



Australian Government
Auditing and Assurance Standards Board

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1 July 2019

Mr Willie Botha
Technical Director
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International Federation of Accountants
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Dear Willie,

AUASB Submission on the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to submit our response on the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews.

The AUASB is a non-corporate Commonwealth entity of the Australian Government, responsible for developing, issuing and maintaining auditing and assurance standards in Australia. The AUASB's role and mandate extends to liaison with other standards setters and participation in global standard-setting initiatives, so we have a very strong interest in these IAASB Exposure Drafts and welcome the opportunity to comment.

In formulating our response to these proposed standards the AUASB sought input from its stakeholders in three principal ways:

1. From hosting a series of roundtable meetings with stakeholders in three large Australian cities. These roundtable meetings were attended by over 50 stakeholders representing a broad range of backgrounds, including assurance providers from a range of audit firms, professional accounting bodies, academics, those charged with governance and preparers of financial statements.
2. Through an open invitation to provide comments on the equivalent AUASB issued Exposure Drafts via the AUASB website.
3. Formal discussions and deliberations by AUASB members at recent AUASB meetings.

The AUASB supports the IAASB's objective to develop and maintain robust international standards that contributes to enhanced engagement quality and consistency of practice throughout the world, and strengthened public confidence in the global auditing and assurance profession. However, the AUASB notes with concern that the IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews, all contain greater complexity and detail than the extant standards they are replacing. This makes the proposed standards more challenging for all auditors (especially those auditors of smaller and medium or less complex entities) to apply, and may result in increased costs with arguably no commensurate increase in the level of audit quality for auditors of all types of entities.

As the IAASB continues to revise these proposed quality management standards, the AUASB considers it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in each of the proposed standards (ISQM 1, ISQM 2 and ISA 220), and explicitly weigh these against the costs of transition and application, as a means to support the successful implementation of the proposed standards once they are finalised.

Detailed responses to the questions on the key issues considered by the IAASB in developing each of the Exposure Drafts have been included in the Appendices to this letter. Additionally, individual responses to the questions contained in each Exposure Draft have been submitted via the IAASB's website.

However, as part of our overall submission on the IAASB's Exposure Drafts for Quality Management there are a number of specific matters which the AUASB would highlight in our response:

Overall considerations

Implementation Period

The AUASB considers that a longer implementation period is required, perhaps even considering a staggered implementation approach across key components. For example, commencing first with the governance and leadership components as the foundation of a firm's System of Quality Management, followed by the other components in subsequent periods.

ISQM 1 is expected to require a significant amount of firms' resources to put into place a risk assessment process and update firms' methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for some network firms will be particularly challenging as the network head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400) on top of the three new or revised standards included in the suite of Quality Management standards. The AUASB considers that for firms to implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these standards may be in the public interest.

ISQM 1

Structure and Granularity of the Standard

The AUASB supports a quality management approach to ISQM 1, however the AUASB is not supportive of the overall standard in its current form.

The AUASB considers the proposed standard to be a hybrid of risk-based quality management requirements that retains a granular level of prescriptive requirement carried over from the extant ISQC 1 standard, which undermines the proper application of a risk-based approach.

The main theme expressed by Australian stakeholders throughout the AUASB's outreach on ISQM 1 was related to its size and level of granularity. All practitioners, large and small, were concerned with the cost and resources needed to develop a quality management framework in line with the proposed standard as currently drafted. The AUASB encourages the IAASB to refine its drafting approach to reduce the length and complexity of the proposed standard, as well as the other proposed Quality Management Standards being exposed concurrently – ED-ISQM 2 and ED-ISA 220.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315 (i.e. the requirements being the "what", and the application material, appendices and guidance constituting the "why" and "how") would facilitate a better risk-based approach that is scalable to the specific circumstances of a firm. This may help mitigate the potentially large cost and resourcing burden that the implementation of this proposed standard imposes on practitioners.

The AUASB particularly highlights to the IAASB that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered. Whilst these examples being included in the proposed standard may assist with implementation, the AUASB suggests the IAASB review the underlying principles in the requirements to make them simpler and more straightforward, which should alleviate the need for many of the examples and illustrations being included in the application guidance and appendices.

Additionally, the AUASB considers that the risk assessment process as designed has the potential to be particularly onerous for practitioners when considering the overall number of prescribed quality objectives required by the proposed standard. To further support a risk-based approach, the AUASB recommends the removal of pre-defined required responses to quality risks in the standard as the AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

Public Interest Benefits

The AUASB considers that it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in ISQM 1, and explicitly weigh these against the costs of transition and implementation, as a means to support the successful implementation of the proposed standard once it is finalised.

Scope of Engagements Subject to Engagement Quality Review

The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review. The AUASB supports a risk-based approach to such a determination which is already required in the proposed standard, where a firm is required to determine whether an engagement quality review is an appropriate response to assessed engagement risks.

It is unclear whether the proposed standard would result in an expectation that an engagement quality review is performed on ALL charities and ALL public sector engagements as these entities will always have a large number and wide range of stakeholders. This may be an unintended consequence of the proposed drafting. Furthermore, the AUASB is concerned that ‘significant public interest’ entity cannot be defined consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

ISQM 2

Guidance regarding a “cooling off” period should reside in the IESBA Code

The AUASB strongly recommends that all guidance relating to the independence and objectivity of the Engagement Quality Reviewer (EQR) should reside in the IESBA Code as it already addresses these matters. Specifically the inclusion of alternative guidance regarding “cooling-off” periods in ISQM 2 increases the risk of inconsistent application and increases complexity for practitioners who may need to consider two different sources when addressing this issue. The AUASB recommends that the application material in ISQM 2 relating to any “cooling-off” period of the (EQR) should be removed from this standard and a reference to the IESBA code instead be considered (if this application guidance is to be retained).

