

FIRST-TIME IMPLEMENTATION GUIDE

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*



FIRST-TIME IMPLEMENTATION GUIDE:
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

CONTENTS

INTRODUCTION	3
RESPONSIBILITY FOR THE SYSTEM OF QUALITY MANAGEMENT	14
THE FIRM'S RISK ASSESSMENT PROCESS.....	17
GOVERNANCE AND LEADERSHIP	33
RELEVANT ETHICAL REQUIREMENTS	36
ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS.....	39
ENGAGEMENT PERFORMANCE.....	41
RESOURCES	43
INFORMATION AND COMMUNICATION	55
SPECIFIED RESPONSES.....	60
THE MONITORING AND REMEDIATION PROCESS.....	63
NETWORK REQUIREMENTS OR NETWORK SERVICES	82
EVALUATING THE SYSTEM OF QUALITY MANAGEMENT.....	87
DOCUMENTATION	92

This publication has been prepared by the Staff of the International Auditing and Assurance Standards Board (IAASB). The objective of this First-Time Implementation Guide is to help understand and apply ISQM 1. It does not constitute an authoritative pronouncement of the IAASB, nor does it amend or override ISQM 1, the text of which alone is authoritative. Further, this publication is not meant to be exhaustive, and any examples are provided for illustrative purposes only. Reading this publication is not a substitute for reading ISQM 1.

INTRODUCTION

What is ISQM 1?



ISQM 1 paragraph:
16(x)

Firms may perform different types of engagements under the IAASB's Engagement Standards:

- Audits or reviews of financial statements performed under the ISAs¹ and ISREs;²
- Assurance engagements other than audits or reviews of historical financial information performed under the ISAEs³ (e.g., assurance of extended external reporting, or assurance on controls at service organizations); or
- Related services engagements performed under the ISRSs⁴ (i.e., agreed-upon procedures and compilation engagements).

The IAASB's Engagement Standards deal with the performance of these engagements, including the responsibilities of the engagement partner and engagement team. These standards are premised on the basis that the firm is subject to ISQM 1 and ISQM 2⁵ or to national requirements that are at least as demanding.

ISQM 1 deals with the firm's responsibility for having a system of quality management (SOQM). The SOQM is the mechanism that creates an environment that enables and supports engagement teams in performing quality engagements. It helps the firm in achieving consistent engagement quality because it is focused on how the firm manages the quality of engagements performed.

ISQM 1 replaces the existing standard ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*.



This icon is used throughout this guide to highlight references to ISQM 1.



This block and icon are used throughout this guide to highlight examples in ISQM 1.

The Key Changes from the Current Standard, ISQC 1

ISQM 1 aims to enhance the robustness of the firm's SOQM. It requires the firm to customize the design, implementation and operation of its SOQM based on the nature and circumstances of the firm and the engagements it performs. It also requires the firm to transition from policies and procedures that address standalone elements, as required by extant ISQC 1, to an integrated quality management approach that reflects upon the system as a whole. Key changes include:

- A more proactive and tailored approach to managing quality, focused on achieving quality objectives through identifying risks to those objectives, and responding to the risks.



This icon is used throughout this guide to highlight changes from the current standard, ISQC 1.

¹ International Standards on Auditing

² International Standards on Review Engagements

³ International Standards on Assurance Engagements

⁴ International Standards on Related Services

⁵ ISQM 2, *Engagement Quality Reviews*

- Enhanced requirements to address firm governance and leadership, including increased leadership responsibilities.
- Expanded requirements to modernize the standard and reflect factors affecting the firm's environment, including requirements to address technology, networks, and the use of external service providers.
- New requirements addressing information and communication, including communication with external parties.
- Enhanced requirements for monitoring and remediation to promote more proactive monitoring of the SOQM as a whole, and effective and timely remediation of deficiencies.

ISQM 1 Applicability, including the Degree that it Applies within the Firm



ISQM 1 paragraphs:
5, 19 and A30

ISQM 1 applies to **all** firms performing audits or reviews of financial statements, or other assurance or related services engagements. If the firm performs **any** of these engagements, it applies.

In circumstances when the firm performs other types of engagements that are not engagements performed under the IAASB's Engagement Standards (e.g., tax services or consulting services), ISQM 1 does not require that the SOQM extend to such engagements.

Nevertheless, ISQM 1 may affect operational areas of the firm (e.g., IT and human resources), other engagements that are not performed under the IAASB's Engagement Standards, or personnel in the firm who are not involved in performing engagements under the IAASB's Engagement Standards. This is because ISQM 1 does not view quality management as a separate function of the firm. Instead, in order to enhance the effectiveness of quality management, ISQM 1 promotes integrating quality management into the culture of the firm, the firm's strategy, operational activities and business processes. Furthermore, in order to fulfill law, regulation or relevant ethical requirements, the firm's SOQM may need to address other areas of the firm.

Examples of how the firm's SOQM may affect other areas of the firm

- ISQM 1 requires the firm to establish a quality objective that "The firm demonstrates a commitment to quality through a culture that *exists throughout the firm*." It further addresses the need for the culture to recognize and reinforce "the importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities." Accordingly, the firm's strategy, decisions, goals, and resource management need to reflect a commitment to quality.
- ISQM 1 addresses human resources and technological resources. As a result, the firm's IT function and human resource function may be affected by the SOQM.
- ISQM 1 addresses resource needs and planning, including obtaining, allocating or assigning resources. This affects how resources, including financial resources, are utilized across the firm.
- ISQM 1 addresses the fulfillment of relevant ethical requirements. In the context of the provisions of the relevant ethical requirements, the firm may need to design and implement policies or procedures that:
 - Prohibit the provision of certain non-assurance services to clients that are public interest entities for which the firm performs audits or reviews of financial statements.

- Prohibit personnel performing audits or reviews of financial statements, or other assurance engagements, as well as other identified individuals within the firm from holding certain financial interests in entities for which such engagements are performed.

Business units that perform other services (i.e., they are not involved in audits or reviews of financial statements, or other assurance engagements) and individuals working in these business units may be affected by such policies or procedures.

The Objective of ISQM 1



ISQM 1 paragraphs:
14–15, 16(s) and A5

Paragraph 14 of ISQM 1 includes the objective of the firm in managing quality, which is to design, implement and operate a SOQM. Similar to any system of internal control, the SOQM needs to have a purpose. The purpose is important for designing the SOQM and determining whether the SOQM is effective (i.e., whether it achieved its purpose). Therefore, paragraph 14 of ISQM 1 includes both the objective of the firm, and the objective of the SOQM.





The objective of the SOQM is explicitly used in the requirements of ISQM 1 as follows:

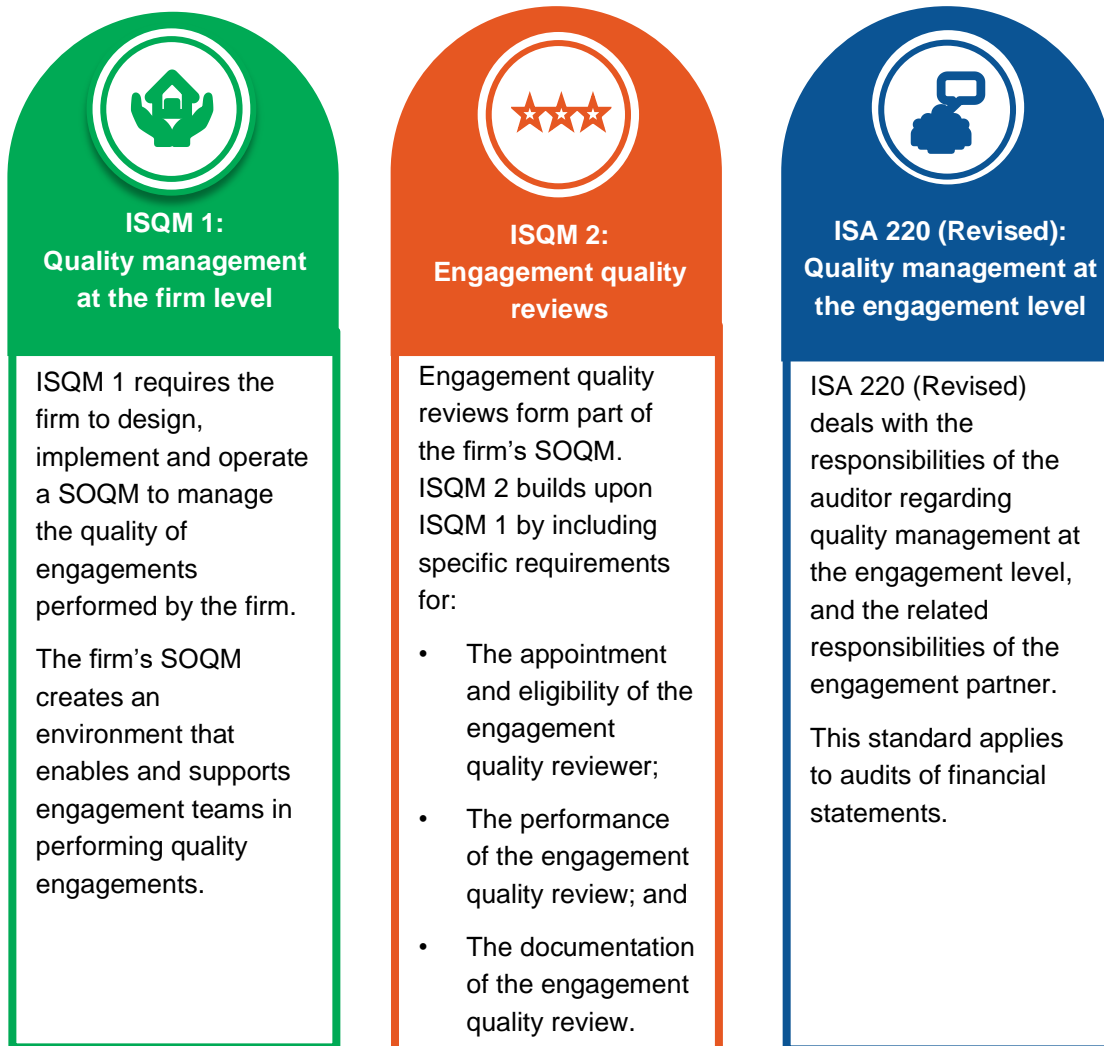
- It is used by the firm to determine whether additional quality objectives need to be established (paragraph 24 of ISQM 1).
- It is used in concluding whether the SOQM provides the firm with reasonable assurance that the objectives of the SOQM have been achieved (paragraph 54 of ISQM 1).

ISQM 1 explains that reasonable assurance is not an absolute level of assurance, because there are inherent limitations of a SOQM. Such limitations include the fact that human judgment in decision making can be faulty and that breakdowns in the SOQM may occur, for example, due to human error or behavior or failures in information technology (IT) applications.

The Relationship of ISQM 1 with ISQM 2 and ISA 220 (Revised)⁶




ISQM 1 paragraphs:
2–3, A1



⁶ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

The firm is responsible for designing, implementing and operating its SOQM. Aspects of the SOQM may be implemented and operate at the engagement level, however the firm remains responsible for the SOQM. The extent to which aspects of the SOQM are implemented and operate at the engagement level depends on the nature and circumstances of the firm and the engagements it performs.

 Paragraph A50 of ISQM 1 includes an example of a response that operates at the firm and engagement level.



The firm, regardless of its size, is required to comply with ISQM 1, and if applicable, ISQM 2. Engagement teams performing audits of financial statements are required to comply with ISA 220 (Revised). For some aspects of the SOQM, a smaller firm may determine that there is no need to establish firm-wide responses, and the firm may instead design and implement responses that operate concurrently with the engagement-level quality management.

Effective Date



ISQM 1 paragraph:
13

The firm is required to have the SOQM designed and implemented in compliance with ISQM 1 by December 15, 2022. The evaluation of the SOQM required by paragraphs 53–54 of ISQM 1 is required to be performed within one year following December 15, 2022.



The IAASB has released a video that discusses practical perspectives on what the firm may think about in preparing for implementation. ([Click this link](#))

This means that by December 15, 2022, the firm is expected to:

- (a) Establish the quality objectives, identify and assess the quality risks and design and implement the responses; and
- (b) Design and implement the monitoring activities.

The operation of the responses and monitoring activities is only required to commence from December 15, 2022 onwards.

Early adoption of ISQM 1 is permitted, however the firm is required to adopt all three quality management standards at the same time.



In cases when a firm is new to the market and only begins performing engagements after the effective date of ISQM 1, the firm is required have its SOQM designed and implemented by the time the firm commences work on the engagements performed under the IAASB's Engagement Standards. The operation of the responses and monitoring activities would commence from that date onwards.

Examples of how the firm may practically implement ISQM 1

- The firm may take a phased approach to implementation, building up to the effective date. For example, this may entail designing and implementing policies or procedures for certain components and commencing the operation of those policies or procedures at various stages

before the effective date. In this case, the firm would establish its own effective date for each of the policies or procedures.

- This approach may lessen the impact of many changes all at once.
- Although the firm would have implemented policies or procedures before the effective date, the firm would not be considered as “early adopting” ISQM 1 because only a portion of the new SOQM has been implemented.
- The firm may commence operation of all the new and revised policies or procedures at the effective date.
- The firm may pilot or test the new SOQM prior to the effective date. The pilot, or testing, may be on certain areas of the SOQM, or by a selection of engagements teams.
 - The SOQM would not be considered to be in operation until the firm has formally implemented and commenced operation of the new SOQM in its entirety.



If the firm currently complies with ISQC 1, the firm will already have policies and procedures in place. The policies and procedures may still be relevant and appropriate for the firm’s new SOQM, or may need to be revised or enhanced such that they are appropriate for the new SOQM. Although the existing policies and procedures may continue to be relevant and appropriate, the firm would still need to establish a SOQM that is compliant with ISQM 1.

The Structure of ISQM 1 and the Components



**ISQM 1 paragraphs:
6 and A3**

ISQM 1 comprises of:

- Eight interrelated components that deal with the key aspects of the SOQM; and
- Other requirements that address specific topics.

The firm is required to meet all of the requirements within ISQM 1, including the requirements in the components.

The firm is not required to organize its SOQM according to the eight components, and may choose to use different terminology or frameworks to describe the components of the SOQM.



Extant ISQC 1 includes six elements for which the firm needs to design policies and procedures.

ISQM 1 has eight components. The components in ISQM 1 are aligned to the elements in extant ISQC 1 and include two new components:

- The firm’s risk assessment process; and
- Information and communication.

An overview of the eight components in ISQM 1

The firm's risk assessment process	A process established by the firm as part of the SOQM	<ul style="list-style-type: none"> The process the firm is required to follow in implementing the risk-based approach to quality management. 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.
Governance and leadership	Establishes the environment in which the SOQM operates	<ul style="list-style-type: none"> Deals with matters such as the firm's culture, leadership responsibility and accountability, the firm's organizational structure, assignment of roles and responsibilities and resource planning and allocation.
Relevant ethical requirements	Specific topic fundamental for engagement performance	<ul style="list-style-type: none"> Deals with fulfilling relevant ethical requirements by the firm and its personnel. Also deals with relevant ethical requirements to the extent that they apply to others external to the firm.
Acceptance and continuance of client relationships and specific engagements	Specific topic fundamental for engagement performance	<ul style="list-style-type: none"> Deals with the firm's judgments about whether to accept or continue a client relationship or specific engagement.
Engagement performance	Specific topics fundamental for engagement performance	<ul style="list-style-type: none"> Deals with the firm's actions to promote and support the consistent performance of quality engagements, including through direction, supervision and review, consultation and differences of opinion. 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.
Resources	Enables operation of other components	<ul style="list-style-type: none"> Deals with obtaining, developing, using, maintaining, allocating and assigning resources in a timely manner to enable the design, implementation and operation of the SOQM. Includes technological, intellectual and human resources, and addresses service providers.

Information and communication	Enables operation of other components	<ul style="list-style-type: none"> Deals with obtaining, generating or using information regarding the SOQM, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the SOQM.
Monitoring and remediation process	A process established by the firm as part of the SOQM	<ul style="list-style-type: none"> The process that: <ul style="list-style-type: none"> Provides the firm with relevant, reliable and timely information about the design, implementation and operation of the SOQM; and Addresses taking appropriate actions to respond to deficiencies such that deficiencies are remediated on a timely basis.

As described above, the firm's risk assessment process and monitoring and remediation process set out **specific processes** the firm is required to follow. The remaining components comprise quality objectives the firm is required to establish, that form the basis for identifying and assessing quality risks and designing and implementing responses.

The other requirements in ISQM 1 that address specific topics in addition to the eight components deal with:

- Assigning responsibilities related to the SOQM;
- Specified responses that the firm is required to design and implement;
- Circumstances when the firm belongs to a network and uses network requirements or network services in its SOQM;
- The annual evaluation of the SOQM by leadership, and leadership's performance evaluations; and
- Documentation.

How the SOQM Operates in a Continual and Iterative Manner



ISQM 1 paragraphs:
7 and A4

A key change in ISQM 1 is that the SOQM is intended to operate in a continual and iterative manner and respond to changes in the nature and circumstances of the firm and its engagements. Furthermore, although ISQM 1 is written in a linear manner, a SOQM does not operate linearly. This means that:

- The various components and requirements in ISQM 1 are intended to be considered in the context of each other; and
- Each component or requirement may affect other components or requirements.

The manner in which the components interrelate and affect other components varies because of the different nature of the components.



This icon is used throughout this guide to highlight an aspect of ISQM 1 that is interconnected to another component or requirement.



Paragraphs A64 and A111 of ISQM 1 include examples of how the components interrelate.

Examples of how components or requirements interrelate across ISQM 1

The risk assessment process and monitoring and remediation process apply pervasively to the SOQM

The firm's risk assessment process is the process that is used to establish quality objectives, identify and assess quality risks and design and implement responses. It applies to the other components (except for monitoring and remediation).

The monitoring and remediation process monitors the entire SOQM, and therefore the monitoring activities are undertaken for all of the components of the SOQM (including the risk assessment process).

Governance and leadership establish the environment that supports the SOQM

For example, if leadership does not reinforce quality and drive and support actions that promote quality, it may be challenging to persuade or compel personnel performing functions within the SOQM (e.g., monitoring or consultations) to fulfill their roles in a manner that promotes quality, and engagement teams to perform quality work.

Resources and information and communication are needed to enable the SOQM to operate

Resources are needed to support other components, for example:

- Technological resources in the form of IT applications may be needed to facilitate the approval of client relationships or specific engagements at appropriate levels within the firm.
- Manuals and guides containing the provisions of the relevant ethical requirements (intellectual resources) may be needed to support an understanding of the relevant ethical requirements.

Information and communication is needed to support other components, for example:

- Information is needed to facilitate the appropriate assignment of personnel to engagements.
- Information is needed to support the firm's judgments about the acceptance and continuance of client relationships and specific engagements.
- Communication of the relevant ethical requirements is necessary to ensure that personnel are aware of their responsibilities regarding relevant ethical requirements.

Components have overlapping qualities

For example, relevant ethical requirements may include provisions relating to the acceptance and continuance of client relationships or specific engagements.

For example, governance and leadership deals with resource needs, resource planning and obtaining, allocating or assigning resources in a manner that is consistent with the firm's commitment to quality.

A response in one component may give rise to a quality risk in another component

For example, the firm may engage a service provider to provide consultation to engagement teams on auditing and accounting matters (i.e., this is a response in the resources component addressing the need to obtain appropriate individuals to enable the operation of the SOQM). The service provider charges the firm an hourly rate for the consultations. Using a service provider for consultations may give rise to a quality risk in the engagement performance component, because engagement teams may attempt to resolve a matter without undertaking consultation, in order to avoid incurring a cost for the firm.

A response may address quality risks across multiple components

For example, the responses designed and implemented by the firm to address complaints and allegations may address quality risks related to the quality objectives in (i) resources (e.g., personnel's commitment to quality), (ii) relevant ethical requirements, and (iii) governance and leadership.

How Scalability is Addressed in ISQM 1



**ISQM 1 paragraphs:
10, 16(o), 19 and A31**

ISQM 1 requires the firm to tailor the design, implementation and operation of its SOQM based on the nature and circumstances of the firm and the engagements it performs. Accordingly, paragraph 19 of ISQM 1 requires the firm to exercise professional judgment in designing, implementing and operating the SOQM.

Examples of the firm exercising professional judgment

In designing the policies or procedures for inspection of completed engagements, the firm exercises professional judgment in determining:

- What are the characteristics of engagements that may prompt the selection of engagements for inspection.
- What are the characteristics of engagement partners that may prompt the selection of engagement partners for inspection.
- The cyclical basis for the selection of engagement partners.

In evaluating whether a finding is a deficiency, the firm exercises professional judgment taking into account factors such as the quality risks the finding relates to, the nature of the finding and how pervasive it is, and how the monitoring activities were designed and performed.

Scalability, and tailoring the SOQM, has been embedded in the requirements of ISQM 1 in a number of ways:

- The quality objectives are outcome-based. The firm determines how to achieve the quality objectives.
- The quality risks are tailored to the firm. In identifying and assessing quality risks, the firm focuses on understanding conditions, events, circumstances, actions or inactions that relate to the nature and circumstances of the firm and its engagements.
- There are only a limited number of required specified responses. The firm is expected to design and implement its own responses that are responsive to the quality risks.
- The requirements for the monitoring and remediation process set out what the firm is expected to have in place to address monitoring and remediation. How the firm implements that process is tailored to the firm's circumstances.

Icons are used throughout this guide to highlight guidance that is specifically relevant to:



A small or less complex firm.



A firm that belongs to a network.



A firm in the public sector.

Various other examples are also included in this guide that are relevant to all firms.

The application material in ISQM 1 includes examples that demonstrate how to apply aspects of the standard to less complex and more complex firms. This guide also includes examples to demonstrate how applying ISQM 1 may differ between various firms.



Examples in ISQM 1 that specifically address scalability:

- Paragraph A35: Assigning roles and responsibilities
- Paragraphs A39 and A52: The firm's risk assessment process
- Paragraph A99: Resources
- Paragraph A111: Information and communication
- Paragraphs A144, A156 and A166: Monitoring and remediation process
- Paragraphs A189 and A199: Evaluating the SOQM and performance evaluations
- Paragraph A203: Documentation



Paragraph 17 of ISQM 1 acknowledges that in some cases, a requirement in ISQM 1 may not be relevant to the firm because of the nature and circumstances of the firm or its engagements, in which case the firm is not expected to comply with the requirement. Paragraph A29 of ISQM 1 provides examples of such circumstances.

