



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **3(c)**
Meeting Date: 13 June 2018
Subject: ISQC 1 – Quality Management at the Firm Level
Date Prepared: 7 June 2018
Prepared by: Matthew Zappulla, AUASB Technical Director

Action Required

For Information Purposes Only

IAASB Project Objective	AUASB SMEs
Initial activities in scoping the project will focus on whether there is a need to revisit specific aspects of the quality control standards to enhance clarity and consistency of their application. This may include restructuring ISQC 1, additional requirements or guidance within the standard or additional guidance in support of the standard. Specific aspects within ISQC 1 being explored include, governance, engagement partner responsibilities, engagement quality control reviews, monitoring, remediation, alternative audit delivery models and specific issues pertaining to small- and medium-sized practices.	Gareth Bird / Matthew Zappulla

Agenda Item Objectives

- To update the AUASB and receive feedback from members on the key matters arising from the IAASB June 2018 Board Papers in respect of ISQC 1, including:
 - Key changes to ISQC 1 since the March 2018 IAASB meeting;
 - Revisions to the structure and content of the proposed standard by the Quality Control Task Force (QCTF); and
 - Next steps / milestones for this project.

Background to the revisions to ISQC 1

- The Quality Control at Firm Level – ISQC 1 Task Force has been in operation for a number of years. The proposal to revise International Standard on Quality Control ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements* was approved by the IAASB in December 2016. Closely associated with this project are the IAASB's projects to revise ISA 220 *Quality Control for an Audit of Financial Statements* and ISA 600 on Group Audits.

This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.

3. The key change proposed to ISQC 1 from the extant standard is to implement a risk-based approach to the management of quality at the firm level, as opposed to the current compliance based approach of the existing ISQC 1.
4. At the AUASB's March 2018 meeting the key points noted in relation to the status of ISQC 1 were:
 - (a) As with past deliberations on ISQC 1, the changes proposed by the IAASB Taskforce appeared reasonable and consistent with current practice and other ISA's.
 - (b) The main risk with the direction of the standard was the potential lack of scalability embedded in the standard, which will make application challenging for small or medium firms. Whilst the new emphasis added on the need to apply professional judgement was designed to support scalability and highlight the need for firms to consider their circumstances in designing a system of quality management that is appropriate to their circumstances, a streamlining in the complexity and breadth of requirements that apply to SMP firms would be more effective.
 - (c) Assuming the overall approach of the QCTF to the standard does not change, the consideration of specific guidance for SMP's supporting the implementation and application of this revised standard (NB: Which as at June 2018 is still to be developed) is critical.
5. At their last meeting in March 2018 the IAASB:
 - (a) Discussed and supported the proposed exposure draft of ISQC 1 (Revised) including its structure and the objective.
 - (b) Discussed the length of the standard and the need for additional guidance, and encouraged the Quality Control Task Force to analyse the application material, develop additional guidance addressing the spectrum of firms, and explore positioning guidance outside of the standard (including the appendix).
 - (c) In addition to suggesting a new term for the quality risk assessment process, the IAASB suggested further refinement of the requirement and definitions in relation to the identification and assessment of quality risks.
 - (d) The IAASB recommended that the quality risk assessment process should be applied to monitoring and remediation, which would result in a restructure of the component.
 - (e) The IAASB agreed that ISQC 1 should strongly encourage firms to communicate, as appropriate, with external stakeholders about the firm's system of quality management (such as through transparency reports).
 - (f) In relation to monitoring and remediation, the IAASB suggested directly addressing quality objectives and quality risks in the framework for the identification of deficiencies and in the definition of deficiencies.
 - (g) Finally, the IAASB discussed how to address concerns raised by certain stakeholders who are seeking requirements specifically for networks, and encouraged the Quality Control Task Force to further explore these concerns and how best they can be addressed.

Changes to the proposed standard since the March 2018 IAASB meeting

6. Key changes to ISQC presented for deliberation at the June 2018 IAASB relate to:
 - (a) Revisions to the introduction to explain the system of quality management (SOQM) and the concept of professional judgment in the context of a SOQM.
 - (b) The overall structure of the standard, including the ordering of the components within the standard (refer picture below).

- (c) Revisions to the quality risk assessment process (RAP).
- (d) Revisions to the monitoring and remediation process, including the revised structure of this component.

