. The engagement partner shall determine that, given the nature and circumstances of the audit engagement (and any changes that may arise during its course), sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team by the firm on a timely basis. (Ref: Para. A52–A61, A63–A64, A67)

¹⁵ ISA 250 (Revised), *Considerations of Laws and Regulations in an Audit of Financial Statements*

24. The engagement partner shall determine that members of the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: Para. A62–A64)
25. If, as a result of complying with the requirement in paragraphs 23 and 24, the engagement partner determines that resources assigned or made available by the firm are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner shall take appropriate action, including communicating with appropriate personnel in the firm about the need to allocate or assign additional or alternative resources to the engagement. (Ref: Para. A65–A66)
26. The engagement partner shall take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement. (Ref: Para. A58)

Engagement Performance

Direction, Supervision and Review

27. The engagement partner shall take responsibility for the nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed, and determine that such direction, supervision and review is: (Ref: Para A68–A76, A81–A83)
 - (a) Planned and performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements;
 - (b) Responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement; and
 - (c) Planned and performed on the basis that the work performed by less experienced team members is directed, supervised, and reviewed by more experienced engagement team members.
28. On or before the date of the auditor's report, the engagement partner shall, through review of audit documentation and discussion with the engagement team, determine that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A77–A80)
29. In complying with the requirements of paragraph 28, the engagement partner shall review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to: (Ref: Para. A77–A80)
 - (a) Significant matters;¹⁶
 - (b) Other areas involving significant judgments, especially those relating to difficult or contentious matters identified during the course of the engagement, and the conclusions reached; and
 - (c) Other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.
30. Prior to dating the auditor's report, and in order to determine that the report to be issued will be appropriate in the circumstances, the engagement partner shall review the financial statements and

¹⁶ ISA 230, *Audit Documentation*, paragraph 8

the auditor's report, including, if applicable, the description of the key audit matters¹⁷ and related audit documentation.

31. The engagement partner shall review, prior to their issuance, any formal written communications to management, those charged with governance, or regulatory authorities.

Consultation

32. The engagement partner shall: (Ref: Para. A84–A87)
- (a) Take responsibility for the engagement team undertaking consultation on:
 - (i) Matters where the firm's policies or procedures require consultation, including on difficult or contentious matters; and
 - (ii) Other matters that in the engagement partner's professional judgment, require consultation;
 - (b) Determine that members of the engagement team have undertaken appropriate consultation during the course of the audit engagement, both within the engagement team, and between the engagement team and others at the appropriate level within or outside the firm;
 - (c) Determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and
 - (d) Determine that conclusions resulting from such consultations have been implemented.

Engagement Quality Review

33. For audit engagements for which an engagement quality review is required, the engagement partner shall: (Ref: Para. A88)
- (a) Be satisfied that an engagement quality reviewer has been appointed;
 - (b) Cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so;
 - (c) Discuss significant matters arising during the engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
 - (d) Not date the auditor's report until the completion of the engagement quality review. (Ref: Para. A89–A92)

Differences of Opinion

34. If differences of opinion arise, within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation, the engagement team shall follow the firm's policies or procedures for dealing with and resolving them. (Ref: Para. A93–A94)
35. The engagement partner shall:
- (a) Take responsibility for differences of opinion being dealt with and resolved in accordance with the firm's policies or procedures;

¹⁷ ISA 701, *Communicating Key Audit Matters in the Auditor's Report*

- (b) Determine that conclusions reached are documented and implemented; and
- (c) Not date the auditor's report until any differences of opinion are resolved.

Monitoring and Remediation

36. The engagement partner shall: (Ref: Para. A97–A98)

- (a) Be satisfied that the engagement team has been made aware of results of the firm's monitoring and remediation process, as communicated by the firm including, as applicable, the results of the monitoring and remediation process of the network or network firms;
- (b) Determine the relevance and effect on the audit engagement of the information referred to in paragraph 36(a) and take appropriate action; and
- (c) Remain alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicate such information to those responsible for the process.

Taking Overall Responsibility for Managing and Achieving Quality

37. Prior to dating the auditor's report, the engagement partner shall determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner shall determine that: (Ref: Para. A99–A101)

- (a) The engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
- (b) The nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures, have been taken into account in complying with the requirements of this ISA.

Documentation

38. The auditor shall include in the audit documentation:¹⁸ (Ref: Para. A102–A104)

- (a) Matters identified, relevant discussions with firm personnel, and conclusions reached with respect to:
 - (i) Fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence.
 - (ii) The acceptance and continuance of the client relationship and audit engagement.
- (b) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement and how such conclusions were implemented.
- (c) If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed on or before the date of the auditor's report.

¹⁸ ISA 230, paragraphs 8-11 and A6

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Application and Other Explanatory Material

Scope of this ISA (Ref: Para. 1)

- A1. This ISA applies to all audits of financial statements, including audits of group financial statements. ISA 600,¹⁹ deals with special considerations that apply to group audits, in particular those that involve component auditors.
- A2. ISA 200 requires the auditor to comply with relevant ethical requirements, including those related to independence, relating to financial statement audit engagements.²⁰ Paragraphs 14–19 and A31–A41 of this ISA include requirements and guidance that deal with complying with relevant ethical requirements that are applicable given the nature and circumstances of the engagement, including those related to independence.

The Firm's System of Quality Management and Role of Engagement Teams (Ref: Para. 2 – 5)

- A3. Proposed ISQM 1 deals with a firm's responsibilities for its system of quality management. A system of quality management is designed, implemented and operated by a firm in accordance with proposed ISQM 1 and is organized into the following eight components:
- Governance and leadership;
 - The firm's risk assessment process;
 - Relevant ethical requirements;
 - Acceptance and continuance of client relationships and specific engagements;
 - Engagement performance;
 - Resources;
 - Information and communication; and
 - The monitoring and remediation process.
- A4. Firms or national requirements may use different terminology or frameworks to describe components of a system of quality management. National requirements that deal with the firm's responsibilities to design, implement, and operate a system of quality management are at least as demanding as proposed ISQM 1 when they deal with all the components referred to in paragraph A3 and impose obligations on the firm to achieve the objective set out in proposed ISQM 1.

Implementing the Firm's Responses to Quality Risks That Are Applicable to the Audit Engagement (Ref: Para. 4(a))

- A5. Quality management at the engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with proposed ISQM 1, the firm is responsible for communicating to relevant personnel, including the engagement team, about their responsibilities for implementing the firm's responses that are

¹⁹ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

²⁰ ISA 200, paragraph 14.

applicable at the engagement level. For example, such firm level responses may include policies or procedures to undertake consultations with designated personnel in certain situations involving complex technical or ethical matters, or to involve firm-designated experts in specific engagements to deal with particular matters (e.g., the firm may specify that firm-designated credit experts are to be involved in auditing credit loss allowances in all audits of financial institutions).

- A6. Firm level responses may include policies or procedures established by a network, or by another firm or group of firms within the same network (network requirements or network services are described further in proposed ISQM 1 within the “Network Requirements or Network Services” section). The requirements of this ISA are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network resources or services or the work of network resources or services on the audit engagement.

Other Firm Level Responses That May be Relevant to the Engagement Team (Ref: Para. 4(a))

- A7. Some firm level responses to quality risks are not performed at the engagement level but are nevertheless relevant when complying with the requirements of this ISA. For example, when determining whether the members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement, the engagement partner may be able to depend on the firm’s policies or procedures dealing with personnel recruitment and professional training. Other examples of firm level responses that the engagement partner may be able to depend on when complying with the requirements of this ISA include:

- Information systems that monitor independence;
- Information systems that deal with acceptance and continuance of client relationships and audit engagements; and
- Audit methodologies and related implementation tools and guidance.

- A8. Matters that the engagement partner may take into account when determining whether, and if so, the degree to which, the engagement partner may depend on the firm’s policies or procedures in complying with the requirements of this ISA include:

- The engagement partner’s knowledge or understanding of, or practical experience with, such policies or procedures.
- Information obtained from the firm, engagement team, or other parties, about the effectiveness of such policies or procedures (e.g., information provided by the firm’s monitoring and remediation processes that indicate that the firm’s policies or procedures are operating effectively or that do not provide any indications of deficiencies).

Designing and Implementing Responses at the Engagement Level (Ref: Para. 4(b))

- A9. Due to the specific nature and circumstances of each audit engagement and changes that may occur during the engagement, a firm cannot identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement partner exercises professional judgment in determining whether to design and implement responses, beyond those set forth in the firm’s policies or procedures, at the engagement level in order to meet the objective of this ISA.²¹ The engagement partner’s determination of whether such engagement level responses are required (and if so,

²¹ ISA 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.

what those responses are) is influenced by the requirements of this ISA, and the engagement partner's understanding of the nature and circumstances of the engagement and any changes thereto. For example, unanticipated circumstances may arise during the course of the engagement that may cause the engagement partner to request the involvement of appropriately experienced personnel in addition to those initially assigned or made available by the firm.

A10. The relative balance of the engagement partner's efforts to comply with the requirements of this ISA (i.e., between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (e.g., an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement partner's actions in complying with the engagement performance requirements of this ISA may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (e.g., planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

Providing the Firm with Information from the Audit Engagement (Ref: Para. 4(c))

A11. The firm's policies or procedures may require the engagement team to provide the firm with specific information from the audit engagement that is relevant to the design, implementation, and operation of the firm's system of quality management. During the engagement, the engagement partner may become aware (including through being informed by other members of the engagement team) that the firm's responses to quality risks are deficient in the context of the specific engagement. Providing such information to the firm may be relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit program provided by the firm does not deal with new or revised regulation, timely communication of such information to the appropriate individuals within the firm enables the firm to take steps to update and reissue the audit program to deal with such regulation.

Information Relevant to Quality Management at the Engagement Level (Ref: Para. 5)

A12. Complying with the requirements in other ISAs may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its environment required to be obtained under ISA 315 (Revised)²² provides information that may be relevant to complying with the requirements of this ISA. Such information may be relevant to the determination of:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas, or the involvement of experts to deal with complex matters;
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations;
- The nature, timing and extent of review of the work performed by members of the team based on the number and significance of the assessed risks of material misstatement; or

²² ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

- The allocation of the budgeted audit hours, including allocating more time, and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher.

Public Interest (Ref: Para. 6)

A13. Relevant ethical requirements contain requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance, the consistent performance of quality engagements forms part of the professional accountant's responsibility to act in the public interest.

Considerations Specific to Smaller Firms (Ref: Para. 2–4)

A14. In a smaller firm, the design and implementation of many responses to the firm's quality risks, may be most effectively dealt with by the engagement partner at the engagement level (i.e., given the nature and circumstances of the firm and the engagements it performs, there may be less need for firm level responses to many of the firm's quality risks). Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence, and rather, independence will be monitored at the individual engagement level by the engagement partner.

A15. If an audit is carried out entirely by the engagement partner, some requirements in this ISA are not relevant because they are conditional on the involvement of other members of the engagement team. For example, the requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

Definitions

Engagement Team (Ref: Para. 10(d))

A16. Engagement teams may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations, and may be organized in groups by activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures²³ on the audit engagement is considered to be a member of the engagement team. External experts and internal auditors providing direct assistance are not members of the engagement team. ISA 620²⁴ and ISA 610²⁵ include requirements for the auditor to comply with when using the work of an external expert or when using the work of internal auditors in a direct assistance capacity. The auditor performs audit procedures to comply with these requirements and these procedures form the basis for the auditor's determination as to whether work performed by external experts or internal auditors providing direct assistance can be used as audit evidence.

²³ ISA 500, *Audit Evidence*, paragraph A10

²⁴ See ISA 620, paragraph 12–13

²⁵ See ISA 610 (Revised 2013), paragraphs 21–25

- A17. Engagement teams may include individuals from service delivery centers who perform audit procedures. For example, the firm may determine that specific tasks that are repetitive or specialized in nature can be performed by a group of appropriately skilled personnel and the engagement team may therefore include such individuals. Service delivery centers may be established at the firm level, at the network level, or by another firm or group of firms from within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.
- A18. Engagement teams may include individuals from network firms or other firms to perform audit procedures, for example, procedures such as attending a physical inventory count or inspecting physical fixed assets at a remote location.
- A19. If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and individuals who assist the engagement quality reviewer in performing the engagement quality review, are not members of the engagement team.

Firm (Ref: Para. 10(e))

- A20. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISA. For example, the IESBA Code defines the “firm” as:
- (a) A sole practitioner, partnership or corporation of professional accountants;
 - (b) An entity that controls such parties through ownership, management or other means; and
 - (c) An entity controlled by such parties through ownership, management or other means.

In complying with the requirements in this ISA, the definitions used in the relevant ethical requirements apply in so far as is necessary to interpret those ethical requirements.

“Network” and “Network Firm” (Ref: Para. 10(f)–10(g))

- A21. The definitions of “network” or “network firm” in relevant ethical requirements may differ from those set out in this ISA. The IESBA Code also provides guidance in relation to the terms “network” and “network firm.” Networks and the firms within the network may be structured in a variety of ways, and are in all cases external to the firm. The provisions in this ISA in relation to networks apply to any structures or organizations that do not form part of the firm, but that exist within the network.

Leadership Responsibilities for Managing and Achieving Quality on Audits (Ref: Para. 11–13)

Taking Overall Responsibility for Managing and Achieving Quality

- A22. The engagement partner’s responsibility for managing and achieving quality is supported by a firm culture that promotes the conduct of quality audit engagements. In addressing the requirements in paragraphs 11 and 12, the engagement partner may communicate directly and reinforce this communication through personal conduct and actions (e.g., leading by example). A commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement.
- A23. The nature and extent of the actions of the engagement partner to reflect the firm’s commitment to quality may depend on a variety of factors including the size, structure, geographical dispersion and complexity of the firm, and the nature and circumstances of the audit engagement. With a smaller engagement team, with few engagement team members, influencing the desired culture through

direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary.

Sufficient and Appropriate Involvement

A24. Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including:

- Taking responsibility for the nature, timing and extent of the direction and supervision of members of the engagement team, and the review of the work performed in complying with the requirements of this ISA;
- Varying the nature, timing and extent of such direction, supervision, and review, in the context of the nature and circumstances of the engagement.

Communication

A25. Communication is the means through which the engagement partner and the members of the engagement team share relevant information on a timely basis in order to comply with the requirements of this ISA, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team, or with:

- (a) The firm, such as with personnel performing activities within the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management;
- (b) Others involved in the audit (e.g., an auditor's external expert or component auditor); and
- (c) Parties that are external to the firm (e.g., management, those charged with governance, or regulatory authorities).

A26. The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the most appropriate means of effective communication with the engagement team members. For example, in-person and more frequent interactions are likely to be a more effective way to direct and supervise less experienced team members.

Professional Skepticism

A27. As explained in paragraph 7, professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, the overall effectiveness of the engagement team in achieving quality at the engagement level. In some circumstances the engagement partner may need to deal with impediments to the exercise of professional skepticism at the engagement level such as:

- Tight deadlines or budget constraints may negatively affect the behavior of those who perform the work as well as those who direct, supervise and review it;
- Lack of cooperation or undue pressures imposed by management may negatively affect the engagement team's ability to resolve complex or contentious issues;
- Insufficient emphasis on the importance of quality may undermine the exercise of professional skepticism by the engagement team;

- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions;
- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible; and
- Overreliance on tools and templates may undermine the exercise of professional skepticism by the engagement team.

A28. Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including for example, the selection of an audit approach, performance of audit procedures, or evaluation of audit evidence. Examples of unconscious auditor biases that may affect the exercise of professional skepticism, and therefore the reasonableness of the professional judgments made by the engagement partner in complying with the requirements of this ISA, include:

- Availability bias, which involves considering information that is easily retrievable from memory as being more likely, more relevant, and more important for a judgment.
- Confirmation bias, which involves seeking, and treating as more persuasive, information that is consistent with initial beliefs or preferences.
- Overconfidence bias, which involves overestimating one's own abilities to perform tasks or to make accurate assessments of risk or other judgments and decisions.
- Anchoring bias, which involves making assessments by starting from an initial numerical value and then adjusting insufficiently away from that initial value in forming a final judgment.

A29. Possible actions that the engagement partner may take to deal with impediments to the exercise of professional skepticism at the engagement level include:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement, and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement;
- Explicitly alerting the engagement team to instances or situations when vulnerability to unconscious or conscious auditor biases may be greater (e.g., areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures (see paragraph A28);
- Changing the composition of the engagement team assigned, for example, involving more experienced staff in order to obtain greater skills or knowledge or specific expertise;
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with;
- Involving members of the engagement team with specialized skills and knowledge, or an auditor's expert to deal with complex or subjective areas of the audit;
- Modifying the nature, timing and extent of direction and supervision of engagement team members, and review of their work, for complex or subjective areas of the audit, including

involving more experienced members of the team, more in-person oversight on a more frequent basis and more in-depth reviews of certain working papers;

- Setting expectations for:
 - Less experienced members of the engagement team to seek advice frequently and on a timely basis from more experienced team members or the engagement partner;
 - More experienced team members to be available to less experienced members of the engagement team throughout the audit and to respond positively and on a timely basis to their insights, requests for advice, or assistance; and
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought.

Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team (Ref: Para. 13)

A30. The engagement partner is ultimately responsible and therefore accountable for managing and achieving quality on the audit engagement. However, it will generally not be possible or practical for all of the requirements in this ISA to be dealt with solely by the engagement partner (e.g., due to the nature and size of the entity, or the complexity of the audit and the need for specialized skills or expertise). In managing quality at the engagement level, the engagement partner may therefore assign responsibility for procedures, tasks, or other actions to appropriately skilled or suitably experienced members of the engagement team who assist the engagement partner in complying with the requirements of this ISA. For example, engagement team members other than the engagement partner may be assigned supervisory roles.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: Para. 14–19)

Relevant Ethical Requirements

A31. ISA 200²⁶ requires that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, there may be requirements related to independence that are applicable only when performing audits of listed entities.

A32. Based on the nature and circumstances of the audit engagement, certain relevant ethical requirements, or aspects of law or regulation, may be of significance to the engagement, for example law or regulation dealing with money laundering, corruption, or bribery.

Firms Policies or Procedures to Deal With Relevant Ethical Requirements

A33. Information and communication, and resources provided by the firm may assist the engagement partner and other members of the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement in accordance with paragraphs 14–19. For example:

²⁶ ISA 200, paragraphs 14 and A16-A19

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
 - Providing training for personnel on relevant ethical requirements.
 - Establishing manuals and guides (i.e., intellectual resources), containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
 - Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements (e.g., ISQM 1 requires that the firm obtain, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or to provide consultation on matters related to relevant ethical requirements.
 - Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner, such as requirements for engagement teams or personnel to:
 - Communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.
 - Communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and if it is not, address the threat by eliminating it or reducing it to an acceptable level.
 - Promptly communicate any breaches of the relevant ethical requirements, including those related to independence.
 - Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.
- A34. The engagement partner may take into account the information, communication and resources described in paragraph A33 when determining whether, and if so, the degree to which, the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements. For example, the engagement partner may be able to depend on information systems that monitor independence. See paragraphs A7–A8.
- A35. Open and robust communication between the engagement partner and the members of the engagement team about relevant ethical requirements may also assist in:
- Drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement; and
 - Keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

Identifying and Evaluating Threats to Compliance with Relevant Ethical Requirements (Ref: Para. 15–16)

- A36. In accordance with proposed ISQM 1, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence, include policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed.
- A37. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be dealt with. For example, the IESBA Code explains that a self-interest threat to compliance with the fundamental principle of professional competence and due care may arise if the fee quoted for an audit engagement is so low that it might be difficult to perform the engagement in accordance with professional standards.

Actual or Suspected Breaches of Relevant Ethical Requirements (Ref: Para. 17)

- A38. In accordance with proposed ISQM 1, the firm is required to establish policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches.

