

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

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

The AUASB supports a quality management approach to ISQM 1, 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 true 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. 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 of the proposals.

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 is the “why” and “how”; would facilitate a true risk-based approach, scalable to the specific requirements of a firm and may help to mitigate the large cost and resourcing burden on practitioners.

- 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 considers that a quality management approach to ISQM 1 provides an appropriate framework, but whether the proposals will generate the benefits intended will depend upon firm’s 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 supports the way 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 resourcing and the cost attached to implementing the proposed standard potentially overly burdensome. The AUASB encourages the IAASB to refine its drafting approach to reduce the length of the proposals.



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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 is the “why” and “how”; would facilitate a true risk-based approach. Such an approach would alleviate the volume and granularity concerns expressed by stakeholders, for example:

- The granular requirements around design and implementation is considered to be counter intuitive to the very nature of a risk based standard, these requirements could form the “how” in application material.
- The introductory paragraphs greatly assist with understanding the risk assessment process and helpfully explain a number of important concepts in the standard. However 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 in the form of a “first time through document”.

In addition, the AUASB recommends that the IAASB provide more guidance and examples on how to effectively scale the work effort in ISQM 1 to less complex entities, such as examples of risks and responses and what and how to document.

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

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 315; that is the requirements are the “what”, the application material, appendices and guidance is the “why” and “how”.

- **Networks**

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 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.

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 currently proposed by the IAASB is required, perhaps even a staggered implementation approach.

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 network firms will be



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particularly challenging as the network head firm 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, there are two additional exposure drafts currently being finalised, those being ISA 315 and ISRS 4400. The AUASB considers that for firms to implement changes in respect of 5 standards almost simultaneously may have an adverse impact on quality.

- 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 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 demonstrate compliance which further supports the need for ISQM 1 to be a true risk based standard as described in 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 responses required under paragraph 24(a)(ii) in relation to firm culture where these responses may include informal staff meetings and in day-to-day actions and behaviours, the AUASB encourages the IAASB to provide examples of documentation.

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

The AUASB has not conducted a full 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 (refer response to question 1(a) above).

The AUASB makes the following high level comments:

- The introductory paragraphs greatly assist with understanding the risk assessment process and helpfully explain a number of important concepts in the standard. However, 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 through document".



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- 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 through document”.
- There are several application material paragraphs that are duplicative of 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 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 Code in a few paragraphs when practitioners need to comply with the full Code.

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

The AUASB is supportive of the 8 components of a Quality Management System and support the risk assessment process embedded within the standard, however the AUASB is not supportive of the standard in its current form with its level of granularity and prescriptiveness.

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 true risk-based approach. 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 is the “why” and “how”; would facilitate a true risk-based approach.

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

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 - performance of quality engagements. However, the AUASB considers 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.

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

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



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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 true 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 315 that is the requirements are the "what", the application material, appendices and guidance is the "why" and "how"; would facilitate a true 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 true risk based approach.

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 true 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 315 that is the requirements are the "what", the application material, appendices and guidance is the "why" and "how"; would facilitate a true risk-based approach without the need for such granularity.

(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 additional objectives required is unclear.

The AUASB understands that there could be certain circumstances that would require the firm to establish additional quality objectives beyond those required by the standard, but these circumstances may be limited, the requirements 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.

(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:





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- 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 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 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 true 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 seeks clarity on how the standard addresses circumstances where a firm did not identify risks to which there are required responses.

This level of granularity undermines a proper application of a true risk-based approach. Furthermore, the AUASB considers 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 true 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 315 that is the requirements are the “what”, the application material, appendices and guidance is the “why” and “how”; would facilitate a true 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 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. The AUASB notes that the proposals are less clear as to how



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the standard addresses circumstances where the firm did not identify risks to which there are required responses.

- (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?*

[AUASB input requested]

### **7. 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 true 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.

### **8. With respect to matters regarding relevant ethical requirements:**

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

[The AUASB understands that this is already common practice.]

- (b) *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.]]

### **9. 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 overly granular and onerous. The specific requirement 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 the 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 is considered in the application material.

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

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 will matter will resolve.

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

The AUASB does not support including '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 quality 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.





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### 12. In your view, will the proposals for monitoring and remediation improve the robustness of firms' monitoring and remediation? In particular:

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

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 not only 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 broadening 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 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 engagement of engagements (serving PIE versus 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 versus what would be considered to be a deficiency would be helpful. 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. 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.



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- 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?*

The AUASB supports the incorporation of a new requirement to investigate the root cause of identified deficiencies and considers the application material allows for sufficient flexibility.

- (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 may act as a motivational tool to employees and also supports the development of the culture required by the governance and leadership component of ISQM 1.

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

The AUASB supports the concepts to address networks perceived 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 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.

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.

### **14. Do you support the proposals addressing service providers?**

Without a definition of service provider, the AUASB is unable to comment further on this question. The AUASB recommends that service provider is defined within ISQM 1 and examples are provided as to not only who is a service provider, but also, who is not.

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

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 to legally enforce which further supports the need for ISQM 1 to be a true risk based standard as described in Question 1(a) above.