ISA 220

Inconsistency in the engagement team definition and application guidance between ISA 220 and ISQM 1

The AUASB raises a significant concern that the definition of engagement team may be interpreted differently due to the different application and explanatory material that applies to this definition in ISA 220 (paragraphs A16-A19) not being replicated in ISQM 1. The impact may be that engagement team members are interpreted differently when the different application and explanatory material in each proposed standard is applied. For example, an Engagement Quality Reviewer (EQR) may be considered to be excluded from the engagement team under the definition and application guidance in ISA 220, but included as part of the engagement team under the definition in ISQM 1.

Should you have any queries regarding this submission, please do not hesitate to contact me or the AUASB Technical Director, Matthew Zappulla (mzappulla@auasb.gov.au).

Yours sincerely,



Professor Roger Simnett AO
Chair

Overall Questions

Q1. Do you support the approach and rationale for the proposed implementation period of approximately 18 months after the approval of the three standards by the Public Interest Oversight Board? If not, what is an appropriate implementation period?

The AUASB considers that a longer implementation period is required, perhaps even considering a staggered implementation approach across key components. For example, commencing first with the governance and leadership components as the foundation of a firm's System of Quality Management, followed by the other components in subsequent periods.

ISQM 1 is expected to require a significant amount of firms' resources to put into place a risk assessment process and update firms' methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for some network firms will be particularly challenging as the network head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400) on top of the three new or revised standards included in the suite of Quality Management standards. The AUASB considers that for firms to implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these standards may be in the public interest.

Q2. In order to support implementation of the standards in accordance with the IAASB's proposed effective date, what implementation materials would be most helpful, in particular for SMPs?

As noted above, the AUASB does not support the IAASB's proposed implementation period. Nonetheless, general implementation material, such as FAQs and specific examples addressing scalability of the requirements, would be highly desirable regardless of the implementation period selected. The AUASB also strongly encourages the IAASB to develop examples and scenarios in its implementation material that demonstrate how the standards would work for a sole practitioner or 2-3 partner firm.

The AUASB requests that the IAASB Quality Management Task Forces focus on identifying and developing appropriate 'implementation' support activities prior to the final agreed implementation date of the proposed standards. Considering the complexity and breadth of the proposed Quality Management standards there is a need for support materials to be issued by the IAASB simultaneously with the release of a final standard and not wait until the 'post-implementation' phase which appears to have been the case with ISA 540.

General Questions

- Q3. *Developing Nations* – Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposals, in particular, on any foreseeable difficulties in applying it in a developing nation environment.**

We have no specific comments on this question.

- Q4. *Public Sector* – The IAASB welcomes input from the public sector auditors on how the proposed standards affect engagements in the public sector regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.**

The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review.

The AUASB notes that Public sector engagements encompass a large range of diverse organisations both in terms of the size of the organisation and the nature of their activities. The AUASB considers that absent a more robust definition or description of what is meant by “entities of significant public interest,” there may be a number of public sector engagements that become subject to an engagement quality (EQ) review where such a review is not warranted.

- Q5. *Translations* – Recognizing that many respondents may intend to translate the final ISQMs and ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed standards.**

We have no specific comments on this question.

Overall Questions

Q1. Does ED – ISQM 1 substantively enhance firms’ management of engagement quality, and at the same time improve the scalability of the standard? In particular:

- a) *Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?*

The AUASB supports a quality management approach to ISQM 1, however the AUASB is not supportive of the overall standard in its current form.

The AUASB considers the proposed standard to be a hybrid of risk-based quality management requirements that retains a granular level of prescriptive requirement carried over from the extant ISQC 1 standard, which undermines the proper application of a risk-based approach.

The main theme expressed by Australian stakeholders throughout the AUASB’s outreach on ISQM 1 was related to its size and level of granularity. All practitioners, large and small, were concerned with the cost and resources needed to develop a quality management framework in line with the proposed standard as currently drafted. The AUASB encourages the IAASB to refine its drafting approach to reduce the length and complexity of the proposed standard, as well as the other proposed Quality Management Standards being exposed concurrently – ED - ISQM 2 and ED - ISA 220.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315 [that is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”] would facilitate a better risk-based approach that is scalable to the specific circumstances of a firm which may help mitigate the potentially large cost and resourcing burden the implementation of this proposed standard imposes on practitioners. The AUASB particularly highlights to the IAASB that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered. Whilst these examples being included in the proposed standard may assist with implementation, the AUASB suggests the IAASB review the underlying principles in the requirements to make them simpler and more straightforward, which should alleviate the need for extensive examples and illustrations being included in the application guidance and appendices.

Additionally, the AUASB considers that the risk assessment process as designed has the potential to be particularly onerous for practitioners when considering the overall number of prescribed quality objectives required by the proposed standard. Furthermore, to further support a risk-based approach, the AUASB recommends the removal of pre-defined required responses to quality risks in the standard as the AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

The AUASB consider it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in ISQM 1, and explicitly weigh these against the costs of transition and implementation, as a means to support the successful implementation of the proposed standard once it is finalised.

- b) *In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional scepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?*

The AUASB consider that a quality management approach to ISQM 1 provides an appropriate framework, but whether the proposals will generate the benefits intended will depend upon each firms implementation. Stakeholder feedback from practitioners of all sizes, indicates that implementing the proposals in the current form will be very challenging as they are resource intensive and costly.



Regarding professional scepticism, the AUASB considers paragraph 22 of ISQM 1 supports the appropriate exercise of professional scepticism at the engagement level.

- c) *Are the requirements and application material of proposed ED – ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstances? If not, what further actions should the IAASB take to improve the scalability of the standard?*

The AUASB considers that the concepts of a Quality Management (QM) System should theoretically make the standard's requirements and application material scalable. However, in its current form we believe firms will find ISQM 1 overly granular and impractical to scale, which is counter intuitive to a risk-based approach. Such granularity may act as a barrier to its effective and consistent application, accordingly, as currently drafted, the AUASB does not consider the standard to be scalable.

