

1 July 2019

Mr. Thomas Seidenstein
Chairman
International Auditing and Assurance Standards Board (IAASB)
International Federation of Accountants (IFAC)
529 5th Avenue
New York, New York 10017 USA

Dear Mr. Seidenstein,

Proposed International Standards on Quality Management 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1) and Quality Management 2 *Engagement Quality Reviews* (ED-ISQM 2)

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on the IAASB's ED-ISQM 1 and ED-ISQM 2.

APESB commends the IAASB on its consideration of the various factors that may impact quality management at both the firm level and engagement level. We favourably note that the IAASB has made significant progress in respect of this project over the last few years.

Background

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, high-quality professional and ethical pronouncements. These pronouncements apply to the membership of the three major Australian professional accounting bodies (CPA Australia, Chartered Accountants Australia and New Zealand (CA ANZ) and the Institute of Public Accountants) who are all full members of the International Federation of Accountants (IFAC).

The Australian accounting profession introduced a firm-wide quality control standard applicable to all services in 1983 (APS 5). Subsequently, in 2004, the IAASB issued the International Standard on Quality Control 1 (ISQC 1). The Australian accounting profession then revised the existing firm-wide quality control standard APS 5 to be aligned with ISQC 1. The rationale for this approach was that it was desirable to have one system of quality control at the firm level and that it applied to both assurance and non-assurance services.

After the creation of the APESB in 2006, the Board issued the previous APS 5 as [APES 320 Quality Control for Firms](#) (APES 320). The requirements of APES 320 remain consistent with ISQC 1. As such, ED-ISQM 1 and ED-ISQM 2 are highly relevant to APESB's mandate to issue a firm-wide quality control standard for Australian accounting firms, which has effectively operated in Australia for over 35 years.

APESB also issues APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) and other professional & ethical standards, including [APES 325 Risk Management for Firms](#) (APES 325).

In Australia, standards and guidance relating to auditing and assurance are the responsibility of the Auditing and Assurance Standards Board (AUASB). As the proposed International Standard on Auditing 220 (Revised) *Quality Management for an Audit of Financial Statements* is within the AUASB's mandate, it is not addressed in this submission.

APESB's stakeholder engagement process in respect of ED-ISQM 1 and ED-ISQM 2

APESB's submission has taken into consideration Australian stakeholders' feedback collected from the following engagement activities:

1. Focus group meeting with CPA Australia Public Practice Advisory Committee on 20th May 2019;
2. Webinar hosted by CA ANZ on 29th May 2019, including stakeholder feedback via poll questions;
3. Webinar hosted by APESB on 31st May 2019 available to all members of Australian professional accounting bodies, including stakeholder feedback via poll questions; and
4. Workshop with CPA Australia quality control reviewers on 6th June 2019.

Stakeholders who attended our webinars were primarily (59%) sole practitioners or from 2-5 partner firms who are Small and Medium Practitioners (SMPs). The revenue range for these firms is from AUD 300,000 to approximately AUD 2 million per annum. These stakeholders consider there to be significant challenges in implementing ED-ISQM 1 in practice, in particular the risk assessment process (95%) and the monitoring, remediation and evaluation process (89%). We also note that the majority of the stakeholders (54%) were of the view that the current proposals are not scalable.

We favourably note there was broad support for a risk-based approach for the system of quality management (82%) and the proposed enhanced monitoring, remediation and evaluation process (87%).¹

Key observations

Based on the stakeholder engagement process undertaken, we have significant concerns about the current form of the proposed standards which we would like to bring to the IAASB's attention for due consideration.

APESB believes that the stakeholder concerns raised with the APESB stem from the fact that the proposals have been written from the perspective of a large multi-disciplinary firm with a focus on large complex Public Interest Entity (PIE) audits.

We strongly believe there needs to be a fundamental shift and a renewed focus for these proposed standards towards sole practitioners and SMPs to obtain their buy-in, as they represent the vast majority of firms globally.

¹ Appendix 1 includes a summary of stakeholder responses to poll questions asked during webinars.

We note in the current environment that sole practitioners and SMPs are time poor and these proposals will add to the regulatory burden which may result in some practitioners being unable to cope with the requirements in the proposed standards. Further, the proposals tend to focus internally on the firm and may not necessarily add value to the actual services being provided to the client, thus making the recovery of the additional costs from the client difficult in the SMP environment.

APESB is of the view that the ISQM proposals in their current form are not commercially viable for sole practitioners and SMPs and will likely result in assurance and related services being redirected to larger firms with extensive resources.

