



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. 5.3.1
Meeting Date: 12 September 2018
Subject: ISQC 1 – Quality Management at the Firm Level
Date Prepared: 5 September 2018
Prepared by: Matthew Zappulla, AUASB Technical Director

Action Required

For Information Purposes Only

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

Agenda Item Objectives

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

Background to the revisions to ISQC 1

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

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

3. The key change proposed to ISQC 1 from the extant standard is to implement a risk-based approach to the management of quality at the firm level, as opposed to the current compliance based approach of the existing ISQC 1.
4. At the AUASB's March 2018 meeting the key points noted in relation to the status of ISQC 1 were:
 - (a) As with past deliberations on ISQC 1, the changes proposed by the IAASB Taskforce appeared reasonable and consistent with current practice and other ISA's.
 - (b) The main risk with the direction of the standard was the potential lack of scalability embedded in the standard, which will make application challenging for small or medium firms. Whilst the new emphasis added on the need to apply professional judgement was designed to support scalability and highlight the need for firms to consider their circumstances in designing a system of quality management that is appropriate to their circumstances, a streamlining in the complexity and breadth of requirements that apply to SMP firms would be more effective.
 - (c) Assuming the overall approach of the QCTF to the standard does not change, the consideration of specific guidance for SMP's supporting the implementation and application of this revised standard is critical.
5. At their meeting in March 2018 the IAASB discussed and supported the proposed exposure draft of ISQC 1 (Revised) including its structure and the objective, the length of the standard and the need for additional guidance. The IAASB encouraged the QCTF to analyse the application material, develop additional guidance addressing the spectrum of firms, and explore positioning guidance outside of the standard.
6. At their last meeting in June 2018 the IAASB discussed the timing of the approval of the proposed exposure draft of ISQC 1 (Revised), and given the extent of changes to this standard and the need to spend time deliberating some very important issues, agreed that the approval of the exposure draft should be deferred to December 2018. The Board also discussed the overall structure of the standard and emphasized the importance of governance and leadership and the need for this component to appear first in the standard. The Board provided various suggestions to improve the requirements addressing the firm's risk assessment process and briefly discussed the introduction of the standard, monitoring and remediation and the proposed new appendix explaining the components. The Board supported the direction of the new appendix and recommended that it further elaborate on the relationship of all components, including resources and acceptance and continuance. The Board also encouraged less focus on the inspection of completed engagements in monitoring and remediation.

Changes to the proposed standard since the March and June 2018 IAASB meetings

7. Changes to ISQC presented for deliberation at the September 2018 IAASB are substantial, with this being the first time the full standard has been present for IAASB deliberation since March. Over half of the standard (which is 55 pages long) has either been replaced or rewritten. Consequently the changes to the standard since the last meeting are not summarised here – it is of little relevance to describe the changes in detail when so much of the standard has been amended.
8. Whilst the changes the IAASB Quality Control Task Force has made the revised standard for this IAASB meeting are extensive in their breadth and number, they are not as prominent in substance. The core concerns we have had with ISQC 1 – described in Paragraph 12 of this paper below – still remain and are unlikely to be addressed in any meaningful way before the standard is released as an ED (currently planned for the December IAASB meeting).
9. On a positive note, the work the QCTF has done to make the wording of the standard clearer and easier to digest is evident. Whilst many of our structural and strategic concerns with the standard have not been and likely will not be addressed, there is little criticism of the actually wording and concepts used in the proposed standard presented for this IAASB meeting.
10. A full clean copy of the proposed ISQC 1 has been included for AUASB review in the September 2018 Board Papers.

Key matters for consideration by the AUASB

11. Overall the outreach and feedback received by the QCTF since the March 2018 IAASB meeting has not been overly supportive of the previous version of the proposed standard – hence the need for substantial changes.
12. Despite the substantial changes made since the last full review of ISQC 1 in March 2018 our main concerns with the current proposed standard remain the same:
 - (a) Its overall complexity and lack of scalability – in particular that the standard is not sufficiently flexible to address the needs of Smaller and Medium Auditing and Assurance practices (SMPs).
 - (b) The very prescriptive approach to each component of the System of Quality Management (SOQM), whereas in practice Firms deal with the different elements of these components in a more unified fashion. NB: This issue has been acknowledged in the revised text of this version of ISQC 1, but little actual amendments to the standard have been made to address this point.
 - (c) The objectives embedded in each component of the SOQM are still very compliance based, in opposition to the QCTF’s intended approach for Firms to apply professional judgement to the quality objectives, risks and associated responses for each component.
13. Whilst the QCTF have certainly gone to great effort to address the feedback they have received through their outreach activities, the AUASB Technical Group’s conclusion is that they have not made significant changes to the structure and complexity of the standard which is likely to satisfy many of the concerns raised by stakeholders.
14. Despite these concerns, the AUASB Technical Group’s comments in relation to the specific changes the QCTF have made to the proposed standard which have been presented to the IAASB at their September 2018 meeting are:
 - (a) The revised wording used throughout the standard is good – so much so that it’s hard to criticise the wording used in individual paragraphs and suggest constructive changes. Nonetheless when considered as a whole the proposed ISQC 1 appears overly wordy and due to its broader scope and objectives has little tangible improvement from the extant version (which it could be argued didn’t have much wrong with it in the first place!).
 - (b) The Leadership and Governance (Paras 21 - 28) and Information and Communication requirements (Paras 44 & 45) are very granular. These elements of the system of quality management in the requirements read more like application guidance and are very prescriptive. The same could be said of the section on Monitoring and Remediation – it is very detailed, although we are less concerned with this as this what regulators will want and (unlike the other sections) it should not differ too much across different Firms. The Network requirements in 60 to 65 are very detailed and possibly could be considered application material as well.
 - (c) The proposed standard appears to contain far too much guidance in its application material. It seems as though the QCTF is trying to cater for every question that may arise or situation within the application guidance. The standard could be almost half the length if a more streamlined approach to the nature and extent of guidance provided was taken. We would encourage the IAASB to consider whether a lot of this could be moved to a ‘best practice’ type guide as opposed to being in the standard itself.
 - (d) The IT elements in the draft standard in A85 onwards and A117 are a concern. This has never really been a focus of existing ISQC1. We believe the standard should be clearer so these relate just to Audit and Assurance and related services to avoid any risk other service lines at large firm are not captured in the scope of the standard.

- (e) A162 refers to obtaining legal advice when a Firm doesn't comply with a requirement in the standard but is unclear when this may apply.

Next steps

15. The IAASB timetable calls for a December approval of the exposure draft for the ISQC 1 standard. It remains uncertain whether this can be achieved, as the changes made to this version presented at September are so extensive and arguably have only gone part of the way to addressing much of the feedback received through the QCTF's outreach activities.
16. AUASB members' feedback on the standard at the September 2018 AUASB meeting will be summarised and provided to our Australasian IAASB members.

Action Required

No.	Action Item	Responsibility
1.	Feedback in respect of the current version of ISQC 1 presented for IAASB review at their September 2018 meeting.	AUASB

Material Presented

Agenda Item 5.3.1	AUASB Board Meeting Summary Paper
Agenda Item 5.3.2	IAASB Board Paper - Agenda Item 2-A (Clean version of draft proposed ISQC 1 (Revised))
<p>NB: The full suite of papers from the September 2018 IAASB meeting in relation to this project have not been included in the AUASB board papers as all matters the AUASB need to consider (including extracts from the IAASB's papers, where relevant) are included in this Board Meeting Summary Paper. However, should AUASB members wish to review the IAASB papers associated with this project they are available at https://www.iaasb.org/meetings/new-york-usa-20.</p>	