The increased length of ISQM 1 is also a potential barrier to its understanding and application, particularly for small or sole practitioners with limited resources, and it is not clear how the additional cost associated with implementing the proposed standard will provide corresponding benefits for these practices. The AUASB encourages the IAASB to refine its drafting approach to reduce the length of the proposed standard where possible as a means of making them more accessible and understandable, which will in our view assist scalability.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315¹ would facilitate a risk-based approach scalable to the specific circumstances of a firm. As noted previously in our response to Question 1(a), the AUASB considers that the large volume of application material, appendices and guidance in the proposed standard needs to be reduced to improve the scalability of the proposed standard.

Furthermore, to further support a risk-based approach, the AUASB recommends the removal of pre- defined required responses to quality risks, as the AUASB considers it appropriate that firms should determine their own specific responses tailored to their specific risk circumstances.

Amendments suggested above would alleviate the volume and granularity concerns commonly expressed by stakeholders, for example:

- The granular requirements around design and implementation are considered to be counter intuitive to the very nature of a risk-based standard, these requirements could form an example of the “how” in application material.
- While the introductory paragraphs assist with understanding the risk assessment process and helpfully explain a number of important concepts in the standard, their inclusion is further evidence of ISQM 1s complexity. We would caution that extensive introductory paragraphs shouldn't be required for all IAASB standards. This introduction or ‘executive summary’ of the standard could be positioned outside of the standard, for example in the form of a “first time through document”.

In addition, the AUASB recommends that the IAASB provide more guidance and examples (e.g. in a “first time application” implementation guide) on how to effectively scale the work effort in ISQM 1 to less complex entities, such as examples of risks and responses that are specific to and appropriate for sole practitioners and what and how to document.

¹ That is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”

Q2. Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?

The AUASB considers that the implementation concerns described below could be alleviated if ISQM 1 is redrafted on the same basis as the proposed new drafting approach to ISA 315². Additionally, implementation concerns could be addressed by the removal of ‘pre-defined’ required responses to quality risks included in the proposed standard. The AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

Additionally the AUASB highlights a number of other areas in the proposed standard which we consider may enhance the implementation of the proposed ISQM 1:

Networks

The enhanced requirements around network firms, while supported by stakeholders, we consider will result in some practical implementation challenges for certain network firms. Some of the AUASB’s stakeholders expressed concern that the granularity of the requirements around relying on network firms may undermine the purpose of being in a network and lead to unintended consequences. Additionally, there was a level of concern raised by stakeholders as to the consistency of application across network firms in different jurisdictions and what this means from a regulatory perspective. As this issue impacts many audit firms across the globe the AUASB considers that more detail may be required in ISQM 1 to demonstrate how, for example:

- The same network requirements are applicable to firms operating in the same city or country versus those in different jurisdictions;
- Requirements may be different dependent upon how a network is structured; and
- Documentation requirements may be different dependent upon the nature of the network firm’s affiliation.

The AUASB notes that the application material in relation to networks provides examples of the types of inquiries and documentation that the firm may consider, but it provides little or no guidance on the extent of the assessment that the firm should perform, nor the extent of the documentation required to evidence such an assessment. The AUASB recommends that such guidance be incorporated into the proposed standard to facilitate consistent and appropriate interpretation and implementation.

Implementation Period

The AUASB considers that a longer implementation period than that currently proposed by the IAASB is required, perhaps even a staggered implementation approach for example starting at with the governance and leadership component of the proposed standard.

ISQM 1 is expected to require a significant amount of firms’ resources to be spent in order to put into place an appropriate quality management process, as well as update firms’ methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for certain network firms and other audit firms will be particularly challenging. For example, for certain network firms, the network firm’s head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, on top of the three new or revised standards included in the suite of Quality Management standards, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400). The AUASB considers that for firms to

² That is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”

implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these Quality Management standards may be in the public interest.

Legislative instruments

The depth of considerations of the proposals of the standard may be greater and have more implications in jurisdictions where the suite of Auditing Standards (including the proposed ISQM 1) are legislative instruments and have the force of law, as is currently the case in Australia. The AUASB is concerned that the granular level of detail contained in the proposed ISQM 1 makes this standard difficult for practitioners to achieve compliance with the extensive list of requirements. This further supports the need for ISQM 1 to be a truly risk-based standard as described in our response to Question 1(a) above.

Documentation

Stakeholders consider that the requirement to document the quality objectives, quality risks and associated responses is onerous and time consuming. There are 8 components to the standard. If each component has multiple quality objectives and each quality objective may have multiple risks associated, and each risk requires a response to address that risk, the AUASB is concerned that meeting this documentation requirement may not have any benefit on quality, rather just become a compliance exercise.

Additionally, the AUASB raises for consideration that the definition of response in paragraph 19(t) includes policies implied through actions or decisions. An implementation challenge will be capturing the responses that are implied through actions or decisions and other responses that are informal in nature and not readily documented. An example of such a challenge is demonstrated in documenting responses required under paragraph 24(a)(ii) in relation to firm culture, where these responses may include informal staff meetings and common day-to-day actions and behaviours. The AUASB encourages the IAASB to provide examples of documentation which are likely to satisfy the needs of those reviewing a firm's system of quality control in these areas to assist with implementation and consistency of application.

Q3. Is the application material in ED – ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

The AUASB has not included in this response a comprehensive review of all the application material paragraphs in the proposed standard, as the AUASB considers that proposed ISQM 1 should be redrafted in a similar drafting convention being proposed to redraft ISA 315. As noted previously in our response to Question 1(a), the AUASB considers that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered in order to improve the scalability of the proposed standard.

The AUASB makes the following additional comments in relation to the application and other material included in the proposed ISQM 1:

- Whilst the introductory paragraphs assist with understanding the risk assessment process and helpfully explain a number of important concepts in the standard, the AUASB considers their inclusion is further evidence of ISQM 1s complexity. We would caution that extensive introductory paragraphs shouldn't be required for all IAASB standards. The AUASB recommends that the introduction or 'executive summary' of the standard could be positioned outside of the standard in the form of a "first time application" guide.