Our key concerns in respect of ED ISQM 1 and ED ISQM 2 are:

- (i) Scalability of the proposals and the use of professional judgement;
- (ii) Evidence of nexus between identified deficiencies and the proposals;
- (iii) Cost-benefit analysis from the practitioner's perspective;
- (iv) The ability to use elements of the existing quality framework;
- (v) Excessive volume of application material;
- (vi) Subjectivity and the regulator's or monitoring body's perspective; and
- (vii) Consistency with the requirements and terminology of the IESBA's *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the IESBA Code).

(i) Scalability of the proposals and the use of professional judgement

The IAASB's focus in developing ED-ISQM 1 was for a “*new approach to managing quality that is scalable to deal with differences in the size and nature of firms or the services they provide*”.² ED-ISQM 1 seeks to achieve scalability through a tailored approach with firms only needing to comply with requirements that are relevant to the firm's nature and circumstances or its engagements.³ It moves from the current system of quality control (ISQC 1) to a system of quality management (SQM). It is a “*transition from policies and procedures that address standalone elements [ISQC 1] to an integrated approach that reflects upon the system as a whole*”.⁴

APESB considers this to be a major shift from extant ISQC 1 requirements which will create a compliance burden (most notably for sole practitioners and SMPs) in implementing the risk assessment process and ongoing monitoring, remediation and evaluation requirements. As noted above, we question the commercial viability of these proposals in the SMP environment.

Implementation of the Risk Assessment Process

The proposed risk assessment process in ED-ISQM 1 aims to enable firms to design and implement a tailored SQM, scalable to the firm's circumstances and engagements. However, the standard is overly prescriptive, and APESB is concerned about the potential cascading effect of its requirements as follows:

² Explanatory Memorandum to ED-ISQM 1, page 28, paragraph 85.

³ Paragraph 21 of ED-ISQM 1.

⁴ Explanatory Memorandum to ED-ISQM 1, page 6, paragraph 8.

- Firms must establish quality objectives for 7 of the 8 components in the standard (excluding the risk assessment process). There are 33 quality objectives stipulated and possibly others if required to achieve the overall objective of the standard.⁵ However, we note there could be fewer quality objectives if the firm determines they are not relevant.⁶ APESB estimates there could be 4 quality objectives on average per component;
- Firms must identify and assess their quality risks⁷ (none are prescribed), and APESB estimates there could be 3 quality risks to each quality objective; and
- Responses to address assessed quality risks are required to be designed and implemented beyond the 32 responses stipulated in the standard, as prescribed responses are identified as insufficient, and additional responses will be required.⁸ APESB estimates there could be 3 responses on average to each quality risk.

The following table highlights the potential cascading effect of these ISQM proposals:

ED-ISQM 1 Framework	Number
Components	7 x
Average Quality Objectives (33 required)	4 x
Estimated Quality Risks per Quality Objective	3 x
Average Responses (32 required)	3 x
Total Responses?	252
Assume 50% Relevant Responses?	126

The IAASB notes “*it would not be possible to comprehensively address all of the responses needed by firms in the standard, given the varying nature and circumstances of firms and the engagements they perform*”.⁹ Accordingly, it is unclear how many responses will be required by any particular firm, however, the number of responses could be significant and vary considerably between firms and based on IAASB’s view, each firm will have unique risks which will accordingly result in a unique ISQM framework for each firm

Even assuming certain quality objectives may be irrelevant, and responses may address two or more assessed quality risks, the cascading impact could be substantial. The IAASB’s example for a small firm relates to 1 quality objective, providing potential quality risks and responses, which results in 3 pages of documentation.¹⁰ Extrapolating this to the 33 required objectives could result in 100 or more pages of tailored documentation for a small firm, which would be time-consuming and an extensive exercise. During our webinars, 76% of stakeholders estimated that it would take them 5 days or more to implement the risk assessment process.

In Australia, we conservatively estimate that there are over 10,000 accounting firms that are either sole practitioners or are 2-5 partner firms (SMP firms). Based on the stakeholder feedback, assuming it takes a senior person with a charge out rate of AUD 200 per hour approximately one week to develop a new ISQM Framework specific to the firm, this would result in a cost of AUD 8,000 per firm. When this cost is extrapolated across 10,000 sole practitioners and SMP firms in Australia (as each firm needs to develop a unique SQM), it will result in a cost of AUD 80 million.

⁵ Paragraph 26 of ED-ISQM 1.

⁶ Paragraph 21 of ED-ISQM 1.

⁷ Paragraphs 28 & 29 of ED-ISQM 1.

⁸ Paragraph 10(c) of ED-ISQM 1.

⁹ Explanatory Memorandum to ED-ISQM 1, page 15, paragraph 39.

¹⁰ The IAASB document *Draft Examples: How the nature and circumstances of the firm and the engagements it performs affect the implementation of proposed ISQM 1*, Scenario 2 pages 3 to 5.

