

Joint submission by Chartered Accountants Australia and New Zealand and The Association of Chartered Certified Accountants

1 July 2019

To: Mr Thomas R. Seidenstein
The Chairman
International Auditing and Assurance Standards Board
529 5th Avenue 6th Floor
New York 10017
United States of America

Submission via IAASB website

Submission on IAASB's Proposed International Standard on Quality Management 1 (ED-ISQM 1)

This submission is made jointly by Chartered Accountants Australia and New Zealand (CA ANZ) and the Association of Chartered Certified Accountants (ACCA) under our strategic alliance.

ACCA and CA ANZ created a strategic alliance in June 2016, forming one of the largest accounting alliances in the world. It represents 800,000 current and next generation accounting professionals across 180 countries and provides a full range of accounting qualifications to students and business. Together, ACCA and CA ANZ represent the voice of members and students, sharing a commitment to uphold the highest ethical, professional and technical standards. More information about ACCA and CA ANZ is contained in Appendix B.

We appreciate the opportunity to comment on the Exposure Draft ISQM 1 ("ED-ISQM 1"). Our responses to the specific matters for comment raised in ED-ISQM1 follow in Appendix A. Should you have any queries about the matters in this submission, or wish to discuss them in further detail, please contact Melanie Scott, Senior Policy Advocate at CA ANZ via email; melanie.scott@charteredaccountantsanz.com and Antonis Diolas, Manager Audit and Business Law at ACCA via email; antonis.diolas@accaglobal.com



Yours sincerely

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Appendix A

Overall Questions

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?

ACCA and CA ANZ support the quality management approach which can be described as a more "thinking" approach in comparison to ISQC1. We are also supportive of a risk assessment based approach, subject to specific concerns on aspects of the proposals. We also believe that separating ISQC 1 into two standards is sensible. Our detailed comments on ED-ISQM2 are available in our separate submission letter on that ED.

We note that in our discussions with stakeholders there was general concern that the proposed application date would not provide sufficient time for firms to make the necessary changes and encourage the board to provide a longer period before the standard becomes applicable.

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

Adopting a risk assessment approach in relation to quality management should produce benefits but to what extent in firms that already apply the extant standards well is unknown. Achieving change in audit quality is dependent on cultural change. The impact of this is hard to assess. There is a concern that there will be a high implementation and maintenance cost without delivering a significant improvement in quality. There needs to be a more explicit evaluation and articulation of the benefits of the proposed approach over the extant standard and a comparison to the likely costs of implementation. Audit firms have finite resources. The time and resources which are directed to the implementation and maintenance of a quality management system equals a reduction of time and resources dedicated to other measures that also impact audit quality, so there must be a clear benefit from the new approach to justify this.

SMPs will need implementation guidance and examples for the benefits to outweigh the costs.

(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 principles appear to be scalable. However, we have concerns that the documentation and implementation will be resource intensive for all firms and particular SMPs. As a result the costs, in terms of time and resources, may outweigh any achieved benefits. The length of the standard and application material is daunting for an SMP to read and absorb. The standard should consist of clearly understandable requirements, supplemented by application material that is not repetitive

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and that assists with application. The ED is too long and repetitive as drafted which is a barrier to successful implementation. There will be a need for guidance on documentation for SMPs, particularly around the risk assessment process, with clear examples to reduce the time and resources required for these entities to implement any changes.

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?

We have concerns over the documentation of the risk assessment and how this will be undertaken in practice when some objectives will have one risk and some risks will match to multiple objectives, and the same with the responses. The assessment process is not a linear construction and therefore will be complicated to map and document. SMPs will need additional supporting materials. There is some support for the idea of having guidance with examples of common risks (particularly for SMPs who may have quite similar risks) mapped to objectives and example responses. The documentation needs to be flexible to meet the needs of firms and networks of a wide range of sizes and level of complexity and examples of how this can be achieved will be needed. There also needs to be an explanation of what should a practitioner should do if a required response does not link to any of the risks.