RESPONSIBILITY FOR THE SOQM

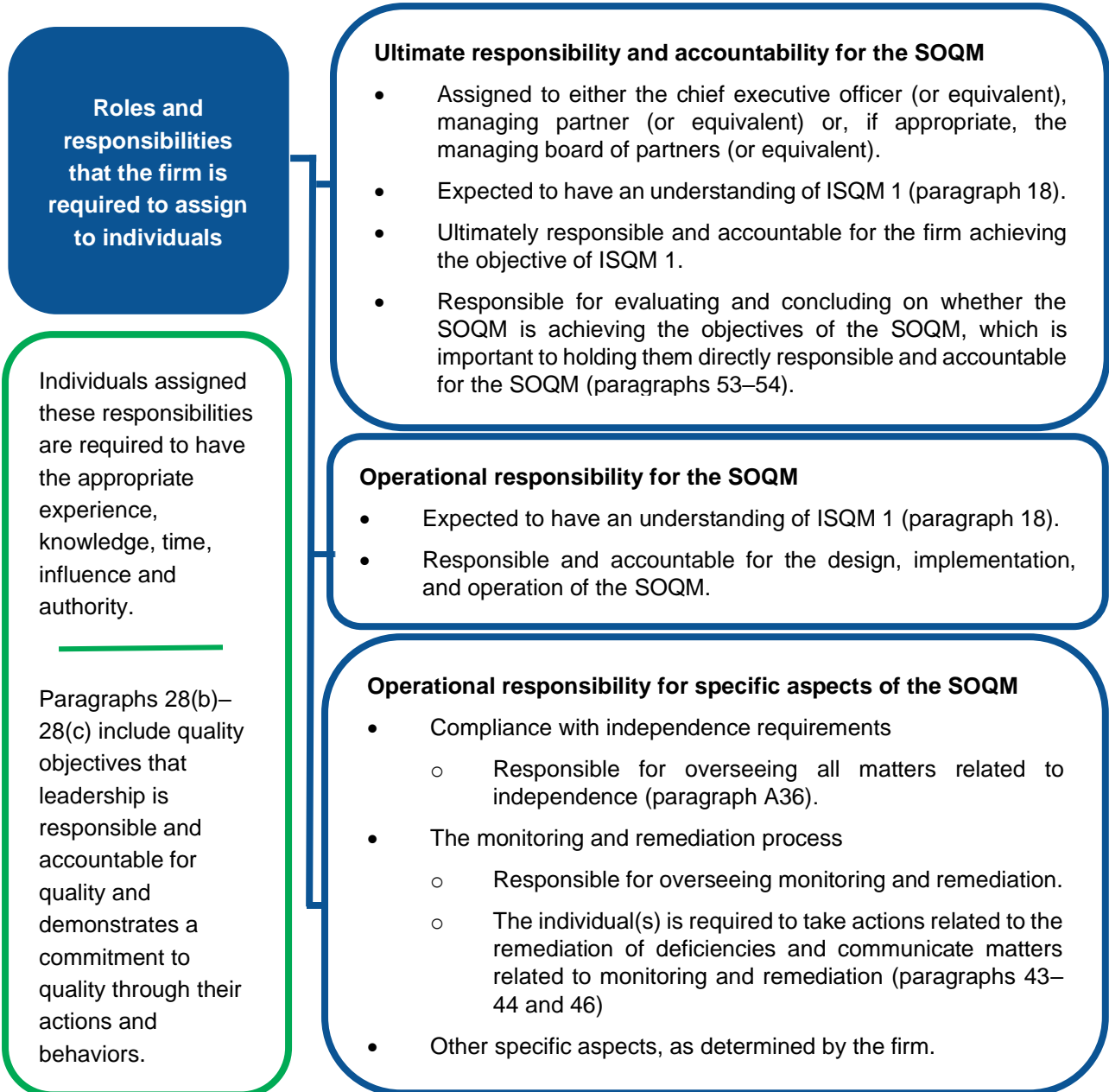


ISQM 1 paragraphs:
17–22, A29–A38

Assigning Responsibilities

Paragraph 19 of ISQM 1 indicates that the firm is required to design, implement and operate a SOQM. As a result, the firm remains ultimately responsible for the SOQM. Nevertheless, the firm is not an individual that can take action; it is an entity. As a result, ISQM 1 requires the firm to assign responsibilities for the SOQM, and other aspects of the SOQM, and to hold the individuals accountable for their assigned roles.

The requirements in ISQM 1 addressing the assignment of responsibilities are as follows:



ISQM 1 explains that how the firm assigns roles, responsibilities and authority within the firm may vary, and may be affected by requirements imposed by law or regulation related to the leadership and management structure or their assigned responsibilities.

Although ISQM 1 requires the firm to assign responsibilities, the individuals(s) to whom the responsibilities are assigned are not themselves expected to perform all procedures, tasks or actions that are needed to fulfill that responsibility. The individuals(s) may delegate procedures, tasks or actions, provided the individual(s) remains responsible and accountable for the responsibilities assigned to them.

i Paragraph A35 of ISQM 1 includes an example to demonstrate how assigning roles and responsibilities may be undertaken, and may differ between a less complex firm and a more complex firm.

i Paragraph A33 of ISQM 1 includes an example to demonstrate how the firm is responsible for the evaluation and conclusion on the SOQM, and further assigns the evaluation and conclusion to the individual(s) with ultimate responsibility and accountability for the SOQM.



The governance and leadership component includes a quality objective that the firm has an organizational structure and assignment of roles, responsibilities and authority that is appropriate to enable the design, implementation and operation of the SOQM.

Paragraph 56 of ISQM 1 requires the firm to undertake periodic performance evaluations of the individual(s) assigned ultimate responsibility and accountability for the SOQM, and the individual(s) assigned operational responsibility for the SOQM. Undertaking periodic performance evaluations promotes the accountability of leadership.

To Whom the Responsibilities for the SOQM, or Aspects Thereof, May be Assigned

ISQM 1 explains that the individuals assigned responsibilities for the SOQM, or aspects thereof, are typically partners in the firm. However, it recognizes that in some cases the individual may not be a partner of the firm itself. For example, this may be the case when the individual is a partner in a regional entity of the network, and the firm comprises one area of the region.

The firm cannot outsource the leadership responsibilities to a service provider because the firm is responsible for its SOQM and the individual(s) are required to have the appropriate influence and authority within the firm.

ISQM 1 requires that the individuals assigned responsibilities for the SOQM, or aspects thereof, also have the appropriate experience and knowledge to fulfill their assigned responsibility. In some cases, the firm may have separate business units or service lines that are not involved in the engagements performed by the firm under the IAASB's Engagement Standards (e.g., consulting services). ISQM 1 does not require that the individuals assigned responsibilities for the SOQM, or aspects thereof, have extensive experience related to particular engagements performed by the firm (e.g., experience or knowledge related to audit engagements). Nevertheless, given the responsibilities of the individuals, they may need to have experience related to, and knowledge of, the firm's strategic decisions and actions and business operations, including engagements performed by the firm.

How ISQM 1 has Changed from the Extant Standard with Respect to Leadership



- Clarification of who is required to have an understanding of ISQM 1.
- Increased emphasis on leadership's accountability for the SOQM.
- Expanded requirements to assign specific responsibilities related to the SOQM:
 - Operational responsibility for the SOQM;
 - Operational responsibility for compliance with independence requirements; and
 - Operational responsibility for the monitoring and remediation process.
- Enhanced requirements addressing the qualifications of individuals assigned responsibilities:
 - Includes the individual(s) assigned ultimate responsibility and accountability for the SOQM.
 - Required to have the appropriate experience, knowledge, influence and authority within the firm, and sufficient time, to perform their assigned responsibility.
- New requirement requiring a direct line of communication between:
 - The individual(s) assigned operational responsibility for the SOQM, compliance with independence requirements and the monitoring and remediation process; and
 - The individual(s) assigned ultimate responsibility and accountability for the SOQM.

THE FIRM'S RISK ASSESSMENT PROCESS



ISQM 1 paragraphs:
16(q), 16(r), 16(u), 23–27,
A25–A27 and A39–A54

The foundation of ISQM 1, and a key change from extant ISQC 1, is that the firm needs to follow a risk-based approach to quality management, which focuses the firm on:

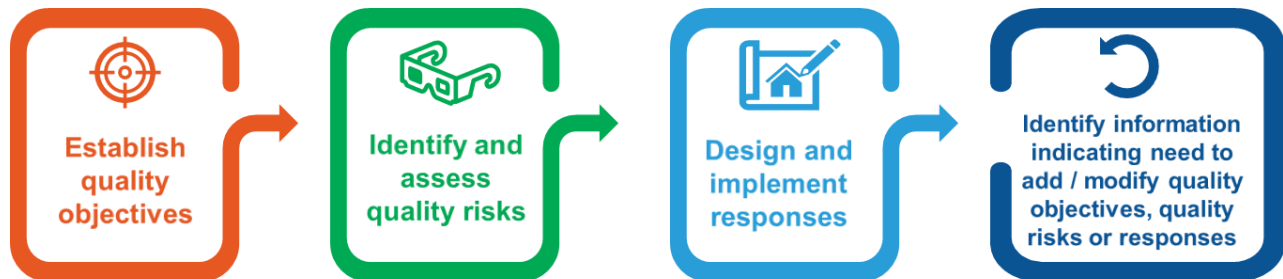


The firm's risk assessment process is new to ISQM 1.

- The risks that may arise, given the nature and circumstances of the firm and the engagements it performs; and
- Implementing responses to appropriately address those risks.

A risk-based approach helps the firm tailor the SOQM to the firm's circumstances, as well as the circumstances of the engagements performed by the firm. It also helps the firm effectively manage quality through concentrating on what matters most given the nature and circumstances of the firm and the engagements it performs.

ISQM 1 requires the firm to have a risk assessment process, the purpose of which is to establish quality objectives, identify and assess quality risks and design and implement responses to address the quality risks. ISQM 1 sets out requirements for how this process should be applied as follows:



The Design of the Firm's Risk Assessment Process



ISQM 1 paragraphs:
23, A39–A41

How the firm goes about establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses will vary from firm to firm. It is influenced by the nature and circumstances of the firm, including how the firm is structured and organized.

Given the proactive and continual approach to managing quality, the information the firm uses to establish quality objectives, identify and assess quality risks, and design and implement responses includes information coming from the firm's SOQM itself, such as:

- Information generated through the information and communication component, which may originate from an internal or external source; and
- The results of the firm's monitoring and remediation process.

i Paragraph A39 of ISQM 1 has an example of how the design of the firm's risk assessment process may be different for a less complex firm versus a more complex firm.

i Paragraph A41 of ISQM 1 has examples of the sources of information the firm may use in its risk assessment process, which may be internal or external sources.

The process of establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses is iterative, and evolving. ISQM 1 explains that:

- In identifying and assessing quality risks, the firm may determine that an additional quality objective(s) needs to be established.
- When designing and implementing responses, the firm may determine that a quality risk was not identified and assessed.
- The firm's responses may give rise to conditions, events, circumstances, actions or inactions that result in further quality risks.

Example of when, in identifying and assessing quality risks, it is determined that a quality objective needs to be established

In understanding law, regulation, professional standards and the environment in which the firm operates, the firm determines that there is a jurisdictional audit firm governance code for which it is necessary to establish additional quality objectives.

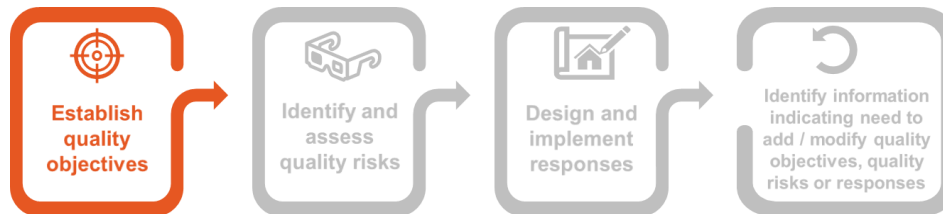
Example of a response that gives rise to a quality risk

The firm engages a service provider to manage all aspects of the firm's IT environment. This creates new quality risks for relevant ethical requirements because the service provider has access to confidential information of clients.

Establish Quality Objectives



ISQM 1 paragraphs:
16(q), 24, A42-A44



A SOQM is effective when it achieves the objectives of the SOQM (the objectives in paragraph 14 of ISQM 1). The objectives of the SOQM in paragraph 14 of ISQM 1 (described previously in this publication) are at a high level. As a result, ISQM 1 includes more specific *quality objectives* for the various components of the SOQM, so that it is clear what outcomes need to be achieved by the firm in order to have a SOQM that is effective in managing quality.

The quality objectives in each component aid the firm in properly identifying and assessing quality risks because the quality objectives focus the firm more specifically on what needs to be achieved, and what could go wrong in achieving the quality objectives.



What Quality Objectives the Firm is Required to Establish

ISQM 1 includes quality objectives for the following components:

- Governance and leadership;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Engagement performance;
- Resources; and
- Information and communication.

There are no quality objectives for the firm's risk assessment process and the monitoring and remediation process because these components are processes, and ISQM 1 sets out specific requirements of how these processes need to be applied.

The firm is required to establish the quality objectives specified for these components. However, there may be circumstances when a quality objective, or an aspect thereof, is not relevant to the firm because of the nature and circumstances of the firm or its engagements.

Example of when a quality objective may not be relevant

The quality objective in paragraph 31(b) of ISQM 1 addressing direction, supervision and review may not be relevant when the firm is a sole practitioner.

The quality objectives set out in the standard are comprehensive. It is important to exercise caution in describing the quality objectives in ISQM 1 using different or abbreviated terminology because doing so could inadvertently change the meaning of a quality objective or lose a key aspect of the quality objective. A partially established quality objective could result in a deficiency in the SOQM.

Example of a partially established quality objective

The firm establishes a quality objective as follows:

Engagement documentation is assembled on a timely basis after the date of the engagement report.

However, the firm has not established the remainder of the objective in accordance with paragraph 31(f) of ISQM 1, as follows:

Engagement documentation is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or professional standards

Example of a quality objective described differently by the firm that has lost a key aspect

The firm establishes a quality objective as follows:

Engagement documentation is archived within 60 days and is retained for five years from the date of the engagement report, or, if later, the date of the auditor's report on the group financial statements, when applicable.

This quality objective has inadvertently lost a key aspect of the quality objective in paragraph 31(f) of ISQM 1. Specifically:

- It fails to deal with the need to maintain the documentation.
- It fails to take into account that the retention periods may need to change as a result of changes in the needs of the firm, law, regulation, relevant ethical requirements, or professional standards.

The firm is not required but may choose to establish sub-objectives to enhance the firm's identification and assessment of quality risks, and design and implementation of responses.

Example of when a firm establishes sub-objectives

The firm has three operating units making up its practice: audit, tax and accounting services. The tax operating unit occasionally performs agreed upon procedure engagements, and the accounting services operating unit compiles financial statements. The firm establishes sub-objectives for its operating units that are specially tailored to be more relevant and suitable for the nature of services and engagements performed by the operating units. For example, the firm establishes the following sub-objectives related to the quality objective in paragraph 32(a)(i) of ISQM 1:

Quality objective in paragraph 32(a)(i) of ISQM 1:

Personnel are hired, developed and retained and have the competence and capabilities to consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs.

Sub-objectives established by the firm:

- Audit operating unit: *Personnel are hired, developed and retained and have the competence and capabilities to consistently perform quality audits, including having knowledge or experience relevant to audits and the industries for whom the firm performs audits.*
- Tax operating unit: *Personnel are hired, developed and retained and have the competence and capabilities to consistently perform quality agreed-upon procedure engagements, including having knowledge or experience relevant to agreed-upon procedure engagements.*
- Accounting services operating unit: *Personnel are hired, developed and retained and have the competence and capabilities to consistently perform quality compilations of financial statements, including having knowledge or experience relevant to compilations of financial statements.*

Establishing Additional Quality Objectives

Since firms' circumstances vary widely, it is possible that there may be quality objectives in addition to those set out in ISQM 1 that the firm needs to establish and achieve, in order to achieve the objectives of the SOQM. Accordingly, ISQM 1 requires the firm to establish additional quality objectives when the firm considers it necessary to achieve the objectives of the SOQM. It is noted that circumstances when the firm may need to establish additional quality objectives is not expected to be common, and therefore not all firms will find it necessary to establish additional quality objectives.

i Paragraph A42 of ISQM 1 has an example of when additional quality objectives may be considered by the firm to be appropriate.

The Relationship Between the Quality Objectives

The quality objectives, if achieved, collectively achieve the objectives of the SOQM. As a result, the quality objectives across the components are interrelated and interdependent. For example, an objective in one component may overlap, be related to, support or be supported by a quality objective in another component.

Example of a quality objective that supports another quality objective

The quality objectives in the information and communication component address the information system, communication and exchange of information throughout the firm and with engagement teams. These quality objectives are essential in supporting the quality objectives in the relevant ethical requirements component because appropriate information that is communicated on a timely basis is essential to properly fulfilling the relevant ethical requirements.

Identify and Assess Quality Risks



ISQM 1 paragraphs:
16(r), 25, A45-A48



Identifying and assessing quality risks puts attention on what can go wrong in achieving the quality objectives. As a result, it assists the firm in designing and implementing responses that are effective in addressing the quality risks. It also helps the firm to use their resources more efficiently and effectively in addressing and improving quality.

What is a Quality Risk?

There may be many risks that could adversely affect the achievement of the quality objectives. However, not all risks are considered quality risks in ISQM 1 because it is not reasonable or practicable for the firm to identify and assess every possible risk, and to design and implement responses for every risk. ISQM 1 aims to focus the firm on risks that have the greatest impact on achieving the quality objectives, so that those risks are appropriately addressed by the firm.

The definition of a quality risk in ISQM 1 includes a threshold for what risks are considered a quality risk. A risk qualifies as a quality risk when it meets both criteria in the definition:

The risk has a reasonable possibility of occurring.

The risk has a reasonable possibility of individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

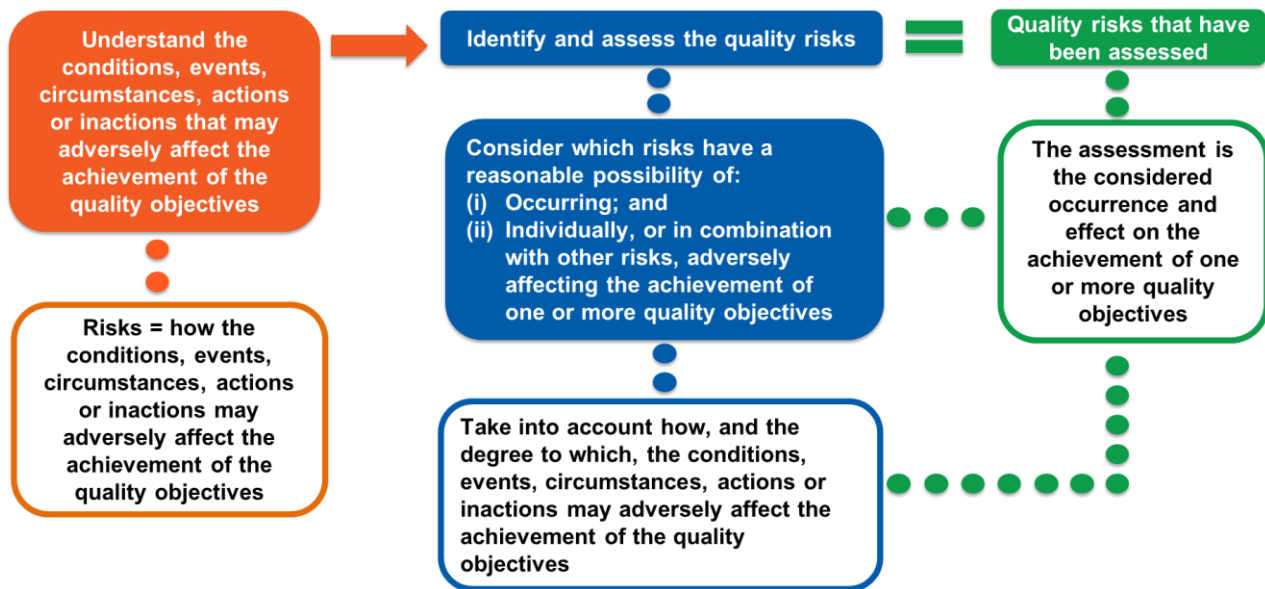
The firm exercises professional judgment in determining whether a risk meets the threshold set out in the definition of quality risks.



Regardless of whether a firm has sub-objectives, the threshold for identifying quality risks is at the level of the quality objectives in ISQM 1. There may be circumstances when a risk has a reasonable possibility of adversely **affecting the achievement of the sub-objective**, but does not have a reasonable possibility of adversely **affecting the achievement of a quality objective**, in which case the risk would not be considered a quality risk.

How the Firm Identifies and Assesses Quality Risks

ISQM 1 sets out the process the firm is required to follow in identifying and assessing quality risks, which is depicted as follows:



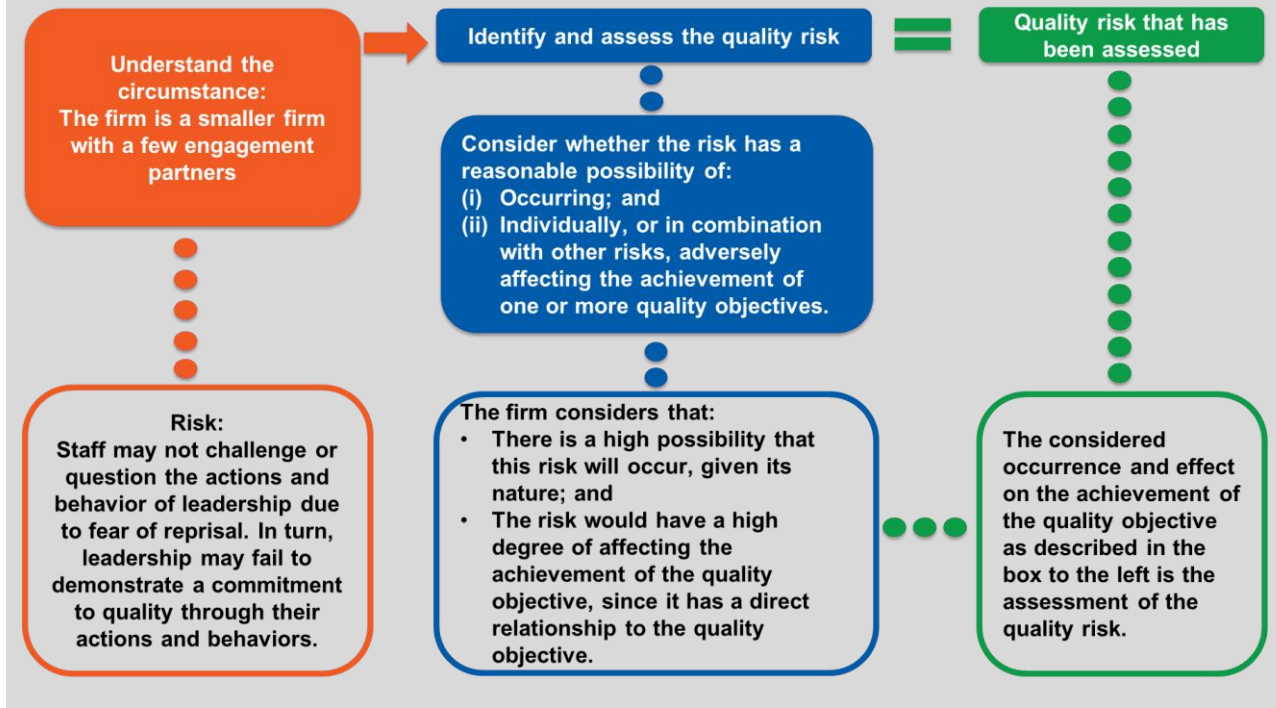
The process focuses first on understanding the various conditions, events, circumstances, actions or inactions related to the firm and its engagements that could adversely affect the achievement of the quality objectives. To emphasize, the firm is required to understand what may **adversely** affect the achievement of the quality objectives.