Given the quantum of the potential investment across the profession, and as noted in issue (iii) below, we believe that a comprehensive cost-benefit analysis of these ISQM proposals should be performed by IAASB to justify the investment of time and associated costs to develop new SQMs.

Although the proposals seek to promote professional judgement and scalability, we believe they are highly prescriptive. For example, if the practitioner can exercise their professional judgement to determine the quality objectives, quality risks, and the required responses, then it is contradictory to state that they are required to have 33 quality objectives and 32 mandatory responses in their SQM as a minimum. Also, it is unclear how the IAASB determined mandatory responses without the quality risks that the responses relate to in the SQM.

APESB is also of the view that the application material which notes that the reasonable possibility of quality risks occurring is more than remote¹¹, may be too low of a threshold and will unnecessarily increase the number of risks which then need to be applied against the second identification threshold.¹²

Further, firms may need to evaluate all potential quality objectives, quality risks, and responses to determine if any requirements are not applicable. This will also add to the compliance burden, particularly for sole practitioners and SMPs, in understanding all requirements, establishing an SQM and documenting why certain requirements were not relevant to justify to a regulator, professional body or another monitoring body.

Potential Ongoing Impacts

The proposals in ED-ISQM 1 for ongoing monitoring, remediation and evaluation intend to improve the SQM's robustness by including additional or enhanced requirements to those in extant ISQC 1.¹³ It is designed to be a “*continual and iterative process and is responsive to changes*”,¹⁴ however, APESB is concerned this may lead to continuous re-evaluations as circumstances or risks change, for example where a firm undertakes different engagement types or engagements in new industries. This is in addition to annually evaluating the effectiveness of the SQM and will add to the compliance burden placed on sole practitioners and SMPs.

Recommendation 1: The IAASB develops the SQM from the perspective of SMPs as presented in Option 1 below. Larger firms could then scale the SQM upwards to suit their firm's services given their access to technical resources.

We respectfully suggest to the IAASB, that from a risk-based perspective, there are more commonalities than differences in respect of sole practitioners and SMPs. [APES 325 Risk Management for Firms](#) (APES 325) provides an example of a true risk-based standard which provides leeway for the firms, professional bodies and members to exercise their professional judgement to develop a risk management framework that suits their practice. This standard-setting approach has enabled CPA Australia to develop a [Risk Management Framework Tool](#) to assist firms with their compliance with APES 325.

¹¹ Paragraph A55 of ED-ISQM 1.

¹² Paragraph 28(b) of ED-ISQM 1, if the risk were to occur it would have a significant effect on the achievement of quality objective(s).

¹³ Explanatory Memorandum to ED-ISQM 1, page 21, paragraph 63.

¹⁴ Paragraph 8 of ED-ISQM 1.

Option 1 – Scaled back SQM

Reduce the requirements of the SQM to a base level for sole practitioners and SMPs with mechanisms to require firms to bolster their system with increasing firm size and complexity. The overarching structure and principles of ED-ISQM 1 could be maintained, including the standard's objective, the risk assessment and monitoring, remediation and evaluation processes with the following simplifications:

- Reduce requirements to that of a sole practitioner or SMP, for example, including base level:
 - Quality objectives, which could be one or more overarching principle-based quality objective(s) per component which are directly relevant to the component and the overall objective of the standard;
 - Quality risks (identified in the standard) to the achievement of the required quality objectives;
 - Responses to address the identified quality risks (including policies and procedures from extant ISQC 1 wherever possible);
- Larger firms may need to assess the nature of their firm and engagements to determine whether additional quality objectives, quality risks, and responses are required to achieve the overall objective of the standard;
- Reduce application and other explanatory material to pure application material (i.e., which directly address requirements) on the reduced requirements detailed above (also refer suggestions below regarding reducing the volume of this material); and
- Provide guidance for firms of varying sizes and complexity, including the framework of what the overall SQM consists of and potential additional quality objectives and responses extracted from the current ED-ISQM 1 as relevant. For example, a:
 - Simplified SQM for sole practitioners;
 - Base level SQM for an SMP; and
 - More detailed and complex SQM for larger firms highlighting areas where additional quality objectives, quality risks, and responses may be required.

(ii) Evidence of nexus between identified deficiencies and the proposals

We understand some of the reasons for developing a new quality management framework stem from the identification of deficiencies in the existing quality control framework from various inspection reports and monitoring activities. However, upon reviewing some of these inspection reports, it appears that the reported deficiencies are related to failures by a firm to¹⁵:

- implement policies or procedures in accordance with existing standards;
- comply with their policies and procedures established by the existing quality control standards;
- comply with the requirements of a technical standard; or
- comply with the documentation requirements of standards.

