



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **4.4**
Meeting Date: 11 September 2019
Subject: ISQM 1
Date Prepared: 30 August 2019

Action Required

For Information Purposes Only

A. Background

- 1 The IAASB issued ED-ISQM 1 in February 2019, with a comment period ending 1 July 2019.
- 2 The AUASB did extensive outreach on this Exposure Draft and submitted a response to the IAASB.
- 3 The ISQM 1 Taskforce has commenced their review of comments received for the September 2019 IAASB meeting.

B. What the Audit Technical Group (ATG) is seeking from the AUASB at the September 2019 AUASB meeting

- 4 The purpose of this Agenda Item is to update the AUASB as to the feedback received from respondents to the IAASB ED; and to update the AUASB as to the taskforces proposed way forward and revised timelines.
- 5 In section D.1 – D.4 the ATG has highlighted the respondents’ key concerns and the taskforces current thinking. The ATG have highlighted (in a box) the questions that the IAASB will consider at the forthcoming September 2019 IAASB meeting. In line with the AUASB international influencing strategy, AUASB members are encouraged to comment on any of these questions to inform the AUASB Chair of their views. The AUASB is specifically directed to the questions under paragraphs 14(c), 17(b) and 22.

C. Summary IAASB issues paper – feedback on ED-ISQM 1:

- 6 99 letters received, supportive of the concepts of a Quality Management System, but extensive concerns with the current drafting particularly in relation to scalability.
 - 7 The ISQM 1 taskforce at the September 2019 IAASB will cover the questions on exposure that address the fundamental issue of scalability (including the standard structure and risk
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assessment process). The remainder of the questions on exposure will be dealt with at later IAASB meetings.

- 8 The general issues raised by respondents in relation to the issues of scalability (including the standard structure and risk assessment process) were consistent with that of the AUASB and centred around:
- (a) Hybrid of risk-based and prescription. Perceived prescriptiveness of the standard and concern around a checklist mentality;
 - (b) Length, granularity and complexity of the standard;
 - (c) Lack of clarity around the risk assessment process (RAP) particularly with reference to establishing additional quality objectives beyond the standard and the identification and assessment of quality risks. Additionally, respondents were concerned about the level of granularity particularly around the extent of quality objectives and responses; while a lack of requirements in relation to quality risks;
 - (d) Concern around the extent of documentation required, with concern around documenting ‘if not why not’;
 - (e) Implementation concerns around time and resources as well as general time to entrench mindset changes and cultural changes across a firm;
 - (f) Application of the standard to non-audit/assurance services; and
 - (g) Concern that considering a) to f) above, this may lead to a decline in audit quality, with respondents seeking the IAASB to undertake a cost/benefit analysis.
- 9 The IAASB issues paper recognises the point specifically raised by the AUASB in relation to standards being legislative instruments, accordingly the prescriptiveness of the requirements exacerbates the challenges in demonstrating compliance with the standard.
- 10 The task force acknowledged the challenge around the need for more examples and guidance but that this could be taken to mean a general clarity of the requirements.
- 11 The IAASB will need to balance general respondents’ comments with comments received from the Monitoring Group members which in many instances held a view that the standard is not prescriptive enough (significant judgement allowed) which makes it difficult to enforce against.

D. The way forward:

- 12 The IAASB has indicated that the timing for approval of these QM standards has been pushed out to June 2020.
- 13 To address the central theme of scalability, (as highlighted in paragraph 7 and 8 above) the IAASB taskforce at the September 2019 IAASB is considering the following areas:
- (a) Components and structure to facilitate easier navigation
 - (b) Quality objectives and required specificity
 - (c) How to simplify the RAP

- (d) Whether ISQM 1 should apply to ALL engagements performed under IAASB standards.