In identifying the quality risks, the firm takes into account:

- How, and the degree to which, the conditions, events, circumstances actions or inactions may affect the achievement of the quality objectives; and
- The possible occurrence of the quality risks. This is necessary to determine whether the risk meets the threshold of a quality risk.

i Paragraph A48 of ISQM 1 provides examples of factors that may affect the degree to which a risk may adversely affect the achievement of a quality objective(s), such as frequency of occurrence and length of effect.

The **assessment** of the quality risks is also affected by how, and the degree to which, the conditions, events, circumstances actions or inactions affect the quality objectives, and the possible occurrence. As a result, the identification and assessment of the quality risks may be undertaken simultaneously. A firm may choose to identify and assess quality risks as two discrete steps, however this is not required or expected.

Example of applying the process for identifying and assessing a quality risk

The Conditions, Events, Circumstances, Actions or Inactions that Could Adversely Affect the Achievement of the Quality Objectives

In order to promote the consistent application of the risk identification and assessment process across firms, ISQM 1 includes conditions, events, circumstances, actions or inactions that the firm is required to understand, which are focused on the nature and circumstances of the firm and its engagements. Paragraph 25(a) of ISQM 1 sets out these conditions, events, circumstances, actions or inactions that the firm is expected to:

- Understand;
- Take into account (i.e., think about) how they may adversely affect the achievement of the quality objectives; and
- Identify whether there are risks that are quality risks.

i Paragraph A46 of ISQM 1 includes examples of the firm's understanding of conditions, events, circumstances, actions or inactions that may adversely affect the achievement of quality objectives, and the quality risks that may arise.

The conditions, events, circumstances actions or inactions in paragraph 25(a) of ISQM 1 that the firm is required to understand

The complexity and operating characteristics of the firm

Understand and consider matters such as the size of the firm, the geographical dispersion of the firm, how the firm is structured, the extent to which the firm concentrates or centralizes its processes or activities (e.g., use of service delivery centers), or the characteristics and availability of the firm's resources.

The strategic and operational decisions and actions, business processes and business model of the firm	Understand and consider matters such as decisions about financial and operational matters, including the firm's strategic goals, how financial resources are managed, growth of the firm's market share, industry specialization or new service offerings.
The characteristics and management style of leadership	Understand and consider matters such as the composition of firm leadership and their tenure, how authority is distributed among leadership, or how leadership motivates and encourages personnel.
The resources of the firm, including the resources provided by service providers	Understand and consider matters such as the general background of the firm's personnel and overall staff profile and structure, the use of technology and how that technology is obtained, developed and maintained, and the availability and allocation of financial resources. With respect to service providers, the nature of the resources provided by service providers, how and the extent to which they will be used by the firm, and the general characteristics of the service providers used by the firm.
Law, regulation, professional standards and the environment in which the firm operates	Understand and consider matters such as regulations directly relevant to the firm, professional standards, other standards or regulation affecting engagements performed by the firm (e.g., general purpose frameworks for financial reporting commonly used in the jurisdiction), economic stability, social factors, or the general public's perception of professional accountancy firms (e.g., a general lack of trust arising from recurring audit failures).
The nature and extent of the network requirements and network services	Understand and consider matters such as the nature of the network, how the network is organized and the general level of quality of network requirements or network services provided.
The types of engagements performed by the firm and the reports to be issued	<p>Understand and consider matters such as which engagements the firm performs, including:</p> <ul style="list-style-type: none"> • Audits or reviews of financial statements, and whether the firm performs engagements to report on summary financial statements or reviews of interim financial statements. • Other assurance or related services engagements, and the types of subject matter for which such engagements are undertaken (e.g., greenhouse gas statements, controls at service organizations etc.). <p>The firm may also understand and consider how the reports the firm issues may be used by users.</p>

The types of entities for which engagements are undertaken

Understand and consider matters such as the industries in which the entities operate and the nature of their business, the size and complexity of the entities, the nature of the entities' shareholding (e.g., owner-managed or listed), or the size or nature of the entities' stakeholders.

It is essential to note that the list of conditions, events, circumstances actions or inactions in paragraph 25(a) of ISQM 1 is not exhaustive. There may be other conditions, events, circumstances, actions or inactions that may adversely affect the achievement of a quality objective, which the firm would need to understand and further consider whether a quality risk exists.

Furthermore, not all of the conditions, events, circumstances actions or inactions are relevant to every quality objective.

Examples of conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives, and quality risks that may arise

Condition, event, circumstance, action or inaction that may adversely affect the achievement of a quality objective	Quality risk that may arise
The complexity and operating characteristics of the firm: The firm is a large firm with multiple offices. Each office has a leader in charge of engagement quality and administrative and operational matters.	In the context of governance and leadership, this may give rise to quality risks relating to how a consistent culture is permeated throughout the firm, because of the dispersion of the firm and the leadership responsibilities.
The strategic and operational decisions and actions, business processes and business model of the firm: The firm has a strategic goal to grow its tax practice and offer more extensive tax planning advice and support.	In the context of relevant ethical requirements, this gives rise to a quality risk that the firm breaches independence requirements regarding non-audit services.
The characteristics and management style of leadership: Given that the firm is small, leadership is concentrated to a single individual who has daily interactions with personnel.	In the context of engagement performance, this gives rise to a quality risk that personnel do not bring differences of opinion that involve leadership to the attention of the firm.
The resources of the firm, including the resources provided by service providers: The firm has a service delivery center located in another jurisdiction that performs certain aspects of the firm's audit engagements.	In the context of engagement performance, this gives rise to a quality risk that the personnel are not appropriately directed and supervised and that their work is not appropriately reviewed.

Condition, event, circumstance, action or inaction that may adversely affect the achievement of a quality objective	Quality risk that may arise
Law, regulation, professional standards and the environment in which the firm operates: The firm is subject to a jurisdictional audit firm governance code.	In the context of governance and leadership, this gives rise to a quality risk that the firm does not fulfill the requirements of the firm governance code as they relate to the firm's organizational structure and assignment of roles, responsibilities and authority.
Law, regulation, professional standards and the environment in which the firm operates: Due to a global pandemic, engagement teams are forced to work remotely.	In the context of information and communication, this gives rise to a quality risk that information is not communicated to engagement teams working remotely in the right form or manner, to enable engagement teams to understand and carry out their responsibilities in performing the engagement.
Law, regulation, professional standards and the environment in which the firm operates: New regulations are introduced mandating audit firm rotation every 10 years, resulting in the firm losing many of its engagements in quick succession and many personnel becoming under-utilized.	In the context of acceptance and continuance, this gives rise to a quality risk that the firm inappropriately accepts a client relationship or specific engagement, given that the firm has excess staff capacity.
The nature and extent of the network requirements and network services: The network requires all firms in the network to use the network developed IT software for independence. Personnel are required to record their financial interests in the software and all services to clients are also logged in the software. The software tracks information to automatically alert the firm if there is an independence breach.	In the context of relevant ethical requirements, this gives rise to a quality risk that the network does not appropriately take into account jurisdictional requirements regarding independence in developing the software, and that the firm is not alerted when there is an independence breach.
The types of engagements performed by the firm and the reports to be issued: The firm performs assurance engagements for greenhouse gas statements.	In the context of resources, this gives rise to a quality risk that the firm does not have appropriate intellectual resources to support these engagements, and that engagement teams use intellectual resources that do not take into account jurisdictional law and regulation related to emissions.

Condition, event, circumstance, action or inaction that may adversely affect the achievement of a quality objective	Quality risk that may arise
The types of entities for which engagements are undertaken: The firm performs compilations of financial statements for entities that operate in an industry where recent revisions to the accounting standards have given rise to complex financial statement disclosures for the industry. Typically, the compilation engagements performed by the firm are not complex.	In the context of engagement performance, this gives rise to a quality risk that the engagement teams performing the compilations do not undertake appropriate consultation, given that they have not previously needed to consult on complex financial statement disclosures.
The types of entities for which engagements are undertaken: The firm performs audits of entities involved in agriculture.	In the context of resources, this gives rise to a quality risk that personnel lack the appropriate knowledge or experience of relevant accounting standards applicable to agriculture.

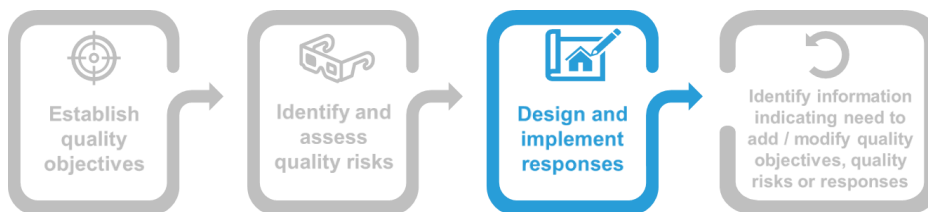


The firm is not required to document the consideration of every condition, event, circumstance, action or inaction that may give rise to a quality risk. The documentation of the quality risks may include the reasons for the assessment given to the quality risks, i.e., the considered occurrence and effect on the achievement of the quality objectives.

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 SOQM.

Further considerations on documentation are included under the documentation section.

Design and Implement Responses



ISQM 1 paragraphs:
16(u), 26, A25–A27
and A49–A51

Responses that are properly designed and implemented to address the quality risks mitigate the possibility that the quality risk occurs, thereby helping the firm to achieve the quality objectives.

How the Firm Designs and Implements Responses

ISQM 1 requires the firm to design and implement responses that properly address the quality risks. In order to properly address the quality risks, the firm needs to think about the reasons for the assessments given to the quality risks, as demonstrated in the table below:

Reason for assessment	How the reason for assessment affects the design of the response
How, and the degree to which, the conditions, events, circumstances actions or inactions affect the quality objectives	<p>Example:</p> <ul style="list-style-type: none"> A quality risk that personnel do not bring differences of opinion with leadership to the attention of the firm cannot be appropriately responded to through policies that involve the same leadership in the differences of opinion process. A quality risk that engagement teams are not appropriately directed and supervised, and their work reviewed, during a global pandemic may have a high degree of effect on the achievement of the quality objectives because of the pervasiveness of the quality risk across the firm. Accordingly, a more robust response may be needed.
The possible occurrence of the quality risks	<p>Example:</p> <p>A quality risk that there may be breaches of independence arising from personnel's financial interests may have a higher likelihood of occurring if the firm has many personnel. As a result, a more robust response may be needed.</p>

A number of factors may be considered by the firm in designing the response, particularly as it relates to the nature, timing and extent of the response.

Nature	Timing	Extent
<p>Factors that the firm may consider:</p> <ul style="list-style-type: none"> Whether the quality risk would be better addressed through a preventative activity, detective activity or a combination of both. Whether a response involving technology would be a more effective means of addressing the quality risk. What resources would be needed to support the response, e.g., specialized knowledge or expertise, and what information is needed. Who will implement the response, such as whether it needs to be implemented at the engagement level. 	<p>Factors that the firm may consider:</p> <ul style="list-style-type: none"> Whether the quality risk would be better addressed through a response that is a periodic activity or ongoing activity. If the response is periodic, how often it needs to occur to effectively address the quality risk. 	<p>Factors that the firm may consider:</p> <ul style="list-style-type: none"> Whether the response should apply to all events that the response relates to, or only a selection of events (e.g., all audit engagements or only certain audit engagements).

Furthermore, the firm may need to consider whether the response alone is sufficient to address the quality risk, or whether a combination of responses is needed. The firm may also design and implement a response that addresses multiple quality risks, provided the response is sufficiently precise to effectively address each of the related quality risks.

The Relationship of Responses

Responses may be related in a number of ways, including as follows:

- A response may address multiple quality risks across various components.
- A response may support another response in another component. This is particularly the case for responses related to resources and information and communication because these elements are often needed to support the operation of other responses.

Example of a response that supports another response

The responses in the resources component addressing intellectual resources may be important in supporting the firm's decisions on whether to accept or continue a client relationship or specific engagement, because the firm may depend on these intellectual resources to obtain information about the engagements and the integrity and ethical values of the client.

Responses Specified by ISQM 1



**ISQM 1 paragraphs:
34, A116-A137**

Paragraph 34 of ISQM 1 includes some specified responses that the firm is required to design and implement. Unlike the quality objectives that are set out in ISQM 1, the specified responses are not comprehensive and would not fully address all quality risks. Accordingly, the firm is expected to design and implement responses *in addition* to those specified in the standard, in order to fully comply with the requirement in paragraph 26 of ISQM 1.

Although the responses in paragraph 34 of ISQM 1 are specified, the nature, timing and extent of the response will vary, given the nature and circumstances of the firm.

Example of a how the firm may consider the nature, timing and extent of a specified response

Paragraph 34(c) of ISQM 1 requires the firm to have the following response:

The firm establishes policies or procedures for receiving, investigating and resolving complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm's policies or procedures established in accordance with this ISQM.


In designing and implementing this response, the firm may consider matters such as:

- Who should receive, investigate and resolve the complaints and allegations, including whether it should be outsourced to a service provider, and whether one, or multiple individuals should be involved in the process.
- Whether law, regulation or relevant ethical requirements establish responsibilities for the firm or its personnel regarding complaints or allegations, such as an obligation on the firm or its personnel to

report the matter to an authority outside the firm (e.g., sections 260 and 360 of the IESBA Code⁷ 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).

- How complaints and allegations should be communicated.
- How confidentiality of complaints and allegations will be retained.
- How complaints and allegations should be dealt with, including when leadership should be informed, and legal counsel should be involved.

There may be circumstances when a specified response, or an aspect thereof, is not relevant to the firm because of the nature and circumstances of the firm or its engagements, in which case paragraph 17 of ISQM 1 applies (i.e., the firm is not expected to comply with the requirement if it is not relevant).

 Paragraph A29 of ISQM 1 includes an example of when a specified response may not be relevant.

Scalability of Responses

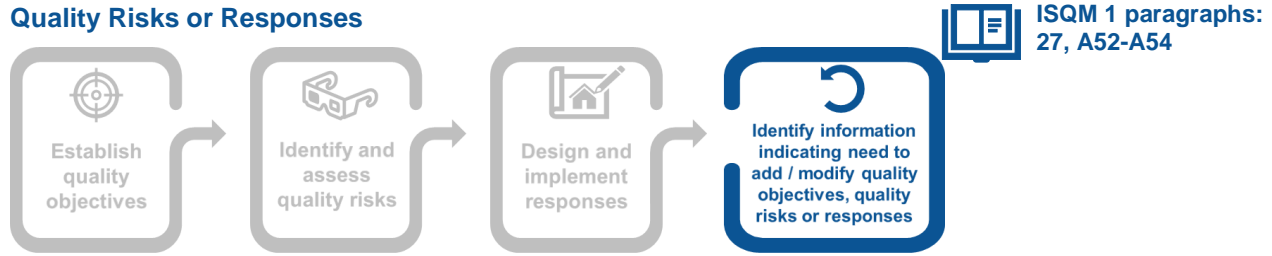
The nature, timing and extent of the responses is driven by the quality risks, which are affected by the nature and circumstances of the firm and its engagements. Smaller and less complex firms are likely to have different quality risks than larger and more complex firms, thereby requiring a different response. For quality risks that are common across all firms of varying size and complexity, the nature, timing and extent of the responses may differ given the circumstances of the firm.

Example of how a response may differ between a smaller and less complex firm, and a larger and more complex firm because of the underlying quality risk

Quality risk	Response
The firm is a small firm with a single location. Leadership is concentrated to a single individual. This gives rise to a quality risk that the daily actions and behaviors of leadership have a significant effect on the firm's culture.	The responses may include independent coaching of firm leadership, including periodically soliciting anonymous feedback from all levels within the firm, so that there is a clear understanding of how leadership's actions and behaviors are affecting the firm, and how they may be improved to achieve the desired culture.
The firm is a large firm with multiple locations, and multiple layers within the leadership structure. This gives rise to a quality risk that a consistent culture is not permeated throughout the firm.	The responses may include establishing firm values in a code of conduct, undertaking firm-wide formal communications that emphasize the importance of quality, formal periodic culture assessments and regular leadership meetings that discuss key messages, decisions and actions.

⁷ The International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

Identify Information Indicating the need for Additions or Modifications to the Quality Objectives, Quality Risks or Responses



Establishing quality objectives, quality risks or responses is not a one-off exercise that the firm needs to undertake. The quality objectives, quality risks or responses may need to change as a result of:

- Changes in the nature and circumstances of the firm or its engagements; or
- Remedial actions to address deficiencies in the firm's SOQM.

Additions or Modifications to the Quality Objectives, Quality Risks or Responses

The firm may identify information that indicates additional quality objectives, or additional or modified quality risks or responses, are needed due to changes in the nature and circumstances of the firm or its engagements. The following additions or modifications may be needed:

Quality objectives	<ul style="list-style-type: none"> • New additional quality objectives may be needed; • Additional quality objectives established by the firm may no longer be needed, or may need to be modified; or • Sub-objectives established by the firm may no longer be needed, or may need to be modified. <p>However, the quality objectives required by the standard may not be modified or removed, unless paragraph 17 of ISQM 1 becomes applicable (i.e., the quality objective is no longer relevant)</p>
Quality risks	<ul style="list-style-type: none"> • New quality risks may be identified; • Existing quality risks may no longer qualify as quality risks; • Existing quality risks may need to be modified; or • Existing quality risks may need to be reassessed.
Responses	<ul style="list-style-type: none"> • New responses may be designed and implemented; • Existing responses may be discontinued; or • Existing responses may need to be modified. <p>Specified responses required by the standard need to be designed and implemented by the firm, although the firm may determine it appropriate to modify how they are designed and implemented. The specified responses may not be discontinued unless paragraph 17 of ISQM 1 becomes applicable (i.e., the response is no longer relevant).</p>

How the Firm Identifies Information Indicating the need for Additions or Modifications to the Quality Objectives, Quality Risks or Responses

ISQM 1 does not prescribe how frequently a firm should re-evaluate its quality objectives, quality risks and responses because they should be proactively modified when changes affecting the SOQM occur, or when deficiencies are identified.

There are two mechanisms in ISQM 1 through which the firm identifies information indicating the need for additions or modifications to the quality objectives, quality risks or responses.

i Paragraph A52 of ISQM 1 includes an example of how the firm's policies or procedures for identifying information about changes in the nature and circumstances of the firm and its engagements may vary for a less complex firm versus a more complex firm.

The firm has policies or procedures, which are part of the firm's risk assessment process, to identify information, which indicates the need for changes to the quality objectives, quality risks or responses, related to changes in the nature and circumstances of the firm

Example:

A global pandemic occurs, prompting audits to be performed remotely. This may give rise to a number of additional quality risks or changes in the assessment of quality risks. For example, in the context of engagement performance, it could increase the assessment of quality risks regarding inappropriate direction, supervision and review.

The firm's monitoring and remediation process provides information about deficiencies related to the quality objectives, quality risks or responses

Example:

A deficiency is identified whereby engagement documentation in a digital format was not properly uploaded to an application on the firm's server, due to power outages. This resulted in a loss of engagement documentation. The firm amends its responses by installing backup generators to support the continual functioning of the firm's servers during power outages.

GOVERNANCE AND LEADERSHIP



ISQM 1 paragraphs:
28, A55-A61

Governance and leadership is of paramount importance to quality management at the firm and engagement level, because 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. A firm's governance also affects the public's perception of the firm; a firm without effective governance may be viewed as one that does not operate in the public interest.

The following summarizes how ISQM 1 has changed from the extant standard with respect to governance and leadership:



- New and enhanced requirements regarding the firm's commitment to quality through its culture. As part of the firm's culture, the requirements now also address:
 - The firm's public interest role;
 - The importance of professional ethics, values and attitudes;
 - The responsibility of all personnel for quality relating to the performance of engagements or activities within the SOQM, and their expected behavior; and
 - Quality in the context of the firm's strategic decisions and actions, including the firm's financial and operational priorities.
- New requirements addressing leadership's behavior and commitment to quality, and their accountability for quality.
- New requirements addressing the organizational structure of the firm and the firm's assignment of roles, responsibilities and authority.
- New requirements addressing resource needs, and resource planning, allocation and assignment, which also include financial resources.

How the Firm Demonstrates a Commitment to Quality through its Culture

Embedding a commitment to quality throughout the firm may be achieved through a number of mechanisms and actions, such as the following:

Tone at the top

ISQM 1 deals with the tone at the top through the various requirements across ISQM 1 addressing leadership:

- The requirements that specify the responsibilities that need to be assigned, and who these need to be assigned to;
- Leadership's responsibility for understanding ISQM 1;
- Leadership's responsibility and accountability for quality;
- Leadership's responsibility for evaluating and concluding on the effectiveness of the SOQM; and
- Leadership's performance evaluations.