Taking Appropriate Action (Ref: Para. 18)

- A39. Appropriate actions may include, for example:
- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate personnel within the firm so that appropriate action can be taken, including as applicable, disciplinary action(s);
 - Communicating with those charged with governance;
 - Communicating with regulatory authorities. In some circumstances, communication with regulatory authorities may be required by law or regulation;
 - Seeking legal advice; or
 - Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Prior to Dating the Auditor's Report (Ref: Para. 19)

- A40. ISA 700 (Revised) requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.²⁷ Performing the procedures required by paragraphs 14–19 of this ISA provides the basis for these statements in the auditor's report.

Considerations Specific to Public Sector Entities

- A41. Statutory measures may provide safeguards for the independence of public sector auditors. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 14. This may include, where the public

²⁷ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 28(c)

sector auditor's mandate does not permit withdrawal from the audit engagement, disclosure through a public report of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 20–22)

- A42. Proposed ISQM 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances.
- A43. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:
- The integrity and ethical values of the principal owners, key management and those charged with governance of the entity;
 - Whether there are sufficient and appropriate resources to perform the engagement;
 - Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement;
 - Whether the engagement team has the competence and capabilities, including sufficient time to perform the engagement;
 - Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement.
- A44. Under proposed ISQM 1, for acceptance and continuance decisions, the firm is required to make appropriate judgments about whether it will have access to information to perform the engagement, or to the persons who provide such information. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process.
- A45. If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained, or used by the firm, in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner being satisfied that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.
- A46. Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this ISA and making informed decisions about appropriate courses of action. For example:
- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework;
 - The entity's timetable for reporting, such as at interim and final stages;
 - In relation to group audits, the nature of the control relationships between the parent and its components; and

- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement which may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed.
- A47. Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other ISAs, as well as this ISA, for example with respect to:
- Establishing an understanding of the terms of the audit engagement, as required by ISA 210;³
 - Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with ISA 315 (Revised) and ISA 240;²⁸
 - Understanding the group, its components, and their environments, in the case of an audit of group financial statements in accordance with ISA 600, and directing, supervising and reviewing the work of component auditors;
 - Determining whether, and how, to involve an auditor's expert in accordance with ISA 620; and
 - The entity's governance structure in accordance with ISA 260²⁹ and ISA 265.³⁰
- A48. Law, regulation, or relevant ethical requirements may require the auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected non-compliance with laws and regulations to the proposed successor auditor. For example, if the predecessor auditor has withdrawn from the engagement as a result of identified or suspected non-compliance with laws and regulations, the IESBA Code requires that the predecessor auditor, on request by a proposed successor auditor, provide all such facts and other information concerning such non-compliance that, in the predecessor auditor's opinion, the proposed successor auditor needs to be aware of before deciding whether to accept the audit appointment.
- A49. In circumstances when the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement in complying with the requirement in paragraph 21.
- A50. In deciding on the necessary action in accordance with paragraph 22, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement, and if so, what additional steps are necessary at the engagement level (e.g., the assignment of more staff, or staff with particular expertise). If the engagement partner has further concerns and is not satisfied that the matter has been appropriately dealt with, the firm's policies or procedures for resolving differences of opinion may be applicable.

Considerations Specific to Public Sector Entities (Ref: Para. 20–22)

- A51. In the public sector, auditors may be appointed in accordance with statutory procedures and the public sector auditor may not need to establish all policies or procedures regarding the acceptance

²⁸ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

²⁹ ISA 260 (Revised), *Communication with Those Charged with Governance*

³⁰ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

and continuance of audit engagements. Nevertheless the requirements and considerations for the acceptance and continuance of client relationships and engagements as set out in paragraphs 20–22 and A42–A47 may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Engagement Resources (Ref: Para. 23–26)

A52. Under proposed ISQM 1, the resources assigned, allocated, or made available by the firm to support the performance of audit engagements include:

- Human resources;
- Technological resources; and
- Intellectual resources.

Under proposed ISQM 1, the firm's quality objectives are required to address appropriately obtaining, developing, using, maintaining, allocating and assigning such resources in a timely manner to enable the design, implementation and operation of the system of quality management. Based on the nature and circumstances of the engagement the engagement partner may be able to depend on the firm's policies or procedures that address the quality risks related to such quality objectives when complying with the requirements in paragraphs 23–26 of this ISA (see also paragraphs A7–A8).

A53. A relevant consideration for the engagement partner, in complying with the requirements in paragraph 23 and 24, is whether the resources assigned or made available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles, such as professional competence and due care.

Human Resources

A54. Human resources assigned or made available by the firm include members of the engagement team and, where applicable, external experts. In addition, as provided for by ISA 610 (Revised 2013) individuals from within the entity's internal audit function may provide direct assistance.

A55. An engagement team includes any individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes, information technology, or in using automated tools to analyze complex data or to perform statistical analysis.

Technological Resources

A56. The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technology may allow the auditor to more effectively and efficiently manage the audit. Technology may also allow the auditor to evaluate large amounts of data more easily in order to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Inappropriate use of such technological resources may however increase the risk of overreliance on the information produced for decision purposes, or may create threats to

complying with relevant ethical requirements, for example, those requirements related to confidentiality.

- A57. The firm's policies or procedures may set forth required considerations or responsibilities for the engagement team when using firm approved technology to perform audit procedures and may require the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output.
- A58. The firm's policies or procedures may specifically prohibit the use of certain technological resources (e.g., software that has not yet been specifically approved for use by the firm) or may include requirements to seek approval to use a new technological resource. In some circumstances the firm's policies or procedures may not specifically deal with the use of a specific technological resource (e.g., a spreadsheet developed by the engagement team or obtained from outside the engagement team or the firm). In these circumstances, the engagement partner may apply professional judgment in considering whether the use of the resource on the audit engagement is appropriate in the context of the engagement, and if so, how the technological resource is to be used.

Intellectual Resources

- A59. Intellectual resources include, for example, firm, network firm, or network audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms.
- A60. The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, laws and regulations, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, industry-specific methodology or related guides and performance aids.

Sufficient and Appropriate Resources to Perform the Engagement (Ref: Para. 23)

- A61. In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team by the firm, the engagement partner may be able to depend on the firm's related policies or procedures as described in paragraph A7. Matters that the engagement partner may take into account when making such a determination are described in paragraph A8. For example, the engagement partner may be able to depend on the firm's technological development and maintenance programs when using firm approved technology to perform audit procedures based on information communicated by the firm.

Competence and Capabilities of the Engagement Team (Ref: Para. 24)

- A62. When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's:
- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
 - Understanding of professional standards and applicable legal and regulatory requirements.
 - Expertise in specialized areas of accounting or auditing.

- Expertise in information technology used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- Knowledge of relevant industries in which the entity being audited operates.
- Ability to exercise professional skepticism and apply professional judgment.
- Understanding of the firm's policies or procedures.

Project Management

A63. In situations where there are many engagement team members, for example on larger, or more complex, audit engagements, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, for a smaller engagement team with fewer engagement team members, project management may be achieved through less formal means.

A64. Project management techniques and tools may support the engagement partner and the other members of the engagement team in managing the quality of the audit engagement by, for example:

- Increasing the engagement team's ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism;
- Facilitating timely performance of audit work to more effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise;
- Monitoring the progress of the audit against the audit plan,³¹ including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources;
- Assisting the engagement partner in taking responsibility for the direction and supervision of engagement team members and the review of their work (see paragraph 27); or
- Coordinating arrangements with component auditors and auditor's experts.

Insufficient or Inappropriate Resources (Ref: Para. 25)

A65. Proposed ISQM 1 requires that the firm's quality objectives include that the firm's strategic decisions and actions, including financial and operational priorities, reflect the firm's commitment to quality and do not undermine the firm's role in serving the public interest by consistently performing quality engagements. However, in certain circumstances the firm's financial and operational priorities may place constraints on the resources assigned or made available to the engagement team.³² In such circumstances, these constraints do not override the engagement partner's responsibility for achieving quality at the engagement level, including for becoming satisfied that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement.

A66. The engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this ISA and

³¹ ISA 300, paragraph 9

³² See also paragraph A37.

the nature and circumstances of the audit engagement. If the engagement partner determines that the resources assigned or made available by the firm are insufficient or inappropriate in the circumstances of the engagement and additional or alternative resources have not been made available, the engagement partner is required to take appropriate action. In such cases, appropriate actions may include:

- If possible, discussing an extension to the reporting deadlines with management or those charged with governance.
- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement.
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Considerations Specific to Public Sector Entities (Ref: Para. 23–26)

A67. In the public sector, specialized skills may be necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such skills may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing.

Engagement Performance

Direction, Supervision and Review (Ref: Para. 27)

- A68. Under proposed ISQM 1, the firm is required to establish policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members.
- A69. Direction and supervision of the engagement team and the review of the work of the engagement team are firm level responses that are implemented at the engagement level of which the nature, timing and extent may be further tailored by the engagement partner in managing quality of the audit engagement. Accordingly, the approach to direction, supervision and review will take into account the nature and circumstances of the engagement and will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses. The approach will vary from one engagement to the next.
- A70. The approach to the direction and supervision of the members of the engagement team and the review of the work performed provides support for the engagement partner in addressing the requirements in this ISA, as well as the conclusion that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph 37.
- A71. Ongoing discussion and communication among members of the engagement team allows less experienced team members to raise questions with more experienced team members (including the engagement partner) on a timely basis and enables effective direction, supervision and review in accordance with paragraph 27(c).

Direction

A72. Direction of the engagement team may involve informing the members of the engagement team of matters such as:

- The responsibility for all engagement team members for contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions.
- The importance of maintaining a questioning mind and being aware of unconscious or conscious auditor biases in exercising professional skepticism in gathering and evaluating audit evidence (see paragraph A29).
- Their responsibilities to fulfill relevant ethical requirements.
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- Respective roles and responsibilities of the engagement team members in performing audit procedures and the roles of more experienced team members in directing, supervising and reviewing the work of less experienced team members.
- The objectives of the work to be performed and detailed instructions regarding the nature, timing and extent of planned audit procedures as set forth in the overall audit strategy and audit plan.
- Threats to the achievement of quality, and the engagement team's expected response in this regard. For example, budget constraints or resource constraints should not result in the engagement team members modifying planned audit procedures or failing to perform planned audit procedures.

Supervision

A73. Supervision includes matters such as:

- Tracking the progress of the audit engagement, which includes:
 - Monitoring the progress against the audit plan;
 - Monitoring whether the objective of work performed has been achieved;
 - Monitoring the ongoing adequacy of assigned resources.
- Taking appropriate action to address issues arising during the engagement, including for example, reassigning planned audit procedures to more experienced members of the engagement team when issues are more complex than initially anticipated.
- Addressing matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.
- Providing coaching and on-the-job training to help engagement team members develop skills or competencies.

- Creating an environment where engagement team members raise concerns without fear of reprisals.

Review

A74. Review of work performed provides support for the conclusion that the requirements of this ISA have been addressed.

A75. Review of work performed consists of consideration of whether, for example:

- The work has been performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the audit procedures have been achieved.

A76. The firm's policies or procedures may contain specific requirements regarding:

- The nature, timing and extent of review of audit documentation;
- Different types of review that may be appropriate in different situations (e.g., detailed review of each individual working paper or a high-level review of selected working papers); and
- Which members of the engagement team are required to perform the different types of review.

The Engagement Partner's Review of Work Performed (Ref: Para. 28–31)

A77. The firm's policies or procedures may specify the nature, timing and extent of the engagement partner's review. As required by ISA 230, the partner documents the extent and timing of the review.³³

A78. Timely review by the engagement partner at appropriate stages during the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation but may do so.

A79. The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team, for example:

- Matters related to planning the engagement such as matters related to determining materiality;
- The composition of the engagement team, including:

³³ ISA 230, paragraph 9(c)

- Personnel using expertise in a specialized area of accounting or auditing;
 - The use of personnel from service delivery centers;
 - The decision to involve an auditor's expert, including the decision to involve an external expert;
 - The engagement team's consideration of risks identified through the acceptance and continuance process and proposed responses to those risks;
 - The engagement team's risk assessment process, including situations where consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team;
 - The engagement team's consideration of related party relationships and transactions and disclosures;
 - Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions in respect of certain estimates, accounting policies, or going concern considerations;
 - The engagement team's evaluation of the work performed by experts and conclusions drawn therefrom;
 - In group audit situations:
 - The proposed overall group audit strategy and group audit plan, including the identification of significant components;
 - Decisions about the involvement of component auditors, including how to direct and supervise their work. For example, if a component auditor is located in a jurisdiction or a firm with significant audit inspection findings, then judgments about their involvement in the engagement and the direction, supervision and review of their work are likely to be more significant; and
 - The evaluation of work performed by component auditors and the conclusions drawn therefrom.
 - How matters affecting the overall audit strategy and audit plan have been addressed;
 - The significance and disposition of corrected and uncorrected misstatements identified during the engagement; or
 - The engagement team's proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.
- A80. The engagement partner uses professional judgment in determining other matters to review, for example based on:
- The nature and circumstances of the audit engagement.
 - Which engagement team member performed the work.
 - Matters relating to recent inspection findings.
 - The requirements of the firm's policies or procedures.

Nature, Timing and Extent (Ref: Para. 27)

- A81. In accordance with paragraph 27(a), the nature, timing and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm's policies or procedures. For example, the firm may require that work planned to be performed at an interim date be directed, supervised, and reviewed at the same time as the performance of the procedures rather than at the end of the period so that any necessary corrective action can be taken on a timely basis.
- A82. In accordance with paragraph 27, the engagement partner is responsible for the nature, timing and extent of direction and supervision of the engagement team and the review of the work performed. The engagement partner may tailor the approach to direction, supervision and review depending on, for example:
- The engagement team member's previous experience with the entity and the area to be audited. For example, if the work related to the entity's information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and frequency of the direction and supervision of the engagement team member may be less and the review of the related working papers may be less detailed.
 - The complexity of the entity, including whether there are significant events that have occurred at the entity or in the industry in which the entity operates since the previous audit engagement or during the current engagement.
 - The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of direction and supervision of engagement team members, and a more detailed review of their work.
 - The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced team members may require more detailed instructions and more frequent, or in person, interactions as the work is performed.
 - The manner in which the engagement partner and manager reviews of work performed are expected to take place. For example, in some circumstances remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
 - The structure of the engagement team, and location of engagement team members, including where service delivery centers are used. For example, direction and supervision of individuals located at remote service delivery centers and the review of their work may need to be more formalized and structured than when members of the engagement team are all situated in the same location.
- A83. In accordance with paragraph 27(b), the engagement partner is required to determine that the approach to direction, supervision and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced member of the engagement team becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members.

Consultation (Ref: Para. 32)

A84. Proposed ISQM 1 requires the firm to establish policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which to consult, and how the conclusions should be agreed and implemented. Consultation may be appropriate or required, for example for:

- Issues that are complex or unfamiliar (e.g., issues related to an accounting estimate with a high degree of estimation uncertainty);
- Significant risks;
- Significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual;
- Limitations imposed by management; and
- Non-compliance with law or regulation.

A85. Effective consultation on significant technical, ethical and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

A86. It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

A87. The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.³⁴

Engagement Quality Review (Ref: Para. 33)

A88. Proposed ISQM 1 requires that the firm establish policies or procedures that require an engagement quality review for certain types of engagements.³⁵ Proposed ISQM 2³⁶ deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review. National requirements that deal with the appointment and eligibility of an engagement quality reviewer and the responsibilities of the engagement quality reviewer are at least as demanding as proposed ISQM 2 when they address all of the requirements in proposed ISQM 2.

Completion of the Engagement Quality Review before Dating of the Auditor's Report (Ref: Para. 33(d))

A89. ISA 700 (Revised) requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial

³⁴ ISA 701, paragraphs 9 and A15

³⁵ Proposed ISQM 1, paragraph 40(e)

³⁶ Proposed ISQM 2, *Engagement Quality Reviews*

statements.³⁷ If applicable to the audit engagement, proposed ISQM 2 requires that the engagement quality review be completed on or before the date of the auditor's report.

- A90. The auditor's report cannot be dated until the completion of the engagement quality review. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate then the engagement quality review is not complete.³⁸
- A91. An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report.
- A92. Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the engagement partner may assign responsibility for coordinating requests from the engagement quality reviewer to another member of the engagement team.

Differences of Opinion (Ref: Para. 34)

- A93. Proposed ISQM 1 sets out requirements for the firm to establish policies or procedures to address differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation.
- A94. In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example:
- Seeking legal advice; or
 - Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Monitoring and Remediation (Ref: Para. 36)

- A95. Under proposed ISQM 1, the firm is required to establish quality objectives and responses that address the firm's monitoring and remediation process that enable the evaluation of the design, implementation and operation of the components of the system of quality management and whether the quality objectives have been achieved. In addition, the firm is required to communicate to personnel information about the firm's monitoring and remediation process to the extent that it is relevant to their responsibilities and to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. The results of the firm's monitoring and remediation activities are based on an evaluation of findings from the firm's monitoring activities, the results of external inspections and other relevant information that the firm obtains or of which the firm becomes aware.
- A96. Information provided by the firm may be relevant to the audit engagement when, for example, it deals with findings identified on another engagement done by the engagement partner or engagement team, findings from the local firm office or previous inspection results of this particular engagement.

³⁷ ISA 700 (Revised), paragraph 49

³⁸ Proposed ISQM 2, paragraph 21(b)

A97. In considering relevant information communicated by the firm and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to deal with identified deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that:

- An auditor's expert should be used;
- The nature, timing and extent of direction, supervision, and review needs to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (e.g., if it relates to a technological resource that the engagement team did not use) then no further action may be needed.

A98. A deficiency in the firm's system of quality management does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the auditor's report was not appropriate.

Taking Overall Responsibility for Managing and Achieving Quality (Ref: Para. 37)

A99. Under proposed ISQM 1, the firm is required to establish objectives relating to the engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement.

A100. Relevant considerations in addressing the requirement in paragraph 37 include determining how the engagement partner has complied with the requirements of this ISA, given the nature and circumstances of the audit engagement, and how the audit documentation evidences the engagement partner's involvement in the engagement.

A101. If the engagement's partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph 37. In addition to taking account of firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example:

- Reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner; or
- Consulting with firm personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

Documentation (Ref: Para. 38)

A102. In accordance with ISA 230,³⁹ audit documentation provides evidence that the audit complies with the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. Documentation of the performance of the

³⁹ ISA 230, paragraph A7

requirements of this ISA, including evidencing the involvement of the engagement partner, may be accomplished in different ways. For example:

- Direction of the engagement team can be documented through signoffs of the audit plan and project management activities;
- Minutes from meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions in respect of culture and expected behaviors that reflect the firm's commitment to quality;
- Agendas from discussions between the engagement partner and engagement team members, and where applicable the engagement quality reviewer, and related time records, may provide evidence of the engagement partner's involvement throughout the audit; and
- Signoffs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

A103. When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to decline the engagement (see paragraph 22), the documentation may include explanations of how the engagement team dealt with the circumstance.

A104. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The nature and scope of the issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

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NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 5.1

Meeting date: 10 April 2019

Subject: IAASB Consultation Paper-Extended External Reporting (EER) Assurance

Date: 25 March 2019

☒ **Action Required**

☐ **For Information Purposes Only**

Agenda Item Objectives

To:

- CONSIDER the International Auditing and Assurance Standard Board (IAASB)'s consultation paper
- PROVIDE feedback to be included in developing the NZAuASB's submission

Background

1. The IAASB has issued a consultation paper seeking initial feedback on Phase 1 of its EER non-authoritative guidance document. This is an interim consultation on draft guidance to assist the IAASB in updating and completing the non-authoritative guidance in Phase 2. An exposure draft of the completed document will be published for public comment in early 2020 with the aim to publish the final guidance in late 2020.
2. Feedback on the Consultation Paper is due to the IAASB by **June 21, 2019**. This is after the June meeting of the NZAuASB and therefore the objective of this agenda is to seek initial input on feedback to include in a New Zealand submission. The NZAuASB will be asked to approve a submission at the June meeting.
3. The NZAuASB has previously submitted to the IAASB in February 2017 [in response](#) to the Discussion Paper *Supporting Credibility and Trust in Emerging Forms of External Reporting*.
4. The NZAuASB has heard indicative feedback on the developing guidance when the IAASB held roundtables late 2018, including an event in both Auckland and in Australia, to inform the development of this consultation paper. In addition, the NZAuASB has heard feedback from the XRAP on the issues related to EER assurance.