We believe that the work effort required to implement the standard is significant and with such granular objectives etc., may drive firms to backfill risks or take other steps to manage the practicality of meeting the requirements. If the process is too resource intensive and time consuming, this may adversely impact audit quality rather than improving it. These concerns are likely to be more significant in the case of SMPs. The standards need to focus on principles and not be overly prescriptive.

Our stakeholders who are members of global firms and networks expressed concerns with the need to challenge the global firm's/networks methodology/quality etc. This is considered high effort for limited benefit.

Similarly, there needs to be clarity around service providers – what is captured by the term 'service provider' and what isn't. For example if large commonly used commercial applications and software aren't captured (for example software such as Microsoft Office and commercially available audit methodology packages that aren't tailored to the purchaser) this needs to be stated clearly.

Further clarity is also needed around the difference between a finding and a deficiency.

There is a general concern with the standard being written in such a way which could result in a firm complying with all the requirements yet not delivering a quality audit. We are not supportive of the "need to consider if there are additional objectives" as currently worded as there is a risk that regulators will expect all firms to have additional objectives. The concept of this consideration is useful; however, the drafting should be explicit in that there may not be any additional objectives identified for some firms and provide guidance on how firms would document this.

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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?

There are areas of repetition in the application guidance. The application guidance needs to focus on how to apply the requirements, and should not repeat or explain the requirements. The requirements should be written to be clear and understandable.

As we have stated in previous submissions, we believe that the preferred approach to drafting the ISAs should be to draft the standard for SMPs and then add additional requirements that are needed to deal with the issues faced by more complex firms and networks. This would enable SMPs to easily understand what is required rather than trying to understand what requirements and guidance are not applicable. Currently standards are being drafted for global firms dealing with complex entities which increases the work burden on SMPs considerably and requires the production of additional guidance to assist the SMPs in interpreting and implementing the standards. The IAASB has recognised that this is an issue with the release of the discussion paper on Less Complex Entities and, if we wish to continue to have global auditing standards with a high adoption rate, there needs to be a change to the drafting philosophy of ISAs.

Specific Questions

4) Do you support the eight components and the structure of ED-ISQM 1?

We broadly support the eight components and the way those are presented in ED-ISQM1. However, although we are supportive of the content, we are less supportive of the introductory paragraphs. We also emphasise that having the need for an explanatory introduction signals that there is complexity in the drafting of the standard.

In light of the minimal guidance provided, we are of the opinion that practitioners will find it difficult to apply the new approach to the eight components of ED-ISQM 1. In particular, the identification of quality risks could be challenging. As the risks for SMPs and sole practitioners are likely to be similar across firms, it would be beneficial, and reduce the implementation cost, if more guidance and/or illustrative examples in this area are included in ED-ISQM1.

Furthermore, one of the eight components in ED-ISQM1 is the Firm's Risk Assessment Process which requires firms to establish certain quality objectives for each of the seven components. However, as per para 26 of the ED-ISQM1 firms are required to consider additional quality objectives beyond those stipulated by the standard, when those objectives are necessary to achieve the objective of the standard. Although we recognise that IAASB's intention here is probably to be flexible and assist practitioners satisfying the objective of ED-ISQM1, deciding which additional quality objectives to include will be an area of increased subjectivity, and our stakeholders expressed concerns that a firm's judgement could be expected to be challenged by regulators. We would therefore expect to see more guidance on what is expected in regards to the additional quality objectives but also what practitioners should document when no additional quality objectives are legitimately identified.

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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?

We broadly support the objective of the standard.

In regards to the public interest, we do not support the introduction the term "significant public interest" as it is inconsistent with the IESBA's Code of Ethics for Professional Accountants (including International Independence Standards) and introduces unnecessary complexity and judgement into the determination of entities that should be subject to an engagement quality review. This will lead to divergence in practice. The IAASB should adopt the IESBA's terminology in relation to public interest entities. Furthermore, ED-ISQM1 considers that in determining if an entity is of significant public interest practitioners have to take into account whether there are a "large number and wide range" of stakeholders (see para A23 and A102) without providing any guidance or benchmark. Practitioners may therefore find it difficult to determine (with sector consistency) the engagements which should be subject to an Engagement Quality Review if no further guidance is given in determining which entities are of public interest for the purposes of ED-ISQM1. We also note that in some jurisdictions there may be regulation which requires an EQR where ISQM 1 does not, and this should be reflected in the standard.