	<p>Examples of other actions leadership may take in addition to addressing the requirements above</p> <ul style="list-style-type: none"> • Establishing trust through consistent, regular and open communication. • Providing transparency within the firm about actions to address quality, and the effectiveness of those actions.
<p>Commitment to quality by all personnel</p>	<p>ISQM 1 deals with the actions and behavior of personnel and their commitment to quality through the following quality objectives:</p> <ul style="list-style-type: none"> • Reinforcing the responsibility of all personnel for quality relating to the performance of engagements or activities within the SOQM, and their expected behavior; and • As part of resources, personnel being expected to demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and being held accountable or recognized through timely evaluations, compensation, promotion and other incentives. <p>Examples of other actions that the firm may take to address personnel's commitment to quality</p> <ul style="list-style-type: none"> • Establishing a code of conduct. • Defining how quality will be measured and incorporating quality-related measures in personnel evaluations, with associated effects on compensation and promotion. • Establishing developmental opportunities for personnel that reinforce quality.
<p>Embedding quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities</p>	<p>Quality management is not a separate function of the firm. To be effective, a culture that demonstrates a commitment to quality needs to be integrated with the firm's strategy, operational activities and business processes.</p> <p>ISQM 1 includes a quality objective addressing the firm's strategic decisions and actions, including the firm's financial and operational priorities, that need to recognize quality.</p> <p>Strategic decisions and actions may include the firm's business strategy, financial goals, how resources are managed, growth of the firm's market share, industry specialization or new service offerings.</p> <p>Example of how to embed quality into the firm's strategic decisions and actions</p> <ul style="list-style-type: none"> • Defining the purpose and values of the firm, and ensuring that these recognize quality.

Given the pervasive nature of the firm's culture, many other aspects of the SOQM reinforce the firm's commitment to quality.

Examples of how other aspects of the SOQM reinforce a commitment to quality

- The firm's policies or procedures addressing consultation that encourage consultation on difficult or contentious issues, and reinforce the importance and benefit of consultation may help to emphasize the importance of quality.
- Implementing a robust system for supporting decisions about the acceptance and continuance of client relationships and specific engagements may contribute to the firm's tone regarding quality.



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.



In circumstances when the firm belongs to a network, the culture of the firm may also be influenced and supported by the network, for example through:

- The tone of leadership at the network level and the emphasis placed on the importance of quality.
- The network holding firm leadership accountable for quality.
- Network requirements and the network's monitoring of the firm's compliance with network requirements.
- How the network manages and responds to matters in relation to quality across all of the network firms, including the timeliness of the responses, communication of quality matters and what actions are taken in relation to network firms that do not comply with network requirements.



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.



RELEVANT ETHICAL REQUIREMENTS

The following summarizes how ISQM 1 has changed from the extant standard with respect to relevant ethical requirements:



- Adjusted to principles-based requirements to establish quality objectives addressing the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence.
- Increased focus on **all** relevant ethical requirements (i.e., not just independence).
- Improved clarity regarding the extent to which the SOQM needs to address the relevant ethical requirements that apply to others outside the firm (i.e., the network, network firms, individuals in the network or network firms, or service providers).
- Improved clarity regarding the scoping of the relevant ethical requirements in the context of the SOQM.

The following requirements in extant ISQC 1 have been captured in ISQM 1 as follows:

- ISQC 1 included specific requirements regarding information and communication related to independence (e.g., requirements to have policies and procedures dealing with communication of independence requirements, engagement partners providing relevant information, or personnel notifying the firm of threats to independence or breaches of independence). The firm's SOQM would still need to address the information and communication related to independence, but it is dealt with through the information and communication component of ISQM 1.
- ISQC 1 included requirements to have specific policies and procedures related to the long association of personnel. The requirement was not retained in ISQM 1. However, the firm's SOQM would need to still address the long association of personnel taking into account the provisions of the relevant ethical requirements, since the quality objectives in ISQM 1 deal with the fulfillment of relevant ethical requirements.



Paragraphs 34(a) and 34(b) of ISQM 1 include specified responses that relate to relevant ethical requirements, which are based on requirements in extant ISQC 1.

The Firm's Responsibility Regarding the Relevant Ethical Requirements that Apply to Others (i.e., Network, Network Firms, Individuals in the Network or Network Firms, or Service Providers)

Given that others external to the firm may be involved in the performance of engagements or various activities in the SOQM, the firm has a responsibility to address the relevant ethical requirements that apply to others. For example, the firm may need to use an engagement quality reviewer from a service provider if the firm does not have personnel within the firm that meet the eligibility requirements in ISQM 2.

i Paragraph A65 of ISQM 1 provides examples of relevant ethical requirements that may apply to others external to the firm.

It should be noted that the firm is only responsible for the relevant ethical requirements that apply to others in the context of the firm and the firm's engagements. Others may be subject to other ethical requirements that do not relate to the firm.

Examples of when the firm is, and is not, responsible for others' fulfillment of ethical requirements

Circumstance	What is the firm not responsible for?	What is the firm responsible for?
The firm is subject to the Ethical Code in Jurisdiction A. The firm uses an auditor's expert (an external expert) to provide a valuation on assets for an audit of financial statements. The expert belongs to an association of valuation professionals and is subject to the ethical requirements of the association. The expert has access to confidential information of the client.	The firm is not responsible for the auditor's expert's fulfillment of the ethical requirements of the association of valuation professionals.	The firm is responsible for ensuring that the auditor's expert understands the confidentiality provisions of the Ethical Code in Jurisdiction A, and that the auditor's expert treats the client's information as confidential.

Circumstance	What is the firm not responsible for?	What is the firm responsible for?
The firm is subject to the Ethical Code in Jurisdiction A. The firm is performing an audit of group financial statements and involves a network firm in another jurisdiction as a component auditor to perform audit procedures at a component. The network firm is subject to the Ethical Code in Jurisdiction B.	The firm is not responsible for the network firm's fulfillment of the Ethical Code in Jurisdiction B.	<p>The firm is responsible for the following:</p> <ul style="list-style-type: none"> • The individuals from the network firm that are assigned to the component fulfilling the provisions of the Ethical Code in Jurisdiction A that apply to them because they qualify as members of the engagement team in terms of the definition of engagement team in the Ethical Code in Jurisdiction A; and • The network firm fulfilling the provisions of the Ethical Code in Jurisdiction A that apply to all network firms within the firm's network, e.g., independence requirements.



- It is best practice for the firm to consider who is involved in the firm's engagements and performing activities for the SOQM, and how relevant ethical requirements may affect them.
- The responses designed and implemented by the firm to address others' fulfillment of relevant ethical requirements will likely differ from the responses designed and implemented by the firm to address personnel's fulfillment of relevant ethical requirements. For example, in relation to understanding the relevant ethical requirements:
 - The firm's personnel may be subject to regular training on the relevant ethical requirements.
 - For service providers, the firm may include the specific relevant ethical requirements in the terms of the contract (e.g., confidentiality requirements).
 - When component auditors are involved (in network or out of network), the relevant ethical requirements may be included in the group audit instructions, and in some circumstances, the group auditor may determine it appropriate to provide additional training to component auditors.

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS



ISQM 1 paragraphs:
30, A67-A74

The following summarizes how ISQM 1 has changed from the extant standard with respect to acceptance and continuance of client relationships and specific engagements:



- Adjusted to principles-based requirements to establish quality objectives addressing the acceptance and continuance of client relationships and specific engagements.
- Focus on the firm's judgments in determining whether to accept or continue the client relationships and specific engagements.
- Enhanced requirement to drive the firm to obtain 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).
- New requirement addressing the financial and operational priorities of the firm in the context of making decisions about whether to accept or continue a client relationship or specific engagement.

The following requirements in extant ISQC 1 have been captured in ISQM 1 as follows:

- ISQC 1 included specific requirements regarding the firm's ability to comply with relevant ethical requirements and conflicts of interest. The firm's SOQM would still need to address fulfilling ethical requirements, including conflicts of interest, through the quality objectives dealing with relevant ethical requirements.
- ISQC 1 included specific requirements for the firm to document how issues have been resolved when issues have been identified by the firm. ISQM 1 includes new principles-based requirements regarding documentation of matters related to the SOQM.

The Firm's Policies or Procedures Addressing Acceptance and Continuance


The firm's policies or procedures addressing acceptance and continuance may:


- Specify the information that needs to be gathered 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). In some cases, the policies or procedures may also suggest or specify where the information needs to be sourced from.
- Set out factors to be considered in determining whether the firm is able to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.

i The application material in paragraphs A67–A69 and A72 of ISQM 1 provide examples of information the firm may obtain in judging whether to accept or continue a client relationship or specific engagement, factors that may affect the information obtained, and the sources of the information.

- Specify (or prohibit) the types of engagements that may be performed by the firm, and may prohibit performing engagements for certain types of entities. For example:
 - The firm may prohibit the performance of assurance engagements over a certain subject matter when the firm does not have appropriate expertise to perform engagements over that subject matter.
 - The firm may prohibit performing assurance engagements, such as an audit of financial statements, for entities operating in certain industries (e.g., emerging industries with high levels of instability and erratic transactions).

The firm exercises the decision whether to accept or continue a client relationship or specific engagement. In accordance with ISA 220 (Revised), the engagement partner determines that the firm's policies or procedures have been followed, and that conclusions reached by the firm are appropriate.

 Paragraphs A122–A123 of ISQM 1 provide examples of matters that may be addressed in the firm's policies or procedures relating to acceptance and continuance.

 ISA 220 (Revised) also requires the engagement partner to:

- Take into account the information the firm obtained as part of the acceptance and continuance process, in planning and performing the audit engagement and complying with the ISAs.
- Communicate information to the firm that may have caused the firm to decline the audit engagement had that information been known by the firm at the time of their decision.



Paragraph 34(d) of ISQM 1 includes a specified response regarding matters that need to be addressed in the firm's policies or procedures for acceptance and continuance. The specified response is based on requirements in extant ISQC 1.



A threat to the firm's integrity may arise as a result of being associated with the subject matter of an engagement that is false or misleading. When the subject matter of an engagement is false or misleading, relevant ethical requirements may include requirements addressing how the firm should address the situation. Furthermore, paragraph 34(d) of ISQM 1 requires the firm to address 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.

ENGAGEMENT PERFORMANCE



ISQM 1 paragraphs:
31, A75-A85

The following summarizes how ISQM 1 has changed from the extant standard with respect to engagement performance:



- Adjusted to principles-based requirements to establish quality objectives addressing engagement performance. Principles-based requirements still include consultation, differences of opinion and addressing the assembly, maintenance and retention of engagement documentation.
- New requirement addressing engagement teams' responsibilities in connection with engagements, including the overall responsibility of an engagement partner for managing and achieving quality on an engagement and being sufficiently and appropriately involved throughout the engagement.
- Enhanced requirement addressing direction and supervision of engagement teams and review of the work performed, which is focused on what is appropriate given the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams.
- New requirement addressing engagement teams exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism.
- Requirements dealing with engagement quality reviews have been relocated in ISQM 1 and ISQM 2 (see further details in the specified responses section).

The following requirements in extant ISQC 1 have been captured in ISQM 1 as follows:

- ISQC 1 included more specific requirements for consultation that the firm needs to have resources to enable consultation. The firm's SOQM would still need to address having resources to support consultation through the resources component.
- ISQC 1 included more specific requirements for consultation and differences of opinion related to the documentation of these matters. Documentation is addressed through the principles-based requirements regarding documentation of matters related to the SOQM.



In a smaller or less complex firm:

- There may be no engagement team members other than the engagement partner (e.g., in the case of a sole practitioner). In such cases, the quality objectives addressing direction, supervision and review may not be relevant. Similarly, the firm's quality risks related to the engagement partner's responsibility for managing and

achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement may be assessed as fairly low.

- The firm may not have personnel internally that have the competence and capabilities to provide consultations. The firm may determine it appropriate to make use of a service provider for the purposes of consulting on difficult or contentious matters.
- It may be challenging to have individuals within the firm who are responsible for dealing with differences of opinion, as it could give rise to conflict in the firm and personnel may avoid raising these differences out of fear of reprisal. The firm may determine it appropriate to make use of a service provider for the purposes of receiving and resolving differences of opinion.

How the Firm Addresses Engagement Teams Exercising Appropriate Professional Judgment and, When Applicable to the Type of Engagement, Professional Skepticism

The firm may design and implement a number of responses to address professional judgment and professional skepticism that are related to the other quality objectives in the engagement performance section, including responses dealing with direction, supervision and review, consultation and differences of opinion. Furthermore, performing engagement quality reviews is one of the responses designed and implemented by the firm to address professional judgment and professional skepticism.

Other aspects of the firm's SOQM may also support engagement teams in exercising appropriate professional judgment and professional skepticism.

Examples of other aspects of the SOQM that may support engagement teams in exercising appropriate professional judgment and professional skepticism

- Taking robust actions to embed a culture that demonstrates the firm's commitment to quality.
- Leadership taking responsibility and accountability for quality, and demonstrating their commitment to quality through their actions and behaviors.
- Assigning appropriate resources to engagements, including human resources, technological resources, and financial resources (e.g., the engagement team may need financial resources for the purposes of engaging an expert or to physically visit certain locations).
- Developing appropriate intellectual resources, including creating alerts for engagement teams on circumstances that are giving rise to the need for professional judgment and professional skepticism and providing guidance for engagement teams in these circumstances.
- Managing the assignment of personnel to engagements, including ensuring they have adequate time to perform their work and fulfill their responsibilities.
- Making appropriate judgments about accepting and continuing engagements, such as considering whether the firm has appropriate resources to perform the engagement, and whether the firm has the time to undertake the engagement given the firm's other commitments.
- Providing appropriate training.

RESOURCES



ISQM 1 paragraphs:
16(f), 16(m), 16(n), 16(v), 16(w), 32,
A13, A20–A21, A28 and A86–A108

The following summarizes how ISQM 1 has changed from the extant standard with respect to resources:



- New requirements that address the need for technological and intellectual resources to enable the operation of the SOQM and performance of engagements.
- Expanded requirements for human resources, in particular:
 - New requirement to have competent and capable human resources to perform activities or carry out responsibilities in relation to the operation of the SOQM, and assign individuals to perform activities within the SOQM;
 - New requirement addressing the need to obtain individuals from external resources (i.e., the network, another network firm or a service provider) when the firm does not have the personnel to operate the SOQM or perform engagements; and
 - New requirement addressing personnel's commitment to quality and accountability or recognition through timely evaluations, compensation, promotion and other incentives.
- New requirement addressing service providers, i.e., that resources from service providers are appropriate for use in the SOQM and performance of engagements.

ISQC 1 included more specific requirements addressing the engagement partner, which addressed defining and communicating the responsibilities of the engagement partner, and communicating the identity and role of the engagement partner with those charged with governance. These have been captured in ISQM 1 as follows:

- Communication with those charged with governance is addressed in ISQM 1 through:
 - A requirement to communicate with those charged with governance of audits of listed entities about the SOQM; and
 - Principles-based requirements addressing external communication when it is appropriate.
- The engagement performance component addresses the responsibilities of engagement teams, and specifically draws attention to the responsibility of the engagement partner.

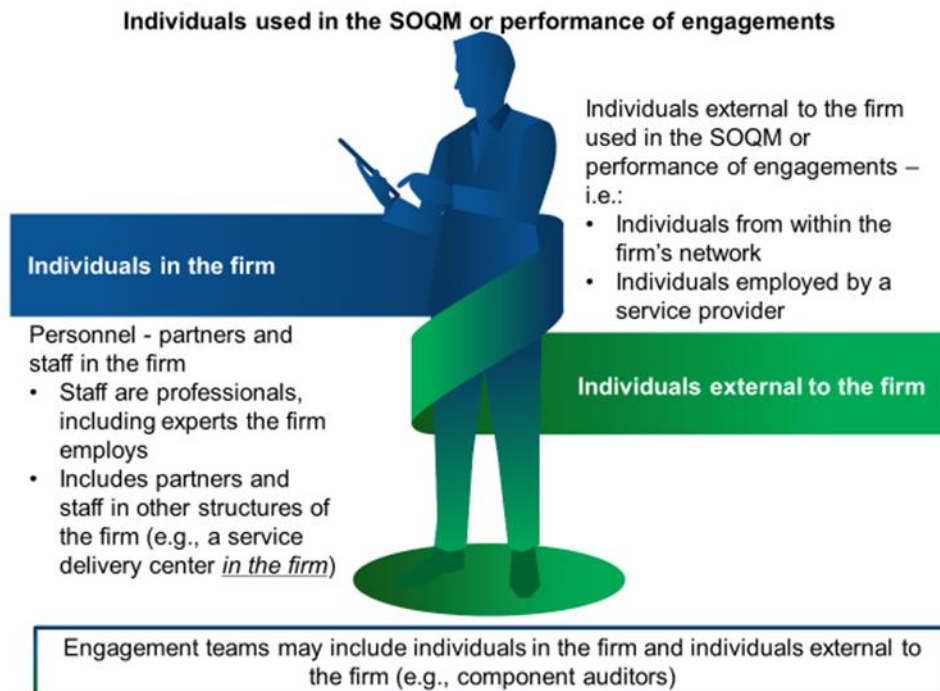


The resources component enables the design, implementation and operation of the SOQM. Accordingly, many aspects of the resources component may overlap with and support other components.

Financial resources are also an important aspect of the SOQM, and are needed to obtain technological, intellectual and human resources. Given that the management and allocation of financial resources is strongly influenced by leadership, financial resources are addressed through governance and leadership in ISQM 1.

Human Resources: What Aspects of ISQM 1 Apply to Personnel versus Other Individuals External to the Firm?

The term “human resources” in ISQM 1 covers the variety of individuals the firm may use in the SOQM or performance of engagements.



When the term “personnel” is used in ISQM 1, it refers to individuals in the firm.

When the term “individual” or “individuals” is used in ISQM 1, it is intended to be interpreted in the context in which it is being used. It may refer to a specific individual, a particular group of individuals, or to all human resources involved in the firm's SOQM or performance of engagements (i.e., individuals in the firm and individuals external to the firm).

The following requirements demonstrate how ISQM 1 may in some instances apply to all individuals used in the SOQM or performance of engagements, and in other instances only apply some of them:

All individuals used in the SOQM or performance of engagements	Only the individuals in the firm (i.e., personnel)	Only the individuals external to the firm used in the SOQM or performance of engagements
<p>Examples of requirements that apply</p> <ul style="list-style-type: none"> Paragraph 31: The engagement team's responsibilities, direction, supervision and review of the engagement team and their work, exercising professional judgment and differences of opinion. Paragraph 32(d): Assigning engagement team members and individuals to perform activities within the SOQM. Paragraph 33(c): Exchanging information between the firm and engagement teams. Paragraph 39: Individuals who perform monitoring activities. Paragraph 47: Communicating matters related to monitoring and remediation to engagement teams and other individuals assigned activities within the SOQM. 	<p>Examples of requirements that apply</p> <ul style="list-style-type: none"> Paragraph 28(a)(iii): Responsibility of personnel for quality relating to the performance of engagements or activities within the system of quality management, and their expected behavior. Paragraph 29(a): Relevant ethical requirements in the context of the firm and its personnel. Paragraph 32(a): Hiring, developing and retaining personnel. Paragraph 32(b): Personnel's commitment to quality. Paragraph 33(b): Responsibility of personnel to exchange information. Paragraph 34(b): Confirming compliance with independence requirements. 	<p>Examples of requirements that apply</p> <ul style="list-style-type: none"> Paragraph 29(b): Relevant ethical requirements in the context of others who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject. Paragraph 32(c): Obtaining individuals from external sources.

Human Resources: How the Firm Deals with Individuals External to the Firm as part of its SOQM

Paragraph A27 of ISQM 1 notes that if the firm uses individuals external to the firm in the SOQM or in the performance of engagements, different policies or procedures may need to be designed by the firm to address the actions of the individuals.

Example of how the policies or procedures that apply to the firm's personnel may be different from those that apply to individuals external to the firm

Paragraph 32(d) addresses assigning engagement team members who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. This includes any individuals external to the firm who perform procedures on the engagement.

Personnel	Individuals external to the firm
<p>The policies or procedures the firm designs and implements for personnel are likely to address:</p> <ul style="list-style-type: none"> • The processes and systems needed to track: <ul style="list-style-type: none"> ○ Engagements and engagement timing; ○ Personnel, including their level, training, experience and vacation days; ○ Engagements that personnel are assigned to; and ○ Overall client portfolios for partners and senior staff. • How the engagement partner, or another senior member of the engagement team, submits a request for personnel to be assigned to the engagement, or changes in personnel needs on the engagement. 	<p>The policies or procedures the firm designs and implements for individuals external to the firm are likely to address:</p> <ul style="list-style-type: none"> • The information needed from the other network firm or service provider about the individuals assigned to the engagement (e.g., their level, training and experience); • The factors to consider in determining whether the individuals assigned by the other network firm or service provider have the appropriate competence and capabilities (and time) to perform the assigned work; and • How concerns about the competence and capabilities of engagement team members are to be resolved. <p>Given the interaction with the other network firm or service provider is likely to happen at the engagement level, the firm may specify that the policies or procedures outlined above are implemented by the engagement partner.</p>

Human Resources: Component Auditors

Component auditors may be engaged as follows:

- The client or component management may appoint the component auditor (e.g., a component auditor may have been appointed to perform an audit of the component for statutory, regulatory or other reasons).
- The firm, or the engagement partner on behalf of the firm, may seek out the component auditor, i.e.,:
 - The firm may identify the need for a component auditor when the firm is determining whether to accept or continue an engagement; or
 - The engagement partner may identify the need for a component auditor when planning and performing the group engagement and the firm's policies or procedures may specify that the engagement partner seek out the component auditor on behalf of the firm.

Irrespective of how the component auditor has been identified or engaged, the firm has a responsibility to determine that:

- The resources (i.e., individuals) from the component auditor are appropriate for use; and
- The individuals assigned to the component have appropriate competence and capabilities, including sufficient time, to consistently perform a quality engagement.

ISQM 1 addresses the appropriateness of component auditors and their competence and capabilities through the following requirements:


Component auditors from within the same network as the firm: <ul style="list-style-type: none"> • <i>Paragraph 32(d) of ISQM 1</i> • <i>Paragraphs 48–52 of ISQM 1 (network requirements or network services)</i> 	Component auditors from outside the same network as the firm, or the firm does not belong to a network: <ul style="list-style-type: none"> • <i>Paragraph 32(d) of ISQM 1</i> • <i>Paragraph 32(h) of ISQM 1 (service provider)</i>
<p>Example of how the requirements may be practically applied to component auditors from within the same network</p> <p>The network has requirements that:</p> <ul style="list-style-type: none"> • Drive a high degree of commonality across the network firms' SOQM; and • Specify criteria that need to be met in order for an individual to be assigned to perform work at a component, when another network firm is the group auditor. The criteria includes the competence and capabilities that need to be met in order that an individual may be assigned to perform work at a component. <p>The firm:</p> <ul style="list-style-type: none"> • Understands the network requirements outlined above. • Establishes policies or procedures for engagement teams to confirm with the component auditor (i.e., the other network firm) that the individuals assigned to the perform work at the component meet the specific criteria set out in the network requirements. • Establishes policies or procedures for engagement teams to consider whether the individuals assigned to perform work at the component need to meet any 	<p>Example of how the requirements may be practically applied to component auditors from outside the firm's network</p> <p>The firm establishes policies or procedures that:</p> <ul style="list-style-type: none"> • Set out the information that needs to be obtained by the engagement partner about: <ul style="list-style-type: none"> ○ The other firm appointed as the component auditor, for example, their experience in the industry, reputation in the market, previous experience with the other firm and public information about the results of regulatory inspections; and ○ The competence and capabilities of the individuals assigned by the other firm to perform work at the component. <p>The policies or procedures may also specify how the information is obtained (e.g., information about the competence and capabilities of the individuals may be requested through the group audit instructions).</p> <ul style="list-style-type: none"> • Set out the criteria the engagement partner needs to consider in determining whether: <ul style="list-style-type: none"> ○ The other firm is appropriate for use in performing the work at the component; and

supplementary requirements in order that they are appropriate to use on the engagement and have the appropriate competence and capabilities.