- The AUASB considers the appendix is educative in nature and while it provides useful information, could be positioned outside of the standard in the form of a “first time application” guide.
- There are several application material paragraphs that are duplicative of requirements or establish requirements, for example A49 and A59.
- There are several application material paragraphs that are duplicate of content elsewhere, for example A36 is duplicative of A32; A178 is duplicative of A174.
- There are several application material paragraphs that are too onerous in nature or too granular in detail, for example A130 in relation to technology; and A67 –A74 in relation to ethics where the IAASB have attempted to summarise the IESBA Code in a few paragraphs, whilst practitioners need to comply with the full Code.

Specific Questions

Q4. Do you support the eight components and the structure of ED – ISQM?

The AUASB is supportive of the principles behind having the 8 components of a Quality Management System. Additionally, the AUASB supports the level of flexibility in the proposed standard whereby firms are not required to organise their systems according to these discreet components. A firm may have different names for the components and may combine components or have additional components.

As noted previously in our response to Question 1(a), the risk assessment process as currently designed in ISQM 1 we consider may be overly complex, based on the number of prescribed quality objectives required by this proposed standard, with each component having multiple quality objectives and multiple pre-defined required responses. The AUASB recommends the removal of pre-defined required responses to quality risks in each component of ISQM 1, as we consider it appropriate that firms determine their own specific responses tailored to their specific risk circumstances.

Q5. Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm’s role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm’s public interest role?

The AUASB supports the objective of the standard and notes that paragraph 7 of ED-ISQM 1 provides clarity on the relationship between the purpose of a system of quality management serving the public interest by supporting the performance of quality engagements. However, the AUASB considers that there is a strong need to more clearly demonstrate and articulate the benefits of the proposed quality management approach and explicitly weigh these against the cost to implement as the proposals are expected to be resource intensive and costly to implement.

Additionally, the AUASB considers that while a system of quality management provides an appropriate framework as is good business practice, whether the proposals will generate the benefits intended depend upon a firms’ implementation – that is, a “compliance” verses “transformational” mindset. The AUASB considers that the standard in its current form lends itself to a “compliance” mindset, which will not achieve the objectives of the standard.

Q6. Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved? In particular:

(a) *Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?*

The AUASB supports the application of a risk-based approach to quality management, however the AUASB is not supportive of the standard in its current form. The AUASB considers the proposed standard to be a hybrid of risk-based quality management while retaining a granular level of prescription, thereby undermining a proper application of a risk-based approach. The main theme expressed by Australian stakeholders throughout the AUASB's outreach on ISQM 1 was related to its overall size and level of granularity. The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315³ would facilitate a risk-based approach.

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

(i) *Are the required quality objectives appropriate*

The AUASB supports the need for firms to identify their own quality objectives specific to the circumstances of their organisation. However, the AUASB is not supportive of the quality objectives requirements of the standard in its current form. The AUASB considers the granular level of prescription of quality objectives to be counter-intuitive to the very nature of a risk-based approach.

(ii) *Is it clear that the firm is expected to establish quality objectives beyond those required by the standard in certain circumstances*

The AUASB agrees with the IAASB's view expressed in paragraph 29 of the Explanatory Memorandum to ED-ISQM 1 that 'the quality objectives in ED-ISQM 1 are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved'. We encourage the IAASB to use this wording in the application material of paragraphs A49-A51 as the extent of establishing quality objectives beyond those required by the standard is unclear.

The AUASB understands that there could be certain circumstances that would require a firm to establish additional quality objectives beyond those required by the standard, but these circumstances may be limited. Specifically, the requirement in paragraph 26 of the proposed ISQM 1, as it currently reads, could be interpreted as firms always needing additional quality objectives, which the AUASB understands is not the intention of the standard. We accordingly believe this requirement in paragraph 26 of ISQM 1 needs to be redrafted to make the circumstances where additional quality objectives need to be established clearer.

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

The AUASB has concerns with the process to identify quality risks as described by paragraph 28 of ED – ISQM 1 with particular reference to:

- The threshold of 'reasonable possibility of occurring'. Reasonably possible was a concept introduced in the recent ISA 315 Exposure Draft where a reasonable possibility was equated with "more than remote". ED-ISQM 1 follows the same approach in paragraph A55 and we

³ That is the requirements are the "what", the application material, appendices and guidance constitutes the "why" and "how".

reiterate our comment made in response to the ISA 315 exposure draft that the AUASB does not support this concept; and

- The threshold of ‘if they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective’. In practice there could be challenges in the consistent interpretation and determination of the term ‘significant effect’.
- (d) *Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks? In particular:*
- (i) *Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?*

The AUASB supports the need for firms to design and implement responses to address their specific quality risks identified. However, the AUASB is not supportive of the design and implementation requirements of the standard in its current form. The AUASB considers the granular level of prescription of design and implementation responses to be counter-intuitive to the very nature of a risk-based approach. Furthermore, the AUASB questions how the standard can propose granular requirements around design and implementation to respond to assessed quality risks when the standard does not have requirements around what those risks are. Additionally, the AUASB is concerned that the pre-determined required responses may not be applicable where a firm has no associated risk. The AUASB recommends that the IAASB provide guidance / clarity around this position.

This level of granularity undermines a proper application of a risk-based approach. Furthermore, the AUASB has concerns that providing a list of required responses may lead to a bottom up approach, starting with the checkbox compliance mentality and working backwards to identify risks to meet these responses.

As expressed in response to question 1(a), the AUASB considers the proposed standard to be a hybrid of risk-based quality management while retaining a granular level of prescription thereby undermining a proper application of a risk-based approach. The main theme expressed by Australian stakeholders throughout the AUASB’s outreach on ISQM 1 was related to its sheer size and level of granularity. The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315⁴ would facilitate a risk-based approach without the need for such granularity.