¹⁵ IFIAR Survey of Inspection Findings 2018 and in particular Tables A-3 and A-4.

Further, the Explanatory Memorandum for ED ISQM 1 and 2 do not provide evidence of the nexus or causal link between the IAASB's quality concerns and deficiencies identified in extant ISQC 1 or how the proposed approach will address apparent deficiencies and/or quality concerns.

APESB annually receives updates from the three professional accounting bodies who monitor compliance and the key matters reported in respect of the quality control standard are:

- A system of quality control has not been documented;
- A system of quality control has been documented but is incomplete; and
- The documented system of quality control has not been fully implemented.

We favourably note that over the last decade, the reported non-compliance % of these metrics have declined, but it is still at a significant level. While in certain instances, it could be a lack of knowledge that may be a contributory factor to non-compliance with the existing standards; availability of sufficient time would also be a significant factor. One may respectfully argue that the additional work created by the ISQM proposals in its current form will have a detrimental impact on quality management, particularly in the SMP environment.

Recommendation 2: An alternative is set out in Option 2 below, which is to maintain extant ISQC 1 and enhance leadership and governance, resourcing and monitoring, remediation and evaluation policies and procedures. This would take global stakeholders on a journey rather than requiring a major change resulting in entirely new systems to be developed and where the benefits are uncertain.

Option 2 – Enhance Extant ISQC 1

This option would maintain extant ISQC 1 obligations with the introduction of additional requirements and enhancements from ED-ISQM 1 in respect of governance and leadership, resources, information and communication, and the monitoring, remediation and evaluation process.

This would lessen the compliance burden on firms as they would only need to introduce additional policies and procedures to their existing system of quality control. This approach would enable firms to gradually adapt to additional requirements rather than undertaking a major shift to an entirely new SQM under the current proposals where the expected benefits may not eventuate. The IAASB could monitor the implementation of these additional requirements to determine whether they address the IAASB's concerns in respect of quality.

(iii) Cost-benefit analysis from the practitioner's perspective

As the causal links between the IAASB's concerns about quality and actual deficiencies in extant ISQC 1 have not been established with quantitative or qualitative research evidence, it is unclear whether expected benefits from the proposals will be realised and outweigh the implementation costs for firms (particularly sole practitioners and SMPs).

Based on stakeholder consultations, we believe the proposed framework will be a significant burden (in time and costs) for sole practitioners and SMPs to implement as they do not have the dedicated technical resources of a large firm. As noted above, to develop unique ISQM frameworks for 10,000 SMP firms may cost AUD 80 million for which the benefits may not

eventuate. Stakeholders also noted it is unclear as to what the deficiencies are in extant ISQC 1 and how these proposals will improve quality.

Recommendation 3: We strongly encourage the IAASB to undertake a cost-benefit analysis, measuring expected improvements to quality compared to significant additional implementation costs of the proposed standards for sole practitioners and SMPs. The IAASB may even consider observing how it could be implemented on a test basis by SMPs.

(iv) *The ability to use elements of the existing quality framework*

APESB is of the view that a mapping of the extant ISQC 1 requirements to those of ED-ISQM 1 and 2 or documenting how existing systems of quality control could be adapted to the proposed SQM, would significantly assist firms in transitioning to the proposed standards. This would indicate which existing requirements and guidance in the extant standard can be incorporated into the new framework and highlight additional requirements or documentation to be developed.

Stakeholders have expressed a significant concern that without such mapping, firms may discard current systems or not understand the differences in requirements, potentially adding to implementation costs. The responses in the new framework require policies and procedures to address quality risks and extant ISQC 1 has relevant policies and procedures which have been in existence and implemented by firms of varying sizes for well over a decade.

It is neither effective nor efficient for accounting firms globally to undertake this mapping exercise individually when it could be undertaken by the IAASB and provided as a useful tool for global use. This would be in the public interest and would have a global application to firms who need to transition to the proposed SQM framework.

Recommendation 4: We strongly encourage the IAASB to map extant ISQC 1 requirements to those in ED-ISQM 1 and 2 or demonstrate how existing policies and procedures required under ISQC 1 could be adapted as quality objectives or responses in the proposed quality management framework.

(v) *Excessive volume of application material*

ED-ISQM 1 includes a significant amount of application and other explanatory material which has increased threefold from extant ISQC 1, consisting of 44 pages and 214 paragraphs (compared to approximately 70 application paragraphs in extant ISQC 1).