- Considers the information from the network about the overall results of the network's monitoring activities across the network firms and whether this information indicates that individuals assigned by other network firms may not be appropriate to use on the firm's group engagements.
- Communicates the information from the network about the overall results of the network's monitoring activities across the network firms to engagement teams.
- Establishes policies or procedures to address circumstances when the engagement partner has concerns about the other network firm performing work at the component, or the competence and capability of individuals assigned to perform the work, including:
 - Requiring the engagement partner to communicate the matter to the firm, other network firm, those charged with governance of the entity or component management; and
 - If the matter cannot be resolved, providing additional resources, or requiring the engagement partner to increase the direction, supervision and review of the work performed at the component.

- The individuals assigned by the other firm to perform work at the component have appropriate competence and capabilities, including sufficient time, to perform quality work.

- Address how the engagement partner should address circumstances when the other firm is not appropriate for use, or the individuals assigned are not appropriately competent and capable, including having sufficient time, including:
 - Requiring the engagement partner to communicate the matter to the firm, other firm, those charged with governance of the entity or component management; and
 - If the matter cannot be resolved, requiring the engagement partner to request additional resources, or to increase the direction, supervision and review of the work performed at the component.

 ISA 220 (Revised) deals with the engagement partner's responsibility to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. In the case of a group audit, component auditors are part of the engagement team and therefore the provisions of ISA 220 (Revised) also apply to component auditors.


ISA 600⁸ addresses special considerations for group audits, and includes requirements and application material addressing the group auditor's responsibilities when involving component auditors.

⁸ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Technological Resources: The Scope of Technological Resources within ISQM 1

Not all technological resources used by the firm fall within the scope of ISQM 1. Technological resources may serve multiple purposes within a firm, and some may be unrelated to the SOQM. Paragraph A99 of ISQM 1 indicates that the following technological resources are relevant for the purposes of ISQM 1:

Technological resources used in designing, implementing or operating the SOQM	Technological resources used by engagement teams in the performance of engagements	Technological resources essential to enabling the effective operation of IT applications
<p>Examples:</p> <ul style="list-style-type: none"> IT applications for independence monitoring and client acceptance and continuance. IT applications used to monitor the SOQM. IT applications for recording time, and to track personnel's time off. IT applications to support training and for personnel's performance evaluations. IT applications for budgeting (planning and allocation of financial resources). IT applications for retaining and maintaining engagement documentation. IT applications for recording and tracking consultations. 	<p>Examples:</p> <ul style="list-style-type: none"> IT applications used to prepare and compile engagement documentation. IT applications used for intellectual resources (e.g., IT applications with policy manuals and methodologies). IT applications that are used as automated tools and techniques, including the use of Excel and macros in Excel. 	<p>Examples:</p> <ul style="list-style-type: none"> The operating systems and databases supporting the IT applications used in operating the SOQM or performance of engagements. The hardware to support the operation of the IT applications (e.g., network systems and user hardware such as laptops). IT systems to manage access to the operating system and IT applications (i.e., password applications).

 The application material in paragraph A99 of ISQM 1 includes examples to demonstrate how the technological resources that are relevant may differ between a less complex firm and a more complex firm.



Resources may create conditions, events, circumstances, actions or inactions that may give rise to quality risks. Accordingly, in identifying and assessing quality risks in accordance with paragraph 25(a) of ISQM 1, the firm is required to understand the resources of the firm.

The following are examples of conditions, events, circumstances, actions or inactions related to technological resources that may give rise to quality risks in other components:

- Engagement teams may place undue reliance on IT applications, and the IT applications may inaccurately process data, process inaccurate data, or both. This may give rise to quality risks related to engagement performance, in particular with regard to exercising appropriate professional skepticism.
- Security breaches may lead to unauthorized access to client data. This may give rise to quality risks related to relevant ethical requirements, i.e., breaches of the confidentiality of information.

Technological Resources: Engagement Teams' Use of Automated Tools and Techniques (ATT)

Engagement teams may use ATT in performing audit procedures on an engagement. In some cases, the ATT may be provided by or approved by the firm, and in other cases, the ATT may be obtained by the engagement team. In both circumstances, the firm's SOQM needs to address the appropriateness of the ATT, even if obtained by the engagement team. For example, paragraph A101 of ISQM 1 explains that the firm may:

- Specifically prohibit the use of ATT or features of ATT until such time that it has been determined that they operate appropriately and have been approved for use by the firm.
- Establish policies or procedures to address circumstances when the engagement team uses an ATT that is not approved by the firm, such as requiring the engagement team to determine that the ATT is appropriate for use prior to using it on the engagement by considering specific matters (e.g., data inputs, how the ATT operates, whether the outputs of the ATT achieve their intended purpose etc.).



The IAASB has developed [Non-Authoritative Support Material for Auditors Regarding Documentation When Using ATT](#).


This guidance includes how the engagement documentation may be affected when the firm has approved the ATT, versus when the ATT has not been subject to the firm's approval process.

The IAASB has also developed [Non-Authoritative Support Material Related to the Risk of Overreliance on Technology when Using ATT and Information Produced by the Entity's Systems](#).

This guidance includes how firms can help engagement teams address automation bias and the risk of overreliance when using ATT.

Service Providers: The Scope of Service Providers within ISQM 1

ISQM 1 recognizes that the firm may not have all of the resources they need internally and therefore may use service providers. Resources from service providers, as defined, include technological, intellectual or human resources used by the firm in the SOQM or performance of engagements. This includes using human resources (e.g., component auditors) from other firms **not** within the firm's network.

 Paragraph A105 of ISQM 1 includes examples of resources from service providers.

The firm cannot outsource its SOQM or responsibility for the SOQM; instead, the resources from service providers assist the firm in fulfilling the requirements of ISQM 1. As a result, when using resources from service providers, the firm is responsible for ensuring that the resources are appropriate for use in the SOQM or performance of engagements.

A service provider may be engaged by the firm, or the engagement team. There may also be circumstances when a service provider is engaged by another party (e.g., in the case of a component auditor from another firm not within the firm's network that is engaged by component management). In all cases, the firm's SOQM needs to address the appropriateness of the service provider, even if engaged by the engagement team or another party. For example, when the service provider is engaged by the engagement team, the firm may establish policies or procedures that set out matters for the engagement team to consider in engaging the service provider.



If the firm uses resources (technological, intellectual or human resources) from within the firm's network, (i.e., from the network, another network firm or another structure or organization in the firm's network), such resources are not considered resources from service providers. Instead, such resources are addressed as part of complying with paragraphs 48–52 of ISQM 1 (i.e., the firm's responsibilities when using network requirements or network services).

Service Providers: Varying Quality Risks and Scalability Considerations

The firm may use many resources from service providers in the SOQM or in performing engagements. The nature of the quality risks related to the resources from service providers, and reasons for the assessment of the quality risks may vary. As a result, the nature, timing and extent of the firm's responses to address quality risks related to whether the resources from service providers are appropriate for use may vary. It should be noted that in some cases, the firm may determine that there is no quality risk related to certain resources from service providers, in which case the firm may not need to design and implement responses related to those resources.

Examples of factors that may affect the quality risks related to resources from service providers, which affects the nature, timing and extent of the firm's responses

Examples of factors	Examples of how the factors affect the quality risks
<p>The nature of the resource</p>	<p>When using a technological resource from a service provider, the quality risks may include:</p> <ul style="list-style-type: none"> • A lack of appropriate updates to the IT application, resulting in it becoming unreliable or unusable, and therefore not appropriate for use in the firm's SOQM or in performing engagements. • Access to client data, particularly when the data is stored in a database managed and operated by the service provider, which could result in confidentiality breaches. <p>When using human resources from a service provider, the quality risks may include:</p> <ul style="list-style-type: none"> • A lack of appropriate competence and capabilities to perform the activity for which the human resource has been engaged, resulting in the resource not being appropriate for use in the firm's SOQM or in performing engagements. • Changes in the individuals assigned by the service provider (e.g., due to reassignment) during the course of the activity for which they have been engaged, and new individuals assigned being inappropriate due to lack of continuity or experience related to the activity.
<p>The firm's responsibilities to take further actions in using the resource</p>	<ul style="list-style-type: none"> • The firm uses an IT application from a service provider that is an off-the-shelf package. The IT application is maintained by the service provider. The service provider distributes updates automatically, and the firm receives an automated alert to accept the update. In this case, since the firm has relatively few responsibilities related to the IT application, the quality risks may relate to: <ul style="list-style-type: none"> ○ Whether the IT application is appropriate for the purpose it will be used for; ○ Whether the service provider provides the necessary updates; and ○ The risk that the firm does not accept the automated updates. • The firm uses an IT application from a service provider. Although the IT application is an off-the-shelf package and is maintained by the service provider, the firm builds on

custom-developed applications that enables the firm to integrate the IT application with other IT applications. In addition, there are a number of responsibilities for the firm in using the IT application, including:

- Capturing firm-specific data into an underlying database, and maintaining the data; and
- Selecting various options related to the functionality of the IT application, which require a periodic review as the functionalities may change when the service provider updates the IT application.

In this case, in addition to the quality risks described in the example above about whether the IT application is appropriate for the purpose it will be used for, and the quality risks related to the updates, the firm may also identify quality risks related to:

- The custom-developed applications not functioning correctly;
- Firm-specific data being incorrectly captured or not properly maintained; and
- The selected functionality options being inappropriate.

Service Providers: Obtaining Information from Service Providers

Paragraph A107 of ISQM 1 explains that in determining whether a resource from a service provider is appropriate for use in the SOQM or performance of engagements, the firm may obtain information about the service provider and the resource they provide from a number of sources. Often such information may need to be obtained directly from the service provider.

In circumstances when the service provider does not provide the information needed by the firm, and the firm is unable to obtain alternative information to satisfy themselves that the service provider is appropriate for use in the SOQM or performance of engagements, the firm may need to use an alternative service provider. In some cases, the firm may be required to use the service provider, and if the firm is unable to satisfy themselves about the appropriateness of the resource, the firm may need to take other action to appropriately respond to the situation.

Examples of circumstances when the firm is required to use a service provider and actions the firm may take if the firm is unable to satisfy themselves that the resource is appropriate for use

Examples of circumstance	Example of actions the firm may take
<p>The network requires the firm to use a specific external IT application that has been developed by a software provider. The software provider distributes the IT application through regional distributors, and therefore the firm is responsible for obtaining the IT application directly from the regional distributor and negotiating the terms of the contract with them. Accordingly, the software provider is a service provider in the context of the firm, and the firm needs to address whether the IT application is appropriate for use.</p> <p>The firm has requested the regional distributor to provide information to support their consideration of whether the IT application is appropriate for use, however the regional distributor has not responded to the firm's requests.</p>	<p>The firm may discuss the matter further with the network and request the network to obtain the necessary information from the global head office of the software provider. In addition, the firm may identify more specific quality risks related to the use of the particular IT application and respond to such quality risks more directly. For example, the firm may pinpoint that there is a risk that the IT application performs certain calculations incorrectly and implements policies or procedures requiring engagement teams to reperform the calculations made by the IT application.</p>



There may be circumstances when a 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. However, for the purposes of ISQM 1, an assurance report from the service provider is not required.



INFORMATION AND COMMUNICATION

The following summarizes how ISQM 1 has changed from the extant standard with respect to information and communication:



- New component in ISQM 1.
- New and enhanced requirements for obtaining, generating or using information and communicating information, to enable the design, implementation and operation of the SOQM. The new requirements address:
 - The firm's information system;
 - The culture of the firm in the context of information and communication (i.e., recognizing and reinforcing the responsibility of personnel to exchange information with the firm and with one another).
 - Exchanging information between the firm and engagement teams (Note: This has been enhanced from ISQC 1 that requires the firm to communicate its policies and procedures to personnel).
 - Communicating information within the firm's network and to service providers.
 - Other communication externally related to the SOQM, i.e., when it is required by law, regulation or professional standards, or to support external parties' understanding of the SOQM.

ISQC 1 included communication-related requirements in some elements of the standard, for example, communication related to independence matters, and communicating the responsibilities of the engagement partner. The information and communication component in ISQM 1 addresses the need for this communication through the principles-based requirements introduced in the information and communication component.



The information and communication component enables the design, implementation and operation of the SOQM. Accordingly, many aspects of the information and communication component may overlap with other components.

Other aspects of ISQM 1 include specific information and communication requirements, such as paragraphs 22, 34(e), 46–47 and 51 of ISQM 1.

The Information System

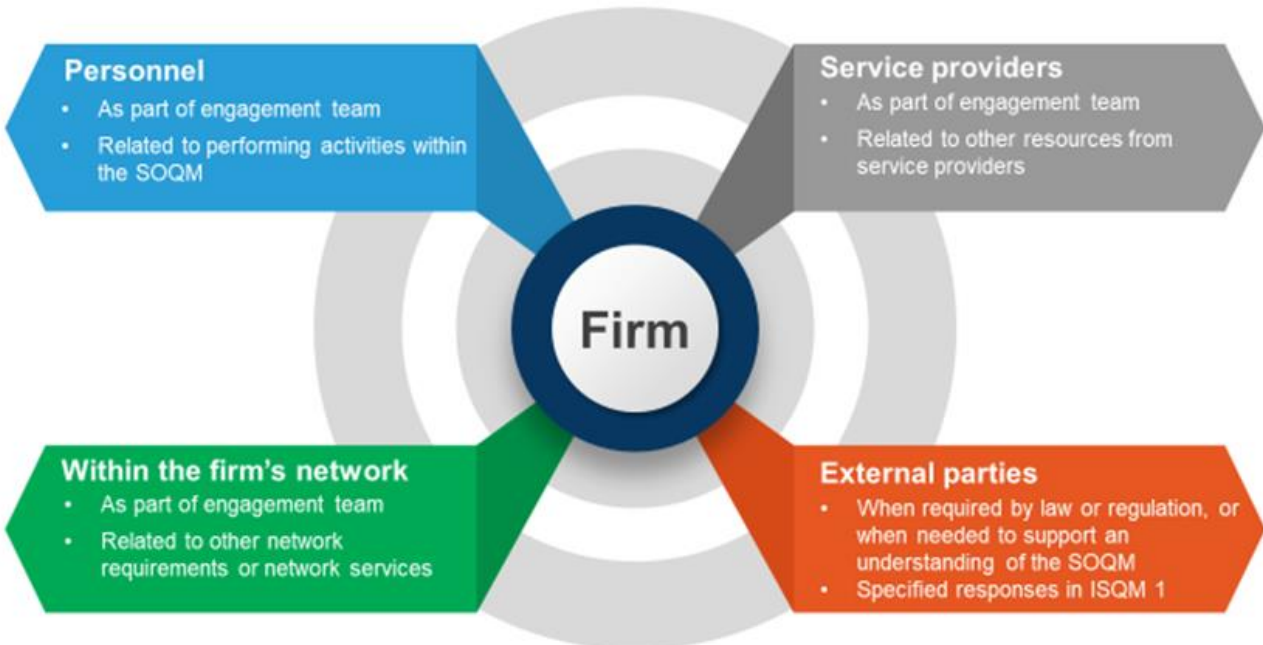
ISQM 1 requires the firm to establish a quality objective related to the firm's information system. ISQM 1 explains that the information system may include the use of manual or IT elements.

Although this is a new requirement in ISQM 1, the firm is likely to already have information systems in place as part of its existing systems of quality control. In implementing ISQM 1, the firm may give consideration to how the existing information system identifies, captures, processes and maintains information.

i Paragraph A111 of ISQM 1 includes a scalability example to demonstrate how the information system may be designed in a less complex firm.

Various Parties with Whom the Firm Communicates and Exchanges Information

Effective two-way communication is essential to the operation of the SOQM and performance of engagements. ISQM 1 recognizes that there are various parties with whom the firm communicates and exchanges information. The information communicated, and the responsibilities of individuals to communicate, differs depending on the role they are undertaking in the context of the firm's SOQM or performance of engagements.



ISQM 1 deals with:

- The general responsibility of personnel to communicate.
- Exchanging information between the firm and engagement teams. In this context, engagement teams include personnel and any individuals from within the firm's network or from a service provider who are part of the engagement team. How the firm exchanges information with individuals from within the firm's network or service provider may differ from how the firm exchanges information with their personnel. For example, the firm's communication to component auditors from within the firm's network or a service provider may be via the group auditor.

- Exchanging information between the firm and personnel performing activities within the SOQM.
- Communicating information within the firm's network or to service providers, in the context of network requirements or network services or resources from service providers.
- Communication with other external parties.

i Paragraph A112 of ISQM 1 includes examples of communication among the firm, personnel and engagement teams. Paragraph A113 includes an example of information obtained by the firm from within the firm's network.

There are a variety of methods a firm may use to communicate information, for example, direct oral communication, manuals of policies or procedures, newsletters, alerts, emails, intranet or other web-based applications, training, presentations, social media, or webcasts. In determining the most appropriate method(s) and frequency of communication, the firm may take into consideration a variety of factors, including:

- The audience to whom the communication is targeted; and
- The nature and urgency of the information being communicated.

In some circumstances, the firm may determine it necessary to communicate the same information through multiple methods in order to achieve the objective of the communication. In such cases, the consistency of the information communicated is important.



In the case of a smaller or less complex firm, communication may be more informal and achieved through direct discussions with personnel and engagement teams. There is no requirement in ISQM 1 that all communication needs to be formally documented, and this is often not practicable to do. The firm would need to document communication to the extent necessary to address the documentation requirements in paragraphs 57–59 of ISQM 1.

Communications with External Parties



**ISQM 1 paragraphs:
34(e), A124-A132**

The firm may communicate with a variety of external parties. External communication related to the firm's SOQM may include a transparency report or audit quality report, direct conversations with external parties, including direct conversations with regulators and audit oversight authorities, or management and those charged with governance of clients, and information on the firm's website or provided through social media.

ISQM 1 addresses communication with external parties through the following:

- A quality objective related to communication with external parties in paragraph 33(d)(ii); and
- A specified response in paragraph 34(e) of ISQM 1.

i Paragraph A125 of ISQM 1 includes examples of external parties who may use information about the firm's system of quality management.

Note: Communication within the firm's network or to service providers is dealt with in paragraph 33(d)(i) of ISQM 1.

The requirements in ISQM 1 to communicate with external parties (other than networks and service providers) are summarized as follows:

When is Communication with External Parties Required or Appropriate?	Who is the Communication With?	What is Communicated?	How is it Communicated?
Law, regulation or professional standards require communication externally	Communicate with external party specified by law, regulation or professional standards	Communicate information specified by law, regulation or professional standards	Nature, timing and extent specified by law, regulation or professional standards
Firm performs audits of financial statements of listed entities	Communicate with those charged with governance of the entity	Communicate how the SOQM supports consistent performance of quality engagements (Policies or procedures established in accordance with paragraph 34(e)(iii))	Nature, timing and extent determined by the firm (Policies or procedures established in accordance with paragraph 34(e)(iii))
Communication is otherwise needed to support external parties' understanding of the SOQM	Communicate with external party determined by the firm (Policies or procedures established in accordance with paragraph 34(e)(ii))	Communicate information determined by the firm (Policies or procedures established in accordance with paragraph 34(e)(iii))	Nature, timing and extent determined by the firm (Policies or procedures established in accordance with paragraph 34(e)(iii))

The requirements in ISQM 1 aim to promote the exchange of valuable and insightful information about the SOQM with the firm's stakeholders, in the most appropriate manner. As a result, even if there are no requirements in law, regulation or professional standards to communicate externally, or the firm does not perform audits of financial statements of listed entities, the firm is expected to at least determine whether it is appropriate to communicate with external parties about the SOQM.



In the case of a smaller firm, in developing its policies or procedures, the firm may identify limited cases when communication with external parties is appropriate. For example, the firm may communicate with those charged with governance of an entity in circumstances when there are findings about a particular engagement.



ISQM 1 includes extensive guidance and examples related to external communication:

- Paragraph A126 describes the matters that may be communicated to external parties.
- Paragraph A130 explains matters that may affect the firm's determination of when it is appropriate to communicate externally.
- Paragraph A131 explains the attributes that the firm may be mindful of in preparing information to communicate externally.
- Paragraph A132 includes examples of the form of communication to external parties.



Jurisdictional law, regulation or professional standards may require the firm to prepare a transparency report or audit quality report, in which case the firm would need to comply with such requirements. ISQM 1 does not require the firm to prepare a transparency report or audit quality report. Paragraph A132 of ISQM 1 indicates that a transparency report or audit quality report is an example of a form of communication to external parties.

SPECIFIED RESPONSES



ISQM 1 paragraphs:
16(d), 16(e), 34, A116-A137

As explained under the firm's risk assessment process, ISQM 1 includes some specified responses that the firm is required to design and implement. The specified responses are not comprehensive and would not fully address all quality risks. Some of the specified responses relate to matters addressed in extant ISQC 1.

The following summarizes which requirements are new in ISQM 1, and those that relate to matters in the extant standard:



- New requirements addressing communication with external parties (see the information and communication section for further details).
- Enhanced requirements:
 - The policies or procedures addressing which engagements need to be subject to an engagement quality review.
 - The policies or procedures addressing threats to compliance with relevant ethical requirements and breaches of the relevant ethical requirements deal with all relevant ethical requirements (extant ISQC 1 focuses on independence). Furthermore, the requirements have been aligned to the IESBA Code, particularly with respect to updates to the IESBA Code regarding [safeguards](#).
 - The requirement to obtain confirmation of compliance with independence requirements has been adjusted to refer to independence requirements, instead of the firm's policies or procedures on independence.
 - The policies or procedures addressing complaints and allegations are similar to extant ISQC 1, with an enhanced focus on receiving, investigating and resolving complaints and allegations.