- (ii) *Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?*

The AUASB understands the IAASB’s view - expressed in paragraph 37 of the Explanatory Memorandum to ED-ISQM 1 - that the responses in the proposed standard are not comprehensive and as a result the firm is required to design and implement responses to address assessed quality risks in addition to the responses required by the standard. However, other than perhaps for the ‘Resources’ component of ISQM 1, the AUASB considers that the need for additional responses beyond those required by the standard may be limited and does not support the wording in paragraph 10(c) and A59. The AUASB recommends that the wording in paragraph 10(c) is changed as follows:

*‘.....However, the responses required by this ISQM alone ~~will~~ **may** not be sufficient to....’*

The AUASB recommends that the wording in paragraph A59 is changed as follows:

⁴ That is the requirements are the “what”, the application material, appendices and guidance constitutes the “why” and “how”.

*“However, the responses required by this ISQM alone ~~will~~ **may** not be sufficient to address all of the firm’s assessed quality risks, as explained in paragraph 10(c). Accordingly the firm ~~is required~~ **may need** to design and implement responses in addition to those required by this ASQM.”*

Additionally, the AUASB is concerned that the pre-determined required responses may not be applicable where a firm has no associated risk. The AUASB recommends that the IAASB provide guidance / clarity around this position.

Q7. Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

The AUASB is supportive of ISQM 1 addressing leadership and governance and agree with the principles of the importance of ‘tone from the top’. However, to reiterate the comments under 1(a) above, the requirements of the proposed standard need to be principles-based and not become prescriptive on how firms manage their businesses. A risk-based approach facilitates firms identifying their own quality objectives, quality risks and responses to address those risks. The AUASB does not consider that it is the role of the standards to prescribe audit firm governance.

An example of the level of granularity is in relation to paragraph 23(a), firm culture, where the AUASB considers that in practice it will be challenging to document the culture of the firm in order to meet the requirements of the standard.

Q8. With respect to matters regarding relevant ethical requirements:

(e) *Should ED-ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?*

The AUASB understands that this is already common practice.

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

The AUASB considers that paragraph A71 appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons in the network.

Q9. Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?

The AUASB is supportive of the recognition of the use of technology in the proposed ISQM 1. The AUASB considers that the balance of requirements is appropriate and that the proposed standard is sufficiently principles based in this area.

The AUASB considers that further guidance and clarification on the scope of IT is required. The usage of customised IT applications in the performance of engagements is increasing rapidly. As part of the quality management system, the firm should establish the necessary processes and policies in place to govern the usage of customised IT applications by the engagement teams (ie identifying the risks that the engagement team must mitigate) as it will not be possible for the firm to determine these for every customised IT application.

Additionally, the AUASB notes that paragraph A129 includes a bullet point on ‘*unauthorised access may result in breaches of confidentiality*’ The AUASB considers that this could be expanded to

note that the firm / engagement teams will need to consider the application of relevant privacy legislation in the conduct of the engagement, including the extraction, storage and presentation of personally identifiable data. Equally this needs to be considered in the authorised access of the data by the engagement team in the conduct of the audit not just in the unauthorised access.

Additionally, the AUASB notes for consideration that paragraph A130 is an example of where the application material is too onerous. The specific application material that ‘it is necessary for the firm to **determine** that the IT application operates appropriately’ may imply a need to obtain absolute assurance rather than reasonable assurance that the quality objectives are being met. Furthermore, the last bullet point in paragraph A130 refers to the consideration that general IT controls are designed appropriately. Historically this would include consideration of controls to manage changes in the code and the prevent access by the users to the code. The AUASB understand that this is not possible in many new IT applications and therefore the engagement team will be required to implement additional mitigating controls. The AUASB recommends that this be considered in the application material.

Q10. Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm’s system of quality management with the firm’s stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so

The AUASB is supportive of guidance around appropriate communications with external parties, however the AUASB is concerned with the drafting convention used in paragraph 41. Transparency reports are not always necessary and the AUASB recommends that the wording in paragraph 41(c)(iv) ‘*in a transparency report or otherwise*’ be moved to application material as an example of external communications. The AUASB considers that if the drafting conventions being proposed for ISA 315 are implemented to ISQM 1, this matter will potentially be resolved.

Q11. Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?

The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review. The AUASB supports a risk-based approach to such a determination which is already required in the proposed standard where a firm is required to determine whether an engagement quality review is an appropriate response to assessed **engagement** risks. Further to this, the AUASB suggests the following amendment to paragraph 37(e)(iii)(b):

*‘The firm determines that an engagement quality review is an appropriate response to assessed ~~quality~~ **engagement** risks, based on the reasons for the assessments given to those risks.’*

The AUASB does not consider that it is the role of the engagement quality review to respond to quality risks but rather engagement risks.

If the IAASB does not remove these entities from the scope, then the AUASB notes that application material paragraph A102 highlights that in making the determination of whether an entity is of significant public interest, firms would take into account whether the entity has a large number and wide range of stakeholders and the nature and size of the business. Accordingly, it is unclear whether the proposed standard would result in an expectation that an engagement quality review is performed on ALL charities and ALL public sector engagements as these entities will always have a large number and wide range of stakeholders. This may be an unintended consequence of the proposed

drafting. Furthermore, the AUASB is concerned that ‘significant public interest’ entity cannot be defined consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

Q12. In your view, will the proposals for monitoring and remediation improve the robustness of firms’ monitoring and remediation? In particular:

- a) *Will the proposals improve firms’ monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?*

The AUASB considers that the proposals will improve the robustness of firms’ monitoring and remediation, particularly through the introduction of the investigation of root causes of deficiencies. The AUASB considers that the identification of root causes should improve the design and evaluation of the remedial actions as well as the evaluation of the system of quality management as a whole. Additionally, the AUASB supports monitoring procedures that can be performed before an engagement report is issued. The AUASB understands that firms use other forms of monitoring / data analysis in addition to reviews of in-process or archived file reviews. For example firms perform targeted activities (for example impairment reviews). The AUASB considers that it is appropriate for the IAASB to recognise other forms of monitoring activities in the proposed standard to recognise the range of such activities.