5. We have included the consultation paper on the XRB website and are seeking feedback from New Zealand stakeholders by 24 May 2019. All feedback received will be brought to the June meeting for consideration.

Matters to consider

6. We have identified possible issues to raise together with some suggested areas for clarification or possible additional examples in the issues paper at agenda item 5.2. We seek feedback on all matters the Board wishes to raise in the submission.

Material Presented

Agenda item 5.1	Board Meeting Summary Paper
Agenda item 5.2	Issues Paper
Agenda item 5.3	Consultation Paper: Extended External Reporting (EER) Assurance

Matters to discuss: EER discussion paper

1. This issues paper provides an overview of the consultation paper and raises possible matters for inclusion in the NZAuASB submission. Overall, we support the development of the guidance and support the use of practical examples. As overarching feedback, we consider that the guidance could be made more user friendly, less repetitive of ISAE 3000 material and make better use of examples. The issues identified in this paper are areas where we consider the guidance could benefit from additional clarification.

The New Zealand perspective

2. The XRB has developed an EER position paper now available on the XRB website.
<https://www.xrb.govt.nz/extended-external-reporting/xrb-position-statement/>
3. In New Zealand, EER is gaining momentum, given that the NZX listing rules now include a requirement to include or explain EER type information. Few entities have issued integrated reports, including Sanford and New Zealand Post. Sanford won a Gold Award for their 2015 Annual Report and three special awards for sustainability and integrated reporting at the 2016 Australasian Reporting Awards. We are aware of other entities preparing to issue or investigating preparing integrated reports.
4. Reporting of service performance information, a more limited form of emerging external reporting, has been common in the Public Sector of New Zealand for many years. This information has historically been audited in conjunction with the audit of the financial statements. Whilst service performance is not as broad as integrated reporting, it is a form of more holistic external reporting, whereby the entity is required to tell its performance story. The NZAuASB has considered many of the key challenges addressed in the IAASB's consultation paper, in the context of developing NZ AS 1 *The Audit of Service Performance Information*.

Key issues to consider

5. Our overarching comment is that the guidance is very lengthy. To make the guidance most user friendly, we would limit repeating ISAE 3000 but rather concentrate on the examples and practical guidance on how to apply ISAE 3000 to EER. We recognize the importance of ISAE 3000 as the standard on which the guidance is based, but consider that an upfront statement that contextualizes that this guidance is built on ISAE 3000 and should be read in conjunction with ISAE 3000 rather than repeating the standard may reduce the bulk of the document and add the most value for the practitioner.
6. We support the use of examples, although consider that some of the examples could be strengthened, possibly by flowing one example throughout the document to provide a clear example that relates to EER. (For particular, the apple example in the supplementary material does not appear to relate to or assist in the application to EER.)
7. We have identified the following key issues to explore further:

- a. Is linking the preconditions and the system of internal control contradicting or conflicting with the requirements of ISAE 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*?
 - b. Is the delineation between the preconditions for an assurance engagement and performing the engagement clear?
 - c. Is the distinction between materiality and materiality process clear and do you consider that it is useful to have a separate chapter on the suitability of the criteria and the materiality process?
- 8. A key challenge for both preparer and practitioner may be a lack of developed integrated thinking, together with a lack of controls and processes to capture the necessary information needed to prepare EER. We consider that the need for integrated thinking prior to the development of controls and processes could be emphasized more.
- 9. We have identified the following paragraphs for possible clarification:
 - a. Paragraph 67 - Consideration of the preparers 'integrated' thinking and readiness to report, as an overarching consideration prior to the detailed processes described in paragraph 67 should also be covered by the guidance.
 - b. Paragraph 71 could not only focus on the process to prepare but include a higher level of governance over what and how best to report.

Re-ordering paragraph 71 to bring Governance and Oversight before the paragraphs on reporting system could be another way to reinforce this. Also amending the diagram in paragraph 62 to have the governance and oversight as an overarching component.

- 10. The challenge related to a lack of controls is covered by the guidance. This issue arising is whether the guidance is sufficiently clear to assist the practitioner deal with this challenge.
- 11. We have heard from stakeholder outreach that there is a general lack of understanding in the preparer community around controls and the preconditions for assurance. Where an entity voluntarily seeks assurance, they may be surprised at the need for controls and processes to support the EER, and therefore in practice, we understand that the current focus from assurance practitioners is in the "assurance readiness" phase, working with clients as they develop their EER, to assist them focus on developing systems that will be "assurable" in the longer term as well as provide better quality information.
- 12. This is a costly exercise and may actually be a barrier for preparers when faced with voluntary reporting of EER. There may not be a declining cost over time either as reporting continuously evolves.
- 13. A key message that the NZAuASB has previously stressed is that the assurance process should not be a barrier to innovation and should encourage preparers on the journey rather than stunt innovation in this space. In addition, the NZAuASB has emphasized a focus on the need for integrated thinking prior to the establishment of siloed processes and policies to prepare EER.
- 14. The need for robust systems that are capable of developing information that can be verified is a precondition for an assurance engagement, i.e. one must expect to be able to get the evidence

needed to support the conclusion for there to be a valid purpose for the engagement. Therefore, we would support that this be included in the guidance and that this is not in conflict with ISAE 3000 (Revised).

15. However, the distinction between what falls within assessing the “precondition” based on preliminary knowledge as opposed to performing detailed walk throughs or testing (i.e., the knowledge needed to make a complete assessment is unlikely to be able to be made without starting to perform some detailed work is a practical challenge. Performing work to understand the control systems (walk through procedures) is not typically done as part of the acceptance of an engagement in practice. This is part of performing the assurance engagement.
16. The focus on the ‘assurance readiness’ work is therefore a useful addition to the guidance since the previous drafts discussed by the NZAuASB. However, it is not as clear cut where there is mandatory assurance required, or where no assurance readiness work is performed, as in the area of service performance information.
17. We suggest that this delineation could be clarified in the guidance, to cater for types of EER where this ‘assurance readiness’ type of work is not practicable.
18. An overarching comment would be that the guidance on the preconditions seems to set a very high barrier to accepting an assurance engagement. Practically, we consider that the practitioner may be unlikely to be able to reach a final conclusion on the suitability of the criteria, understand the materiality process and identify whether the internal control system is robust enough to be able to provide the evidence needed to conclude, until the practitioner has actually started to gain the understanding and do a system walk through that is traditionally performed as part of the assurance engagement.
19. We consider that the guidance may need to recognize even further that preparers are on a journey to evolve their reporting, and that the assurance practitioner needs to be able to evolve with them. On this journey some of the measures reported may be able to be assured and some may not. It may however not be as black and white as accepting and scoping the engagement accordingly, but rather may be more appropriate to report on this journey. This is something that the NZAuASB recognized in developing NZ AS 1, i.e., by encouraging the assurance practitioner to include recommendations in the assurance report.
20. If a readiness assessment is not performed separately, in many instances it is unclear how a practitioner would practically be able to determine whether the preconditions have been met, based only on a preliminary knowledge. Examples of where we consider that the delineation between ‘precondition’ and ‘the work performed as part of the assurance engagement’ could be made clearer are in the following paragraphs in the consultation paper:
 - a. The section ‘Responses where the Preconditions are not Present’, paragraphs 75-77 could be revised to highlight this point. In particular, further clarification is needed as to when reference to ISAE 3000 can be made or not, as described in paragraph 77. The distinction between referring to ISAE 3000 in paragraph 123 and not doing so as described in paragraph 77 should be clarified. Rather than prohibiting reference to ISAE 3000, it may be more useful to highlight that the practitioner may need to direct the work effort to an assurance readiness type of engagement rather than an assurance

engagement, (i.e., redirect the assurance practitioner to where on the spectrum of services the preliminary knowledge is directing the assurance practitioner) rather than just prohibit a reference to ISAE 3000.

The NZAuASB's experience in developing NZ AS 1, would indicate that auditors will be required to undertake assurance engagements by law or regulation, even where an entity is in an early stage of developing its SPI reporting. In some instances, the preparer may be able to produce some information that is able to be assured and some that is not due to a lack of maturity in internal controls, resulting in a situation where the auditor is unable to obtain sufficient evidence to support their conclusion. In this instance, the auditor would modify the conclusion appropriately, however further explanation as to why a reference to ISAE 3000 is not appropriate would be useful or clarification as to when such a reference may be made. The example in paragraph 77 seems at odd with the approach taken in NZ AS 1.

- b. Paragraph 107 - that references underlying data and source information to be sufficiently accurate and complete and for it to be collected and processed in a neutral manner may be beyond an evaluation of whether the criteria are reliable. This strays into testing how the preparer has applied the criteria to its circumstances. This would fall into the evidence gathering procedures to be performed by the practitioner. It is important to delineate between an evaluation of the suitability of the criteria (as a precondition for accepting the engagement) based on a preliminary knowledge versus the testing of the application of the criteria by the preparer, which is part of conducting the assurance engagement.
 - c. This is exacerbated by the example in paragraph 114 on water intake. Concerns related to whether water meters have been expertly calibrated and on what days the readings are taken, appear to blur the line between an assessment of the suitability of the criteria and whether there is a material misstatement in the measures reported. Practically this level of detail would not be evident at the acceptance stage.
 - d. Paragraph 117 could be extended to include where changes are made to criteria as the entity develops systems and processes to support alternative criteria. This is reflective of the journey that entities may be on in developing the EER report. It may be that this year on year innovation never ends as entities continue to refine their EER information, and as the priorities and risks to be reported against change over time.
 - e. Paragraph 128 references the requirement to consider the process used to prepare the subject matter information or to obtain an understanding of internal control over the preparation of the subject matter information. Clarification around where in the process this consideration or understanding fits would be useful, rather than to start blurring this with the preconditions for an engagement.
21. In terms of structuring the guidance, this emphasis on the iterative nature of these evaluations and assessments on suitability of criteria, the appropriateness of the internal controls and the consideration of the materiality process could be further emphasized.
22. We also wondered whether separating the chapter on the suitability of the criteria (Chapter 7) and the consideration of the 'materiality process' (chapter 8) adds an element of confusion, and

may exaggerate this compartmentalization, rather than emphasizing the iterative nature of the evaluation.

23. Indicative feedback at the roundtable discussions highlighted mixed views on whether identification of 'what to report on' is linked to materiality. Separating the terms and highlighting the difference is helpful, however there remains the matter that if a significant matter is omitted, then this may result in a material misstatement. This cannot be limited to just a precondition for the engagement, but may be a conclusion after performing the assurance procedures.
24. The guidance in Phase 2 on performance materiality will be challenging. NZ AS 1 identified that it is difficult to conclude on overall SPI information, as well as whether a material misstatement exists within one measure. These matters are not mutually exclusive.

25. The NZAuASB is asked for views on:

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| <ol style="list-style-type: none">a. the emphasis on internal controls in the guidance and whether you consider this to be contrary to ISAE 3000;b. the delineation between preconditions and performing the assurance engagement;c. the distinction between materiality and materiality process. |
|--|

Other Matters to raise in developing a submission arranged by question

Does the draft guidance adequately address the challenges for practitioners which have been identified as the scope of the draft guidance developed in phase 1? If not, where and how should it be improved?

Paragraphs 9-15 (scope of draft guidance)

26. The following matters have been identified as possible additional areas to raise:
 - a. Applying appropriate skills in an EER assurance engagement will be considered in phase 2. It is however unclear what would be addressed in phase 2. Under the 'obtaining evidence' heading in Chapter 2, the consultation papers states that use of experts and the work of another practitioner are outside the scope of this guidance. In practice, the need to use experts or the work of another practitioner is a particular challenge where additional guidance and examples would be welcomed.
 - b. Other information has also been identified as outside the scope of the guidance. Other information that has been scoped out of an EER assurance engagement (that will be covered in scoping the engagement) is also a particular challenge for practitioners. Additional guidance and examples would be welcomed after paragraph 57 of the guidance.
 - c. Guidance on how to make the criteria available to intended users in Phase 2. This may be linked to the reporting but not always. The requirement in ISAE 3000 (Revised) for the practitioner to evaluate whether the criteria are available to intended users proved to be a challenge when developing NZ AS 1. It is unclear from paragraph 37 of the draft

guidance as to whether this will be covered in Phase 2. Adding additional guidance in Chapter 3 and/or when developing guidance on reporting would be useful.

The example of water intake in paragraph 107 could be used to clarify this point. Is reporting xx litres of water, making the criteria available?

Paragraph 116 clearly articulates a key issue discussed in developing NZ AS 1 – i.e. the multiple layers within criteria. Additional guidance on how to refer to this multiple layering of criteria in the assurance report would be helpful to address in phase 2.

Paragraph 25 (preconditions and the system of internal control)

27. Possible matters to raise include:

- a. Paragraph 49 - The NZAuASB received feedback when developing NZ AS 1, that it is more appropriate for the practitioner to evaluate the entity's process for identifying intended users and evaluating whether this is reasonable, rather than expecting the practitioner to identify intended users. The intended users may also be defined by the EER framework that is used and may be narrowly or more broadly defined by these frameworks.
- b. Matters identified as key matters above, including a caution that a focus on the maturity of the 'controls' may be a restrictive way of describing the need for a maturity of thinking that is a precursor to prepare many types of EER.

Paragraph 29 (suitability of criteria)

28. Possible matters to raise include:

- a. Matters identified as key matters above, i.e. the guidance in paragraph 107, that requires the underlying data and source information to be sufficiently accurate and complete and for it to be collected and processed in a neutral manner is beyond an evaluation of whether the criteria are reliable. This strays into testing how the preparer has applied the criteria to its circumstances.
- b. Support for including guidance as developed in paragraph 116. This has been a key challenge addressed by the NZAuASB in developing NZ AS 1. We urge the IAASB to extend this guidance when developing guidance on reporting in Phase 2, i.e. how to refer to this dual level of 'criteria' in the assurance report.

Paragraph 33 ('materiality processes')

29. Possible matters to raise include:

- a. The issue of who the intended users are is an important one where we have heard feedback that this may be broader than the traditional intended users of financial statements. On the other hand, there is a caution against extending the net too wide, i.e. it is not possible to cover every and all users, and neither the preparer nor the practitioner should be identifying all stakeholders as intended users. The differing

information needs of various users is a key challenge. The guidance clarifies the different types of intended users to think about and we consider helpfully emphasizes that the intended users may be defined by the preparer and the EER framework selected. Linking the idea of the intended user as identified by the preparer, to the purpose of the assurance engagement may need to be further emphasized.

- b. How to clarify where consideration of the materiality process fits in. By separating this chapter from the chapter on suitable criteria, it may confuse practitioners as to how this step fits in with ISAE 3000. For example, the examples in paragraph 149 link closely to relevance under the suitability of the criteria.
- c. Caution against the practitioner establishing reporting requirements. Where the EER framework has no materiality process requirements or reporting requirements, it may not be appropriate for the practitioner to encourage a preparer to disclose details of the materiality process. (refer to paragraph 164).

Paragraph 35 (materiality of misstatements)

- 30. We seek feedback as to whether the distinction between materiality of misstatements and a preparers materiality process is clear.

Paragraph 40 (assertions)

- 31. Possible matters to raise include:
 - a. The NZAuASB has discussed the link between suitable criteria and assertions. In discussion on NZ AS 1, analogy was drawn between suitable criteria and the qualitative characteristics rather than the qualitative characteristics and the assertions. (Refer to paragraph 171). The link between the three could be made clearer (Refer to paragraph 174)
 - b. It is unclear what paragraph 172 means when it states 'Assertions are used by the practitioner at the level of the categories into which they fall rather than at the level of detailed assertion about aspects of the subject matter information' or how this will assist the practitioner.

Paragraph 41 (narrative and future-oriented information)

- 32. No specific matters identified. Indicative feedback highlighted that practitioners may find the idea of assuring future oriented information difficult but were more comfortable to consider whether assumptions seem reasonable and whether the methodology used seems appropriate. This is work they currently perform in the audit of financial statements.

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| 33. The NZAuASB is asked for views on whether the draft guidance adequately addresses the challenges for practitioners? |
|--|

Is the draft guidance clear and easy to understand, including through the use of examples and diagrams, and the way terminology is used? If not, where and how should it be improved?

34. The NZAuASB has previously expressed support for use of examples and diagrams, and non-authoritative guidance is a useful place to include such guidance.
35. Possible matters to raise:
- a. Extending the example of water quality to deal with contextual information and/or impacts as described in paragraph 150, to illustrate the importance of context in evaluating the suitability of the level of aggregation;
 - b. Consistent use of preparer rather than measurer or evaluator. For example, in paragraph 49, the last bullet point example refers to responsible party and the measurer or evaluator could be simplified and made more consistent by referring to preparer;
 - c. Focus on the practitioners role in the guidance only. Exploring the preparers role in the guidance (e.g. in Chapter 8 on the materiality process), starts to blur the role of the practitioner in these matters.

36. The NZAuASB is asked for views on whether the draft guidance is clear and easy to understand?

Do you support the proposed structure of the draft guidance? If not, how could it be better structured?

37. Possible matters to discuss:
- a. Is separating Chapter 7 and 8 useful?

38. The NZAuASB is asked for views on the structure of the guidance?

Do you agree that the draft guidance does not contradict or conflict with the requirements or application material of ISAE 3000 (Revised), and that the draft guidance does not introduce any new requirements?

39. Possible matters to discuss are covered in the key matters above, i.e. the delineation between the preconditions and performance of the engagement.

Do you agree with the way that the draft guidance covers matters which are not addressed in ISAE 3000 (Revised)?

40. Possible matters to discuss include matters highlighted above:
- a. The need to clarify where the consideration of the materiality process fits within the ISAE 3000 requirements
 - b. How the assertions, the qualitative characteristics and the characteristics of suitable criteria interact.

41. The NZAuASB is asked for views on:

- a. Possible areas of contradiction or conflict with ISAE 3000 (Revised);
- b. The way in which additional matters not covered by ISAE 3000 have been addressed.

Do you agree that the additional papers contain further helpful information and that they should be published alongside the final guidance?

- 42. We found the information in the Four Key Factor Model for Credibility on page 77 very useful and would support its publication alongside the guidance.
- 43. We found the material in the Background and contextual information section on page 72 to be confusing. It is unclear how much of this information will assist a preparer. If this material is published we would recommend that the examples are changed and that it is clear how this guidance will assist. Areas we found especially confusing include:
 - a. A distinction drawn between criteria and benchmarks (two separate bullet points in paragraph 6). ISAE 3000 defines criteria as benchmarks so separating these two is confusing. We understand that the measurement, recognition, presentation and disclosure bases are a part of the criteria.
 - b. We do not find the example of the apple to illustrate the idea of “elements” and “qualities” helpful. We consider the examples in the guidance to describe an element and its qualities, e.g. water quality will be more helpful for a broad stakeholder group as they relate to actual EER information. The apple example does not seem to clarify or assist.

44. The NZAuASB is asked for views on the additional papers.

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	7.1
Meeting date:	10 April 2019
Subject:	Meeting with the NZASB Chair and Director Assurance Standards
Date:	29 March 2019
Prepared By:	Sylvia van Dyk

☐

Action Required

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For Information Purposes Only

Agenda Item Objectives

To receive an overview of the current activities of the NZASB.

Background

1. To ensure the NZASB and the NZAuASB keep informed of each Board's activities, the Chair and Director of each Board will provide updates every 6 months to the other Board.
2. Kimberley Crook, Chair of the NZASB and Anthony Heffernan, Director Assurance Standards will provide the Board with an overview of the current activities of the NZASB.
3. We provided an update of the NZAuASB's activities to the NZASB at its meeting February.