ED-ISQM1 does not provide any information in respect of what constitutes 'related services'. We therefore would consider it beneficial for greater clarity on this.

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?

We believe that the work effort required to implement the standard is significant and with such granular objectives etc., may drive firms to backfill risks or to take other steps to manage the practicality of meeting the requirements. If the process is too resource intensive and time consuming, this may adversely impact audit quality rather than improving it. These concerns are likely to be more significant for SMPs.

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?

We support that the firm's risk assessment process should be applied to the other components of the system of quality management with the exception of the monitoring and remediation component which we do not support.

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

i. Are the required quality objectives appropriate?

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We find that the quality objectives stated in ED-ISQM1 are not appropriate as they seem more like responses to risks rather than quality objectives. For example para 23 (f) refers to the firm fulfilling its responsibilities in accordance with law, regulation and professional standards that relate to the governance and leadership of the firm. This objective seems more like a response to the risk of not being in compliance with the law, regulation etc. The objectives are overly granular. The need to consider so many objectives (and to consider the need for further objectives) will require significant time and resource to be invested in performing and documenting the assessment (and ongoing effort to maintain and manage the QM approach). If the process is too resource intensive and time consuming, this may adversely impact audit quality rather than improving it.

ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?

Paragraph 26 of the ED-ISQM1 requires firms to consider additional quality objectives beyond those required by the standard, when those objectives are necessary to achieve the objective of the standard. However, we don't find it clear in which circumstances this might be necessary. This needs to be stated unambiguously.

Deciding which additional quality objectives to include will be an area of increased subjectivity and the assessment may be challenged when viewed retrospectively (hindsight bias) and be subject to unwarranted criticism by regulators. In the absence of clear drafting which emphasises that the approach is flexible and must be tailored to the individual firm, regulators may need to develop their own "lists" of objectives/risks/response they expect to see.

We would therefore expect to see more guidance on what is expected in regards to the additional quality objectives but also what the practitioner should do when no additional quality objectives are identified.

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

We support the process. However, it causes confusion as to why certain key risks aren't identified when objectives and responses are. We believe that this increases the work effort and raises concerns regarding consistent application. This additional burden will significantly impact SMPs if each firm has to start from first principles in identifying risks. Further guidance is needed in this area.

Exercise of professional judgements in determining the significant of the effect of a quality risk, Paragraph A56 of ISQM 1 states that "The significance of the effect of a quality risk on the achievement of a quality objective(s) is judged in the context of the underlying conditions and events that gave rise to the quality risk, as well as the nature and circumstances of the firm and its engagements..." It could be difficult to apply the threshold as provided in the proposed standards. ED-ISQM1 only states that there is a reasonable possibility of a quality risk occurring when the likelihood of its occurrence is more than remote. We are concerned that this is too low a bar and will lead to too many risks being identified. Firms need to focus on those risks that actually impact their quality. The work effort will be too onerous if there are too many risks and will not achieve the outcome of increasing audit quality.

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In addition, to assessing what constitutes “significant effect” firms are also required to exercise professional judgement. There is minimal guidance provided on the determination of “significant of the effect of a quality risk”. In the “Draft Examples: How the Nature and Circumstances of the Firm and the Engagement It Performs Affect the implementation of Proposed ISQM 1”, the examples provided are mainly on ethical requirements. More guidance is therefore needed with a wider range of examples.

(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?