Again, the AUASB draws attention to the response to question 1(a) in redrafting ISQM 1 in the same manner as proposed redraft to ISA 315. An example of where this is required is in relation to monitoring and remediation: paragraph 45 (inspections may include in-process reviews) is not strictly a requirement. The idea of an in-process review is often more proactive and preventative than monitoring completed engagements, however, if this is not required, and may not replace the inspection of a completed engagement, the AUASB recommends that this should only be referenced in application material.

- b) *Do you agree with the IAASB’s conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?*

The AUASB supports the proposal to retain the requirement for the inspection of completed engagements on a cyclical basis. The AUASB is supportive of the guidance in paragraph A169 regarding the ability of firms to establish different cyclical periods, however to promote consistency in application and consistency in quality across firms and jurisdictions, further guidance and examples within this paragraph could be enhanced. For example, refer to nature or assessed risk of engagements (different approaches for “PIE” and “non PIE”) as a way to demonstrate flexibility in the cycle or how the results of in-process reviews may impact the cycle.

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

The AUASB does not consider the distinction between a finding and a deficiency to be clear. The AUASB considers that illustrative examples of what would be a finding and what would be considered to be a deficiency would be helpful. Additionally, the AUASB notes that while deficiency is defined, there is no definition of a finding. The AUASB recommends that the definition of finding be incorporated into the proposed standard. This is particularly important given that firms will be required to respond in different ways. Stakeholders expressed concern that a root cause analysis may be required in order to determine whether a finding is a deficiency. The AUASB recommends that the language should be clearer to clarify that a root cause analysis is not required to be performed for all findings; rather, firms’ policies or procedures should address when a root cause analysis is appropriate.

In practice, firms may be performing root cause analysis on findings categorised as “high”, i.e. those findings for which there is a high risk of a material misstatement occurring.

- d) *Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:*
- (i) *Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?*

In its current form, without the clarity around findings verses deficiencies the AUASB does not support the incorporation of a new requirement to investigate the root cause of identified deficiencies and does not consider that the application material allows for sufficient flexibility. The AUASB supports a root cause analysis on “significant” deficiencies as detailed in the response to question 12(c).

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

The AUASB supports that there is no requirement to undertake root cause analysis of positive findings, however supports the encouragement, through application material paragraph A178, for firms to consider performing root cause analysis on positive findings where considered beneficial. The AUASB considers that positive findings have the potential to be applied more broadly across the firm and assist with improvements in audit quality. Positive findings also supports the development of the culture required by the governance and leadership component of ISQM 1.

- e) *Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?*

The AUASB considers there are challenges to fulfilling the requirement particularly for sole practitioners. In such situations, requiring individual(s) to evaluate the system of quality management for which they are ultimately responsible may not enhance quality, unless this evaluation can be supported by information gathered by other individuals. This may be more practicable for larger firms but may not be effective for SMPs where the individual(s) evaluating the system of quality management is(are) also involved in the engagements that are performed. Additionally, this requirement may also be difficult to achieve for certain network firms where there may not necessarily be one individual tasked with ultimate responsibility and accountability for the system.

Q13. Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?

The AUASB supports the concepts to address network firms perceived or actual undue reliance on network requirements or services. The enhanced requirements around network firms, while supported by stakeholders, is seen to be a practical challenge that will need to be worked through by network firms. Some stakeholders expressed concern that the granularity of the requirements may undermine the purpose of being in a network and may lead to unintended consequences. Additionally, there was a level of concern raised by stakeholders as to the consistency of application across network firms in different jurisdictions and what this means from a regulatory perspective. As previously described in our response to Question 2, the AUASB considers that more detail may be required in ISQM 1 to demonstrate how this can be achieved.



The AUASB notes that the application material in relation to networks provides examples of the types of inquiries and documentation that the firm may consider, but it provides little or no guidance on the extent of the assessment that the firm should perform, nor the extent of documentation required to evidence such an assessment. The AUASB recommends that such guidance be incorporated into the proposed standard to facilitate consistent and appropriate interpretation and implementation.

Q14. Do you support the proposals addressing service providers?

The AUASB supports the proposals addressing service providers in ISQM 1, but recommends that the term ‘service provider’ is more clearly defined within ISQM 1, with examples provided to assist practitioners identify not only who is a service provider captured under ISQM 1, but also to provide clarity as to who is outside the definition.

Q15. With respect to national standard setters and regulators, will the change in title to “ISQM” create significant difficulties in adopting the standard at a jurisdictional level?

The depth of considerations of the proposals of the standard may be greater and have more implications in jurisdictions where the suite of Auditing Standards (including ISQM 1) are legislative instruments and have force of law implications. The AUASB is concerned that the granular level of detail contained in proposed ISQM 1 makes this standard difficult for practitioners to achieve compliance with all the requirements. This further supports the need for ISQM 1 to be a risk-based standard as described in Question 1(a) above.

Q1. Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

The AUASB generally supports the IAASB creating a separate standard specific for engagement quality reviews (EQR) as set out in ED-ISQM 2. Given the importance of the EQR role the AUASB considers creating a separate standard effectively communicates the importance of the EQR's role and responsibilities. We support the requirement in ED-ISQM 1 paragraph 37(e) which identifies those engagements where an EQR is required. This allows firms to clearly determine those engagements that do and do not require an EQR.

The AUASB agree that ED-ISQM 1 should deal with determining the criteria for which an EQR is required and ED-ISQM 2 should deal with all remaining aspects of appointment, eligibility and responsibilities for performing and documenting an EQR.

Q2. Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?

The AUASB believe the linkages between ED-ISQM 1 and ED-ISQM 2 are appropriate.

However we consider that the definition of an EQR in ED-ISA 220 is inconsistent with ED-ISQM 2 and this needs to be addressed. Specifically, the EQR definition in ED-ISA 220 requires that a 'suitably qualified' partner or other individual appointed by the firm to be responsible for the performance of the engagement quality review, but this requirements is not captured in ED-ISQM 2.