Some of the content repeats requirements, is often descriptive without providing information on how to apply the requirements it relates to and at times is more akin to guidance material or a basis for conclusions. For example, paragraph A21 repeats the requirements of paragraph 55 of ED-ISQM 1 and paragraphs A40 to A43 provide very descriptive ways for firms to undertake performance evaluations required by paragraph 24(b) of ED-ISQM 1, which could be extracted into guidance material. Stakeholders have expressed concern that this voluminous material will confuse and detract from the standard's requirements.

Recommendation 5: APESB strongly recommends the IAASB improve readability and scalability of the application and other explanatory material by removing duplication of requirements and extracting other explanatory material into a basis of conclusions or a guide to implementing the proposed standards, as appropriate. We recommend that drafting conventions

adopted during the IAASB's Clarity Project during 2009/10 be revisited and strictly followed to streamline these ISQM proposals.

(vi) *Subjectivity and the regulator's or monitoring body's perspective*

ED-ISQM 1 requires firms to exercise a significant amount of professional judgement.¹⁶ While this is intended to enable the SQM to be tailored to the firm and promote scalability, it could lead to subjectivity and disparity in the design, implementation and operation of SQMs. Different firms may make very different risk assessments, and even firms with the same nature, circumstances, and engagements will likely result in different SQMs.

Invariably, there will be a degree of subjectivity when a practitioner determines the quality objectives, quality risks and relevant responses. When the relevant practitioner's SQM is subject to review in the future, it is possible that the regulator, professional body, or another monitoring body may not share the same view, especially where firms determine requirements to be irrelevant.¹⁷ As such, firms will likely need to develop, not only their SQM but, document reasons why requirements have not been implemented, adding to the compliance burden.

Currently, as there is an agreed quality control framework (extant ISQC 1), there is less likelihood of a dispute if an element does not exist or there is observed non-compliance with the framework. With a variable quality management framework, the monitoring process will become very challenging and time-consuming.

APESB is of the view that adopting Option 2 of enhancing extant ISQC 1 as detailed above to improve scalability would also reduce the subjectivity of the proposed standards.

(vii) *Consistency with the requirements and terminology of the IESBA Code*

APESB is concerned that the IAASB propose a cooling-off period for a previous Engagement Partner (EP) before they become an Engagement Quality Reviewer¹⁸ and the application material suggests a minimum period of two years for listed entities.¹⁹

We believe this is inconsistent with the requirements of the IESBA Code which takes into account the possibility of multiple Key Audit Partner (KAP) roles (EP, Engagement Quality Control Reviewer (EQCR) or other KAP) and has rules in place where a combination of roles occur. APESB does not consider it best practice in standard setting to have an aspect of rotation rules outside of the IESBA Code. We are strongly of the view this matter should be considered by the IESBA and addressed in the IESBA Code as:

- (i) KAP rotation is comprehensively dealt with in the IESBA Code;
- (ii) There is no current prohibition in respect of movement between EP and EQCR, as long as, collectively the practitioner adheres to the applicable time on and time off periods when they perform a combination of KAP Roles. Further, if there is an independence threat for an EP moving to EQCR role, then it is dealt with by the conceptual framework of the IESBA Code; and

¹⁶ Paragraph A4 of ED-ISQM 1.

¹⁷ Paragraph 21 of ED-ISQM 1.

¹⁸ Paragraph 16 of ED-ISQM 2.

¹⁹ Paragraph A5 of ED-ISQM 2.

- (iii) Audit partner rotation relates to ethical obligations, and it is advisable for all such ethical obligations to be dealt with in one place (the IESBA Code).

Recommendation 6: APESB recommends the proposed cooling-off period for a previous EP before they become an Engagement Quality Reviewer be considered by the IESBA and if applicable be included in the IESBA Code. We are supportive of the existing audit partner rotation roles in the IESBA Code, which take into consideration the performance of a combination of roles.

We note the proposed standards refer to entities of '*significant public interest*'²⁰, which is considered to be a comparable term to PIE to identify entities in respect of which Engagement Quality Reviews (EQR) should be performed. We do not support this proposal as we believe that the adoption of such a term instead of the PIE definition will cause market confusion.

We note that in some jurisdictions, such as Australia, the relevant National Standards Setter have issued additional guidelines on the IESBA Code's definition of a PIE. We respectfully suggest that entities which require EQRs are likely to be the same entities that need to comply with the stricter auditor independence requirements of the IESBA Code such as audit partner rotation requirements. This presents an opportunity for the IAASB to align the applicability of the EQR requirements with the IESBA Code by having one definition in respect of PIEs.

Recommendation 7: APESB recommends that the IAASB uses the PIE definition rather than entities of '*significant public interest*' as the engagements that require an EQR are likely to be the same engagements which are required to apply the stricter auditor independence requirements and this will also achieve consistency with the IESBA Code.