Material Presented

Agenda item 7.1 Board meeting summary paper

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 8.1
Meeting date: 10 April 2019
Subject: National Standards Setters Meeting -IESBA
Date: 29 March 2019
Prepared by: Sylvia van Dyk

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Objective

To consider matters to raise at the IESBA NSS meeting to be held in May 2019 in Paris.

Background

1. The Chair of the NZAuASB and Director of Assurance Standards will attend the NSS meeting in May. Misha Pieters will also attend the meeting as staff of the IESBA and will present on the eCode.
2. The draft agenda covers:
 - a. Matters arising in each jurisdiction
 - b. Rollout and eCode
 - c. Role and Mindset
 - d. Fees
 - e. Non-assurance services
 - f. Technology
 - g. NSS section – TBD.

Matter for discussion

3. The Board is asked for feedback to be conveyed at the NSS meeting on these topics.

Material Presented

Agenda item 8.1	Board Meeting Summary Paper
Agenda item 8.2	Matters to discuss

Agenda	8.2
Date	29 March 2019
Author	Sylvia van Dyk
Subject	IESBA NSS – feedback on matters for discussion on individual agenda items

The following topics will be discussed at the IESBA NSS meeting where the views of NSS will be sought on proposals of the Task Forces. A summary of the various Task Force proposals as discussed at the March 2019 IESBA meeting is given below.

Jurisdictional Developments

We have identified the following matters to highlight

- The NZAuASB issued the new restructured Code in New Zealand for assurance practitioners in Dec 2018. We have been looking at ways to make it more interactive but we have been waiting to see how the Ecode is being developed as we do not want to duplicate efforts. We are very interested in being able to use the ECode in New Zealand.
- The New Zealand Regulatory Board professional body CA ANZ adopted the restructured Code for Professional accountants in March 2019 to apply to all members in New Zealand from 15 June 2019. The revised Code is broadly consistent with the NZAuASB Code of Ethics.
- A key matter the FMA continues to raise on the review of FMC entities is the level of NAS provided to audit clients. Both the FMA and the Auditor-General in New Zealand believes that the Code should be strengthened. There is no clear evidence that the firms are considering independence in appearance issues, with the result that there are some high levels of non- assurance services being provided relative to the audit fee. The comment has been made that the ethical standards are not strong enough.

[Are there any other matters the Board wishes us to highlight?](#)

Role and mindset

Highlight of task force proposals

- New introduction to the Code to cover the role of the profession and acting in the public interest (some push back on this – possible to include this material in the Code rather)
- Section 100 – linkage between provisions of the Code and behaviour and expected approach of the PA in meeting responsibility to act in the public interest (debate around whether if you follow the Code you will always be acting in the public interest and whether the Code should state as much).
- Revision to description of objectivity (IESBA rejected inclusion of perception, emotion or imagination and to add undue reliance)
- Conceptual framework – inclusion of a “questioning mindset” as a requirement (IESBA rejected addition of “questioning mindset into the exercise of professional judgement
- New application material on bias – some push back on “commonly known as” bias.

[What are the Board’s views on the proposals?](#)

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Non assurance services (NAS)

Highlight of task force proposals

For PIEs:

- New prohibition for NAS if outcome might be included directly or indirectly in financial statements and might create self-review threats – concern around how wide “indirectly” could apply
- New requirement for firms to obtain pre-approval for NAS from TCWG
- New provisions to re-evaluate threats to independence when the ratio of NAS to audit fees reach a particular threshold
- Withdrawal of exception relating to accounting and bookkeeping services
- Withdrawal of materiality as a “qualifier” in prohibitions for specific type of services
- Clarity about the periods for which independence is required

For PIEs and non-PIEs

- New provisions to enhance and encourage auditor communication with TCWG about NAS
- Repositioned management responsibility section – great deal of angst about whether this contravenes structure of revised code
- Clarification on applying the conceptual framework
 - New guidance for identifying threats
 - Explicit requirement for evaluating and address NAS threats
- Strengthen provisions for where firm provides multiple NAS to same audit client
- New application material of actions that might be safeguards

What are the Board's views on the proposals for NAS?

Fees

Highlight of task force proposals

Level of fees

- Require firms to be satisfied that fees quoted do not affect firm's ability to perform the audit in accordance with professional standards
- Require engagement partner to determine whether sufficient and appropriate resources are assigned, irrespective of fees quoted – discussion around need to replicate matters dealt with in ED ISQM 1
- Add level of fees as a factor to consider in assessing level of threats in accepting a new engagement
- New application material re pressure exerted by a PAIB on another PA to provide professional services at a fee level that does not allow for sufficient and appropriate resources
- Require firms to communicate with TCWG that the audit fee quoted will allow the firm to perform the engagement in accordance with professional standards
- PIE – establish provisions to ensure that the audit fee is disclosed. (whilst this is done in New Zealand there was some concern around such a requirement. Difficult for the

IESBA to mandate this as this is either a financial reporting disclosure matter or a disclosure for the auditor report.)

Fee-dependency

PIEs

- Encourage (or require) firms to disclose to TCWG if total fees from PIE client exceed threshold in the Code after the first year of the engagement. Consider if this should be publicly disclosed
- Require firm to determine application of pre-issuance review as a safeguard, instead of allowing a post-issuance review, once total fees significantly exceed the established threshold
- Require firm to end the engagement if total fees from PIE client continue to exceed the threshold for 5 consecutive years
- Require the firm to disclose publicly each year if the PIE client continues to exceed the threshold until the firm is required to end the engagement.

Non-PIEs

- Encourage (or require) firms to disclose to TCWG if total fees from non-PIE client exceed 30% after the first year of the engagement. Encourage firms to discuss with TCWG whether this info should be publicly disclosed.
- Require firm to disclose to TCWG when total fees from client reach 30% of the firm for 3 or 5 consecutive years and discuss with TCWG what actions might be applied as safeguards
- No requirement to cease to be audits when fee threshold is exceeded for a specified number of consecutive years.

[What are the Board's views on the Fees proposals?](#)

Technology

The presentation made to the IESBA at the March meeting is included in the international update. The IESBA is still in an exploratory space and there are no firm proposals as yet.

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 8.3
Meeting date: 10 April 2019
Subject: National Standards Setters Meeting -IAASB
Date: 29 March 2019
Prepared by: Sylvia van Dyk

<input checked="checked" type="checkbox"/> Action Required	<input type="checkbox"/> For Information Purposes Only
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Objective

To consider matters to raise at the IAASB NSS meeting to be held in May 2019 in Paris.

Background

1. The Chair of the NZAuASB and Director of Assurance Standards will attend the NSS meeting in May.
2. We have not yet received the agenda for the NSS meeting but understand that the format of the 2-day meeting will be as follows:
 - a. Day 1 – organised by the IAASB:
 - i. Joint meeting with the IESBA NSS. The likely topic to be discussed is the Monitoring Group's CP which is expected to be issued later in April 2019.
 - ii. Jurisdictional developments.
 - b. Day 2 – morning session organised by the IAASB, and afternoon session a NSS session only, organised jointly by NSS (Chairs of AUASB, NZAuASB, Canada AASB). Possible topics will be
 - i. Role of NSSs and working together
 - ii. LCE project
 - iii. Quality management projects

Matter for discussion

3. The Board will be discussing the LCE consultation paper at agenda item 6. We will provide the Board with a verbal update on the results of the quality management workshops and discuss the quality management standards at agenda 3. There are no other materials available to provide to

the Board this time. The Chair and Roger Simnett will provide more information at the meeting about the NSS session only.

4. Jurisdictional developments to share

- Issued standard on auditing service performance information
- Commenced a project to develop an engagement standard for smaller not-for-profits
- Amending SRE 2410 for new auditor reporting requirements
- Commended a project to develop an assurance standard on the examination of prospective financial information

Are there any other items to raise?

5. Any other matters to discuss will be raised verbally with the Board at the meeting

Material Presented

Agenda item 8.3

Board Meeting Summary Paper

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	9.1
Meeting date:	10 April 2019
Subject:	IAASB Strategy and Work Plan
Date:	28 March 2019
Prepared by:	Sharon Walker

☒ **Action Required**

☐ **For Information Purposes Only**

Agenda Item Objectives

1. The objective of this agenda item is to CONSIDER and provide feedback on the draft submission on the IAASB's *Proposed Strategy for 2020-2023 and Work Plan for 2020-2021*.

Background

2. The evolving environment in which the IAASB operates demands a strategy that reflects, among others, changing technology; a dynamic small- and medium-sized entity landscape; and emerging reporting needs.
3. In the *Proposed Strategy for 2020-2023 and Work Plan for 2020-2021*, the IAASB puts forth a way forward that it believes meets stakeholders' evolving needs, and is in the public interest. Enhancing the IAASB's processes, including using technology and appropriate resourcing, are included in the strategy and are crucial to success. These activities will maximise the impact of the IAASB's activities, thereby enabling more timely responses to global trends and needs.
4. The Work Plan highlights the IAASB's commitment to completing significant projects currently underway, while balancing the needs of different stakeholders.
5. The IAASB has requested feedback on the consultation by 4 June 2019. This is before the Board's June meeting.
6. Feedback from the NZAuASB's stakeholders is requested by 20 May 2019.
7. We have prepared a draft submission on the strategy and work plan for the Board's consideration which is presented in item 10.2. We will update the draft for any feedback from stakeholders and from the Board received at this meeting. We will circulate the updated draft for the Board's approval during the last week in May 2019.

Matters to Consider

8. The Board is asked to CONSIDER and provide feedback on the draft submission on the IAASB Strategy and Work Plan.

Material Presented

Agenda item 9.1

Agenda item 9.2

Agenda item 9.3

Board Meeting Summary Paper

Draft Submission

IAASB Proposed Strategy and Work Plan

4 June 2019

Mr Willie Botha
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, 10017
USA

Dear Willie,

IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021

Thank you for the opportunity to comment on the IAASB's proposed Strategy for 2020-2023 and Work Plan for 2020-2021 (the "Consultation Paper"). We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

The External Reporting Board (XRB) is a Crown Entity responsible for developing and issuing accounting and auditing and assurance standards in New Zealand. The XRB's outcome goal is to contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance framework that engenders confidence in New Zealand financial reporting, assists entities to compete internationally and enhances entities' accountability to stakeholders. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards, including ethical standards for assurance practitioners.

Overall Comments

The NZAuASB acknowledges the strategic based approach the IAASB has taken in developing the proposed strategy for 2020-2023, and welcomes the context provided in the introduction to the proposed strategy. The NZAuASB applauds the IAASB's continued efforts in its outreach activities with various stakeholder groups in exploring how best to meet the public interest need in an evolving world. The NZAuASB encourages the IAASB to continue with its very strong outreach program to key stakeholders.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk (sylvia.vandyk@xrb.govt.nz).

Yours sincerely,

Robert Buchanan

Chairman

Email: robert@buchananlaw.co.nz

Submission of the New Zealand Auditing and Assurance Standards Board

IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021

I Schedule of Responses to the IAASB's Specific Questions

1. Do you agree with *Our Goal, Keys to Success and Stakeholder Value Proposition* (see page 6), as well as the *Environmental Drivers* (see page 7)?

Response:

The NZAuASB considers that the goals, keys to success and stakeholder value proposition as well as the environmental drivers are appropriate.

To achieve standards that are globally relevant, scalable, forward-looking and operable, it is necessary to set standards that are relevant to all entities. Standards must start with general principles that are applicable to all and then build up for more complex entities.

The NZAuASB fully supports leveraging the skills and resources of national standard setters when appropriate to assist in providing timely responses to issues.

2. Do you agree with *Our Strategy and Focus* and *Our Strategic Actions* for 2020-2023 (see pages 8 to 13)?

Response:

The NZAuASB supports the strategy and focus of the IAASB and the strategic actions for 2020-2023, in particular, the decision to prioritise and focus on completing current key projects including quality management and group audits, as well as developing the necessary implementation support. In addition, the NZAuASB is fully supportive of the LCE initiative.

In progressing all projects, the NZAuASB stresses the benefits of principles-based standards, and cautions against increasing the requirement burden on practitioners unnecessarily as this may ultimately detract from audit quality, decreasing the attractiveness of the profession, and impacting the ability to attract and retain good talent.

The NZAuASB believes that the key to developing standards that are scalable for all entities is to take a bottom up approach, developing standards that are applicable to all engagements and then to consider the additional requirements to address complexities. Standards must be high level, principles-based. Detailed compliance and guidance could be contained in separate industry and other technical guidance.

3. Do you agree with the IAASB's *framework for Activities*, and the possible nature of such activities (see pages 11 and 12) as set out in Appendix 2 (see pages 19 and 20)?

Response:

The NZAuASB supports the Framework for Activities approach, whereby research is undertaken providing sufficient information to inform the appropriate response.

4. Do you support the actions that have been identified in our detailed *Work Plan for 2020-2021* (see pages 15 and 16). If not, what other actions do you believe the IAASB should prioritize?

Response:

The NZAuASB agrees that the topics chosen by the IAASB for inclusion in the work plan for 2020-2021 are appropriate in light of the strategic goals set out in the IAASB's strategy for 2020-2023. As noted in response to question 5 below, the NZAuASB is of the view that a revision of ISAE 3400 would also merit inclusion in the current work plan.

There have been significant changes in some of the core standards over the last few years, for example, ISA 540, ISA 315 and the quality management standards. To ensure proper implementation and consistent application of these standards, thereby improving audit quality, it will be necessary to provide appropriate and timely implementation support.

5. Are there any other topics that should be considered by the IAASB when determining its 'information-gathering and research activities' in accordance with the new *Framework for Activities*. The IAASB has provided its views on tentative topics to be included in its 'information-gathering and research activities' (see page 10)?

Response:

The NZAuASB notes that the IAASB has not identified the revision of ISAE 3400, *The Examination of Prospective Information*, as a priority in its work plan. We believe this standard is out of date and in need of revision. An assurance standard on prospective information is relevant for both listed entities and in the public sector, for example, in New Zealand all local government entities are required to prepare a 10 year Long Term Plan that is required to be audited every three years. The NZAuASB encourages the IAASB to include the revision of ISAE 3400 in its information gathering and research activities.

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

PROPOSED STRATEGY FOR 2020–2023 AND WORK PLAN FOR 2020–2021

Business Strategy
Marketing
Analysis
Ideas
Success
Management

IAASB

International Auditing
and Assurance
Standards Board

The International Auditing and Assurance Standards Board (IAASB) is a global independent standard-setting body that serves the public interest by setting high-quality international standards which are generally accepted worldwide.

The IAASB believes that a single set of robust international standards contributes to enhanced engagement quality and consistency of practice throughout the world, and strengthened public confidence in the global auditing and assurance profession. The IAASB sets its standards in the public interest with advice from the IAASB Consultative Advisory Group (CAG) and under the oversight of the Public Interest Oversight Board.

The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants® or IFAC®.

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CHAIRMAN'S FOREWORD

The IAASB's current strategy period 2015–2019 has seen hard work on key standards. These projects covered the important subjects of auditing accounting estimates (ISA 540 (Revised)),ⁱ and the core risk assessment standard (ISA 315 (Revised)).ⁱⁱ In our flagship project on Enhancing Audit Quality, we have been addressing the fundamentals of the audit, including a focus on a proactive quality management approach and the application of professional skepticism. Some of these projects have taken longer than we originally anticipated, but we are confident that the new and revised standards will contribute to higher-quality audits.

While we have made many changes and improvements, some stakeholders have commented on the volume of change, and have challenged us to do more to consider the length and complexity of the standards, and the ability to implement them in less complex situations. Furthermore, the world continues to change at an ever-increasing rate, with complexity becoming more prominent, in particular in relation to technology. Thus there is some urgency to deal with changes that are needed to keep the standards relevant and fit-for-purpose.

We have already identified two new initiatives that will progress in earnest in 2019: one dealing with audits of less complex entities and the other on audit evidence, including how changes in the use of technology affect the gathering and evaluation of audit evidence. We will begin with research for both of these projects to provide important input to help us determine, with an open mind, the most appropriate actions to address the challenges. In the meantime, we will continue to think more about what can be done in the short-term in relation to automated tools and techniques, in particular those that are becoming more prevalent in our environment as technologies continue to evolve.

We are also mindful that the delivery of standards is only the first step. We will be committing to a focus on the implementation of the changes, working with others as necessary to support effective and efficient adoption of the changes. Fundamental to our work, and underlying many of our communication efforts with our stakeholders, is a significant outreach program.

Moving into our new strategy period is daunting but exciting. There is the unknown of the changes that may come from the Monitoring Group review, but at the same time we recognize that there is opportunity to enhance our operations, and meet the needs of all of our stakeholders, including the Monitoring Group. This may include the development and implementation of a framework for our activities, and strengthening our collaboration with the International Ethics Standards Board for Accountants (IESBA) as it advances its work. We will look for ways to innovate our processes, delivery mechanisms, and communications with our stakeholders. Changing processes and structures will take time, but the IAASB is confident that these changes will help it operate more effectively in addressing the challenges it faces.

This Consultation Paper has been developed bearing all of this in mind, and the IAASB welcomes the views of all stakeholders in helping the IAASB adapt as it moves forward in the medium-term.



Prof. Arnold Schilder
IAASB Chairman



REQUEST FOR COMMENTS

This Consultation Paper was developed by the IAASB and informed by significant outreach efforts (see Appendix 1). Comments are welcome on whether:

1. You agree with *Our Goal, Keys to Success and Stakeholder Value Proposition* (see page 6), as well as the *Environmental Drivers* (see page 7).
2. You agree with *Our Strategy and Focus and Our Strategic Actions* for 2020–2023 (see pages 8 to 13).
3. You agree with the IAASB's proposed *Framework for Activities*, and the possible nature of such activities (see pages 11 and 12), as set out in Appendix 2 (see pages 19 and 20).
4. You support the actions that have been identified in our detailed *Work Plan for 2020–2021* (see pages 15 and 16). If not, what other actions do you believe the IAASB should prioritize?
5. There are any other topics that should be considered by the IAASB when determining its 'information-gathering and research activities' in accordance with the new *Framework for Activities*. The IAASB has provided its views on tentative topics to be included in its 'information-gathering and research activities' (see page 10).

Comments are requested by **June 4, 2019**. In answering the questions, please explain why you agree or disagree with the IAASB's proposals.



OUR GOAL, KEYS TO SUCCESS AND STAKEHOLDER VALUE PROPOSITION

Our mandate is straightforward. However, standard-setting itself is not, especially in a global context. The following messages frame the broad lens of our strategic thinking.

OUR GOAL

- **Sustained public trust** in financial and other reporting, enhanced by high-quality audits, assurance and related services engagements, through delivery of **robust global standards** that are capable of **consistent and proper implementation**.

KEYS TO OUR SUCCESS

Achieving our strategy relating to our areas of focus:

- Through our commitment to **engage, listen and learn**, and to **lead and adapt** in our global standard setting responsibilities.
- By **fostering confidence** in the quality and relevance of our processes and standards, evidenced by the many jurisdictions (currently 128) using or committed to using our standards, including their oversight bodies (regulatory and inspection), and by user and practitioner communities.

OUR STAKEHOLDER VALUE PROPOSITION

- **Our Strategy:** Public-interest focused activities and future-oriented processes and work plans that are viewed as meaningful in contributing to the achievement of our goal.
- **Our Standards:** Globally relevant, scalable, forward-looking and operable; developed and implemented through activities that are timely and responsive to needs of our stakeholders.
- **Our Engagement with Our Stakeholders:** Timely and meaningful dialogue with a broad range of stakeholders, including with regulatory, user and practitioner communities.
- **Our Work Plans:** Focused on timely identification and appropriate resolution of issues that affect the global standards, while balancing speed and quality, capacity utilization, and coordination with others.
- **Our Methods:** Rigorous and inclusive, yet nimble, leveraging external resources where feasible. Continuously reviewed and improved to better facilitate delivery of work plans.
- **Our Collaboration Efforts:** Strengthened coordination and cooperation with, in particular, the IESBA and National Standard Setters (NSS).
- **Our Implementation Support on Major New and Revised Standards:** Supporting the development of timely and effective implementation of the IAASB's standards.