The following requirements in extant ISQC 1 have been captured in ISQM 1 as follows:

- ISQC 1 included requirements addressing the eligibility of the engagement quality control reviewer, and the performance and documentation of the engagement quality control review. These are now addressed in ISQM 2.
- ISQC 1 included specific requirements addressing deficiencies identified as a result of complaints and allegations. This is addressed as part of the monitoring and remediation process.

The sections in this publication for the relevant ethical requirements component and acceptance and continuance component, also explain requirements in ISQC 1 that have been captured elsewhere in ISQM 1.

- The policies or procedures addressing specific matters relating to engagement acceptance and continuance have been clarified, and expanded to require the firm to also address circumstances when the firm is obligated by law or regulation to accept a client relationship or specific engagement.

Engagement Quality Reviews

Engagement quality reviews are a firm-level response to quality risks. The engagement quality review is undertaken at the engagement level by the engagement quality reviewer on behalf of the firm. The requirements dealing with engagement quality reviews are contained in ISQM 1 and ISQM 2 as follows:

➔ See the [IAASB's first time implementation guide for engagement quality reviews](#).

ISQM 1 requires the firm to establish policies or procedures that:

- Address engagement quality reviews in accordance with ISQM 2; and
- Require an engagement quality review to be performed for specified engagements.

ISQM 2 deals with:

- The criteria for an individual to be eligible to perform the engagement quality review and the appointment of engagement quality reviewers; and
- The performance and documentation of the review.

What does this mean?

The firm is expected to establish policies or procedures that address:

- Which engagements need to be subject to an engagement quality review. The policies or procedures need to include the scope of engagements specified by ISQM 1.
- The eligibility criteria for an individual to perform an engagement quality review, and the appointment of the engagement quality reviewer. The policies or procedures need to also comply with the eligibility requirements in ISQM 2 and the requirements addressing the appointment of the reviewer.
- The performance and documentation of the engagement quality review. The policies or procedures need to also comply with the performance and documentation requirements in ISQM 2.



Paragraph A136 of ISQM 1 notes that in some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review is needed. It should be noted that the requirement in ISQM 1 to establish policies or procedures addressing engagement quality reviews would still apply to the firm. However, the nature and circumstances of engagements the firm performs may be such that they do not require an engagement quality review in accordance with the firm's policies or procedures.



The firm may design and implement other types of engagement reviews as a response to quality risks, that are not engagement quality reviews. For example, for qualifying audit engagements, the firm may require a review of the engagement team's further audit procedures to address significant risks or reviews of certain matters by individuals within the firm who have specialized technical expertise. In some cases, these reviews may be undertaken in addition to an engagement quality review.

Complaints and Allegations

ISQM 1 does not specify who should receive, investigate and resolve complaints and allegations. However, the requirements addressing resources in paragraphs 32(c) and 32(e) apply. This means that the individual assigned to receive, investigate and resolve complaints and allegations needs to have appropriate competence and capabilities, including sufficient time, to perform the role. In the event that the firm does not have personnel with the appropriate competence and capabilities to fulfill this role, the firm would need to obtain an individual from an external source.

The appropriate competence and capabilities to fulfill the role of receiving, investigating and resolving complaints and allegations may include having:

- Experience, knowledge, and appropriate authority within the firm; and
- A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the SOQM.

THE MONITORING AND REMEDIATION PROCESS



ISQM 1 paragraphs:
16(a), 16(h), 35–47, A10–A12,
A15–A17 and A138–A174

The purpose of the monitoring and remediation process is:

- To monitor the SOQM so that the firm has relevant, reliable and timely information about the design, implementation and operation of the SOQM.
- To take appropriate actions to respond to identified deficiencies, such that deficiencies are remediated on a timely basis, to prevent them from reoccurring. Taking appropriate actions may also include, if necessary, rectifying findings that relate to engagements when it appears that procedures were omitted on an ongoing or completed engagement, or a report issued was inappropriate.

Monitoring and remediation facilitates the proactive and continual improvement of engagement quality and the SOQM. Identifying and remediating deficiencies is constructive and is an essential part of an effective SOQM.



The monitoring and remediation process has been extensively enhanced from extant ISQC 1, including:

- A new focus on monitoring the SOQM as a whole;
- A new framework for evaluating findings and identifying deficiencies, and evaluating identified deficiencies; and
- More robust remediation.

The requirements addressing communication of matters related to monitoring and remediation are similar to extant ISQC 1.

How Information About the Design, Implementation and Operation of the SOQM and Deficiencies May be Used

Information about the design, implementation and operation of the firm's SOQM, including deficiencies and remedial actions, may be used by:

- Firm leadership in the annual evaluation of the SOQM.
- The firm, or individuals assigned activities within the SOQM, to proactively and continually improve engagement quality and the SOQM. This includes engagement quality reviewers who may use the information as a basis for performing the engagement quality review.
- Engagement partners to manage and achieve engagement quality.

The Various Aspects of a Monitoring and Remediation Process

The monitoring and remediation process can be broken down into four aspects:



As further explained in the sections that follow, the design of the monitoring and remediation process will vary based on many factors, including how other aspects of the SOQM are designed, and the nature and circumstances of the firm.

The monitoring and remediation process is intended to be a non-linear process that operates in a dynamic and iterative manner.

Example of how the monitoring and remediation process is dynamic and iterative

In evaluating findings related to personnel recording financial interests in the firm's independence IT application, it is identified that the monitoring activities did not address the functioning of the independence IT application itself, such as access controls to the IT application, how the IT application has been programmed, how changes to the programming are managed, or how data captured in the IT application is stored and maintained. Accordingly, the firm determines that further monitoring activities of the independence IT application are necessary, to provide a holistic view of the effectiveness of the firm's responses to address independence.

Design and Perform Monitoring Activities



ISQM 1 paragraphs:
36-39, A139-A156



What the Firm Monitors

The firm monitors the SOQM as a whole. This may include monitoring:

- How responsibilities are assigned to leadership and whether the requirements of ISQM 1 have been met.
- The design and operation of the firm's risk assessment process, i.e., how the firm goes about establishing quality objectives, identifying and assessing quality risks, designing and implementing responses, and identifying information related to changes in the nature and circumstances of the firm and engagements it performs that may impact the quality objectives, quality risks or responses.
- The implementation and operation of the responses, including whether they properly operate according to how they have been designed and whether the responses effectively address the related quality risks.
- Whether the firm's monitoring and remediation process is achieving its intended purpose.
- How the firm has addressed network requirements or network services and whether it complies with the requirements of ISQM 1.
- Leadership's evaluation of the SOQM and whether it has met the requirements of ISQM 1.

How the Firm Monitors the SOQM

The firm designs and performs monitoring activities that are tailored for the firm. The nature, timing and extent of the monitoring activities are tailored by taking into account a number of factors set out in ISQM 1. Below are the factors that ISQM 1 requires the firm to take into account, together with illustrative examples that demonstrate how that factor may affect the nature, timing and extent of the monitoring activities.

The reasons for the assessments given to the quality risks

Example

The firm has a quality risk related to the engagement partner providing insufficient direction, supervision and review. The assessment of the quality risk is greater for some categories of engagements, such as group audits and audits of listed entities. One of the responses the firm designs for this quality risk is an automated tool that tracks the engagement partner's time spent on engagements throughout the course of the engagement against predicted averages. The tool sends an alert to the engagement partner at any point in the engagement if it detects that the time being spent is too low.

In monitoring the tool, the firm obtains a report of alerts, and follows up on a selection of engagements to determine how the engagement partner responded to the alert. The firm's selection (i.e., the extent of the monitoring activity) is focused on engagements where the assessment of the quality risk was greater (i.e., group audits and audits of listed entities).

The design of the responses

Example

Using the same example above, the firm's monitoring activities include determining that the predicted averages used by the tool are appropriate. In doing so, the firm uses an IT expert to check that the timesheet data is accurately transferred into the tool, and that the tool's algorithms for determining the predicted averages remain appropriate (nature of the monitoring activity). The IT expert undertakes this evaluation annually (timing of the monitoring activity).

The design of the firm's risk assessment process and monitoring and remediation process

Examples

- *Monitoring the firm's risk assessment process:* As part of the firm's risk assessment process, the firm has a committee that meets quarterly to discuss changes in the firm and its environment, and how these may impact the SOQM, in particular whether new quality risks exist and responses needed to address those risks. The nature of the firm's monitoring activities may involve observing a committee meeting, and understanding the information the committee uses to identify changes in the firm and its environment.
- *Monitoring the monitoring and remediation process:* The firm is a small firm and therefore has engaged a service provider to perform the firm's monitoring activities. The service provider performs the monitoring activities on a quarterly basis, and provides the results to the individual(s) assigned operational responsibility for the monitoring and remediation process. The nature of the firm's monitoring of the design, implementation and operation of the monitoring activities may involve the firm:
 - Considering whether the monitoring activities the service provider was instructed to perform provide adequate information about the SOQM;
 - Considering the appropriateness of the service provider;

- Reviewing the information provided by the service provider to determine whether they have performed the monitoring activities in accordance with the firm's instructions; and
- Inquiring of the service provider whether they have insights or recommendations that would enhance the effectiveness of the design of the firm's monitoring activities.

Changes in the system of quality management

Example

The firm implements a new IT application to manage the acceptance and continuance of clients and engagements. The firm determines that it needs to undertake monitoring activities to determine whether the IT application is functioning as intended and is achieving its intended purpose, within three months after the launch of the new IT application (timing of the monitoring activity).

Previous monitoring activities

Examples

Previous monitoring activities highlight areas of focus: The results of the firm's previous annual inspection of completed engagements highlighted that engagement teams had inadequate time to perform the engagements, which was an identified deficiency that was considered severe and pervasive. The firm took a number of actions to remediate the deficiency, including hiring additional staff and mandatory project management training for senior staff and partners. Given the severity and pervasiveness of the deficiency, the firm closely monitors on an ongoing basis (timing of the monitoring activity) the assignment of staff to engagements and has regular meetings (nature and timing of the monitoring activity) with senior staff and partners to discuss how the outcomes of the project management training are being implemented.

Monitoring activities have not been undertaken for an extensive period of time: The firm has an IT application for timesheets, which it has used for many years, and which has not changed. In the first year when the firm acquired the IT application, the firm's monitoring activities checked that the IT application was functioning as intended. Many years have passed since the IT application was last monitored, and therefore the firm identifies the need to perform new monitoring activities over the IT application (timing of the monitoring activity).

Other relevant information – complaints/allegations, external inspections, service providers

Example

The firm receives an anonymous complaint internally that an engagement partner did not adhere to the firm's policies or procedures regarding non-compliance with laws and regulations, when there was identified non-compliance with laws and regulations by client management. The firm follows up on the complaint and takes action to deal with the non-compliance in accordance with relevant ethical requirements. Nevertheless, given the engagement partner did not comply with policies or procedures, in selecting engagement partners for inspection of completed engagements, the firm selects the engagement partner that was the subject of the complaint (extent of monitoring activity).

Examples of other matters that may also affect the nature, timing and extent of the monitoring activities:

The size, structure, and organization of the firm	The involvement of the firm's network in monitoring activities	The resources the firm intends to use to enable monitoring activities
<p>Example</p> <p>The firm is a large firm that operates in multiple locations. Therefore, the firm has a dedicated team of personnel who perform the firm's monitoring activities. Since the team is dedicated to monitoring, many activities are designed as ongoing monitoring activities performed at regular intervals throughout the year.</p>	<p>Example</p> <p>The firm's network undertakes monitoring of engagements and various aspects of the SOQM on an annual basis. In the current review, the network has focused on the firm's responses to address independence. The firm considers the nature and extent of the network's monitoring activities over independence in determining the nature, timing and extent of the firm's own monitoring activities on independence.</p>	<p>Example</p> <p>The firm engages a service provider to perform monitoring activities as instructed by the firm. Given the service provider is not engaged by the firm on a full-time basis, many of the monitoring activities are designed by the firm to be undertaken quarterly (i.e., they are periodic activities).</p>

Ongoing and Periodic Monitoring Activities

Ongoing monitoring activities may be more suitable in some circumstances, while periodic monitoring activities are more suitable in others. The combination of ongoing and periodic monitoring activities may enable effective monitoring as a whole.

Ongoing monitoring activities	Periodic monitoring activities
<i>Routine activities, built into the firm's processes and performed on a real-time basis, reacting to changing conditions</i>	<i>Activities conducted at certain intervals</i>
<p>Example</p> <p>Various reports are generated from the firm's IT application for independence on a monthly basis, and reviewed by the individual assigned operational responsibility for compliance with independence requirements. The individual uses the report to identify anomalies and non-compliance with the firm's policies or procedures related to independence.</p>	<p>Example</p> <p>Inspection of completed engagements or inspection of training records to determine that personnel have completed required training.</p>

Types of Monitoring Activities, Including the Inspection of Completed Engagements

Inspections of completed engagements are one of the monitoring activities performed by the firm. They are required to be performed by ISQM 1. Inspections of completed engagements, although focused on engagements, provide information to the firm about the SOQM. For example, the outcomes of inspections may provide information about:

- Whether there are quality risks that have not been identified by the firm, or whether the assessment of quality risks may need to be modified;
- Whether engagement teams have implemented the firm's policies or procedures (i.e., responses) as designed, and whether the responses are effective in addressing the quality risks;
- Whether there needs to be modifications to the design of the firm's policies or procedures (i.e., responses) based on the implementation of the firm's policies or procedures by engagement teams;
- The quality of engagements and culture and attitude towards quality;
- Whether engagement partners have fulfilled their overall responsibility for managing and achieving quality on the engagements they are assigned to; and
- Actions by engagement teams that have given rise to positive outcomes, which may provide the firm with ideas on how to further improve or enhance the SOQM.

Only performing inspections of completed engagements will unlikely provide the firm sufficient and timely information about the design, implementation and operation of the SOQM, i.e., the firm will likely need a combination of monitoring activities to achieve the purpose of the monitoring and remediation process.

Examples of other types of monitoring activities

- Inspections of in-process engagements.
- Interviewing firm personnel, or undertaking formal surveys, to understand how personnel perceive the culture of the firm.
- Considering the consistency of leadership's communications and messaging, and whether they reflect the firm's values and focus appropriately on quality.
- Checking and evaluating IT applications used for functions related to the SOQM, such as independence systems or automated tools used for audits.
- Automated alerts, for example, automatic notifications when policies are not applied.
- Inspecting documentation and contracts supporting engaging service providers, to determine whether proper consideration was given to whether the service provider was appropriate for use.
- Checking records of attendance at training events.
- Inspecting time records for number of hours spent by engagement partners and other senior personnel and assessing the sufficiency of such hours.



In some cases, a response to address a quality risk may be confused with, or appear to be similar to, a monitoring activity. For example, inspections of in-process engagements (which are a monitoring activity) may be confused with engagement reviews that are designed to prevent a quality risk from occurring (which are responses).

Why is the inspection of engagements a monitoring activity?

Inspections of engagements are designed to evaluate whether policies or procedures (i.e., responses) or other aspects of the SOQM are designed, implemented and operating in the manner intended.

When is an engagement review a response?

Responses are designed to prevent a quality risk, or detect and correct failures or shortcomings in the SOQM that would result in the quality risk occurring. For example, an engagement quality review is designed to evaluate the judgments of the engagement team before the engagement report is issued, or the firm may have pre-issuance reviews of the financial statements and engagement documentation for certain engagements to determine whether the financial statements appear appropriate.

How does the firm differentiate?

When designing the SOQM, the firm determines what is the nature of an activity (i.e., is it a response or a monitoring activity), based on what the activity it is intended to achieve. For example:

- If the firm establishes a policy that requires engagements to apply or be subject to a certain procedure to prevent a quality risk from occurring, then it is likely a response (e.g., the firm's methodology requires engagements meeting certain criteria to be subject to a pre-issuance review to assist in determining the appropriateness of the engagement report before it is issued).
- If the firm designs the activity to accumulate information about the execution of policies or procedures to determine their effectiveness, it is most likely a monitoring activity (e.g., inspections of engagements that include determining whether the engagements meeting the criteria for a pre-issuance review were appropriately subject to the pre-issuance review, and that the reports issued were appropriate in the circumstances).

Inspection of Completed Engagements: Selecting Completed Engagements for Inspection

The inspection of completed engagements is focused on selecting a combination of engagements and engagement partners:

- **Engagements** may be selected based on the risks associated with such engagements. For example, the firm may determine that audits of financial statements of listed entities or engagements performed in certain industries need to be subject to inspection more frequently than other engagements.
- **Engagement partners** may be subject to inspection for reasons associated with the partner. For example, the firm may select engagement partners based on how long it has been since the engagement partner was last subject to inspection, the results of previous inspections of the engagement partner, or the experience of the engagement partner.

i Paragraph A151 of ISQM 1 has examples to demonstrate how the factors that affect the design of monitoring activities may affect the selection of completed engagements or engagement partners for inspection.

i Paragraph A153 of ISQM 1 has an example illustrating how a firm may determine and apply the cycle for selecting engagement partners. The illustration includes when the firm may need to select an engagement partner more proactively and frequently, and when it may be appropriate to defer the selection of an engagement partner.

The intent of the standard is that the firm makes the determination of which engagements or engagement partners to select taking into account three interrelated considerations:

<p>The factors that affect the design of all monitoring activities</p> <p>The factors include those described above, such as:</p> <ul style="list-style-type: none"> • The reasons for the assessments given to the quality risks. • Changes in the SOQM. • The results of previous monitoring activities, and whether remedial actions to address previously identified deficiencies were effective. • Other relevant information, including complaints and allegations, information from external inspections and information from service providers. 	<p>Other monitoring activities undertaken by the firm</p> <p>Depending on the nature and extent of other monitoring activities and the results of the activities, they may affect:</p> <ul style="list-style-type: none"> • Which completed engagements to select for inspection. • Which engagement partners to select for inspection. • How frequently to select an engagement partner for inspection. • Which aspects of the engagement to consider when performing the inspection. 	<p>The cycle for the selection of engagement partners</p> <p>The cycle for the selection of the engagement partner is determined by the firm, and may vary according to a number of factors, such as:</p> <ul style="list-style-type: none"> • The types of engagements the firm performs. • The size of the firm and number of engagement partners. • Other monitoring activities the firm performs. <p>A firm may determine it appropriate to set different cyclical periods for engagement partners that perform audits of financial statements versus those who do not.</p>
--	---	---

How the Inspection of Completed Engagements Relates to Other Monitoring Activities

The information from the inspection of completed engagements, and information from other monitoring activities may affect each other as demonstrated below.

Information from the inspection of completed engagements may indicate areas where further monitoring activities are needed	Information from other monitoring activities may affect the firm's inspection of completed engagements
<p>Example</p> <p>Through the inspection of completed engagements, the firm identifies that on engagements performed in a particular industry, engagement team members lack appropriate knowledge of the industry. In investigating the root cause of this deficiency, the firm notes that the engagement team members did not receive any training about this industry. The firm therefore undertakes further monitoring of its training programs to understand whether they focus on industry-specific training, and which personnel are attending the training.</p>	<p>Example</p> <p>Through interviewing personnel on matters related to the effectiveness of the firm's culture, the firm identifies multiple comments from personnel regarding engagements where they felt they did not receive appropriate direction and supervision. The firm uses this information to determine which engagements to select for inspection.</p>

Monitoring the Monitoring and Remediation Process to Determine Whether it is Achieving its Intended Purpose

Without an effective monitoring and remediation process, the firm may not be able to determine whether deficiencies exist and remediate them. Accordingly, it is important that the firm monitors the monitoring and remediation process to determine whether it is achieving its intended purpose, i.e.:

- Providing relevant, reliable and timely information about the design, implementation and operation of the SOQM; and
- Taking appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

Monitoring of the monitoring and remediation process is not intended to be a circular process. How the firm goes about monitoring the monitoring and remediation process, i.e., the nature, timing and extent of the firm's activities, may be affected by a number of factors, including:

- How the firm's monitoring and remediation process is designed; and
- The nature and circumstances of the firm.

In some cases, particularly small and less complex firms, the firm may have readily available information about whether the monitoring and remediation process is achieving its intended purpose through leadership's knowledge (i.e., in a small firm leadership is likely to have frequent interaction with the SOQM). In such cases, the monitoring of the monitoring and remediation process may be simple.

i Paragraph A144 of ISQM 1 has examples to demonstrate the monitoring activities for the monitoring and remediation process.

Examples of factors affecting the firm's monitoring activities for the monitoring and remediation process:

- The size and complexity of the firm.
- The nature, timing and extent of the monitoring activities.
- Who performed the monitoring activities (e.g., a service provider, the network, a separate group within the firm designated to perform monitoring activities or personnel who are responsible for the response).
- The results of previous monitoring activities.
- Information available from other sources about the effectiveness of the firm's monitoring and remediation process (e.g., external inspections, a network or service provider), including information that indicates that the firm's monitoring activities failed to identify a deficiency.
- Information obtained from performing the root cause analysis of identified deficiencies.
- New monitoring activities that have not previously been performed, or changes to the design of monitoring activities.

Monitoring the Remediation Process

Paragraph 43 of ISQM 1 requires the individual(s) assigned operational responsibility for the monitoring and remediation process to evaluate whether:

- Remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s) and determine that they have been implemented; and
- Remedial actions implemented to address previously identified deficiencies are effective.

This evaluation may form part of the information used by the firm to monitor the remediation process. Nevertheless, the firm may need to monitor that the individual(s) assigned operational responsibility for the monitoring and remediation process is fulfilling their responsibilities required by paragraphs 43 and 44 of ISQM 1.

Who Performs the Monitoring Activities?

ISQM 1 does not specify who is required to perform the monitoring activities. However, it does specify that the firm needs to have policies or procedures dealing with the competence and capabilities (including sufficient time) of the individuals performing the activities, and the objectivity of the individuals. It further specifies that for inspections of engagements, the individual cannot be an engagement team member or the engagement quality reviewer of the engagement.

Whether an individual has the appropriate competence, capabilities and objectivity to perform a monitoring activity depends on a number of factors.

Examples of factors affecting the competence, capabilities and objectivity of the individuals performing monitoring activities:

- The nature of the monitoring activity being performed.
- The nature of the underlying matter being monitored, including whether it is specialized and complex and requires specific expertise.
- The extent of objectivity needed to properly monitor the underlying matter, given the nature of the underlying matter and level of judgment involved.
- Other monitoring activities also being performed on the underlying matter.
- The authority needed to appropriately monitor the underlying matter (e.g., the authority of the individual monitoring leadership's actions and behaviors may need to be greater than the authority of an individual monitoring training attendance).

ISQM 1 specifically acknowledges that others external to the firm may perform the monitoring activities or aspects of the monitoring activities (i.e., the individuals would be from a service provider or the firm's network).