Q3. Do you support the change from "engagement quality control review/reviewer" to "engagement quality review/reviewer?" Will there be any adverse consequences of changing the terminology in respondents' jurisdictions?

The AUASB supports the change to "engagement quality review/reviewer" as it is consistent with the proposed suite of quality management standards which now refer to quality management rather than quality control. The AUASB do not believe there would be any unintended consequences as a result of the change.

Q4. Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

The AUASB are supportive of the eligibility requirements of the "engagement quality reviewer" as outlined in paragraphs 16 & 17.

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

The AUASB notes that IESBA has changed the IESBA code to include more detailed and specific requirements for auditor rotation for Public Interest Entities (PIEs) with detailed rotational rules and limits for combined roles of Audit Partner, Key Audit Partner, and EQR roles, as well as specified clean periods depending on the combination of the roles held by the partner.

The AUASB considers that any reference to the "cooling-off" period, including the guidance currently included in paragraph A5 of ED-ISQM 2 "that firms establish the cooling-off period

and that the determination of a suitable cooling-off period depends upon the facts and circumstances of the engagements (and applicable provisions of law or regulation or relevant ethical requirements)” should reside in the IESBA code. If these principles reside within the IESBA code they will apply to all professional accountants (or their firms, as applicable) and address the fundamental principles, including independence, and apply the conceptual framework. This would then support consistency across jurisdictions. The test of partner rotation and suitable cooling-off periods is linked to independence and as such should therefore be addressed within the IESBA code.

Accordingly, the AUASB is of the view that the application material in paragraph A5 relating to any “cooling-off” period should be removed from ISQM 2 and a reference to the IESBA code instead be considered if this application guidance is to be retained.

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

The AUASB strongly recommends that all guidance relating to the independence and objectivity of the EQR should reside in the IESBA Code as it already addresses these matters. The inclusion of alternative guidance regarding “cooling-off” periods in ISQM 2 increases the risk of inconsistent application and increases complexity for practitioners who may need to consider two different sources when addressing this issue.

Q5. Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?

The AUASB agrees with the requirements in ED-ISQM 2 relating to the nature, timing, and extent of EQR’s procedures, with the following exceptions:

- Paragraph 22(c), the use of “identify the areas involving significant judgments” could be viewed as expanding the role of the EQR beyond what is intended. We recommend replacing “identify” with “evaluate”.
- Paragraph 22(f), it is uncertain as to how an EQR would “evaluate the basis for the engagement partner’s conclusion” and the related application guidance does not provide further clarity. We recommend further clarification around the documentation of the evaluation of the conclusion.

We also refer to the AUASB’s submission on ED-ISA 220 and our response to Question 2 of the ‘Request for Comments’ where we comment further on the proportionality between the roles of the engagement team and the EQR.

Q6. Do you agree that the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional scepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional scepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

The AUASB agrees that the EQR’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional scepticism.

The AUASB does not believe that ED-ISQM 2 should further address the exercise of professional scepticism by the EQR. The role of the EQR is limited to evaluating the significant judgments made by the engagement team, and whether an appropriate level of professional scepticism has been

exercised and evidenced in designing and executing procedures and concluding on those areas by the engagement team and is appropriately reflected in the documentation.

The AUASB agrees that the EQR's evaluation of the engagement team's significant judgements includes evaluating the engagement team's exercise of professional scepticism, however consider additional application guidance to make it clear how this is appropriately documented in the audit file.

The AUASB is not supportive of the use of the term 'professional scepticism' in place of what we regard as really being 'professional judgement' by the EQR. Specifically we consider the IAASB needs to review the current requirements in ED-ISQM 2 that require the EQR to evaluate and document the exercise of professional scepticism in relation to significant judgements made by the engagement team.

Q7. Do you agree with the enhanced documentation requirements?

The AUASB is supportive of the enhanced documentation requirements.

Q8. Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

The AUASB agrees that the requirements in ED-ISQM 2 are scalable for firms of varying sizes and complexity.

Matters for further consideration in relation to ISQM 2

Q9. Do you consider that the requirements in ED-ISQM 2 are appropriate for all engagements to which the standard will apply through ED-ISQM 1 e.g. other assurance and related services engagements and not just audits of a financial report? An example of this may be the "cooling-off periods".

The AUASB is generally supportive of ED-ISQM 2 applying to other assurance and related services engagements and not just audits of financial statements if a risk-based approach to ED-ISQM 1 is appropriately adopted. However the AUASB do note for the IAASB's consideration where there may be areas within ISQM 2 that may not extend themselves as logically to non-financial statement audit engagements - e.g. cooling off periods (independence test) and escalation of issues to the EQR on significant judgements where this concept may not apply to other assurance and related services engagements.

Q10. Do you think the requirement for an engagement quality reviewers overall conclusion in paragraph 24 adds value to the performance of the engagement quality review as a whole?

The AUASB is not supportive of the inclusion of the "stand back" requirement in paragraph 24 as currently drafted. The AUASB notes that the stand back provision may represent good practice for some recently revised auditing standards, however there needs to be a clearer articulation of the purpose of the stand back requirement as it relates to the role of the EQR in ISQM 2.

The AUASB is supportive of the second limb of paragraph 24 being that the EQR shall notify the engagement partner that the EQR is complete.

Q1. Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?

In general the AUASB is supportive of the IAASB clarifying the engagement partner’s responsibilities and emphasising that the engagement partner has ultimate responsibility for the engagement. However, the AUASB considers that it may be difficult to practically meet the requirements in paragraphs 11-13 on a larger audit engagement (such as a multinational or group audit), particularly allowing for the broader Engagement Team definition now contained in the proposed standard. The AUASB specifically draws attention to the requirement in paragraph 13(b) outlining the engagement partner’s responsibility to monitor and review the work of assignees, which we consider may be difficult to achieve with this expanded engagement team definition in place.

The AUASB is cautious that the broad definition of engagement team may draw in unintended personnel into the engagement team giving rise to a number of challenges for the engagement partner being able to satisfy the requirements in paragraphs 11-13.