OUR OPPORTUNITIES AND CHALLENGES— ENVIRONMENTAL DRIVERS

Understanding our key opportunities and challenges, and balancing the needs of all of our stakeholders, is crucial to the continued use and ongoing adoption of our standards on a global basis. The most significant environmental drivers that have shaped our Strategy for 2020–2023 (Strategy) and Work Plan for 2020–2021 (Work Plan) include:

Advancement in, and Use of, Technology	<ul style="list-style-type: none"> • Businesses and economies are increasingly affected by rapidly changing and evolving technologies (e.g., artificial intelligence, robotics, blockchain, cloud computing, social networks and new digital payment platforms). • Developments in the use of advancing technologies are having a revolutionary effect on audit and assurance engagements, including how automated tools (including automated data analytics) are used to perform work on such engagements, and the way that engagement teams are structured and interact.
Environment for Small- and Medium-Sized Entities	<ul style="list-style-type: none"> • Increasing pressure regarding the scalability and proportionality of the standards, in particular the ISAs. • Changing audit thresholds are increasing the demand for other types of assurance or other services by small- and medium-sized entities (SMEs).
Increasing Complexity and Its Implications	<ul style="list-style-type: none"> • The business environment is becoming increasingly complex because of, for example, ongoing globalization and advancing technologies. As a result, financial reporting standards are responding and becoming more complex. • Accounting practice is evolving—as transactions become more complex and financial reporting changes, more estimates and management judgments are needed.
Changing Reporting Needs of Stakeholders	<ul style="list-style-type: none"> • Corporate reporting is evolving, with many users of corporate reports increasingly focusing on available non-financial information (e.g., sustainability reporting, reports addressing an entity's governance and internal control and other forms of extended external reporting) and seeking assurance thereon.
Changing Expectations and Public Confidence in Audits	<ul style="list-style-type: none"> • Decreasing confidence, and declining trust, in audits arising from continuing high levels of reported poor results of external inspections and recent high profile corporate failures in some jurisdictions. • Stakeholders' expectations are also changing about what the standards should require the auditor to do, for example, in relation to the detection and reporting of fraud, and the consideration of going concern issues.

OUR STRATEGY AND FOCUS

Adapting to the environment to meet stakeholders’ needs is key to our success. Our **Strategy and Focus** sets out how we intend to focus on timely identification and resolution of issues that affect our global standards in response to current and forward-looking challenges and risks to our standards. Delivery of our committed work is key to our success.



THEME A:**COMPLETE OUR MAJOR AUDIT QUALITY ENHANCEMENTS AND ENABLE THEM TO 'TAKE ROOT'**

Prioritizing the completion of the key ISA and other projects underway at the start of 2020 is crucial, as is undertaking activities to focus on the effective and efficient implementation of the changes made to these and other core ISAs during the 2015–2019 strategy period.

THEME B:**FURTHER CHALLENGE AND ENHANCE THE FUNDAMENTALS OF OUR INTERNATIONAL STANDARDS**

Core to our activities is revising and developing our standards on a timely basis to respond to the continuously changing environment (including the increasingly evolving technologies and automated tools being used by entities and auditors), and the changing needs of our stakeholders. This theme is vital to the continued use and ongoing adoption of our standards on a global basis.

THEME C:**DEVELOP WAYS TO ADDRESS COMPLEXITY, WHILE MAINTAINING SCALABILITY AND PROPORTIONALITY**

Addressing the robustness of auditing standards in an increasingly complex business environment and the need to maintain their scalability and proportionality is a key focus area for us to make sure that our standards are fit-for-purpose for audits of all entities, regardless of their complexity.

THEME D:**STRENGTHEN AND BROADEN OUR CAPABILITY AND CAPACITY TO RESPOND BY INNOVATING OUR WAYS OF WORKING**

Enhancing our processes is critical to our success, including using technology and appropriate resources to maximize the impact of our activities, thereby enabling us to respond on a more timely basis to issues and challenges.

THEME E:**DEEPEN OUR CONNECTIVITY AND COLLABORATION OPPORTUNITIES**

Leveraging external resources and maintaining and building relationships with stakeholders to achieve globally relevant, progressive and operable standards.

OUR STRATEGIC ACTIONS

THEME A:

COMPLETE OUR MAJOR AUDIT QUALITY ENHANCEMENTS AND ENABLE THEM TO ‘TAKE ROOT’

Strategic Actions – In the strategy period commencing in 2020, we will:

- Progress and complete, as a top priority, our projects on **Quality Management**ⁱⁱⁱ and **Group Audits**.^{iv} Monitor the need for, and develop as necessary, **implementation support** for our projects on **Quality Management** and **Group Audits**.
- Continue implementation support for **ISA 540 (Revised)**^v and **ISA 315 (Revised)**^{1 vi} as needed.
- Complete our **Auditor Reporting**^{vii} and **ISA 540 (Revised) Post-Implementation Reviews**, report findings and determine and carry out necessary actions arising from these reviews.

THEME B:

FURTHER CHALLENGE AND ENHANCE THE FUNDAMENTALS OF OUR INTERNATIONAL STANDARDS

Strategic Actions – We will:

- Complete the guidance for our **Extended External Reporting (EER)** initiative.^{viii}
- Identify and prioritize future actions through our research activities based on the assessment of:
 - The need for changes in the standards to address issues and challenges related to **audit evidence**, in particular in relation to evolving technologies and automated tools that are being used, as well as thinking more about how professional skepticism can be further enhanced within the ISAs.^{2 ix}
 - Further implications on our standards of evolving **technologies** used by entities and auditors.
 - The changing **corporate reporting** environment.
 - **Ongoing work of the IESBA** that may require changes within our standards.
 - Other possible topics that have been on the IAASB’s radar, including:
 - Expectations of the role of auditors in connection with **fraud and non-compliance with laws and regulations** (for example, anti-money laundering) in financial statement audits.
 - Expectations of the role of auditors in connection with **going concern** in financial statement audits.
 - Consistency and rigor of audits in **key performance areas**, such as applying materiality, and responding to risks of material misstatement.
- Continue our focus on **professional skepticism** in our ongoing ISA projects and consider what more can be done in this area.

¹ On the basis that ISA 315 (Revised) is finalized in June 2019 as targeted.

² The work of the Professional Skepticism Working Group and the Data Analytics Working Group may be amalgamated in the Audit Evidence project.

THEME C:**DEVELOP WAYS TO ADDRESS COMPLEXITY, WHILE MAINTAINING SCALABILITY AND PROPORTIONALITY'**

Strategic Actions – We will:

- As a top priority, complete our information-gathering and research activities relating to **Audits of Less Complex Entities**,^x which will inform the Board's future deliberations about the most appropriate actions to address the identified issues and challenges.
- Commit to continue considering how to develop principle-based standards and guidance that is clearly articulated, and able to be applied to a wide variety of circumstances.
- Enhance the accessibility and ease of use of our standards, for example by digitizing the standards to enhance navigation and search functions.

In undertaking work in this strategic theme, the IAASB remains open-minded about the effort needed to achieve an outcome that is supportive of the needs of many of our stakeholders.

THEME D:**STRENGTHEN AND BROADEN OUR CAPABILITY AND CAPACITY TO RESPOND BY INNOVATING OUR WAYS OF WORKING'**

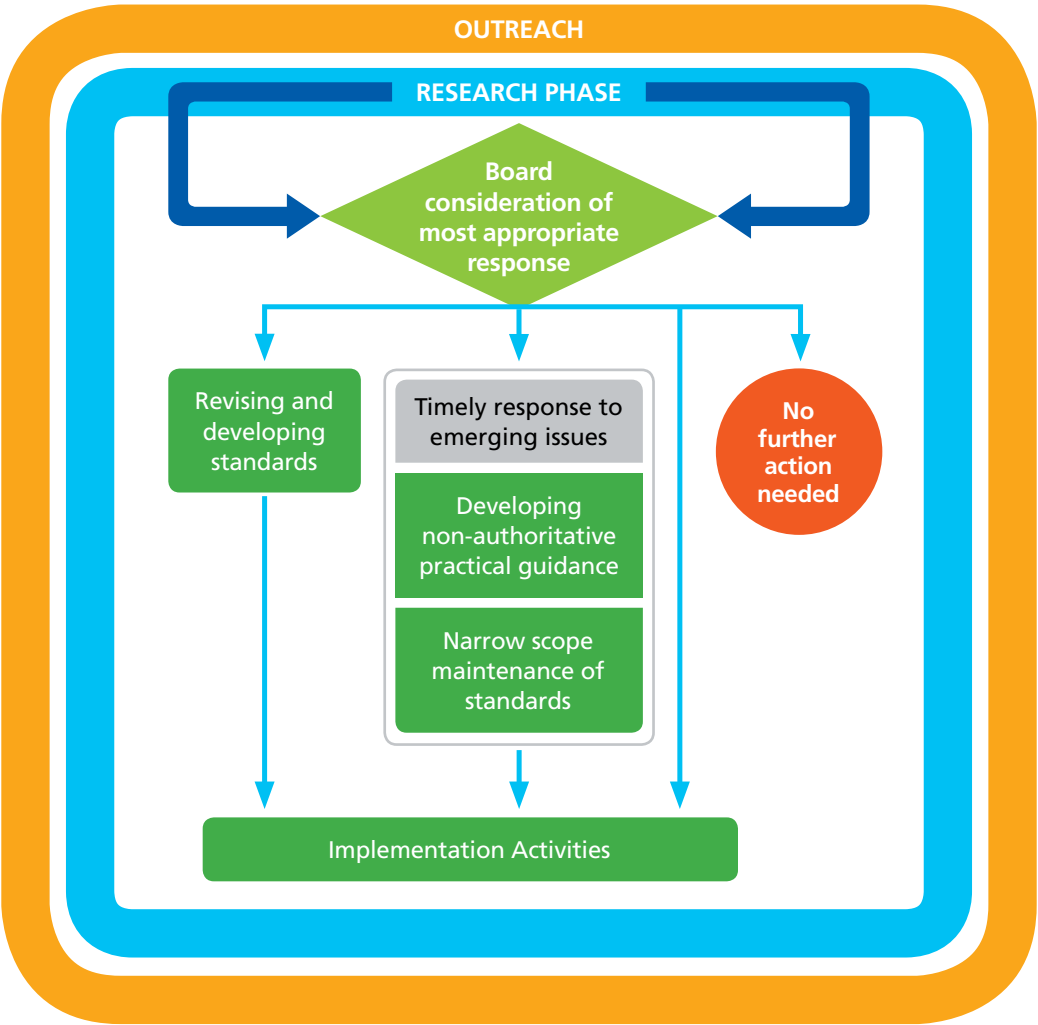
Strategic Actions – We will develop and implement a **Framework for Activities** (the "Framework") so that we do "the right work at the right time." As part of this theme, we will also further consider our capacity and whether further resources are needed to deliver on our committed actions effectively. Importantly, in implementing the Framework, leveraging technology for undertaking our work will be at the forefront of our minds. Key features of this Framework include:

- Robust **information-gathering and research activities** as a cornerstone to future work streams, including:
 - Fact-finding activities to understand emerging issues and developments, which may also include consideration of findings from academic research, post-implementation reviews and other work already undertaken by NSS.
 - Defining the problem / issue / challenge we are addressing (including further understanding the causal factors).
 - An assessment of available options, including the impact of possible actions.
 - Scoping future projects.

Appendix 2 more fully describes the proposed information-gathering and research activities.

- **Mechanisms for addressing issues and challenges on a more timely basis**, including:
 - Developing non-authoritative practical guidance.
 - Developing a process for ‘limited-scope’ revisions to standards (with appropriate due process to support more timely changes).
 - Considering whether to implement an ‘interpretations’ mechanism to help communicate Board intentions when originally setting the standards.

The diagram below captures our more formalized and structured approach to our activities (each of these activities is further described in Appendix 2). However, there are still many aspects of the Framework that will need to be further developed if this approach is supported by our stakeholders. At this stage, we also remain mindful that the Framework will need to remain adaptable so as to accommodate any further changes arising from the Monitoring Group review.



THEME E:

DEEPEN OUR CONNECTIVITY AND COLLABORATION OPPORTUNITIES

Strategic Actions – We will:

- Continue to **interact with the CAG**. The IAASB’s CAG is a fundamental part of the IAASB’s engagement with its stakeholders and is a key element of the IAASB’s due process. The CAG is comprised of over 30 member organizations representing global regulators, business and international organizations, accountancy regional bodies and users and preparers of financial statements.
- Further enhance our **coordination efforts with the IESBA**.
- Explore new ways to expand our **collaboration with NSS** to optimize our activities.
- Further enhance working relationships with **regulators, firms and others** (as appropriate) to help understand their concerns, and further explore causal factors.
- Further explore whether the **IAASB can collaborate, as appropriate, with the International Federation of Accountants (IFAC)** and its various committees, in relation to implementation support activities.
- Continue to establish **subject-specific Advisory Panels** as needed to enable Task Forces and Working Groups to receive timely input on developing proposals from a broad range of relevant stakeholders.
- Continue our two-way liaison with the **International Accounting Standards Board (IASB)**, providing input on auditability and verifiability of new and revised International Financial Reporting Standards, thereby contributing to the quality of financial reporting.^{xi}
- Continue communication with our stakeholders through timely and meaningful **outreach activities** focused on:
 - Promoting **adoption and effective implementation** of the ISAs and our other standards, in particular for audits of less complex entities, emerging markets and the public sector.
 - Understanding **issues that affect our standards**, including financial reporting issues, implementation challenges, and opportunities for collaboration to enhance audit and other engagement quality.

OUR WORK PLAN FOR 2020–2021

Our Work Plan is focused on the ongoing, timely identification of new issues that may affect our global standards, and timely analysis and resolution of these identified issues. In prioritizing actions to address the identified issues that are expected to have a meaningful effect on our goal over our strategy period, this Work Plan seeks to:

- Provide a reasonable balance between the need for speed and quality of response;
- Prioritize the use of available resources;
- Depict the realistic prospects of identifying sources of additional resources; and
- Illustrate the need for coordination with others.

KEY GUIDING CONSIDERATIONS

Given the competing demands for IAASB actions, we will consider the following in determining the most appropriate action, and how such action should be prioritized.

-
- ***The significance of the benefits to the public interest***, including the extent to which the action will further:
 - Enhance the quality and benefits of audit, assurance and related services globally;
 - Enhance engagements that are currently conducted on a widespread basis internationally or are expected to be in the near future; or
 - Facilitate high-quality financial and corporate reporting and enhance public confidence therein.
-
- ***The time needed*** to undertake effective action in light of emerging practice, market demands and developing a response that is capable of international application.
-
- ***The degree of urgency*** for addressing the particular matter, including the potential implications for the public interest if action is not taken or is delayed.
-
- ***The degree to which an identified issue would be addressed effectively*** through change to the standards or through other appropriate action.
-
- ***The pervasiveness of the matter and the global applicability*** of the potential actions in relation to entities of different sizes and complexity, different industries, and across jurisdictions.
-

OUR DETAILED WORK PLAN FOR 2020–2021

Our detailed Work Plan is presented below. This proposed Work Plan is our best estimate, at the time of publication of this Work Plan, for how we will progress the various projects and is subject to changes, especially given the nature of the issues and the complexities of the projects. During 2020–2021, we will be transitioning to more structured processes and activities around how we undertake our work (see Theme D above and Appendix 2). In order to effectively transition, time will need to be spent on how best to realign our activities.

Appendix 3 sets out a description of each of the projects carrying over from the IAASB's Work Plan for 2019 to provide context for the IAASB's Work Plan for 2020–2021.

Cells with an 'X' indicate that IAASB plenary meeting time is scheduled for a project, while the green highlighted cells indicate Working Group, Task Force or Staff expected activity on a project. Cells with an 'E' indicate the targeted publication of an Exposure Draft and cells with a 'F' indicate the targeted finalization of a project.

	2019				2020				2021			
Project	March	June	Sept	Dec	March	June	Sept	Dec	March	June	Sept	Dec
Revising and Developing Standards												
ISA 315 (Revised)	X	F										
ISQM 1 ^{xii}			X	X	F							
ISQM 2 ^{xiii}			X	X	F							
ISA 220 (Revised) ^{xiv}			X	X	F							
ISA 600 (Revised) ^{xv}	X	X	X	E			X	X	F			
ISRS 4400 (Revised) ^{xvi}		X	X	F								
Developing Non-Authoritative Guidance												
Extended External Reporting	X	X	X	E		X	F					

³ The detailed Work plan also includes the intended plan for progression of projects in 2019 to provide context for 2020 and 2021

	2019				2020				2021			
Project	March	June	Sept	Dec	March	June	Sept	Dec	March	June	Sept	Dec
Implementation Activities⁴												
Auditor Reporting ⁵												
ISA 540 (Revised)												
ISA 315 (Revised)												
Revised Quality Management Standards												
Research Phase⁶												
Research (will include the activities of the Innovation Working Group) ⁷		X				X		X		X		X
Audits of Less Complex Entities	X	X	X	X	X ⁸							
Audit Evidence	X	X	X	X	X ⁸							
Professional skepticism	X	X	X	X	X	X	X	X	X	X	X	X
Other Ongoing Activities												
Coordination with the IESBA			X				X				X	
Liaison activities with the IASB	X				X				X			
Strategy and Work Plan			X	F								

⁴ Due to the uncertain nature of the implementation activities at this time, specific Board discussions have not been presented. However, it is likely during the period of activity there will be Board plenary discussions, and this will be determined as the implementation support activities are developed for each project.

⁵ The findings from the Auditor Reporting Post Implementation Review, which will commence in 2019, may result in further work related to Auditor Reporting in 2020 and 2021.

⁶ The cornerstone of our new Framework will be robust information-gathering and other related research activities to further understand causal factors of issues and challenges and properly scope projects. Research activities will involve actions related to a number of topics that are currently in that phase (e.g., information gathering, scoping, post-implementation review etc.). However, these have not been separated out at this time as they have not yet been determined, but it is likely that there will be ongoing discussions by the Board of one or more of these topics at each Board meeting. Once a specific project is identified it will be separated on this forward agenda. The research phase will include the activities of our Innovation Working Group. For more information about the Innovation Working Group see the project page: <http://www.iasb.org/projects/innovation-working-group>.

⁷ Time within Research Activities stream includes discussions by the IAASB regarding realignment of its activities, as necessary, into the structured streams set out in the *Framework for Activities*.

⁸ The outcome of information gathering and research activities may continue into 2020 (in which case there will be more Board discussions in 2020–2021) or may result in standard-setting or other activities (see footnote 6). If standard-setting is undertaken, the projection of Board plenary discussions and timing of exposure drafts and finalization will be presented in this Work Plan at the time when the project proposal is approved.

MANAGING DELIVERY OF THE STRATEGY AND WORK PLAN

Accountability to our stakeholders about how our Strategy and Work Plan are being progressed is key to building trust and inspiring confidence. Communication and transparency about our actions is therefore an essential part of the IAASB's activities in the 2020–2023 strategy period. We manage the delivery of our Strategy and Work Plan under the constant scrutiny by ourselves and our stakeholders in relation to:

- Meeting targeted outcomes set out in our Work Plan.
- Expanding global adoption of our standards, including adoption of new and revised standards by jurisdictions who are already using our standards.
- Facilitating the implementation of new and revised standards.
- Building stronger relationships with key stakeholders.

APPENDIX 1

THE DEVELOPMENT OF THIS CONSULTATION PAPER

The development of this Consultation Paper was informed by:

- A Stakeholder Survey. We received 76 responses from a wide range of stakeholders including 12 responses from global organizations and one from a Monitoring Group member (the International Organization of Securities Commissions). A [summary of the survey responses](#) was discussed at our September 2018 meeting;
- Ongoing global outreach by our members;
- Targeted outreach with stakeholders we ordinarily do not hear from. This included outreach with individuals representing investor groups, groups representing those charged with governance, preparers of financial statements, smaller firms, regulators and academics; and
- Discussions with the CAG.