D.1 *Components and Structure*

14 Respondents specific comments on exposure and task forces suggestions:

- (a) RAP and monitoring/remediation are processes (how something is managed) not components (what needs to be managed). Task forces considerations:
 - (i) Standard to clarify that these components are process in nature and introduce a requirement in each of these components that requires the firm to establish a process, so that it's clear these components are processes. E.g.: *The firm shall establish a risk assessment process that enables the firm to establish quality objectives, identify and asses quality risks to the achievement to the achievement of the quality objectives and design and implement responses to address quality risks.*
- (b) Moving RAP first – impacts on all components
 - (i) Move the RAP to the front of all the components – eases confusion about how the RAP relates to all components and may result in a reduction of introductory material
 - (ii) However – some elements from governance and leadership (assigning responsibilities for the system of quality management) will be moved upfront in the standard under the heading of system of quality management.
- (c) RAP shouldn't apply to monitoring and remediation
 - (i) Agreement by taskforce. Monitoring and Remediation requirements are more prescriptive than other components, as such requirement to establish quality objectives and responses is unlikely to provide much benefit. Refer paragraph 11(a)(ii) above, a requirement to establish a M&R process will be introduced to the standard instead of setting out required quality objectives. E.g.: *The firm shall establish a monitoring and remediation process that enables the evaluation of design, implementation and operation of the components of the system of quality management to determine whether the quality objectives have been met.*

Q1: Does the AUASB agree that the RAP should not apply to monitoring and remediation?

D.2 *Quality Objectives*

15 Respondents specific comments on exposure:

- (a) Required responses creates a perception that it is not risk-based;
- (b) Lack of quality risks;
- (c) Disproportionate required responses – suggests varying levels of importance;

- (d) Monitoring Group supports more prescriptive requirements to support inspections while other respondents would like to see reduced prescriptiveness
- 16 Task force recognises that that to address scalability concerns the approach to quality objectives and responses in individual components needs to be reconsidered as such task force is proposing:
- (a) Revise quality objectives to be a higher level
 - (b) Introduce risk considerations – combination of details from quality objectives and repurposing some responses. Taskforce considered:
 - (i) Instead of listing risks – provide conditions/events that could indicate risk
 - (ii) Not phrasing risks in the negative – so that the risks are not seen to be prescriptive
 - (c) Reducing responses – repurpose to risks, removing duplication, removing as otherwise appropriate.

D.3 Risk Assessment Process

- 17 Respondents specific comments on exposure and task force suggestions:
- (a) Too prescriptive/and two step (separate identification of risk and assessment of risk) process seen to be too complicated and somewhat duplicative.
 - (i) Task force aims to simplify the requirements into a one step process of identification and assessment to provide a basis for design and implementation of responses.
 - (b) Threshold at which quality risks is identified is too low (monitoring group do not hold this position).
 - (i) By introducing quality risks in each component – this will drive consistency in risk identification so a reduced need for a quality risk threshold.
 - (ii) Reconsideration of whether likelihood should continue to refer to reasonable possibility of occurrence – however the application material would no longer refer to more than remote.

Q2: Does the AUASB agree to keep the concept of reasonable possibility in the context of likelihood or is there another term?

- (c) Clarifying expectations when firms need to establish additional quality objectives and D&I beyond the requirements of the standard
 - (i) Task force will clarify that additional quality objectives is a consideration not a requirement – it is not expected to be common practice.
 - (ii) In relation to additional D&I – because the standard is expected to be redrafted with fewer responses, the requirements will clarify that in all cases D&I in addition to those listed in the standard will be required.

D.4 Scope of Firms and services

- 18 Respondents specifically commented that ISQM 1 is audit focused – is it appropriate to be applicable to related services engagements as a risk-based approach is not applicable to related services engagements.
- 19 Task force recognises that firm level quality management for related services engagement may be simpler because of the limited public interest of related services engagements and the nature of such engagements. Additionally, the task force acknowledges that there may be requirements not relevant or necessary for related services engagement for example independence.
- 20 Task force proposes having separate requirements for quality management of audit/assurance and that of related services engagements. Firms that perform audit/assurance and related services could then choose to apply full ISQM 1 to everything or ISQM 1 to audit/assurance and separate requirements for related services to the management of quality for related services.
- 21 Options taskforce is proposing, with taskforce preference being option a below:
- (a) New ISQM 3 – for quality management for related services engagement.
 - (b) Discreet requirements within ISQM 1
 - (c) Firm requirements directly into ISRS 4400/4410
- 22 The Taskforce recognises that option 18(a) above is a significant change in approach; and that a short survey to solicit stakeholder feedback supporting such an approach is appropriate.

Question 3:

- (a) Does the AUASB agree with the need to develop separate requirements for related services engagements?
- (b) If yes to (a) above, what is the preferred option as outlined in paragraph 21 above?
- (c) Does the AUASB agree with obtaining stakeholder feedback by way of a survey?