Our answer relates to our response to c) above. It is unclear, and confusing for practitioners, as to why certain key risks aren't identified in the standard when objectives and responses are. This may result in firms trying to come up with risks that tie in with those objectives and responses rather than assessing their actual quality risks. Supplying a list of required responses may lead to a bottom up approach. We recommend that some key risks are identified in the standard, or in the application material with an additional requirement that the firm is required to assess whether there are additional risks applicable to their individual circumstances. This will reduce the implementation burden for SMPs who are likely to have a degree of commonality in key risks.

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?

Yes, but more guidance is needed on how to document such a flexible and interrelated matrix of objectives/risks/responses where risks may map to one or multiple objectives and responses may map to one or multiple risks. Additionally, there needs to be clarity about what a firm is expected to do in situations where it completes its risk assessment procedure but legitimately does not identify any additional responses.

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

We found that the revisions to the standard appropriately address leadership and governance; however, the requirements need to be principles-based and not become prescriptive on how firms manage their businesses. There is the risk that overly prescriptive requirements may inadvertently drive incorrect behaviours and therefore it should be for the firms to determine how to implement the principles in their particular circumstances and culture.

There are challenges around the assignment of individuals for ultimate responsibility and the subsequent evaluation of those individuals, particularly in the case of SMPs.

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?

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We agree in principle yes, but this may present challenges in practice. To improve audit quality you need everyone in the firm to take responsibility and embrace quality management. The standards must have principles that firms can apply to best enhance and develop a culture of quality management.

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

We believe that there are challenges around this. In reality firms already have procedures in place to manage independence so it is arguable whether this is likely to produce a benefit that would exceed the work effort required.

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

We support the acknowledgement of use of technology in ED- ISQM1, however, we believe it could go even further to not just acknowledging the use of technology but also establishing principles on how firms should evaluate and adopt new technologies in the audit process.

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?

We believe the need for transparency reports should be driven by local jurisdiction requirements. For example, transparency reporting is required for some firms in Australia and not required in New Zealand. The Australian experience has been that the transparency reports are not widely utilized by stakeholders other than the regulator, and therefore question whether the benefits outweigh costs.

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?

Yes. However, as we note our response to question 5 we have concerns about the use of the term "significant public interest entity". Introducing a new term in relation to degrees of public interest is confusing and unnecessary. Terminology should be aligned with the IESBA code which uses "public interest entity".

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?

We have concerns that the proposals will be difficult to implement by SMPs and particular sole practitioners.

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(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?

We agree in principle, however, as per para 45 (b) in determining the nature, timing and extent of the inspection of engagements a firm shall include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm could be unnecessary for some firms particularly SMPs. This is because in the case of completed engagements the remedial action comes only after they are completed.

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

No, we received feedback is that this is unclear and confusing. The requirements as drafted lack clarity around the difference between a finding and a deficiency that requires a response.

(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?

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

Yes, we support this. Many firms have already introduced root cause analysis (RCA). The standard needs to allow for flexibility of approach to RCA and include guidance for SMPs and sole practitioners on how they perform and document RCA.

(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?

Yes, however, challenging in practice, particularly in the case of SMPs and sole practitioners. For example, firms with limited number of partners may struggle to decide who the individual with the assigned ultimate responsibility and accountability for the system of quality management would be.

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?

It is reasonable for firms to be required to understand the network and how this impacts them. However the requirements may be difficult and challenging to implement. Further clarity and guidance on what firms are expected to do and document is required.

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14) Do you support the proposals addressing service providers?

Yes, but more clarity is needed about who constitutes a service provider. For example, if small firms are using widely available commercial off the shelf solutions for audit methodology does the provider fall within the definition of service provider? A broad definition will increase costs without positively impacting audit quality.

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?

One significant consequence is that in certain jurisdictions changes in national legislation will be required to implement this. This may lead to consequential delays in adoption.

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Appendix B

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 121,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its 219,000 members and over 527,000 students in 179 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of 110 offices and centres and 7,571 Approved Employers worldwide, who provide high standards of employee learning and development.

Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

ACCA has introduced major innovations to its flagship qualification to ensure its members and future members continue to be the most valued, up to date and sought-after accountancy professionals globally.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; audit; pensions; education; corporate governance and corporate social responsibility.



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