March 2018 Draft	Proposed new Structure
1. Governance and leadership	1. Firm's risk assessment process
2. Quality risk assessment process	2. Governance and leadership
3. Information and communication	3. Relevant ethical requirements
4. Relevant ethical requirements	4. Acceptance and continuance of client relationships and specific engagements
5. Acceptance and continuance of client relationships and specific engagements	5. Resources
6. Resources	6. Engagement performance
7. Engagement performance	7. Information and communication
8. Monitoring and remediation process	8. Monitoring and remediation process

Key matters for consideration by the AUASB

- 7. Only a limited amount of the proposed standard has been presented to the IAASB for consideration at this meeting, with at least half of the requirements and no application material subject to review in the June 2018 IAASB papers.
- 8. Overall the outreach and feedback received by the QCTF since the March 2018 IAASB meeting has not been overly supportive of the current version of the proposed standard. The AUASB Chair's and Technical Director's observations and discussions with other National Standard Setters (NSS) at the IAASB NSS meeting in May 2018, as well as feedback from other stakeholders (such as representatives from the large audit firms) also indicate ongoing concerns with the current proposed standard. The main concerns raised with the current proposed standard are:
 - (a) Its overall complexity and lack of scalability.
 - (b) That it is difficult to read and may create difficulties with translation interpretation.
 - (c) That the standard is not sufficiently flexible to address the needs of Smaller and Medium Auditing and Assurance practices (SMPs). [NB: On this point it should be noted that, as at the point these IAASB board papers on ISQC 1 were made available, consultation with the IFAC SMP committee is still to occur].
 - (d) The very prescriptive approach to each component of the SOQM, whereas in practice Firms deal with the different elements of these components in a more unified fashion.
 - (e) The objectives embedded in each component of the SOQM are still very compliance based, in opposition to the QCTF's intended approach for Firms to apply professional judgement to the quality objectives, risks and associated responses for each component.
- 9. Whilst the QCTF have certainly gone to great effort to address the feedback they have received through their outreach activities, the AUASB Technical Group's conclusion is that they have not

made significant changes to the structure and complexity of the standard which is likely to satisfy many of the concerns raised by stakeholders.

10. The AUASB Technical Group’s comments in relation to the specific changes the QCTF have made to the proposed standard which have been presented to the IAASB at their June 2018 meeting are:
 - (a) The changes to the introduction of the standard appear reasonable, however add a lot of words and complexity, which is contrary to the feedback received on the standard to date.
 - (b) The QCTF has sought to address some of the concerns about the readability and understandability of the standard by changing the overall structure. This has inevitably made the standard longer, although to be fair this is offset somewhat by the fact that a number of definitional or descriptive paragraphs have now been moved to an Appendix. And notwithstanding the additional length created by these changes, the revised structure appears reasonable and is supported.
 - (c) In relation to the changes made to the revisions to the quality risk assessment process embedded in the standard, the key question is whether or not quality risks are required to be identified for each component of the proposed standard or whether it should be up to the Firm to determine whether or not specific risks are required for each element. The QCTF is clearly of the view that each component of the proposed standard needs to have quality risks and associated responses identified to achieve the overall objective of the standard, however they have presented an alternative approach to this in the board papers to address some of the feedback they received that the standard is too prescriptive and compliance focused.
 - (d) In relation to the ‘Monitoring and Remediation Processes’ component of the standard the QCTF has taken a more prescriptive approach to the requirements in this area. This is different to the other components, where there is a risk-based approach required. However, this lends itself well to this section of the proposed standard, and the changes made here are all supported.
11. A final comment on the proposed standard would be that there are still many elements that have not been presented to the IAASB yet, which makes it uncertain that a September approval of the exposure draft can be achieved, not only based on the fact so much is outstanding but also that the changes have only gone part of the way to addressing much of the feedback received through the QCTF’s outreach activities.

Action Required

No.	Action Item	Responsibility
1.	Feedback to the following questions raised by the AUASB Technical Group in respect of the current version of ISQC 1: <ol style="list-style-type: none"> a. Does the AUASB believe each component of the proposed ISQC should have its own full suite of unique quality objectives, risks and responses; or is it acceptable for the standard to allow Firms to tailor a more targeted or prescriptive response to the quality objectives in each component? b. Based on the summary provided by the AUASB Technical Group is there any other feedback the AUASB would like to provide to the IAASB about the current status of ISQC? 	AUASB

Material Presented

Agenda Item 3(c)	AUASB Board Meeting Summary Paper
<p>NB: No papers from the June 2018 IAASB meeting in relation to this project have been included in the AUASB board papers as all matters the AUASB need to consider (including extracts from the IAASB's papers, where relevant) are included in this Board Meeting Summary Paper. However, should AUASB members wish to review the IAASB papers associated with this project they are available at https://www.iaasb.org/meetings/new-york-usa-19.</p>	