APPENDIX 2

DETAILED DESCRIPTION OF THE FRAMEWORK FOR ACTIVITIES

Research Phase	<p>Structured Board activities and formalized projects and processes for:</p> <ul style="list-style-type: none"> Identifying and further understanding causal factors of issues and challenges within existing standards. Information-gathering to understand emerging issues and developments to help determine a global need for action. When applicable, post-implementation reviews to identify whether the standard is achieving its objective and, if not, whether further amendments should be considered. Post-implementation reviews may also lead to a new research initiative, or may result in a maintenance or implementation work stream. <p>Output from these activities is to assist the Board in deciding whether or not to add a work stream to its Work Plan, or to provide a more evidence-informed approach to revising or developing standards.</p>
Revising and Developing Standards	<p>A new standard-setting project is not started until the research phase has gathered sufficient information that a revision of a standard, or a new standard, is required, which is generally when:</p> <ul style="list-style-type: none"> The benefits to the public interest will enhance public trust in the project being undertaken; The issues are pervasive and affect the global profession; It is in the public interest to undertake the work, and not delay it; and It is feasible to undertake the work within a realistic timeframe. <p>In developing changes, or a new standard, the Board follows due process to develop proposals for public consultation, analyzes the feedback, and refines the proposals to issue the final revised, or new, standard.</p>
Developing Non-Authoritative Guidance	<p>The development of non-authoritative guidance will start when the research phase indicates that non-authoritative guidance is required, which is generally when guidance to support application of the IAASB's International Standards is needed and is considered to be an appropriate alternative to authoritative guidance. This may be the case when:</p> <ul style="list-style-type: none"> The marketplace is still developing and detailed standards could risk stifling innovation and experimentation. The issues relate to a specific industry (e.g., banking or insurance industry) or a specific topic (e.g., financial instruments).

Narrow Scope Maintenance of Standards	<p>Appropriate Board actions to maintain the standards may include developing processes for:</p> <ul style="list-style-type: none"> • Narrow-scope amendments to a standard, following due process as appropriate, if that is determined to be the most appropriate action to address an urgent issue (rather than revising the entire standard); and • Supporting the application of the approved standards by providing interpretations to a specific question about a standard (i.e., a change to the standard itself is deemed unnecessary).
Implementation and Application of Standards	<p>Board activities to support the implementation of new and revised standards by developing supporting materials, which may include:</p> <ul style="list-style-type: none"> • Webinars; • Train-the-trainer events; • Implementation working groups to develop supporting materials as necessary (such as frequently asked questions, articles, etc.); • Targeted outreach; and • Working or coordinating with others, such as NSS or IFAC, in developing support materials as needed.
Outreach	<p>All of the IAASB's activities benefit immensely from the input of the IAASB's wide range of stakeholders. The IAASB's outreach activities will include continuing with its rigorous program of international outreach, including regular interactions with key stakeholder groups, such as its project advisory panels, as well as targeted outreach that may be project- or topic-specific.</p>

APPENDIX 3

DESCRIPTION OF PROJECTS AND INITIATIVES

Projects Underway and IAASB Activities in 2017 to 2019

1. In 2017 and 2018, the IAASB continued with revisions to a number of its key and foundational ISAs, as well as its quality management projects. The objective of these revisions is to address issues and challenges identified by the [IAASB's ISA Implementation Monitoring project](#) and the Invitation to Comment, *Enhancing Audit Quality in the Public Interest, A Focus on Professional Skepticism, Quality Control and Group Audits*, as well as feedback from its stakeholders, through meetings, inspection findings, outreach and roundtables.
2. In 2019, the IAASB will continue to progress finalizing its changes to ISA 315 (Revised) and developing guidance relating to EER, and will discuss the responses to the exposure draft relating to changes to Agreed-Upon Procedures engagements. Exposure Drafts of the Board's proposals for ISQM 1, ISQM 2 and ISA 220 (Revised) will be published in February 2019. The IAASB will also progress its work in relation to audits of less complex entities, and plans to publish a Discussion Paper seeking stakeholder views in the second quarter of 2019.
3. The approval of ISA 540 (Revised) in June 2018 signified the first revised standard to be completed as part of the IAASB's work program 'Addressing the Fundamental Elements of an Audit' and the IAASB's efforts in 2019 are now focused on implementation support activities.
4. In 2019, the IAASB will also further consider how it can enhance its working relationships with the IFAC, NSS, regulators, firms and others (as appropriate) to help advance its implementation activities for ISA 540 (Revised), as well as for those projects targeted to be completed in the next 18 months.
5. The IAASB will also start to plan for its future strategy period as proposed in this Consultation Paper. Time has been planned for discussions by both the Steering Committee of the IAASB, as well as the Board itself, to start to make the change to more focused activities within structured streams, including the development of related processes or criteria, as appropriate.
6. More detail about the projects, including proposed timing, for the IAASB activities in 2019 can be found in the IAASB's [Work Plan for 2019](#).

*Description of Projects for 2020–2021***Quality Management projects (ISQM 1, ISQM 2, ISA 220 (Revised))**

This project addresses revisions to ISQC 1 and ISA 220, and the development of a new standard for engagement quality reviews, ISQM 2. The purpose of the revisions to ISQC 1 is to improve firms' management of quality for all engagements performed under the IAASB's International Standards. This will be achieved through the introduction of a risk-based approach to the management of quality and strengthening various aspects of the standard, including governance and leadership, resources, information and communication, monitoring and remediation and networks. The new risk-based approach also aims to improve the scalability of the standard. ISQM 2 aims to strengthen and clarify various aspects of engagement quality reviews, including the engagements to be subject to such reviews, the eligibility criteria for engagement quality reviewers and the performance and documentation of the reviews. The revisions to ISA 220 include strengthening aspects of quality management at the individual engagement level.

The project pages for ISQM 1, ISQM 2 and ISA 220 (Revised), containing more information about the project, can be found [here](#).

Targeted Milestones

The IAASB targets to finalize the new and revised standards in March 2020. The Board will also consider the extent of the implementation activities necessary. (See box on Quality Management projects implementation support below).

Group Audits – Revision of ISA 600

This project addresses revisions to ISA 600 to strengthen the auditor's approach to a group audit and clarify the role of ISA 600 in relation to other ISAs, such as ISQM 1, ISA 220 (Revised), ISA 315 (Revised) and ISA 330, *The Auditor's Responses to Assessed Risks*.

As part of this project the IAASB issued a [Staff Audit Practice Alert: Responsibilities of the Engagement Partner in Circumstances when the Engagement Partner is not Located Where the Majority of the Audit Work is Performed](#) in August 2015 and a [Project Update](#) in October 2017.

The project page, containing more information about the project, can be found [here](#).

Targeted Milestones

The IAASB commenced this project in 2014 but decided to focus on some of the IAASB's other projects given that some of the foundational issues to be dealt with in the revisions to ISA 600 need to be first considered and addressed in other projects, such as ISQM 1, ISQM 2, ISA 220 (Revised), and ISA 315 (Revised). As these projects are nearing completion, the IAASB will intensify and progress its work on revising ISA 600 and will work towards the following milestones:

- Exposure Draft of revised ISA 600 – Targeted December 2019
- Final revised ISA 600 – Targeted March 2021

Extended External Reporting

The IAASB will continue to develop non-authoritative guidance in applying International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, to EER and continue to provide thought leadership on assurance issues in relation to EER.

Phase 2 of the project is targeted to run from early 2019 until late 2020, subject to the availability and allocation of the necessary resources. This phase is due to cover issues including determining the scope of an EER assurance engagement, exercising professional skepticism and professional judgment, obtaining the competence necessary to perform the engagement, and communicating effectively in the assurance report.

The project page, containing more information about the project can be found [here](#).

Targeted Milestones

Following the public consultation on the draft guidance developed during phase 1 and phase 2 in early and late 2019 respectively, the IAASB is expected to consider the responses received and update the guidance before seeking approval to publish it in final form in September 2020.

Audit Evidence

The scope of a project on Audit Evidence will need to be further considered by the IAASB, as there may be many relevant areas in the ISAs affected by a project on this topic. Topics likely to be considered for inclusion in this project include:

- A revision of ISA 500, *Audit Evidence*;
- Aspects of automated tools and techniques (including data analytics); and
- Professional skepticism.

Further consideration may also be given to whether, and how, it should encompass the need for possible revisions to ISA 230, *Audit Documentation* (including the impact of further consideration of professional skepticism), ISA 520, *Analytical Procedures*, ISA 530, *Audit Sampling*, ISA 320, *Materiality in Planning and Performing an Audit*, and other changes that may be warranted given the advances in technology.

Targeted Milestones

Initial information gathering and research activities relating to scoping the project, including discussions with the US Auditing Standards Board about current developments in its project on this topic, will commence in the first half of 2019. The discussions with the IAASB on the appropriate scoping of the project will help determine what would be included in a project proposal. More significant standard-setting activities are likely to commence in 2020.

Audit of Less Complex Entities

The objective of this project is to address the perceived challenges and issues relating to an audit of a less complex entity using the ISAs, and explore possible actions for IAASB consideration. The IAASB will initially develop a Discussion Paper for public consultation, and the feedback from the Discussion Paper and related outreach activities will help develop recommendations for IAASB consideration about the way forward.

The project page, containing more information about the project, can be found [here](#).

Targeted Milestones

The IAASB will publish a Discussion Paper in the second quarter of 2019 regarding perceived challenges and issues in relation to audits of less complex entities. A second Small- and Medium-sized Practices (SMP)/ SME Conference will be held in May 2019, in addition to other targeted outreach activities. The feedback from the Discussion Paper and outreach will help the IAASB determine the way forward for its work on audits of less complex entities.

Post-Implementation Review on Auditor Reporting Standards

The post-implementation review of the Auditor Reporting standards will commence in 2019. As part of the post-implementation review, we will monitor developments in auditor reporting around the world and will also focus on practical implementation issues and other issues that are causing the standards to not achieve their intended purpose. In addition to this, the post-implementation review will explore whether there are ways to improve the quality of the communication of key audit matters and other matters that could improve transparency about the audit that were not included in the new and revised Auditor Reporting Standards.

The project page, containing more information about this initiative can be found [here](#).

Targeted Milestones

Depending on the findings of the post-implementation review, the IAASB will perform further work as necessary in 2020 and 2021.

ISA 540 (Revised) Implementation Support

As ISA 540 (Revised) is implemented globally, the IAASB will continue to undertake activities for the effective implementation of this standard.

Towards the end of 2021 the IAASB will also develop an initial outline of the planned post-implementation review, in particular the scope and purpose of the review, as well as the expected timing.

The project page, containing more information about the project, can be found [here](#).

ISA 315 (Revised) Implementation Support

The IAASB will develop material to support awareness, understanding and effective implementation of ISA 315 (Revised). This material may include an ‘at a glance’ document, overview slide presentation, frequently asked questions and webinars. It may also include flow charts that show the overall risk assessment, the understanding of internal control and the understanding of the IT environment.

Quality Management projects (ISQM 1, ISQM 2, ISA 220 (Revised)) Implementation Support

The IAASB plans to develop material to support awareness, understanding and the effective implementation of the quality management standards. This material may include practical examples to demonstrate how the requirements of ISQM 1 may be implemented based on the nature and circumstances of the firm and its engagements. The IAASB is also exploring the development of an ‘at a glance’ document, frequently asked questions, a slide presentation, and webinars.

- i ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*
- ii ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*
- iii For more information about the Quality Management projects see the following project pages:
 - Proposed ISQM 1: <http://www.iaasb.org/projects/quality-management-firm-level-isqm-1>
 - Proposed ISQM 2: <http://www.iaasb.org/projects/engagement-quality-reviews-isqm-2>
 - Proposed ISA 220 (Revised): <http://www.iaasb.org/projects/quality-management-engagement-level-isa-220>
- iv For more information about the Group Audits project see the project page: <http://www.iaasb.org/projects/group-audits-isa-600>
- v For more information about the implementation of ISA 540 (Revised) see the project page: <http://www.iaasb.org/projects/isa-540-revised-implementation-working-group>
- vi For more information about the project on ISA 315 (Revised) see the project page: <http://www.iaasb.org/projects/isa-315-revised>
- vii For more information about the Auditor Reporting Post-Implementation Review see the project page: <http://www.iaasb.org/projects/auditor-reporting-implementation-working-group>
- viii For more information about the EER project see the project page: <http://www.iaasb.org/projects/emerging-forms-external-reporting-eer-assurance>
- ix For more information about the Data Analytics project see the project page: <http://www.iaasb.org/projects/data-analytics>. For more information about the Professional Skepticism project see the project page: <http://www.iaasb.org/projects/professional-skepticism>.
- x For more information about the Audits of Less Complex Entities project see the project page: <http://www.iaasb.org/projects/audits-less-complex-entities>
- xi For more information about the IAASB’s liaison with the IASB see the project page: <http://www.iaasb.org/projects/iaasb-iasb-liaison>
- xii Proposed International Standard on Quality Management (ISQM) (previously International Standard on Quality Control (ISQC)) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*
- xiii Proposed ISQM 2, *Engagement Quality Reviews*
- xiv ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*
- xv ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- xvi International Standard on Related Services (ISRS) 4400, *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information*

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IAASB

International Auditing
and Assurance
Standards Board



NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

DATE: 29 March 2019

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: International Update

Introduction

1. This Update summarises the significant news of the IAASB, other national auditing standards-setting bodies and professional organisations for the Board's information, for February and March 2019

International Federation of Accountants (IFAC)

1. There have been no significant developments related to audit and assurance to report in the period.

International Auditing and Assurance Standards Board (IAASB)

1. The IAASB Ongoing projects (refer to appendix 1)
2. The IAASB recently released a suite of proposed international standards on quality management. The proposals change the way professional accountancy firms are expected to manage quality—for audits, reviews, and other assurance and related services engagements.

[This short video](#) introduces the IAASB's three quality management standards and explains why the proposals are important to firms and other stakeholders.

[This document](#) is realised by the IAASB professional scepticism task force to explain the role of professional scepticism in quality management.

3. On 4th of February 2019, the IAASB issued its [2019 work plan](#) and its [proposed strategy for 2020-2023](#).

International Ethics Standards Board for Accountants (IESBA)

1. The IESBA issued [Exposure Draft, Proposed Revisions to Part 4B](#) of the Code on 27th of March 2019. This exposure draft seeks views from practitioners and other stakeholders in relation to proposed revisions to Part 4B of the revised and restructured International Code of Ethics for Professional Accountants (including International Independence Standards) to reflect terms and concepts used in International Standard on Assurance Engagements 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information.

The proposals in the Exposure Draft include:

- Changes in key terminology, including a revised definition of the term “assurance client”;

- Enhanced and clarified independence requirements for attestation engagements;
- Clarification of the types of assurance engagement addressed in Part 4B;
- Simplified guidance on assurance engagements that refers to the definitive source of explanatory material on such engagements in IAASB literature.

Accountancy Europe (AE) (former FEE)

1. Following the 2013 Accounting Directive, small European Union (EU) companies are no longer required to have a statutory audit. However, the EU legislation allows Member States to impose an audit on their small companies based on their specific circumstances.

[This publication](#) follows up on our 2016 factsheet and presents the current audit exemption thresholds in Europe and how several countries have recently amended them.

FEE survey results show that four EU countries have lowered their audit exemption thresholds while two countries have increased them between mid-2016 and early 2019. Overall, there was no clear upward/downward trend in the development of the thresholds in this period. FEE also found diverging national policies and views on auditing smaller entities.

Public Interest Oversight Board of IFAC (PIOB)

1. There have been no significant developments related to audit and assurance to report in the period.

International Integrated Reporting Council (IIRC)

1. Major international corporate reporting standard setters and framework providers have today [28 February 2019] [released a position paper](#) supporting the development of better reporting guidelines for the Sustainable Development Goals (SDGs).

Participants of the 'Corporate Reporting Dialogue' – an initiative convened by the International Integrated Reporting Council bringing together the major standard setters and framework providers internationally – advocate working together to provide guidance and structure for businesses to be transparent and accountable, and to ensure better decision-making that promote financial stability and sustainable development.

In the paper, entitled "SDGs and the future of corporate reporting", CDP, the Climate Disclosure Standards Board, the Global Reporting Initiative, the International Integrated Reporting Council, the International Organization for Standardization and the Sustainability Accounting Standards Board identify how corporate reporting can illustrate which SDGs are relevant to a company's business model, enabling both companies and investors to focus on those SDGs most likely to impact financial performance.

The paper also articulates the importance of driving integration of financial and non-financial information to demonstrate how companies create value for stakeholders over the short and long-term.

Global Reporting Initiative (GRI)

1. The [Technical Expert Group on Sustainable Finance](#) set up by the European Commission in July 2018 has published its first report on companies' disclosure of climate-related information in January 2019.

The adverse events associated with climate change cause damage to people and ecosystems, cost millions in damage, and disrupt business. And businesses have a large part in greenhouse gas emissions. This is why disclosure on ESG issues has become a must for investors to best assess impacts and risks, and for companies to take action to mitigate them. More importantly,

more transparency can also help companies identify opportunities, and contribute to securing capital and a more diverse investor base.

GRI as part of the Technical Expert Group on Sustainable Finance (TEG) is proud to support the report, which can be found [here](#).

International Forum of Independent Audit Regulators (IFIAR)

1. There have been no significant developments related to audit and assurance to report in the period.

International Organization of Supreme Audit Institutions (INTOSAI)

1. There have been no significant developments related to audit and assurance to report in the period.

International Organization of Securities Commissions (IOSCO)

1. There have been no significant developments related to audit and assurance to report in the period.

Australia

The Australian Auditing and Assurance Standards Board (AUASB)

1. Having deliberated and piloted a new process to expose IAASB standards in 2018, the AUASB considered a paper proposing further revisions to the ED process to facilitate the release of the EDs for the Quality Management Standards ('the QM Standards'). AUASB members requested some changes to the process which will provide greater clarity to AUASB staff and stakeholders about the ED process in future. These changes require further amendments to the EDs and associated documentation relating to the QM Standards, so the final review and approval of these EDs has been deferred to an AUASB teleconference which will be convened on 20th March 2019.

The AUASB also agreed in light of this delay that the proposed deadline for responses to the EDs for the QM Standards will be pushed back to the second week of June to allow more time for stakeholder analysis and responses to be submitted. A comprehensive engagement and outreach program relating to the QM Standards is also to be developed and approved at the April AUASB meeting.

2. The AUASB reviewed the draft response to the IAASB in relation to the revised International ED on AUP, ISRS 4400. The AUASB considered responses received from a range of stakeholders on the AUASB Consultation Paper released in December 2018 seeking feedback on the proposed version of this ED, with particular emphasis on where the ED differs from ASRS 4400 Agreed-Upon Procedures to Report Factual Findings.

The AUASB deliberated over a number of elements of the ED based on the current Australian requirements and feedback received on the Consultation Paper – specifically in respect of professional judgment, independence and restriction of use of the AUP report. Feedback from the AUASB will be captured in a revised response to the IAASB which will be sent to AUASB member for final 'fatal flaw' review and then submitted to the IAASB before the closing date for submissions on 15 March 2019.

3. The AUASB discussed Audit Quality considerations arising from:
 - The latest ASIC Audit Inspection Report which was released in January 2019;
 - A report recently issued by the Parliamentary Joint Committee on Corporations and Financial Services which includes an analysis of the committee's ongoing concerns on audit quality matters overseen by ASIC and the Financial Reporting Council (FRC); and

- Recent public inquiries about the audit market and implications for audit quality that have recently been completed or are in progress in the United Kingdom.
The AUASB also received an update on the joint publication currently nearing completion by the FRC and AUASB about Investors' current perceptions on audit quality in Australia.
4. The AUASB reviewed a revised version of the Exposure Draft for ASRE 2410, with some minor amendments requested. This ED is being compiled in conjunction with the New Zealand Auditing and Assurance Standards Board, and will be brought back to the AUASB for review and approval at the next regular meeting on 16 April 2019.