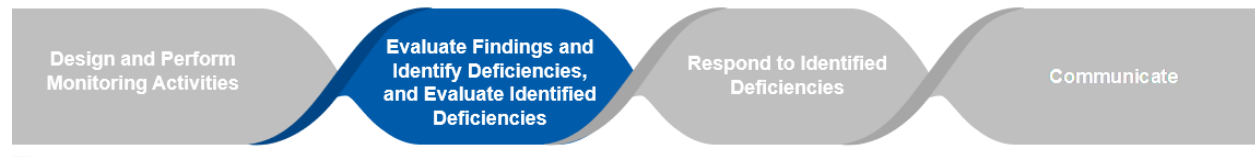


Using individuals external to the firm to perform monitoring activities could be advantageous, as it may provide more objective information to the firm about the SOQM, and help the firm identify areas for improvement in the SOQM

Evaluate Findings and Identify Deficiencies and Evaluate the Severity and Pervasiveness of Deficiencies

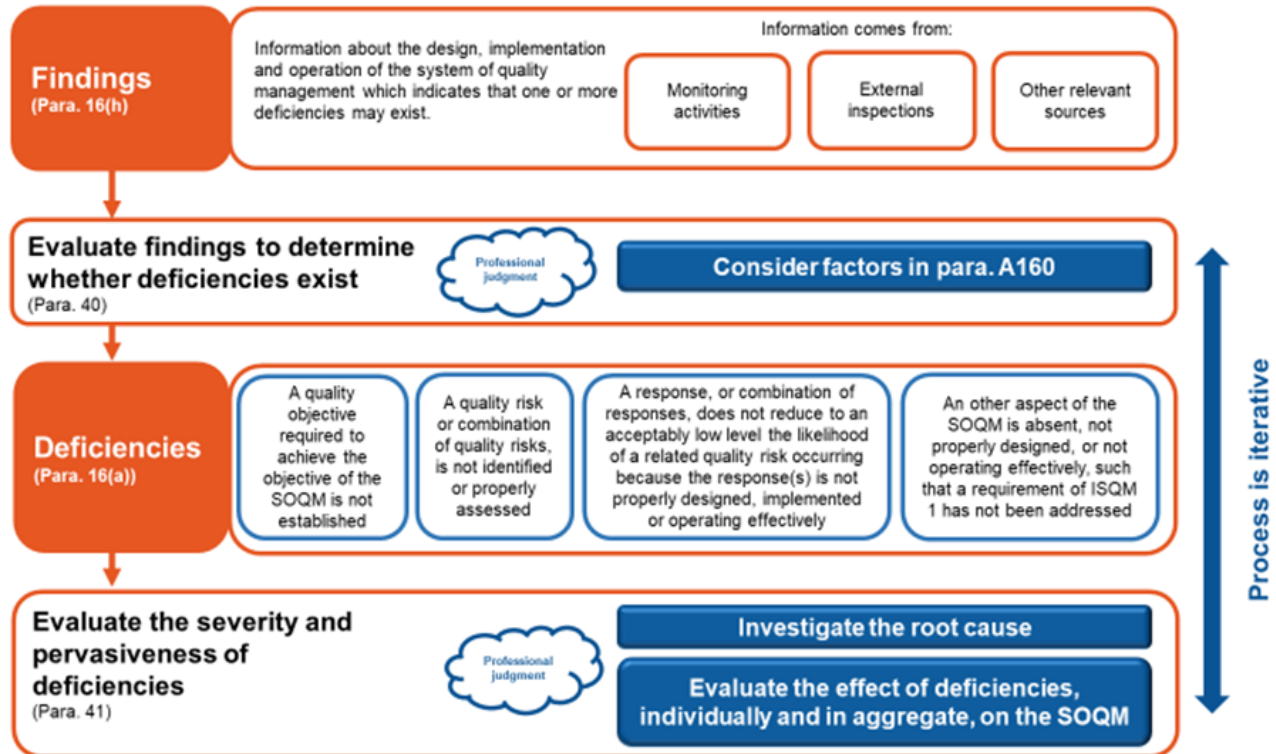


ISQM 1 paragraphs:
16(a), 16(h), 40-41, A10-A12,
A15-A17 and A157-A169



The key purpose of monitoring and remediation is to obtain information about the SOQM in a timely manner to determine whether it is effective, and take appropriate actions to respond to the information. As a result, it is essential that the firm evaluates the information it has on a timely basis to identify deficiencies, so that deficiencies can be remediated. If deficiencies do exist, the firm needs to understand how severe or pervasive those deficiencies are.

ISQM 1 includes a framework for evaluating findings to identify deficiencies, and then to further evaluate the severity and pervasiveness of the deficiencies, as follows:



Evaluate Findings to Determine Whether Deficiencies Exist

In determining whether deficiencies exist, the firm considers whether a finding, or combination of findings when considered together, meet the definition of a deficiency as follows:


Quality objectives	<ul style="list-style-type: none"> A quality objective required by ISQM 1 has not been established or has only been partially established. An additional quality objective that is needed to achieve the objective of the SOQM has not been established.
Quality risks	<ul style="list-style-type: none"> A quality risk has not been identified. An identified quality risk has not been properly assessed. <p><i>An absent quality risk or a quality risk that has not been appropriately assessed may also lead to a response being absent, inappropriately designed or inappropriately implemented.</i></p>
Responses	<ul style="list-style-type: none"> A response, or combination of responses does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the response(s) is not properly designed, implemented or operating effectively. <p><i>Not all responses that are absent, inappropriately designed or inappropriately implemented are deficiencies.</i></p>

	<i>In effect, a response, or combination of responses, that does not reduce a quality risk to an acceptably low level, could cause the firm not to achieve a quality objective.</i>
Other aspects	<ul style="list-style-type: none"> An other aspect of the SOQM is absent, not properly designed or not operating effectively, such that a requirement in ISQM 1 has not been addressed <p><i>Paragraph A12 of ISQM 1 provides examples of when there may be deficiencies related to other aspects of the SOQM.</i></p>

Not all findings are deficiencies. In considering whether a finding is a deficiency, the firm uses professional judgment, and may take into account:

- The relative importance of the finding (or combination of findings) in the context of the quality objectives, quality risks, responses or other aspects of the SOQM to which they relate.
- Quantitative and qualitative factors relevant to the finding(s).

i Paragraph A160 of ISQM 1 has examples of quantitative and qualitative factors that the firm may consider in determining whether findings are a deficiency.

	Findings are information which indicates that one or more deficiencies may exist. However, the monitoring activities, external inspections or other relevant sources may provide information that reveals other observations about the SOQM, such as:	<p><i>Why is this important?</i></p> <p>The firm may use the other observations to:</p>
	<ul style="list-style-type: none"> Actions, behaviors or conditions that have given rise to positive outcomes in the context of quality or the effectiveness of the SOQM; or 	<ul style="list-style-type: none"> Help investigate the root cause(s) of identified deficiencies (e.g., through contrasting why things went well, versus why things didn't go well which led to the deficiency).
	<ul style="list-style-type: none"> Similar circumstances where no findings were noted (e.g., engagements where no findings were noted, and the engagements have a similar nature to the engagements where findings were noted). 	<ul style="list-style-type: none"> Identify practices that the firm can support or apply more extensively (e.g., across all engagements).
		<ul style="list-style-type: none"> Highlight opportunities for the firm to enhance the SOQM.

Evaluate the Severity and Pervasiveness of Deficiencies

The firm is required to evaluate the severity and pervasiveness of identified deficiencies because it:

- Drives the nature, timing and extent of remedial actions to respond to the identified deficiencies, by focusing on deficiencies that pose the biggest risk to the SOQM; and
- Affects leadership's evaluation of the SOQM.

Furthermore, the severity and pervasiveness of identified deficiencies may affect whether, or the extent to which, audit engagement teams depend on the firm's policies or procedures in complying with the requirements of ISA 220 (Revised).⁹

How the Severity and Pervasiveness of Deficiencies is Evaluated

In order to evaluate the severity and pervasiveness of deficiencies, the firm:

- Investigates the root cause(s) of the identified deficiencies; and
- Evaluates the effect of the identified deficiencies, individually and in aggregate, on the SOQM.

Examples of questions that may be asked in evaluating the severity and pervasiveness of an identified deficiency

- What is the nature of the identified deficiency, and if it related to engagements, what type of engagements did it relate to?
- What is the root cause?
- What aspect of the SOQM does it relate to? How significant is that aspect to the SOQM overall?
- Is the deficiency a design deficiency, or was the deficiency in the implementation or operation of the SOQM?
- If there was a failure in a response, were there any compensating responses that were operating effectively?
- How frequently did the underlying issue occur (e.g., if it related to engagements, how many engagements were affected)?
- How quickly did it take for the underlying issue to have an effect on the SOQM and how long did it last? Is it still ongoing?
- How long did it take the firm to detect the underlying issue through the firm's monitoring activities?

i Paragraph A192 of ISQM 1 explains when an identified deficiency may be considered pervasive.

Also paragraphs A192 and A193 of ISQM include examples to contrast:

- A deficiency that is severe but not pervasive; and
- A deficiency that is severe and pervasive.

Investigating the Root Cause(s) of Identified Deficiencies

Investigating the root cause(s) of identified deficiencies focuses on understanding the underlying circumstances that caused the deficiency. In addition to providing insights to the firm to help evaluate the severity and pervasiveness of deficiencies, knowing what caused the deficiency helps the firm properly remediate it.

⁹ Paragraph A10 of ISA 220 (Revised) states that ordinarily the engagement team may depend on the firm's policies or procedures in complying with the requirements of ISA 220 (Revised), unless:

- The engagement team's understanding or practical experience indicates that the firm's policies or procedures will not effectively address the nature and circumstances of the engagement; or
- Information provided by the firm or other parties, about the effectiveness of such policies or procedures suggests otherwise (e.g., information provided by the firm's monitoring activities, external inspections or other relevant sources, indicates that the firm's policies or procedures are not operating effectively).

The nature of the root cause procedures, and the timing and extent of them, will vary based on a number of factors including:

- The nature of the identified deficiencies and their possible severity; and
- The nature and circumstances of the firm.

ISQM 1 is not prescriptive about the types of procedures that need to be undertaken or who undertakes them, and not all root cause(s) investigations need to be an intense or rigorous process – in some cases the procedures may be very simple. As a result, the individuals performing the investigation of the root cause(s) exercise professional judgment in determining the nature, timing and extent of procedures needed to properly understand the underlying circumstances that caused the deficiency.

In investigating the root cause(s) of deficiencies, the firm may identify:

- A deficiency with multiple root causes, which may exist across multiple components or aspects of the SOQM.
- Multiple deficiencies affected by the same root cause.

i Paragraph A166 of ISQM 1 explains factors that may affect the nature, timing and extent of the procedures to investigate the root cause(s) of deficiencies, and demonstrates how those factors apply to specific examples.

Paragraph A168 of ISQM 1 also illustrates how to identify a root cause that is appropriately specific.



The firm may decide to also investigate the root cause(s) of positive outcomes because it may reveal opportunities for the firm to improve, or further enhance, the SOQM.

The Evaluation Process is Iterative and Non-Linear

Given the integrated nature of the SOQM, evaluating findings, identifying deficiencies and evaluating the severity and pervasiveness of identified deficiencies (the evaluation process) is an iterative and non-linear process. Furthermore, not all information about findings will be available to the firm simultaneously – i.e., monitoring activities may be ongoing and new information may become available that may bring into question the firm's judgments previously made related to findings, deficiencies and root cause(s). Accordingly, establishing an evaluation process that is dynamic and responsive facilitates proactive and timely remediation of deficiencies.

Examples of how the evaluation framework is iterative and non-linear

- In investigating the root cause(s) of identified deficiencies that relate to inappropriate judgments on engagements, the firm determines that the root cause(s) relates to the engagement team's inappropriate knowledge of the underlying accounting standards. The firm had findings related to the firm's responses for learning and development of personnel, but had not considered them deficiencies. Since the firm has identified that engagement teams lack appropriate knowledge, the firm adjusts its evaluation of the findings related to the learning and development of personnel, and classifies them as deficiencies.
- In evaluating the severity and pervasiveness of deficiencies, the firm determines that many of the deficiencies lasted several months as it took time for the firm's monitoring activities to detect the deficiencies. The firm had findings related to the monitoring activities but had not classified the findings as deficiencies. Since the firm has identified that the monitoring activities took time to

detect other deficiencies, the firm adjusts its evaluation of the findings related to the monitoring activities and classifies them as deficiencies.

Respond to Identified Deficiencies



ISQM 1 paragraphs:
42-45, A170-A173



The firm needs to take appropriate action to respond to identified deficiencies. This is achieved through:

- Remediating identified deficiencies in a timely manner to prevent them from reoccurring; and
- Evaluating the effectiveness of the remedial actions, and if they are not effective, taking further action.

As part of this process, the firm also addresses findings related to engagements, when there are engagements for which procedures required were omitted during the performance of the engagements or reports issued may be inappropriate (see the section of this publication “Address Findings Related to Engagements, If Necessary”).



Firm leadership takes into account the actions taken to respond to identified deficiencies when evaluating the SOQM.

The effectiveness of remedial actions may impact the overall evaluation of the SOQM, and leaderships' conclusion about whether the SOQM is achieving its objectives.

Design and Implement Remedial Actions

The remedial actions designed and implemented by the firm are required to be responsive to the underlying root cause. Furthermore, the more severe and pervasive the deficiency, the more urgency is needed to design and implement remedial actions.

In some instances, it may take time to properly design and implement remedial actions to address a deficiency, or it may take time for the remedial actions to have their desired effect. In some cases, the firm may have temporary remedial actions to address the deficiency until such time as the desired remedial actions can be fully designed and implemented.

Example of a temporary remedial action

The firm uses an audit tool that is provided by a service provider and identifies a deficiency related to the audit tool, whereby it generates incorrect audit programs for certain industries. To remediate the deficiency, the firm needs to request the service provider to correct the audit tool, which will take time. As a result, as an interim measure, the firm emails the correct audit programs to the engagement teams and requests the engagement teams to instead use the emailed audit programs in place of the ones in the audit tool.



The remedial actions may include establishing additional quality objectives, or quality risks or responses may be added or modified, because it is determined that they are not appropriate. The information from the monitoring and remediation process about the quality objectives, quality risks and responses should be taken into account in the firm's risk assessment process.

Evaluate the Effectiveness of the Remedial Actions, and if Not Effective, Take Further Action

ISQM 1 requires the individual(s) assigned operational responsibility for the monitoring and remediation process to evaluate the remedial actions, and take appropriate actions to respond to the evaluation.

Are the remedial actions appropriately designed to address the identified deficiencies and their related root cause(s) and have they been implemented?

This part of the evaluation may be undertaken as soon as the remedial actions have been designed and implemented.

Once remedial actions have been implemented, have they been effective in addressing the identified deficiency?

This part of the evaluation may only be undertaken once the remedial action has operated for a sufficient amount of time so that it can be determined whether it has been effective. In some cases, that may be more immediate, and in other cases the remedial action may need to operate for some time before its effectiveness can be considered.



If the evaluation indicates that these are not satisfactory (i.e., the remedial actions are not appropriately designed, not implemented, or not effective), the individual is required to take further appropriate action to ensure the remedial actions are appropriately modified.

Address Findings Related to Engagements, If Necessary

Findings (which may indicate a deficiency) may have affected the underlying engagements. Since the firm focuses its efforts on designing and implementing remedial actions to prevent deficiencies from reoccurring, it is not necessary to rectify all findings. However, when the findings have indicated that there is an engagement(s) for which procedures required were omitted during the performance of the engagement(s) or the report issued may be inappropriate, the firm is expected to take further action as follows:

- Take appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements. For example, omitted procedures may be performed, the matter may be discussed with management or those charged with governance or there may be consultation within the firm.
- When the report is considered to be inappropriate, the firm may consider the implications and take appropriate action, including considering whether to obtain legal advice.

Ongoing Communication Related to Monitoring and Remediation



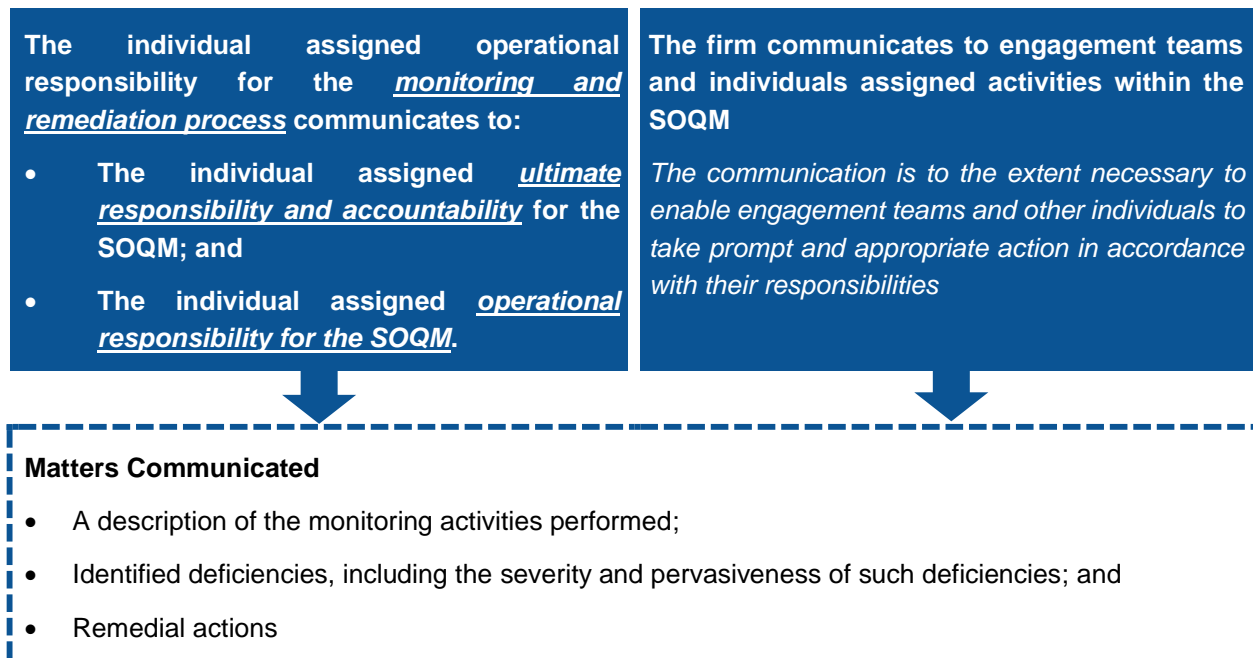
ISQM 1 paragraphs:
46-47, A174



Information from the monitoring and remediation process is used throughout the SOQM and is also used by engagement teams. For example:

- Leadership uses the information as a basis for the annual evaluation of the SOQM, to determine what to communicate to personnel, to hold individuals accountable for their responsibilities or to identify key issues in a timely manner.
- Individuals assigned activities within the SOQM use the information to perform their functions related to the SOQM.
- Engagement quality reviewers use the information as a basis for performing the engagement quality reviews, particularly when the information relates to areas involving significant judgments made by engagement teams.
- Engagement partners use the information to establish whether the engagement team may depend on the firm's policies or procedures in performing the engagement, or areas where further responses are needed at the engagement level.

ISQM 1 includes minimum requirements of what needs to be communicated related to monitoring and remediation, including by whom, and to whom, as follows:



Examples of matters communicated to engagement teams and personnel (i.e., to extent necessary to enable them to take prompt and appropriate action)

- Engagement teams – the information communicated may be focused on deficiencies that have been identified at engagement level, and the firm’s remedial actions.
- Personnel – information communicated to **all** personnel across the firm may relate to deficiencies related to independence, and the firm’s remedial actions.



In the case of a smaller firm, an individual may assume responsibility for all aspects of the SOQM, i.e., ultimate responsibility and accountability for the SOQM, operational responsibility for the SOQM and operational responsibility for monitoring and remediation. In such cases, the communication requirement in paragraph 46 of ISQM 1 would not be relevant.



The firm may communicate the root causes of identified deficiencies to increase awareness and understanding of why deficiencies occurred, which may influence the behavior of engagement teams and individuals assigned activities within the SOQM.

The firm may also communicate positive outcomes that indicate practices that engagement teams could apply more extensively.



The firm may communicate information from the monitoring and remediation process externally to:

- The firm’s network;
- Service providers;
- Those charged with governance when performing an audit of financial statements of listed entities; or
- Other external stakeholders.

i Paragraphs 33, 34(e), A109-A115 and A124–A132 of ISQM 1 deal with the firm’s consideration of whether to communicate externally, and if so the information to be provided.



ISQM 1 paragraphs:
16(k), 16(l), 48–52,
A19 and A175-A186

NETWORK REQUIREMENTS OR NETWORK SERVICES

Networks may establish requirements regarding the firm's SOQM, which are described as "network requirements." Networks may also make services or resources available that the firm may choose to implement or use in its SOQM, which are described as "network services."



Paragraph A175 of ISQM 1 includes examples of network requirements or network services.



The requirements addressing network requirements or network services are mostly new to ISQM 1.

Extant ISQC 1 only includes a requirement dealing with the network's communication when the firm relies on the network's common monitoring policies and procedures.

The Extent to Which the Requirements in ISQM 1 Apply to Requirements and Services from Other Network Firms, Structures or Organizations in the Network

The term "network" and "network firm" are defined in ISQM 1 in paragraphs 16(k) and 16(l) respectively. A network firm is a firm or entity that belongs to the firm's network. Paragraph A19 of ISQM 1 explains that networks and the network firms may be structured in a variety of ways.

Any network requirements or network services that are obtained from the network, another network firm or another structure or organization in the network are considered "network requirements or network services." As a result, they are subject to the requirements in paragraphs 48–52 of ISQM 1.



Network requirements or network services includes component auditors from another network firm that are involved in a group audit engagement. The resources section describes how the requirements in ISQM 1 may be practically applied to component auditors from within the same network.

The Firm's Responsibilities Related to Network Requirements or Network Services

The firm is responsible for its own SOQM. As a result, in order to place reliance on network requirements or network services used in the SOQM, it is important that the firm understands the network requirements or network services and the impact they have on the firm's SOQM. The firm also needs to understand their responsibilities for any actions that are necessary to implement the network requirements or use network services.



Paragraph A176 of ISQM 1 includes examples of responsibilities for the firm in implementing the network requirements or network services.