With regard to the roles of other senior members, including other partners, the AUASB would like the IAASB to provide further guidance dealing with situation where there are multiple partners on an engagement. Whilst Australian stakeholders did not view this as a significant issue with the proposed standard, the AUASB considers that with global actions in response to audit quality, such as proposals for more than one audit firm to perform an engagement, the need for clarification will arise in the future and should be addressed now to avoid reopening the standard.

Q2. Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures?

Overall the AUASB considers that ISA 220 links, where appropriate, to the ISQMs. However, the AUASB raises a significant concern that the definition of engagement team may be interpreted differently under ISA 220 and ISQM 1 due to the different application and explanatory material that applies to this definition in ISA 220 (paragraphs A16-A19) not being replicated in ISQM 1. The potential unintended consequence of this different application guidance is that engagement team members could be interpreted differently when the different application and explanatory material in each proposed standard is applied. For example, an Engagement Quality Reviewer (EQR) may be considered to be excluded from the engagement team under the definition and application guidance in ISA 220, but included as part of the engagement team under the definition in ISQM 1.

The AUASB also raises for consideration whether an appropriate balance has been achieved between the role of the engagement partner under ISA 220 and the role of the EQR under ISQM 2. In particular, the AUASB draws attention to paragraph 22(c) of ISQM 2 where the EQR is required to “identify” areas involving significant judgments rather than “evaluate” the areas identified by the engagement team; and paragraph 22(f) where the EQR is required to evaluate the Engagement Partner’s (EP) stand-back requirement. The level of work expected of the EQR in some areas appears to be at the same level as an EP and, in the view of the AUASB, is not in line with the objectives and proportionate responsibilities of an EQR.

Q3. Do you support the material on the appropriate exercise of professional scepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)

The AUASB is supportive of the inclusion of the material on the exercise of professional scepticism, however, the AUASB views that the objective of paragraph 7 is unclear. Presently, the requirement may appear to lead engagement team members to question or ‘second guess’ their colleagues and/or the firm in meeting the requirements of this standard. The AUASB questions whether this was the intention of this revision to the proposed standard and considers that paragraph 7, and other appropriate areas of ISA 220, should more clearly emphasise how the engagement partner is responsible for establishing an environment that supports the exercise of professional scepticism and setting an appropriate ‘tone from the top’ across the engagement team.

The AUASB supports the application material which more clearly articulates this responsibility. For example, paragraph A27 outlines the impediments to the engagement team’s ability to exercise professional scepticism that an engagement partner may have to deal with. The AUASB recommends the inclusion of other impediments to the exercise of professional scepticism at the engagement level to assist the engagement partner in establishing an environment that allows the engagement team to exercise appropriate professional scepticism.

Q4. Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

The AUASB welcomes the introduction of application and explanatory material in the standard on the use of technological resources. However, as presently drafted, the AUASB considers that the standard does not adequately deal with advances in technology and potential changes in the auditing environment. For example, as the use of Artificial Intelligence/machine learning becomes more common, it is unclear how the review requirements of the standard will be met, particularly where specialist knowledge is required to review such tools.

The AUASB recommends that the IAASB considers the impact of new and emerging technology on all aspects of the engagement partner’s responsibilities and is not limited to engagement resources. In the absence of appropriate technology considerations within the standard, additional implementation and guidance materials may be required to support practitioners to understand how an engagement partner can meet the requirements of the standards in a modern environment.

Q5. Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

The AUASB considers that whilst the direction, supervision and review requirements on their own do not appear overly onerous, they may not be practically achievable as a result of the broader engagement team definition. The AUASB is concerned that the broad definition of engagement team may draw in unintended personnel into the engagement team.

In particular, it is presently unclear whether a component auditor engagement team is captured as part of the engagement team under ISA 220. The AUASB considers it is impractical to expect an engagement partner to perform the direction, supervision and review requirements for component auditor team members, and in practice this is more likely performed at the component auditor team level.

The application material of the engagement team definition draws in service delivery centres and may also draw in technology support staff assisting the engagement team in using tools and processing data. It may be impractical for the engagement partner to meet the direction, supervision and review requirements for each of these possible groups of engagement team members, particularly where they only perform functions to support the engagement team.

The ability for the engagement partner to practically meet the review requirements of ISA 220 is further impacted by the use of technology in the audit. In an environment where the use of technology and handling large volumes of data becomes common, engagement partners may not have the specialist knowledge required to review the outputs of such tools.

Overall, the ability to practically meet the direction, supervision and review requirements of the proposed standard is further impacted by removal of paragraph 4 from the extant ISA 220 which stated “Engagement teams are entitled to rely on the firm’s system of quality control process, unless information provided by the firm or other parties suggests otherwise”. The IAASB’s proposed approach of using the terms “shall be satisfied” and “shall determine” to differentiate between actions that can occur at a firm level and actions that must occur at an engagement level is not clearly articulated in the body of ISA 220 and is not commonly used throughout the suite of auditing standards which may result in diverse interpretation.

The AUASB understands the IAASB's concerns regarding the over reliance on firm policies and procedures by the engagement teams, however, some quality risks are more effectively and efficiently responded to at a firm level. The situations where an engagement team can rely on the firm’s systems should be more clearly articulated in the standard, as well as what is required of an engagement partner where they choose to rely on those firm systems.

Q6. Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?

The AUASB generally views that the documentation requirements in conjunction with the requirements of ISA 230 provide sufficient guidance on documentation although this can be enhanced by a link between the review requirements of the engagement partner and the documentation requirements to evidence this review.

Q7. Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?

Australian stakeholders raised that the removal of paragraph 4 from the extant ISA 220 which stated “Engagement teams are entitled to rely on the firm’s system of quality control process, unless information provided by the firm or other parties suggests otherwise” and changes to the standard to explicitly state that the firm’s system of quality control cannot be relied upon in certain situations may impact on scalability. Stakeholders viewed that the benefits of being part of a network may be lost, therefore placing more onus on individual firms and partners impacting scalability.