Other comments

Networks and Service Providers

ED-ISQM 1 acknowledges that quality systems of networks can enhance quality for the firms in the network. However, the ultimate responsibility for the achievement of the standard's objective fall on the individual firm²¹. The standard is also clear that when a firm uses a service provider, it is responsible for understanding the provider, nature and scope of services, that the resource is appropriate and that the firm remains responsible for the SQM²².

This approach is consistent with [APES GN 30 Outsourced Services](#) (originally issued by APESB in 2013 and revised in 2015) which guides on the professional and ethical obligations when dealing with outsourced services.

Separation of ED-ISQM 1 and ED-ISQM 2

APESB supports the approach taken by the IAASB to have ED-ISQM 1 address the engagements for which an EQR is required and for ED-ISQM 2 to address eligibility criteria and performance and documentation requirements for EQRs.²³ The separation improves scalability because if a firm determines under ED-ISQM 1 that an EQR is not a required response, it does not need to consider ED-ISQM 2.

²⁰ For example, paragraph 37(e)(ii) of ED-ISQM 1.

²¹ Paragraph 58 of ED-ISQM 1.

²² Paragraph 64 of ED-ISQM 1.

²³ Explanatory Memorandum to ED-ISQM 1, page 20, paragraph 58.

APESB believes that there is also an opportunity to expand the scope of engagements that should be subject to an EQR to include where a firm prepares a public document to raise funds from the public (for example, through the issue of shares or debt instruments).

Recommendation 8: APESB recommends that where a firm prepares a public document to raise funds from the public (for example, through the issue of shares or debt instruments), then these engagements should also be subject to an EQR.

Overall observation

Subject to the above significant concerns, APESB supports the IAASB's overall aims of ED-ISQM 1 and ED-ISQM 2 to enhance consistent engagement quality, the principles of the proposed standards, the separation of EQR responsibilities to the proposed ED-ISQM 2 and the adoption of a risk-based approach.

However, we believe further work needs to be done for these proposals to enable them to be commercially viable across all firms and in particular to sole practitioners and SMPs. We also encourage the IAASB to consider the likely future developments of technology and its impact on quality management.

Appendix 1 provides a summary of responses received from Australian stakeholders during APESB webinars. We also provide our detailed responses to the IAASB's specific questions on ED-ISQM 1 and ED-ISQM 2 in Appendices 2, 3 and 4.

Recommendations

In summary, APESB's key recommendations for the IAASB's consideration are:

1. Improve scalability by developing the SQM from the perspective of SMPs. Larger firms could then scale the SQM upwards to suit their firm's services given their access to extensive technical resources.
2. Alternatively, maintain extant ISQC 1 and enhance leadership and governance, resourcing and monitoring, remediation and evaluation policies and procedures. This would take global stakeholders on a journey rather than requiring entirely new systems to be developed, particularly where there is significant uncertainty about the benefits.
3. Undertake a cost-benefit analysis, measuring expected improvements to quality compared to potential additional implementation costs of the proposed standards for sole practitioners and SMPs. The IAASB may even consider observing how it could be implemented on a test basis by SMPs.
4. Map extant ISQC 1 requirements to those in ED-ISQM 1 and 2 or demonstrate how existing policies and procedures could be adapted as quality objectives or responses in the proposed quality management framework. This would be in the public interest and would have global application to firms who need to transition to the proposed SQM framework.
5. Improve readability and scalability of the application and other explanatory material by removing duplication of requirements and extracting other explanatory material into a basis of conclusions or a guide to implementing the proposed standards, as appropriate, and consider revisiting and strictly following the drafting conventions of the IAASB's Clarity Project (2009/10).

6. The proposed cooling-off period for a previous EP before they become an Engagement Quality Reviewer be considered by the IESBA and if applicable be included in the IESBA Code.
7. Use the PIE definition rather than entities of '*significant public interest*' as the engagements that require an EQR are likely to be the same engagements which are required to apply the stricter auditor independence requirements, and this will also achieve consistency with the IESBA Code.
8. Where a firm prepares a public document to raise funds from the public (for example, through the issue of shares or debt instruments), then these engagements should also be subject to an EQR.

Concluding comments

We trust you find these comments useful in your final deliberations. Should you require any additional information, please contact APESB's Chief Executive Officer, Channa Wijesinghe at channa.wijesinghe@apesb.org.au.