United Kingdom

FRC

1. The Financial Reporting Council (FRC) has extended its investigations into the preparation, approval and audit of the financial statements of Carillion plc to include certain matters relating to the financial statements for the year ended 31 December 2013.

The FRC announced on **29 January 2018**, its investigation into KPMG's audit of the financial statements of Carillion plc. for the years ended 31 December 2014, 2015 and 2016, and additional audit work carried out during 2017.

The FRC also announced on **19 March 2018**, an investigation into the conduct of Mr Richard Adam and Mr Zafar Khan, former Group Finance Directors of Carillion plc and members of the ICAEW, in relation to the preparation and approval of the financial statements of Carillion plc for the years ended 31 December 2014, 2015 and 2016, and the six months ended 30 June 2017, and the preparation and reporting of other financial information during the period 2014-2017.

Updates on the progress with the FRC investigations were announced on **16 May 2018** and **22 January 2019**.

2. The Financial Reporting Council (FRC) proposes to increase the work required of auditors when assessing whether an entity is a going concern. The consultation on important revisions to International Standard on Auditing (ISA) (UK) 570 *Going Concern* follows concerns about the quality and rigour of audit and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after as well as findings from recent FRC Enforcement cases. In proposing these revisions, requirements on UK auditors will be significantly stronger than those required by international standards.

The FRC proposes:

- auditors make greater effort to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;
 - improved transparency with a new reporting requirement for the auditor to provide a conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and
 - a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.
3. The FRC has issued a **position paper** which sets out how Ethical and Auditing Standards will be developed to respond better to the needs of users of audited financial information, following the recent call for feedback. The paper sets out the issues that will be developed to support a public consultation on the text of revised standards over the summer. It also sets out how the FRC's work on the standards responds to certain recommendations made by Sir John Kingman in his independent review of the FRC, how proposals are being developed to support the Competition and Market Authority's Market Study of the UK Statutory Audit Market; and how revisions made to the international Code of Ethics will be incorporated into the FRC Ethical Standard.

The **position paper** also draws the attention of Public Interest Entity auditors to changes that will take place to UK law in the event that the UK exits the European Union with no deal or transitional

period at 11PM on 29 March 2019. An appendix to the paper shows the most important implications of this, which audit firms will need to address. The FRC will also be writing to the Heads of Audit for all UK PIE audit firms, and to the Professional Accountancy Bodies to draw attention to this – the most immediate issues will be a change to the definition of a Public Interest Entity and implications for the provision of certain non-audit services which will be prohibited on a global basis rather than just within the European Union.

Institute of Chartered Accountants in England and Wales

1. Mazars LLP provides insight into how it approaches due diligence for human rights reporting, discussing its work with India-based steel manufacturer Jindal Stainless Ltd

The demand for more transparent and accountable disclosure of human rights risks and impacts has never been greater: business partners, investors, institutions and other stakeholders want corporate social responsibility (CSR) reporting that reflects companies' consideration of human rights.

But for this reporting to have credibility it must be backed by rigorous due diligence processes. 'Human rights reporting must be more than a marketing and communications exercise. It should reflect culture within a company, demonstrate its actions to mitigate against its human rights impacts, and be a fair representation of the company's position in this area,' says Richard Karmel, a partner at Mazars LLP UK and head of social performance and human rights reporting

The Charity Commission

1. There have been no significant developments related to audit and assurance to report in the period.




Association of Chartered Certified Accountants (ACCA)

1. There have been no significant developments related to audit and assurance to report in the period.

United States of America

Public Company Accounting Oversight Board (PCAOB)

1. The Public Company Accounting Oversight Board today released three staff guidance documents developed to support implementation of the new critical audit matter (CAM) requirements. Auditors will soon be required to communicate CAMs in the auditor's report under the standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

The staff guidance consists of the following: (1) a high-level overview of CAM requirements , (2) thematic observations that arose from the Office of the Chief Auditor's review of audit firms' CAM methodologies , and (3) a deeper dive on the determination of CAMs . While these documents primarily offer insights for auditors, the high-level overview—"The Basics"—may also be of interest to preparers, audit committees, and investors.

American Institute of Certified Public Accountants (AICPA)

1. There have been no significant developments related to audit and assurance to report in the period.

Center for Audit Quality (CAQ) - (affiliated with AICPA)

1. There have been no significant developments related to audit and assurance to report in the period.

Canada

Canadian Auditing and Assurance Standards Board (AASB)

1. The AASB provided input to the International Auditing and Assurance Standards Board (IAASB) members from Canada on the IAASB's project to revise International Standard on Auditing (ISA) 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. The Board discussed:
 - the use of a top-down, risk-based approach to scoping group audits;
 - definitions of component, significant component and group engagement team; and
 - the need for further clarification of component materiality considerations.The Board will continue to discuss this project at future meetings.
2. The AASB provided input to the IAASB members from Canada on issues related to the responses received on the Exposure Draft of proposed ISA 315 (Revised), *Identifying and Assessing the Risk of Material Misstatement*. The Board discussed the IAASB's proposed changes to:
 - understanding of the entity's system of internal control;
 - individual components of internal control;
 - separate assessment of inherent and control risk; and
 - concepts of relevant assertions and significant classes of transactions, account balances and disclosures.The Board will continue to discuss this project at future meetings.
3. The AASB considered Canadian stakeholders' views on its Exposure Draft of proposed Canadian Standard on Related Services (CSRS) 4400, *Agreed-Upon Procedures Engagements*, and finalized its response letter to the IAASB Exposure Draft.

CPA Canada

1. There have been no significant developments related to audit and assurance to report in the period.

Project	Overview of the project and its current status
<p>Quality Control</p> <p>No Update for the period</p>	<p>Objective of the Project: Initial activities in scoping the project will focus on whether there is a need to revisit specific aspects of the quality control standards to enhance clarity and consistency of their application. This may include restructuring ISQC 1, additional requirements or guidance within the standard or additional guidance in support of the standard. Specific aspects within ISQC 1 and ISA 220 being explored include, governance, engagement partner responsibilities, engagement quality control reviews, monitoring, remediation, alternative audit delivery models and specific issues pertaining to small- and medium-sized practices</p> <p>Background and current status: The proposed changes to QC were included in the IAASB Audit Quality ITC. The ITC response period is closed now. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, and developed project proposals for quality control that were presented at the September 2016 IAASB meeting.</p> <p>The IAASB considered the Quality Control Other Working Group's (QCOWG) proposals in respect of:</p> <ul style="list-style-type: none"> • Setting the objective of an engagement quality control (EQC) Revising the definition of an EQC review; • Determining the scope of the engagements subject to an EQC review; and • The execution of an EQC review. <p>At its March 2017 meeting, the IAASB discussed matters to do with the eligibility of the engagement quality control reviewer.</p> <p>QC-Firm Level</p> <p>In June 2017 the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC 1, a result of incorporating a quality management approach (QMA) into ISQC 1, that included a discussion of a working draft of ISQC 1 (Revised) and how the proposals are expected to change firm behaviors. The Board was supportive of the overall direction proposed by the QCTF and emphasized the importance of outreach with a variety of stakeholders to seek input on the practicality of the proposals. The Board also encouraged the QCTF to develop guidance and examples to accompany the revised standard in order to explain the implementation and application of the standard.</p> <p>In its September 2017, the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC1 in relation to documentation of the system of quality management. The Board was supportive of the QCTF's proposals and suggested various refinements. Some of the key proposals were as follow:</p> <ul style="list-style-type: none"> • the proposal to retain the requirement for an EQC review for all audits of financial statements of listed entities, i.e., not only for general purpose financial statements

	<ul style="list-style-type: none"> • the proposals in relation to other engagements for which the firm determines that an EQC review is required (see here for details) • the objective of ISQC 2, including whether it is appropriate to locate the responsibilities of the EQC reviewer in ISQC 2, instead of ISA 220 • the IAASB supports the proposal to remove the reference to “team” from the definition of an EQC reviewer, and instead explain the use of a team in the application material supporting the appointment of the EQC reviewer • the proposed requirements and application material in relation to the eligibility of the EQC reviewer. <p>The Board also discussed the QCTF’s recommendations in relation to EQC reviews that would be incorporated in ISQC 1 and the proposed new standard, ISQC2. The Board confirmed that the purpose of the EQC review is to evaluate the significant judgments made by the engagement team. In addition to various recommendations to further enhance and clarify the various requirements and application material, the Board encouraged the QCTF to improve the robustness of the requirement relating to the scope of the engagements subject to EQC review.</p> <p>In December 2017, the Board discussed a first read of the proposed exposure draft of ISQC 1 (Revised) 5 and was broadly supportive of the direction of the standard. The Board focused on the scalability of the standard, clarifying the interrelationship of the components, and the appropriate placement of the governance and leadership component. As well as requesting the Task Force to clarify the meaning of deficiencies and major deficiencies, the Board asked that a framework be developed for assessing deficiencies in the system of quality management and requested clarification of how such deficiencies may impact the achievement of the overall objective of the standard. The Board also asked the Task Force to reconsider the threshold for the identification of quality risks and encouraged the Task Force to explore the development of appropriate guidance to accompany the proposed exposure draft that addresses the application of the standard to a spectrum of firms.</p> <p>The Board discussed the exposure draft (ED) of proposed ISQC 1 (Revised)1 and was supportive of the direction that the Quality Control Task Force was taking the standard, noting the improvement in the readability and understandability overall. The Board encouraged the Quality Control Task Force to consider whether there are further opportunities to address scalability, including further refinement and simplification of the standard, where possible. The Board also discussed changing the title of the standard</p> <p>In finalizing the ED in December 2018, the Board discussed the definition of deficiencies and bringing more emphasis to positive findings from the firm’s monitoring activities and how they may be used in the system of quality management. The Board also discussed the requirement for the firm to establish additional quality objectives beyond those required by the standard and further clarifying the identification and assessment of quality risks. In addition, the Board suggested further simplification of the requirement addressing communication with external parties, although in general agreed to retain an explicit reference to transparency reports in the requirement. The Board also discussed network requirements or network services, and</p>
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	<p>adjusted the requirement to clearly reflect the expectations of the firm regarding the effect of network requirements or network services on the firm's system of quality management.</p> <p>The Board supported the Quality Control Task Force's recommendations regarding matters to be addressed in the Explanatory Memorandum, including the proposed questions.</p> <p>Quality Control – Engagement Level</p> <p>In December 2017, The IAASB supported the direction of the proposed changes to ISA 220.4 In particular, the Board supported the proposed changes that emphasize that the engagement partner is responsible and accountable for audit quality. The Board encouraged the ISA 220 Task Force to consider, as it progresses revisions to ISA 220, how the proposed changes will strengthen the performance of quality audits.</p> <p>The Board discussed a draft ED of proposed ISA 220 (Revised)² and was supportive of the proposed changes. The discussions focused on whether changes were needed to the objective of the standard and the wording of the requirement regarding the engagement partner being “sufficiently and appropriately involved.” The Task Force plans on presenting the ED of proposed ISA 220 (Revised) for approval by the Board at the December 2018 meeting.</p> <p>In December 2018 the Board supported the requirement for the firm to establish policies or procedures addressing limitations on the engagement partner moving into the role of engagement quality reviewer, including the reference to a cooling-off period in the application material. The Board agreed that stakeholder views were needed relating to the objectivity of the engagement quality reviewer and a cooling-off period and supported the ISQM 2 Task Force's recommendation for including specific questions in the Explanatory Memorandum on this matter to be developed in coordination with the IESBA. The Board also clarified the requirement for notifications by the engagement quality reviewer to the engagement partner and, when applicable, individual(s) within the firm, as well as the documentation requirements.</p> <p>The Board discussed the requirements that address firm policies or procedures, the role of the engagement partner vis-à-vis other members of the engagement team and the difference between the usages of the phrases “the auditor shall determine” and “the auditor shall be satisfied.” The board also discussed how best to clarify the requirement addressing communications from the firm about the firm's monitoring and remediation process.</p>
<p>Group Audits– ISA 600</p> <p>Has update for the period</p>	<p>Objective of the project: Determining the nature of the IAASB's response to issues that have been identified, relating to Group Audits, from the ISA Implementation Monitoring project and outreach activities, inspection reports from audit regulators, discussion with NSS and responses to the IAASB's Work Plan consultation (i.e., whether standard-setting activities are appropriate to</p>

	<p>address the issues, and if so, whether specific enhancements within ISA 600 or a more holistic approach to the standard would be more appropriate).</p> <p>Background and current status: The IAASB commenced work on one aspect of this project relating to the responsibilities of the engagement partner in circumstances where the engagement partner is not located where the majority of the audit work is performed in December 2014. A Staff Audit Practice Alert on this aspect was published in August 2015. Information gathering on the broader aspects of group audits commenced in March 2015.</p> <p>The issues identified and discussed at the IAASB meetings form part of a combined Invitation to Comment on Enhancing Audit Quality in the public interest which was issued in December 2015 and is open for comments till May 16, 2016. The ITC is now closed. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting.</p> <p>In its June 2017 meeting, the IAASB received an update on the activities of the GATF. The IAASB supported the proposal of the GATF to engage more directly with the QCTF, ISA 220 TF and ISA 315 (Revised)³ TF, to help ensure that the requirements in those standards provide appropriate connection points between those projects and ISA 600.⁴ The IAASB also supported the proposal of the GATF to publish a short project update and asked the GATF to consider topics that are related to standards not under revision, for example, materiality and audit evidence.</p> <p>In December 2017, the Board received a presentation about the interconnections between ISA 600 and other ongoing projects, and how the Task Force is monitoring the activities of the other task forces, providing input and considering implications of changes in the other standards on ISA 600.</p> <p>Update for the period</p> <p>In March 2019, the Board was updated on the work performed by the Group Audit Task Force since the start of the project to revise ISA 600¹ and was asked for its views on issues related to scoping a group audit, the definitions, and the linkages with other ISAs. The Board continued to support developing a risk-based approach for scoping a group audit and generally supported the Group Audit Task Force's approach on the definitions and the issues that were presented in relation to the responsibilities of the group engagement partner, acceptance and continuance, understanding the group and its components, understanding the component auditor, identifying and assessing the risks of material misstatement and responding to assessed risks, the consolidation process, communication between the group auditor and component auditors, and evaluating the audit evidence obtained. These and other issues need to be further developed in the context of the risk-based approach and changes made to other of the IAASB's International Standards. The Group Audit Task Force will continue to work on the issues related to scoping a group audit, the</p>
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¹ International Standard on Auditing (ISA) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

	<p>definitions and other issues identified in the Invitation to Comment, and will present it for further discussion at the June 2019 IAASB meeting.</p>
<p>Professional Scepticism</p> <p>No Update for the period</p>	<p>Objective of the project: To make recommendations on how to more effectively respond to issues related to professional scepticism.</p> <p>Background and current status: The IAASB commenced its initial information gathering on the topic of professional scepticism in June 2015. The issues identified and discussed at the IAASB meetings are part of the Invitation to Comment on Enhancing Audit Quality in the Public Interest which was issued in December 2015 and is open for comments till May 16, 2016.</p> <p>The working group is comprised of representatives from the IAASB, the International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB) to explore the topic of professional scepticism, enabling the three independent standard-setting Boards to consider what actions may be appropriate within their collective Standards and other potential outputs to enhance professional scepticism.</p> <p>Together with the Quality Control and ISA 600-Group Audits project, this project is part of the Audit Quality Enhancements Coordination Group (AQECG). The AQECG intends to coordinate the various inputs to the invitation to comment developed at the individual working group level, and take a holistic approach as to how the matters are presented in one invitation to comment. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting.</p> <p>Subsequent to the December 2016 IAASB meeting, the joint PSWG held a teleconference to discuss matters related to potential changes to the concept/definition of professional scepticism in the ISAs. The March meeting papers are available here.</p> <p>In June 2017 meeting, the IAASB received an update on the activities of the Professional Skepticism Working Group (PSWG) and the Professional Skepticism IAASB Subgroup since the last Board meeting in March 2017. The Board supported the release of a communication to update stakeholders about the actions and current status of the PSWG's work. The Board also discussed the concept of "levels" of professional skepticism and supported the recommendations of the Professional Skepticism IAASB Subgroup not to introduce the concept into the ISAs.</p> <p>The IAASB discussed the Professional Skepticism Subgroup's analysis and related conclusions regarding different "mindset" concepts of professional skepticism and the use of the words in the ISAs in its December 2017. The Board supported the conclusions of the Subgroup, including that the current concept of the attitude of professional skepticism involving a "questioning mind" continues to be appropriate and should be retained within the ISAs. The IAASB Professional Skepticism Subgroup will liaise as needed with the Professional Skepticism Joint Working Group.</p> <p>In September 2018 meeting, The Board received an update on the activities of the IAASB's Professional Skepticism Subgroup (Subgroup) since March 2018. The Chair of the Subgroup also presented the Board with a draft</p>

	<p>publication that seeks to highlight the IAASB's efforts to appropriately reflect professional scepticism into the IAASB standards as well as other relevant news and information on professional skepticism, including collaboration with the International Ethics Standards Board for Accountants (IESBA) and International Accounting Education Standards Board (IAESB). The Board supported the issuance of the publication and future publications of this nature.</p>
<p>Accounting Estimates (ISA 540) and Special Audit Considerations Relevant to Financial Institutions (No Update for the period)</p>	<p>Objective of the project: The objective of the financial institutions project is to:</p> <ul style="list-style-type: none"> A. Clarify and enhance the relationship between the banking supervisors and the bank's external auditors; B. Consider and address issues of particular significance in audits of financial institutions; and C. Consider as to whether the issues relating to ISA 540 that have been highlighted as particularly relevant to audits of banks and other financial institutions are more broadly applicable to other entities <p>Background and current status: The ISA Implementation Monitoring project, specific requests from banking and insurance regulators and outreach activities by the ISA 540 Working Group, have identified issues with respect to auditing accounting estimates, in particular in relation to audits of financial institutions. Also, inspection finding reports from audit regulatory bodies highlighted consistent issues with respect to the audit of accounting estimates, including in relation to audits of financial institutions. There are areas where there have been calls for clearer or additional requirements or guidance to enable auditors to appropriately deal with increasingly complex accounting estimates and related disclosures, including obtaining sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements as a whole.</p> <p>A draft exposure draft of revised ISA 540 has been developed and is to be deliberated by IAASB with an approved ED expected to be issued for comment in December 2016. The board reviewed the draft in its June 2016 meeting.</p> <p>IAASB expects to complete its deliberation of responses to the exposure draft and resulting proposed changes to ISA 540 (Revised) in 2017 with the revised standard expected to be issued in last quarter of 2017.</p> <p>The IAASB has released the ED ISA 540 for comment in May 2017.</p> <p>The Board received an overview of the comment letters received on proposed ISA 540 (Revised) in its September 2017 meeting. The Board discussed respondents' concerns about the complexity of the proposed ISA and potential difficulties in understanding and applying it in practice, and asked the ISA 540 Task Force to look at ways to restructure the proposed ISA to improve its clarity and readability. The Board also discussed the scalability of the ISA, how risk factors could be taken into account, and how best to structure the response to the assessed risks of material misstatement. The Board highlighted the importance of achieving the right balance between issuing a high-quality standard and the public interest in finalizing the ISA in a timely fashion. The IAASB is holding an additional meeting in October to progress proposed ISA 540 (Revised).</p>

	<p>The IAASB discussed key issues raised by respondents in relation to the Exposure Draft of ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures', including the scalability of the ISA, the use of the term "reasonable," the exercise of professional skepticism and the Task Force's approach to the application material. The IAASB also discussed the Task Force's revisions to requirements and application material based on comments received on the Exposure Draft. The IAASB asked the Task Force to focus on redrafting the application material according to the planned approach with a view to conducting a first read of ISA 540 (Revised)¹ in March 2018, ahead of a targeted approval in June 2018.</p> <p>The ISA (540) was approved in IAASB's June 2018 meeting.</p>
<p>Data Analytics</p> <p>No Update for the period</p>	<p>Objective of the project: The objective of the Data Analytics Working Group (WG) is to:</p> <p>A) Explore emerging developments in audit data analytics; and</p> <p>B) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe.</p> <p>Background and current status: Information gathering on data analytics began in April 2015 and the Data Analytics Working Group will continue with its planned outreach activities in future. The DWAG published its first publication "The IAASB's Work to Explore the Growing Use of Technology in the Audit" in June 2016.</p> <p>At the March meeting, the IAASB received a video presentation of a panel discussion among members of the DAWG that was presented at the International Forum of Independent Audit Regulators Inspections Workshop.</p> <p>The Chair of the DAWG provides an update on the project in February 2017 on the IFAC website.</p> <p>In its June 2017 meeting, the IAASB received a presentation of high-level observations from respondents to the IAASB's Request for Input: Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics. It was noted that respondents supported the IAASB in undertaking this work and encouraged continued active participation of the Data Analytics Working Group in other current standard-setting projects of the IAASB underway.</p>
<p>Emerging External Reporting</p> <p>Has update for the period</p>	<p>Objective of the project: The objective of the Integrated Reporting Working Group (IRWG) is to:</p> <p>A) Explore emerging developments in integrated reporting and other emerging developments in external reporting;</p> <p>B) Gather further information on the demand for assurance, the scope of the assurance engagement and the key assurance issues; and</p> <p>C) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe.</p> <p>Background and current status: At its September 2014 meeting the Innovation WG proposed, and the IAASB agreed to establish a WG to</p>

specifically monitor the developing interest in integrated reporting and the demand for assurance on integrated reports. This includes initial thinking on the nature of such engagements, including the scope of the assurance engagement, the suitability of the criteria, and other matters related to assurance on integrated reports. The Board considered the draft working paper prepared by the IRWG [Supporting Credibility and Trust in Emerging Forms of External Reporting](#) in its June 2016.