The network may specify the firm's responsibilities	The firm may determine their own responsibilities
<p>Example</p> <p>The network may specify that in order to use a particular IT application, the firm needs to have laptops with certain minimum specifications, so that the IT application properly functions on the laptops.</p>	<p>Example</p> <p>The firm may use a training course provided by the network. The firm may determine that its responsibilities include identifying facilitators to deliver the training, and training the facilitators on how to deliver the training course appropriately.</p>

ISQM 1 requires the firm to:

- Determine how the network requirements or network services are relevant to, and are taken into account in, the firm's SOQM, including how they are to be implemented.
- Evaluate whether and, if so, how the network requirements or network services need to be adapted or supplemented by the firm to be appropriate for use in its SOQM. Although the network may drive network requirements to promote consistent quality across a network, the firm may need to adapt and supplement the network requirements or network services so that they are appropriate for the nature and circumstances of the firm and engagements it performs.

i Paragraph A179 of ISQM 1 includes examples of how the network requirements or networks services may need to be adapted or supplemented.

ISQM 1 also includes requirements for the firm if the firm identifies a deficiency in the network requirements or network services. This includes designing and implementing remedial actions to address the effect of the identified deficiency in the network requirements or network services.

Example of a network service and the firm determining how the network service is relevant to, and is taken into account in, the firm's SOQM, and whether the network service needs to be adapted or supplemented

<p>Network service</p>	<p>The network issues extensive guidance to address a global pandemic. The guidance addresses:</p> <ul style="list-style-type: none"> • The possible implications of the global pandemic on financial statements prepared in accordance with International Financial Reporting Standards. • The possible implications of the global pandemic on audit engagements, including: <ul style="list-style-type: none"> ○ The impact on how engagements are directed, supervised and work is reviewed, and considerations in using technology to assist in performing the engagement. ○ Adaptations to the types of audit procedures that may be performed, and considerations for audit teams in using these procedures. ○ Risks of material misstatement as a result of the global event, how subsequent events may need to be considered and accounted for and considerations related to going concern.
-------------------------------	---

	<ul style="list-style-type: none"> ○ Reporting implications for the auditor's reports.
How the network service is relevant to, and is taken into account in the firm's SOQM, including how they are to be implemented	<p>The firm has been impacted by the global pandemic, and therefore determines that the network service is relevant to the firm, and the engagements performed by the firm. Given that the firm has not yet issued their own guidance to deal with the global pandemic, the firm determines that they will use the guidance issued by the network. The firm determines how best to disseminate the guidance to engagement teams, and determines that it will:</p> <ul style="list-style-type: none"> • Hold several webinars to discuss the content of the guidance. • Place the guidance on the firm's intranet and embed the guidance in the firm's audit IT application.
Whether the network service needs to be adapted or supplemented	<p>The firm identifies the need to adapt and supplement the guidance as follows:</p> <ul style="list-style-type: none"> • The firm enhances the accounting guidance by elaborating on how the global event may impact the financial statements for certain industries for which the firm performs audit engagements. • The firm enhances the auditing guidance by elaborating on: <ul style="list-style-type: none"> ○ How engagement teams may communicate and interact, in particular requirements that need to be met for teams to be able to meet in-person, which takes into account regional rules on in-person gatherings. ○ How engagement teams may interact with clients, and which audit procedures may be expected to be performed in-person. ○ Specific risks of material misstatement relevant to the jurisdiction as a result of the global pandemic, how to address significant events that have affected the jurisdiction as a whole, and the economic conditions of the jurisdiction and how it may affect going concern. ○ How engagements teams may initiate consultations within the firm, and the types of matters on which consultation may be needed.

Circumstances When the Network Performs Monitoring Activities

The network may perform monitoring activities across the network firms. The nature, timing and extent of these monitoring activities varies across networks, and may also vary from year to year within a network.

ISQM 1 requires the firm to comply with paragraphs 35–47 of ISQM 1 dealing with monitoring and remediation. As a result, when the network performs monitoring activities of the firm's SOQM, the firm is expected to:

Determine the effect of the monitoring activities	<p>Example</p> <p>The network's monitoring activities involve an annual inspection of a selection of completed engagements. The firm may consider:</p>
--	---

performed by the network on the nature, timing and extent of the firm's monitoring activities.

- In relation to the engagements selected, whether the engagements are representative of the engagements the firm would have selected in performing their own inspection program.
- In relation to the selection of engagement partners:
 - Whether the engagement partners selected are the same as the engagement partners the firm would have selected in accordance with the firm's policies or procedures (including the partners that would have been selected based on the firm's cyclical period).
 - Whether the engagements selected for each engagement partner are representative of the engagements the firm would have selected for that engagement partner.
- The matters considered in performing the inspections of the engagements, and whether they are similar to the matters the firm would have considered had the firm performed the inspection.

Determine the firm's responsibilities in relation to the monitoring activities, including any related actions by the firm.

Example

Building on the example above, the firm has a number of responsibilities to support the network's inspection of completed engagements, including providing:

- Information about the firm's engagements and engagement partners to support the selection of engagements and engagement partners.
- Information from other monitoring activities performed by the firm, or other information that may be relevant, which may be used by the network to select engagements and engagement partners.
- Access to engagement files.
- Supporting resources to assist with the inspection of completed engagements (e.g., human resources).

As part of evaluating findings and identifying deficiencies in paragraph 40, obtain the results of the monitoring activities from the network in a timely manner.

Example of how the firm may use the results of the monitoring activities

In evaluating findings to determine whether deficiencies exist, the firm uses the results of the network's monitoring activities and compares the information to the results from the firm's inspection of its completed engagements. The firm notes that its monitoring activities failed to identify a deficiency across a number of engagements. Therefore, the information from the network's monitoring activities has resulted in two deficiencies being identified:

- The deficiency related to the engagements; and
- A deficiency related to the firm's monitoring activities (i.e., a deficiency in the inspection of completed engagements).

ISQM 1 also addresses the network's monitoring activities across other network firms, and the need for the firm to obtain information from the network about the overall results of the network's monitoring activities across the network firms. Paragraph A182 of ISQM 1 explains how this information may be used by the firm.



The firm may also use the results of the network's monitoring activities relating to the firm's SOQM, and the results across other network firms, in determining the nature, timing and extent of the firm's monitoring activities (see paragraph 37(f) of ISQM 1).

EVALUATING THE SOQM



ISQM 1 paragraphs:
53–56, A187–A201

ISQM 1 includes requirements for the individual(s) assigned ultimate responsibility and accountability for the SOQM to evaluate the SOQM. Based on the evaluation, the individual(s) is required to conclude on whether the objectives of the SOQM **are being** achieved.



The requirement to evaluate the SOQM and conclude on its effectiveness in achieving the objectives of the SOQM is new to ISQM 1.

The evaluation is at a point in time and the conclusion is focused on whether the SOQM provides reasonable assurance that:

- The firm and its personnel **are fulfilling** their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and engagements **are being** conducted in accordance with such standards and requirements; and
- Reports **being** issued by the firm and engagement partners are appropriate in the circumstances.

Although the evaluation is focused on the present, it uses information about how the SOQM has performed over a period as the basis for determining whether it is providing reasonable assurance that the objectives of the SOQM are being achieved.

The evaluation is internal to the firm; the firm is not required to obtain independent assurance about the effectiveness of its SOQM.

Why the Individual(s) Assigned Ultimate Responsibility and Accountability for the SOQM Evaluates the SOQM

Although the evaluation of the SOQM is, in effect, a self-assessment, it is important to reinforcing the responsibility and accountability of the individual(s) assigned ultimate responsibility and accountability for the SOQM. The outcome of the evaluation of the SOQM may be indicative of how leadership has fulfilled their responsibilities, and therefore is an essential consideration in undertaking the performance evaluations of leadership.

Although the individual(s) assigned ultimate responsibility and accountability for the SOQM undertakes the evaluation, the firm remains responsible for the evaluation through holding the individual(s) responsible and accountable for their assigned role. In other words, the firm is required to ensure that the evaluation is undertaken, by holding the individual accountable for doing the evaluation.

i Paragraph A33 of ISQM 1 includes an example to demonstrate how the firm is responsible for the evaluation and conclusion on the SOQM, but assigns the evaluation and conclusion to the individual(s) with ultimate responsibility and accountability for the SOQM.



As part of the firm's monitoring activities, the firm may monitor leadership's evaluation of the SOQM and whether it has met the requirements of ISQM 1.

A deficiency may arise when the evaluation has not been performed, or has not been properly designed, implemented or operated, such that the requirements in paragraphs 53–54 of ISQM 1 have not been addressed.

How the Evaluation is Undertaken, Including What Information is Considered

ISQM 1 recognizes that the individual(s) assigned ultimate responsibility and accountability for the SOQM may be assisted by others in performing the evaluation, however the individual(s) remains responsible and accountable for the evaluation.

Information about the firm's monitoring and remediation that is communicated to the individual(s) assigned ultimate responsibility and accountability for the SOQM may generally provide the information that is needed to perform the evaluation.

Based on the evaluation of the SOQM, the individual(s) assigned ultimate responsibility and accountability for the SOQM is required to conclude on whether the objectives of the SOQM are being achieved. The individual(s) may take into consideration the following in concluding whether the SOQM is effective in achieving its objectives:

i Paragraph A189 of ISQM 1 includes examples to demonstrate how the information that provides the basis for the evaluation of the SOQM may be obtained for a less complex firm, versus a more complex firm.

Paragraphs A192 and A193 of ISQM 1 includes explanations and examples of when:

- An identified deficiency is severe but not pervasive; and
- An identified deficiency is severe and pervasive.

The severity and pervasiveness of identified deficiencies, and the effect on the achievement of the objectives of the SOQM

Whether remedial actions have been designed and implemented by the firm, and whether the remedial actions taken up to the time of the evaluation are effective

Whether the effect of identified deficiencies on the SOQM have been appropriately corrected (E.g., correcting engagements when procedures were omitted)

ISQM 1 allows for three possible conclusions. The firm is required to take further action in accordance with paragraph 55 of ISQM 1, depending on which conclusion is reached.

The table that follows outlines examples of the three possible conclusions, and the factors considered in reaching the conclusions. ***The table below is illustrative since professional judgment is needed in reaching the appropriate conclusion.*** For example:

- Professional judgment is needed in determining the severity and pervasiveness of the deficiencies, and whether remedial actions were effective.
- The effect of deficiencies may be partially corrected (e.g., only some engagements have been corrected and the correction of other engagements is in progress). Therefore, professional judgment is needed in considering the degree to which the deficiencies have been corrected, and how this impacts the conclusion on the effectiveness of the SOQM.

ISQM 1: FIRST-TIME IMPLEMENTATION GUIDE

Deficiencies		Remedial actions were taken and are effective	The effect of deficiencies have been appropriately corrected (Note 1)	Conclusion	Further action required?
Severe	Pervasive				
No	No	N/a	N/a	The SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved	No
Yes	No	Yes	Yes		
No	Yes	Yes	Yes		
Yes	Yes	Yes	Yes		
Yes	No	No	No	Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation and operation of the SOQM, the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved	Yes
Yes	No	No	Yes		
Yes	No	Yes	No		
No	Yes	No	No	The SOQM does not provide the firm with reasonable assurance that the objectives of the SOQM are being achieved	Yes
No	Yes	No	Yes		
No	Yes	Yes	No		
Yes	Yes	No	No		
Yes	Yes	Yes	No		
Yes	Yes	No	Yes		

Note 1: This includes addressing paragraph 45 of ISQM 1, which requires the firm to respond to circumstances when findings indicate that there is an engagement(s) for which procedures required were omitted during the performance of the engagement(s) or the report issued may be inappropriate.

The Timing of the Evaluation of the SOQM and Performing the Evaluation More Frequently

ISQM 1 requires that the evaluation is undertaken as of a point in time, and performed at least annually. The point in time at which the evaluation is undertaken may depend on the circumstances of the firm, and may coincide with the fiscal year end of the firm or the completion of an annual monitoring cycle.

In some circumstances the firm, or the individual(s) assigned ultimate responsibility and accountability for the SOQM, may determine that it is appropriate to perform the evaluation more frequently than annually. For example, this may be the case when the point in time at which the evaluation is undertaken needs to be amended (e.g., to coincide with a fiscal year end change of the firm, or when the firm is considering a merger with another firm).

Undertaking the First Evaluation of the SOQM Following the First Time Implementation of ISQM 1

As explained under the effective date, the first evaluation of the SOQM following the implementation of ISQM 1 is required to be performed within one year following December 15, 2022.

In the first year of implementation, given the timing of how ISA 220 (Revised) and ISQM 2 will come into effect and impact engagements, there may be many engagements that are still being performed under extant ISA 220, or the extant requirements for engagement quality control reviews in ISQC 1 and ISA 220. For example, an audit of financial statements with a financial year end of June 30, 2023 will still be conducted under extant ISA 220, and the engagement quality control review, if applicable, will be performed under the extant requirements.

ISQM 1 requires the firm to initiate the operation of the monitoring activities with effect from December 15, 2022. Monitoring activities that involve the inspection of engagements may therefore include engagements still being conducted under extant ISA 220 and the extant engagement quality control review requirements. Accordingly, in the first year following implementation (and possibly in the second year), the information from monitoring activities may include a combination of information arising from:

- Engagements performed under the extant standards and/or in accordance with the firm's policies and procedures that comply with extant ISQC 1; and
- Engagements performed under the new standards, and/or in accordance with the firm's new SOQM.

In evaluating the SOQM, the firm may take into consideration:

- Information from the monitoring activities designed to monitor the SOQM as a whole (i.e., the activities that are not targeted at the engagement level).
- Information from the monitoring activities related to inspections of engagements. The firm may use information arising from engagements performed under the extant standards and/or in accordance with the firm's previous policies and procedures in identifying deficiencies and evaluating the SOQM. For example, such information may prompt the firm to consider:
 - How the firm has addressed a matter in the new SOQM; and
 - Whether the manner in which the firm addresses this matter in the new SOQM is appropriate.

Performance Evaluations of Leadership

ISQM 1 requires the firm to undertake periodic performance evaluations of:

- The individual(s) assigned ultimate responsibility and accountability for the SOQM; and
- The individual(s) assigned operational responsibility for the SOQM.

As highlighted previously, the evaluation of leadership is required to take into account the evaluation of the SOQM.



Paragraph 32(b) of ISQM 1 deals with personnel demonstrating a commitment to quality, which includes being held accountable or recognized through timely evaluations. This quality objective addresses all personnel, including individuals assigned other roles and responsibilities related to the SOQM, such as the individual assigned operational responsibility for the monitoring and remediation process.



In the case of a smaller firm, the information used by the firm to undertake the periodic performance evaluations of leadership may include the results of the firm's monitoring activities, and the evaluation of the SOQM. In a larger firm, there may be information in addition to the results of the firm's monitoring activities that is used by the firm in undertaking the periodic performance evaluations of leadership.



Paragraph A199 of ISQM 1 includes examples to demonstrate how the firm may undertake performance evaluations of leadership in a less complex firm and a more complex firm.

DOCUMENTATION



ISQM 1 paragraphs:
57–60, A202–A206

The following summarizes how ISQM 1 has changed from the extant standard with respect to documentation:



- New and enhanced requirements from extant ISQC 1, comprising:
 - An overarching principles-based requirement for documentation (this requirement has similarities to the documentation principles in ISA 230¹⁰); and
 - Specific requirements to document certain matters related to the SOQM.
- The requirement addressing the retention of documentation for the SOQM is consistent with extant ISQC 1.

ISQC 1 included a specific requirement for the firm to establish policies and procedures requiring documentation of complaints and allegations. This has been addressed through the principles-based requirements for documentation.

Why Documentation is Important

Documentation is important because:

- It helps personnel understand the SOQM and what is expected of them, so that they are able to perform engagements, and fulfill their roles and responsibilities with respect to the firm's SOQM.
- It enables the responses to be implemented and operated in the manner that the firm intended.
- It helps the firm retain organizational knowledge and the basis for why decisions related to the SOQM were made.
- It helps the firm monitor the SOQM, and provides information so that leadership is able to evaluate and conclude on the SOQM.
- It establishes accountability for the firm by evidencing that the firm has designed, implemented and operated a SOQM in accordance with ISQM 1 and applicable legal and regulatory requirements.
- It helps external oversight authorities in fulfilling their duties in inspecting the firm's SOQM, which is an important element to the financial reporting ecosystem.

The firm's SOQM may change and evolve over time. Retaining documentation of the SOQM and how it is designed may be important to explaining how the SOQM was designed at a point in time. For example, documentation of the SOQM at a point in time may be important when there are investigations into the firm arising from an audit failure.

¹⁰ ISA 230, *Audit Documentation*

The Nature and Extent of Documentation

ISQM 1 does not prescribe every matter that needs to be documented by the firm, because the nature and extent of documentation will vary as a result of a number of factors, including the size and complexity of the firm and the types of engagements performed by the firm.

ISQM 1 requires the firm to prepare documentation to achieve three principles:

Support a consistent understanding of the SOQM by personnel, including an understanding of their roles and responsibilities with respect to the SOQM and the performance of engagements

Support the consistent implementation and operation of the responses

Provide evidence of the design, implementation and operation of the responses, to support the evaluation of the SOQM by the individual(s) assigned ultimate responsibility and accountability for the SOQM

Over and above applying these principles, ISQM 1 requires the firm to prepare documentation addressing specific matters. This includes a requirement to document the following related to the firm's risk assessment process:

- The quality objectives
- The quality risks; and
- A description of the responses and how the firm's responses address the quality risks. Paragraph A205 of ISQM 1 suggests that, in documenting how the firm's responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (i.e., the considered occurrence and effect on the achievement of one or more quality objectives).



A less complex firm may not need to have granular documentation, such as a matrix, that indicates the quality objective, the related quality risk(s), and the related responses to address those quality risks. This is because it may be obvious how the quality risks relate to the quality objectives, or how the responses address the quality risks. In these circumstances, the firm's documentation may include lists of the quality objectives and quality risks, and a memorandum that explains the responses and how they address the quality risks.

As the complexity of the firm's SOQM increases, there may be a need to have more granular documentation that indicates the quality objective, the related quality risk(s), and the related responses to address those quality risks. This may become important when the volume of quality risks and responses create challenges in being able to identify which quality risks relate to which quality objectives, and which responses address which quality risks.



The granularity and form of documentation of the quality objectives, quality risks and responses may assist the firm in identifying and evaluating deficiencies, including investigating the root cause(s) of deficiencies. In particular, if the documentation is clear, it may enable the firm to identify where deficiencies have arisen, how they affect the achievement of the related quality objectives, the severity and pervasiveness of the deficiency and the remedial actions needed to address the deficiency.

An illustration of how the firm may document the quality objectives, quality risks and responses is included below. However, as highlighted above, the nature and extent of documentation depends on a number of factors.

Required documentation in ISQM 1:	Example of how this may be documented
Quality objectives <i>Include in the documentation the firm's quality objectives (paragraph 58(b))</i>	<p>The established quality objective: The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces:</p> <ul style="list-style-type: none"> (i) The firm's role in serving the public interest by consistently performing quality engagements; (ii) The importance of professional ethics, values and attitudes; (iii) The responsibility of all personnel for quality relating to the performance of engagements or activities within the SOQM, and their expected behavior; and (iv) The importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities.
Quality risks <i>Include in the documentation the firm's quality risks (paragraph 58(b))</i>	<p>Quality risk 1: The daily actions and behaviors of leadership may not reflect a commitment to quality, which may have a negative effect on the firm's culture.</p> <p><i>Reasons for assessment (the application material in paragraph A205 of ISQM 1 suggests this documentation may be helpful – the format, wording and level of detail are subject to the firm's judgment):</i></p> <p>Given the firm is small, leadership has regular interactions with personnel across the firm. Their direct actions and behavior are very visible and have a strong influence over the firm's culture. Leadership's actions and behaviors that do not reflect the firm's culture could severely affect the firm's ability to achieve its objective of having a culture that represents a commitment to quality. There is a high likelihood that leadership's actions and behaviors significantly affect the firm's culture.</p>

Required documentation in ISQM 1:	Example of how this may be documented
Responses <i>Describe the responses and how they address the quality risks (paragraph 58(c))</i>	<p>Response 1.1:</p> <p>The firm will undertake annual anonymous surveys of personnel, with questions that solicit information about how personnel experience the firm's culture and values, and leadership.</p> <p>Response 1.2:</p> <p>Leadership is required to have independent coaching.</p>
Responses <i>Document evidence of the design, implementation and operation of the responses (paragraph 57(c))</i>	<p>Response 1.1:</p> <p>The results of the survey are likely to be in a documented form (e.g., a report from a web-based application used to conduct the survey).</p> <p>Response 1.2:</p> <p>The firm may have evidence that leadership is undertaking coaching and receiving annual feedback through calendars providing evidence of meetings between coaches and leadership, and leadership's individual development plans.</p>



In circumstances when the firm uses network requirements or network services in the SOQM, ISQM 1 includes specific documentation requirements.

The documentation related to network requirements or network services may vary based on a number of factors, including:

- The nature of the network requirement or network service.
- The documentation provided by the network in relation to the network requirement or network service, and whether it is at a sufficient level of detail to fulfill the requirements of paragraphs 58–59. However, the firm is responsible for their SOQM, and therefore is also responsible for the documentation.

Example of documentation related to a network requirement

The firm is required by the network to have a policy or procedure (i.e., a response). The documentation related to the network requirement may include:

- The firm's evaluation of the network policy or procedure, and whether it needs to be adapted or supplemented to address jurisdictional requirements or circumstances, to be suitable for use in the firm's SOQM (fulfills paragraph 59 of ISQM 1).
 - The firm determines it appropriate to document this evaluation in a table format, including all policies or procedures provided by the network, and questions about jurisdictional circumstances, law or regulation to prompt a

thoughtful consideration of whether the policies or procedures are suitable for the firm.

- A description of the policy or procedure (paragraph 58(c) of ISQM 1).
 - The firm determines it appropriate to include this in the firm's policies or procedures manual.
- How the policy or procedure addresses the quality risks (paragraph 58(c) of ISQM 1).
 - The firm determines it appropriate to document this as part of the firm's evaluation described in the first bullet.

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® or IFAC®.

The IAASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Copyright © June 2021 by IFAC. All rights reserved.

The 'International Auditing and Assurance Standards Board', 'International Standards on Auditing', 'International Standards on Assurance Engagements', 'International Standards on Review Engagements', 'International Standards on Related Services', 'International Standards on Quality Control', 'International Auditing Practice Notes', 'IAASB', 'ISA', 'ISAE', 'ISRE', 'ISRS', 'ISQC', 'IAPN', and IAASB logo are trademarks of IFAC, or registered trademarks and service marks of IFAC in the US and other countries.

For copyright, trademark, and permissions information, please go to [permissions](#) or contact permissions@ifac.org.



**International Auditing
and Assurance
Standards Board**

529 Fifth Avenue, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.iaasb.org