Yours sincerely



Nancy Milne OAM
Chairman

Appendix 1
Poll Question Results from APESB Webinars on Proposed International Standards of Quality Management

Poll Question	Question	Response	CA ANZ Webinar %	APESB Webinar %	Overall %
1	To assist the APESB to prepare a submission on the proposed standards, please indicate your firm's size:	Sole Practitioner	25%	57%	45%
		2 to 5 Partners	21%	10%	14%
		6 to 10 Partners	0%	2%	1%
		11 or more Partners	7%	6%	6%
		Big 6	0%	6%	4%
		Other (for example not in public practice)	46%	18%	29%
		Total	100%	100%	100%
2	Do you support the new system of quality management approach in ED-ISQM 1?	Yes	85%	80%	82%
		No	15%	20%	18%
		Total	100%	100%	100%
3	Are there any aspects of the risk assessment process that may create challenges in practice?	Yes, the establishment of quality objectives	0%	5%	3%
		Yes, the identification and assessment of quality risks	12%	16%	14%
		Yes, the design and implementation of responses	12%	14%	13%
		Yes, all of the above	73%	59%	65%
		No	4%	5%	5%
		Total	100%	100%	100%
4	How many days of work do you estimate it will take for your Firm to implement the risk assessment process of ED-ISQM 1?	1 day	4%	5%	5%
		3 days	8%	27%	20%
		5 days	25%	20%	22%
		10 days or more	63%	49%	54%
		Total	100%	100%	100%
5	Do you consider the proposed effective date of December 2021 provides sufficient time to become compliant?	Yes	79%	82%	81%
		No	21%	18%	19%
		Total	100%	100%	100%

Appendix 1
Poll Question Results from APESB Webinars on Proposed International Standards of Quality Management

Poll Question	Question	Response	%	%	%
6	Do you support the monitoring, remediation and evaluation process in ED-ISQM 1?	Yes	100%	81%	87%
		No	0%	19%	13%
		Total	100%	100%	100%
7	Are there any aspects of the monitoring, remediation and evaluation process that may create challenges in practice?	Yes, the design and implementation of monitoring activities	4%	11%	9%
		Yes, the evaluation of findings and investigation of root causes	26%	6%	13%
		Yes, the design and implementation of remedial actions	0%	4%	3%
		Yes, annual evaluation of whether the SQM provides reasonable assurance	0%	4%	3%
		Yes, all of the above	61%	62%	61%
		No	9%	13%	11%
		Total	100%	100%	100%
8	Do you support the proposals addressing networks to reduce undue reliance on network resources and services?	Yes	88%	0%	88%
		No	12%	0%	12%
		Total	100%	0%	100%
9	Do you support a separate standard ED-ISQM 2 to cover appointment, eligibility, performance and documentation requirements for EQRs?	Yes	94%	79%	83%
		No	6%	21%	17%
		Total	100%	100%	100%
10	Do you consider ED-ISQM 1 is appropriately scalable (applicable to firms of varying size, complexity and circumstances)?	Yes	24%	55%	46%
		No	76%	45%	54%
		Total	100%	100%	100%

APPENDIX 2

Response Template: Quality Management Covering Explanatory Memorandum

Note to Respondents:

- The questions below are from the covering explanatory memorandum of the IAASB's exposure drafts related to quality management, which is available at www.iaasb.org/quality-management. These questions address key issues pervasive to the three standards.
- Respondents are asked to respond separately to each of the exposure drafts and the overall explanatory memorandum.
- We request that comment letters do not include tables as they are incompatible with the software we use to help analyze respondents' comments.

Overall Questions

1) 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?

Response:

APESB does not support the ISQM proposals in its current form and considers them to be a significant shift from extant requirements which will create a major compliance burden (most notably for sole practitioners and SMPs). APESB is of the view that 18 months for implementation may be too short. However, it should be noted that we have not received significant resistance from stakeholders in respect of the proposed implementation period and 81% of stakeholders considered this time to be sufficient.¹

2) 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?

Response:

We strongly encourage the IAASB to map extant ISQC 1 requirements to those in ED-ISQM 1 and 2 or demonstrate how existing policies and procedures could be adapted as quality objectives or responses in the proposed quality management framework. This would indicate which existing requirements and guidance in the extant standard can be incorporated into the new framework and highlight additional requirements or documentation to be developed.

¹ Refer Appendix 1 for a summary of stakeholder responses to poll questions asked during webinars.

Stakeholders have expressed a significant concern that without such mapping, firms may discard current systems or not understand the differences in requirements, potentially adding to implementation costs. The responses in the new framework require policies and procedures to address quality risks and extant ISQC 1 has relevant policies and procedures which have been in existence and implemented by firms of varying sizes for well over a decade.

It is neither effective nor efficient for accounting firms globally to undertake this mapping exercise individually when it could be undertaken by the IAASB and provided as a useful tool for global use. This would be in the public interest and would have global application to all firms who need to transition to the proposed SQM framework.

APESB also recommends the IAASB develop more guidance on the application of the standards, particularly for sole practitioners and SMPs as detailed in the covering letter to this submission.