The Discussion Paper was issued in August 2016.

In its June 2017 meeting, the IAASB received a presentation about the high-level observations from the comment letters received to the Discussion Paper, Supporting Credibility and Trust in Emerging Forms of External Reporting. It was noted that respondents generally supported the development of guidance on how to apply existing international assurance standards rather than developing new standards, and that the IAASB should continue to provide thought leadership on assurance issues and coordinate its work with other relevant organizations.

The Board received an update on the project in December 2017. It was noted that the grant agreement with the World Business Council for Sustainable Development (WBCSD) was finalized for the funding of the project and that the Project Proposal and Feedback Statement has been finalized to be published on the IAASB's website. The board also received an update on the plan for developing the framework for the non-authoritative guidance for EER during the next year, including the required research to be gathered and the establishment of a Project Advisory Panel (PAP).

In its September 2018 meeting, the EER Task Force presented the remaining Phase 1 'issues' that were not presented in June alongside a first draft of the Phase 1 guidance. The Board noted the need for the guidance to demonstrate its full alignment with the requirements of ISAE 3000 (Revised), 5 and for the EER Task Force to provide further explanations about any guidance that goes beyond the requirements and application material in ISAE 3000 (Revised). The EER Task Force expects to receive further input from stakeholders during its forthcoming series of discussion events and will present a revised draft of the guidance to the IAASB in December 2018.

In December 2018 The EER Task Force presented an updated version of the Phase 1 draft guidance, which reflects changes to address feedback received from the IAASB at the September 2018 IAASB meeting, and from other stakeholders, including in relation to a 'materiality process' and assertions as they relate to the characteristics of suitable criteria. The Board noted that the draft guidance had significantly improved since discussions at the September 2018 meeting, but that further work on the drafting is enquired. The Board will discuss a further version on a teleconference in January 2019 before the draft guidance is published for public comment.

Update for the period:

The Board approved for public comment Phase 1 of the draft guidance in January 2019. At its March 2019 meeting, the Board discussed several challenges related to Phase 2 of the guidance. The challenges include: determining the scope of an EER assurance engagement; communicating

	<p>effectively in the assurance report; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and obtaining evidence in respect of narrative and future-oriented information. The Board's deliberations of the challenges concerned were facilitated through breakout sessions, after which each breakout group reported back to the Board in a plenary session. The EER Task Force will consider the inputs that were received in progressing the development of Phase 2 of the guidance for further discussion at the June 2019 IAASB meeting.</p>
<p>Agreed-Upon Procedures</p> <p>No Update for the period</p>	<p>The objective of the project is to:</p> <p>A) Revise International Standard on Related Services (ISRS) 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information in the Clarity format; and</p> <p>B) Consider whether standard-setting or other activities may be appropriate for engagements that use a combination of procedures derived from review, compilation and agreed-upon procedures engagements (also known as "hybrid engagements"), in light of the existing standards that may be applicable to these services in the IAASB's current suite of standards.</p> <p>Background and current status: During consultations on the IAASB's 2015-2019 Strategy and the related 2015-2016 Work Plan, many stakeholders expressed the need to revise ISRS 4400 to meet the growing demand for agreed-upon procedure engagements. In response to the stakeholders' comments, the IAASB established a working group to explore issues involving agreed-upon procedure engagements. The issues identified and discussed at the IAASB meetings will be used to revise ISRS 4400 and possibly develop new standard(s) or guidance that would address engagements where there is a combination of agreed-upon procedures and assurance.</p> <p>The Agreed-Upon Procedures (AUP) Working Group presented a first draft of its Discussion Paper, <i>Exploring the Growing Demand for Agreed-Upon Procedures Engagements and Other Services and the Implications for the IAASB's Standards</i>, to the Board in June 2016. The IAASB provided the AUP Working Group with input to enhance the Discussion Paper and suggested that the paper pose a question to explore whether the IAASB should develop guidance on multi-scope engagements. The AUP Working Group will present a revised draft of the Discussion Paper at the September 2016 IAASB meeting.</p> <p>In its September 2017 meeting, the Board discussed the feedback received on the Discussion Paper and approved a standard-setting project proposal to revise ISRS 4400, subject to clarifications around the use of judgment, independence, restriction of the report of factual findings and required documentation.</p> <p>In its September 2018 meeting, The Board approved the ED of ISRS 4400 (Revised)³ for public exposure. In finalizing the ED, the Board agreed that independence is not required for an AUP engagement and that the AUP report would include statements addressing circumstances when the practitioner is (or is not) required to be independent, and whether the practitioner is (or is not) independent. The ED will be issued in early November with a 120 day comment period</p>

ISA 315 (Revised)
has update for
the period

The tentative objectives of the projects at this stage are:

- A) to address the issues that have been identified by the ISA Implementation Monitoring project.
- B) Possible changes that may be necessary to ISA 315 (Revised) to enhance the requirements and guidance for evolving environmental influences (such as changing internal control frameworks and more advanced technology systems being utilized by both management and auditors).
- C) In its June 2016 meeting, the IAASB directed the ISA 315 (Revised) Working Group to present a project proposal for the IAASB's consideration at its September 2016 meeting to commence standard-setting activities. The [project proposal](#) was presented and approved in the IAASB's September 2016 meeting.

Since the December 2016 IAASB meeting, the task force has had one physical meeting and two teleconferences to develop the [March meeting papers](#).

In September 2017, the ISA 315 Task Force presented proposed changes to the requirements in ISA 315 (Revised) to address identified issues relating to understanding the entity and its environment, including the applicable financial reporting framework, and internal control, including obtaining an understanding of the five components of internal control. The Board broadly supported the proposals, but asked for consideration about some of the proposed changes to the definitions, as well as the perceived focus on controls in obtaining the necessary understanding of the components of internal control. With regard to proposed changes to the identification and assessment of inherent and control risk, the Board supported a separate assessment of inherent and control risk, but asked that the ISA 315 Task Force further consider how this works practically and highlighted that further clarification is needed relating to the assessment of control risk.

In December 2017, the Board discussed a first read of proposed changes to the requirements and application material of ISA 315 (Revised)². The Board broadly supported the proposals, but asked for further consideration by the Task Force on various matters, including aspects of the definitions of 'controls' and 'relevant assertions,' and regarding the introduction of the term 'business model' and its interactions with current requirements of the standard. The Board also questioned the use of 'sufficient and appropriate' as it relates to potential confusion with "sufficient appropriate audit evidence" and whether a change may have unintended consequences if this concept were to be introduced as proposed. The Board encouraged further consideration about how fraud can be included as a qualitative inherent risk factor, taking into account how this would link to the fraud risk factors in ISA 240.3 The Board continued to be supportive of the introduction of "spectrum of risk" but thought the spectrum of risk could be better emphasized and explained earlier in the standard.

The Board recognized the need for further consideration about scalability, but agreed that scalability should be presented through the requirements and application material in context of the auditor's consideration of risk thereby eliminating the need for "considerations for smaller entities."

	<p>The Task Force will continue to progress the proposed changes to the standard for a second read of an exposure draft in March 2018.</p> <p>The ED was issued in July 2018 for public consultation.</p> <p>Update for the period</p> <p>In March 2019 The Board discussed the ISA 315 Task Force's initial proposals to address specific responses to the proposed ISA 315 (Revised)² (ED-315), in particular, the broad concerns in relation to the length and complexity of the standard. In doing so, the Board considered alternative approaches about how to present the requirements for the auditor's understanding of the entity's system of internal control.</p> <p>The Board agreed to move forward by presenting the requirements at a broader, higher level (i.e., in a more direct way in terms of focusing on the 'what' that is required from the auditor), while maintaining the robustness of the current standard. Accordingly, all of the requirements will be reconsidered, the criteria or matters that are definitional will be relocated to definitions, and the 'why' and 'how' will be further explicitly considered as to where it is appropriate to be moved to. The Board acknowledged that scalability was likely best addressed in the application material.</p> <p>The Board's discussions also focused on proposed changes to address specific issues within the section on understanding the entity's system of internal control, in particular, in relation to clarifications on controls relevant to the audit, the information system and control activities components, and the various evaluations required within this section of the standard.</p> <p>Aspects of ED-315 and related feedback that have not been addressed during this meeting will be presented at the June 2019 IAASB meeting. The ISA 315 Task Force will continue to progress the proposed changes to ED-315 with a targeted approval of the final standard at the September 2019 IAASB meeting.</p>
<p>Less Complex Entities</p> <p>Has update for the period</p>	<p>Update for the period:</p> <p>IN March 2019 the Board discussed a proposed Discussion Paper (DP), <i>Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Implementing the ISAs</i>. The discussion highlighted the shift in focus on complexity of the entity rather than its size in driving the ongoing discussions and activities to address issues and challenges in audits of less complex entities (LCEs). The Board was supportive of the DP's overall direction, noting the importance of the project and the need for action by the IAASB and others.</p> <p>The Board liked the simple, clear way the DP had been presented and noted it was appropriate for its key target audience (i.e., auditors of LCEs). The Board made suggestions for improvements, particularly with respect to the issues and challenges, the possible actions presented within the DP and the questions to be posed to respondents in order to obtain relevant and useful feedback.</p>

² Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

	Proposed changes to the DP will be presented in a Board call on April 10 th , with the final DP targeted to be published for public consultation before the end of April 2019.
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NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

DATE: 29 March 2019

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: Domestic Update

Introduction

1. This Update summarises the significant news from Financial Market Authority, New Zealand Institute of Chartered Accountants and other organisations for the Board's information, for the period February and March 2019.

Financial Markets Authority (FMA)

1. The Professional Conduct Committee of the Chartered Accountants Australia New Zealand (CA ANZ) has published its findings in relation to Richard Owen Dey and Michael Derek Wood.

The FMA referred the conduct of the audit firm involved, Ingham Mora, to CA ANZ in December 2017.

The referral followed an audit quality review that identified a compliance breach in relation to the mandatory rotation of the key audit engagement partner after 7 years.

The FMA considers that continuing engagements after 7 years is unacceptable to those auditors who do comply with the mandatory rotation requirements set out in the Professional and Ethical Standards. The FMA therefore referred this matter to CA ANZ's Professional Conduct Committee.

CA ANZ's Professional Conduct Committee agreed with our findings. A copy of the determination by the PCC can be found [here](#).

The final determination of the PCC provides further clarification to the Professional and Ethical Standards when it comes to mandatory auditor rotation. The FMA recommends auditors take note of the PCC findings.

The New Zealand Institute of Chartered Accountants

1. The CAANZ published an article: [Modular thinking - the future of audit?](#)

CPA Australia

1. The CPA Australia NZ published the following articles:

- [Audit quality: is it time for a different approach?](#)
- [Why professional scepticism is a crucial weapon in an auditor's armoury](#)
- [How technology and data are transforming accounting and audit](#)

The Institute of Directors (IoD)

1. There have been no significant developments relating to audit and assurance to report in the period.

Sustainability Matters

1. There have been no significant developments relating to audit and assurance to report in the period.

To: NZAuASB members
From: Dr Rowena Sinclair
Date: 28th March 2019
Re: Academic update 2019-2

Agenda 10.3

This second academic update for 2019 considers studies that are applicable for the updated long association of personnel requirements in PES1 (NZAuASB, 2018); as well as studies related to the tenure of audit firms. Following this New Zealand and Australian research on sustainability assurance is presented.

Recent research sought to answer the question “*why auditors are blamed when something goes wrong?*”. Hoos, Saad & Lesage’s (2018, page 431) experimental study not surprisingly supported the two most common expectations i.e. “*the deep pocket [of audit firms] and investors’ poor knowledge of the audit function*”. However, contrarily they also found that the communication strategy of the audit firm can be an active contribution to the ‘*blame game*’ i.e. “*there is a risk that steady communication by an audit firm that ‘trust is what auditors sell’ fires back when something goes wrong*” (Hoos, et al., 2018, page 423).

(1) LONG ASSOCIATION / AUDIT TENURE

Long Association of personnel

Arthur, Endrawes & Ho’s (2017, page 378) Australian study found that “*audit partner rotation can enhance audit quality but only when both the incoming audit partner and the incoming audit firm are industry specialists*”. This may not be feasible in a small audit country like New Zealand.

Laurion, Lawrence & Ryans’ (2017) US study suggests that “*auditor partner rotation provides a fresh look at the audit engagement*” but that the “*fresh look effects are fairly modest*”. Hence, not the big increase in audit quality that regulators have sought.

Audit firm tenure

Bleibtreu & Stefani’s (2018) study covers a contrasting viewpoint between; mandatory audit firm rotation; and non-mandatory audit firm rotation. They state that “*proponents argue that rotation would strengthen independence and decrease audit market concentration, opponents stress the importance of auditors’ learning effects, which would be eliminated by a change in auditors*” (Bleibtreu & Stefani, 2018, page 1).

Singer & Zhang’s (2018, page 315) US study found that “*longer audit firm tenure leads to less timely discovery and correction of misstatements*”.

By contrast, Bratten, Causholli & Omer’s (2019, page 295) US study “*does not support calls for mandatory audit firm rotation for large complex institution*”. The study focuses on the US Banking industry i.e. “*a regulated industry where regulatory safeguards potentially limit the role of the audit firm*” (Bratten, et al., 2019, page 322). Their study finds that “*additional benefits accrue with very long audit firm tenure*” due to the complexity of banks (Bratten, et al., 2018, page 423).

(2) SUSTAINABILITY ASSURANCE (New Zealand research)

The February 2019 release of NZ AS 1 The Audit of Service Performance Information (NZAuASB, 2019) provides an example of extended external reporting (EER) where information goes beyond the financial statements and its accompanying notes.

Sustainability reporting is another form of EER. Farooq & de Villiers’ (2019, page 307) New Zealand and Australian study examined the “*competition between accounting sustainability assurance*

providers and non-accounting sustainability assurance providers". They found that accounting sustainability assurance providers preferred to use ISAE (NZ) 3000 (NZAuASB, 2016). They presented "sustainability assurance as similar to a financial audit", and thus argued "in support of a single provide for financial audits and sustainability assurance" (Farooq & de Villiers, 2019, page 307). Conversely, non-accounting sustainability assurance providers preferred using sustainability assurance standard AA1000AS (AccountAbility, 2008). Figure 1 provides a depiction of their study's findings and broader implications.

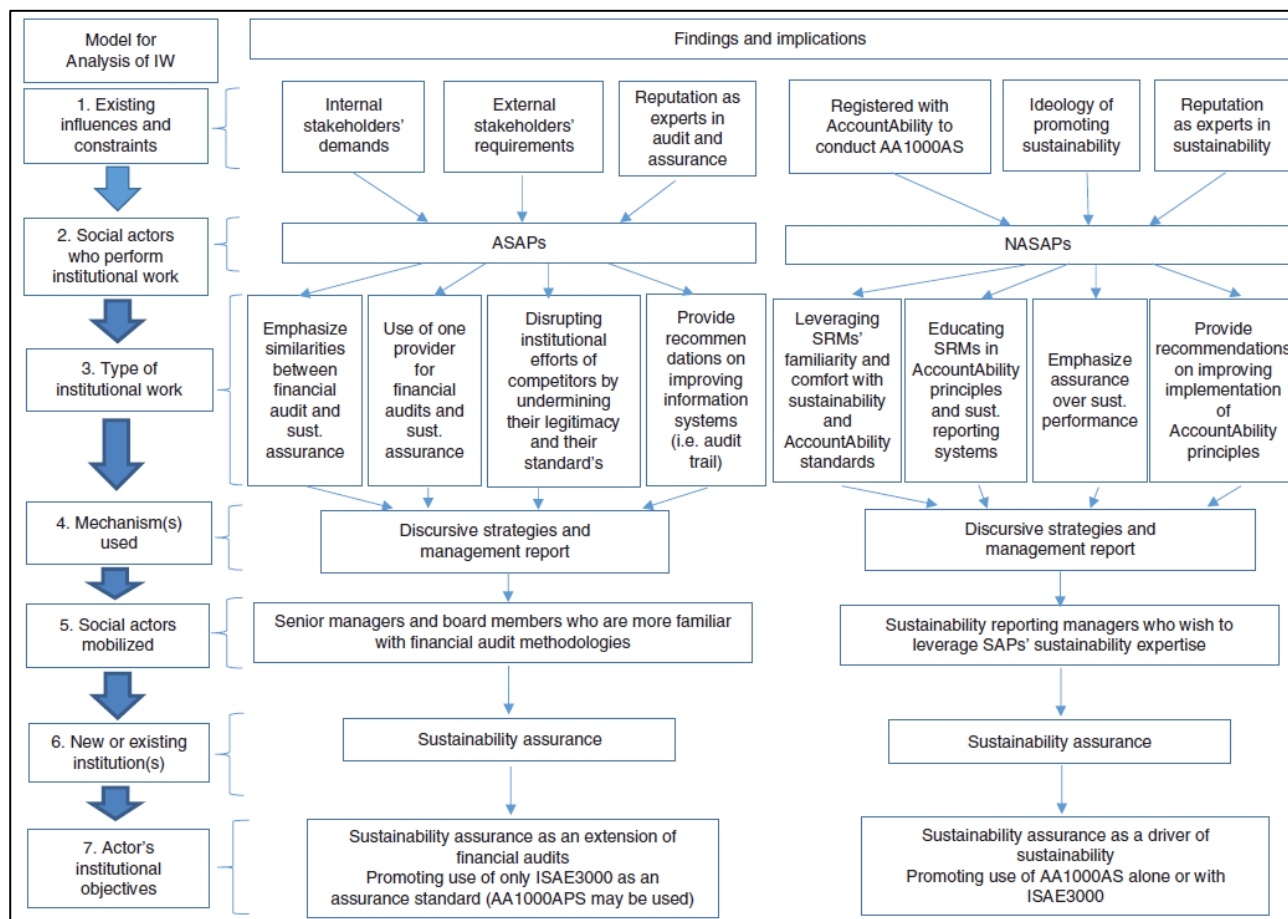


Figure 1: Depiction of the findings and their broader implications (Farooq & de Villiers, 2019, page 328)

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