General Questions

In addition, the IAASB is also seeking comments on the general matters set out below for all three EDs:

- (a) 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.

Response:

Not applicable.

- (b) Public Sector—The IAASB welcomes input from public sector auditors on how the proposed standards affect engagements in the public sector, particularly regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.

Response:

APESB makes no comment on this question.

- (c) 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.

Response:

Not applicable.

APPENDIX 3

Response Template: Proposed ISQM 1

Note to Respondents:

- The questions below are from the exposure draft of proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, which is available at www.iaasb.org/quality-management.
- Respondents are asked to respond separately to each of the exposure drafts and the overall explanatory memorandum.
- We request that comment letters do not include tables as they are incompatible with the software we use to help analyze respondents' comments.

General Comments on Proposed ISQM 1

[Please include here comments of a general nature and matters not covered by the questions below.]

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?

Response:

APESB is of the view that ED-ISQM 1 will not improve the scalability of the standard, particularly for sole practitioners and SMPs (we consider SMPs to be firms with revenue of up to approximately 2 million AUD per annum) and is, in fact, less scalable than extant ISQC 1.

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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1 (as detailed in our covering letter and in this response template), APESB supports the IAASB's overall aims of ED-ISQM 1 and ED-ISQM 2 to enhance consistent engagement quality, the principles of the proposed standards, the separation of EQR responsibilities to the proposed ED-ISQM 2 and the adoption of a risk-based approach. However, we believe further work needs to be done for these proposals to enable them to be applicable across all firms and in particular sole practitioners and SMPs.

We also encourage the IAASB to consider the likely future developments of technology and its impact on quality management.

We favourably note there was broad support from APESB stakeholders during our webinars for a risk-based approach for the system of quality management (82%) and the proposed enhanced monitoring, remediation and evaluation process (87%).¹

- (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?

Response:

We are of the view that the proposals will not generate the expected benefits to engagement quality. We understand some of the reasons for developing a new quality management framework stem from the identification of deficiencies in the existing quality control framework from various inspection reports and monitoring activities. However, upon reviewing some of these inspection reports, it appears that the reported deficiencies are related to failures by a firm to²:

- implement policies or procedures in accordance with existing standards;
- comply with their policies and procedures established by the existing quality control standards;
- comply with the requirements of a technical standard; or
- comply with the documentation requirements of standards.

Further, the Explanatory Memorandum for ED ISQM 1 and 2 do not provide evidence of the nexus or causal link between the IAASB's quality concerns and deficiencies identified in extant ISQC 1 or how the proposed approach will address apparent deficiencies and/or quality concerns.

APESB annually receives updates from the three professional accounting bodies who monitor compliance and the key matters reported in respect of the quality control standard are:

- A system of quality control has not been documented;
- A system of quality control has been documented but is incomplete; and
- The documented system of quality control has not been fully implemented.

We favourably note that over the last decade, the reported non-compliance % of these metrics have declined, but it is still at a significant level. While in certain instances, it could be a lack of knowledge that may be a contributory factor to non-compliance with the existing standards; availability of sufficient time would also be a significant factor. One may

¹ Refer Appendix 1 for a summary of stakeholder responses to poll questions asked during webinars.

² IFIAR Survey of Inspection Findings 2018 and in particular Tables A-3 and A-4.

respectfully argue that the additional work created by the ISQM proposals in its current form will have a detrimental impact on quality management, particularly in the SMP environment.

One option set out below, is to maintain extant ISQC 1 and enhance leadership and governance, resourcing and monitoring, remediation and evaluation policies and procedures. This would take global stakeholders on a journey rather than requiring a major change resulting in entirely new systems to be developed and where the benefits are uncertain.

Option to Improve Scalability – Enhance Extant ISQC 1

This option would maintain extant ISQC 1 obligations with the introduction of additional requirements and enhancements from ED-ISQM 1 in respect of governance and leadership, resources, information and communication and the monitoring, remediation and evaluation process.

This would lessen the compliance burden on firms as they would only need to introduce additional policies and procedures to their existing system of quality control. This approach would enable firms to gradually adapt to additional requirements rather than undertaking a major shift to an entirely new SQM under the current proposals where the expected benefits may not eventuate. The IAASB could monitor the implementation of these additional requirements to determine whether they address the IAASB's concerns in respect of quality.

Cost/Benefit Analysis

As the causal links between the IAASB's concerns about quality and actual deficiencies in extant ISQC 1 have not been established with quantitative or qualitative research evidence, it is unclear whether expected benefits from the proposals will be realised and outweigh the implementation costs for firms (particularly sole practitioners and SMPs).

Based on stakeholder consultations, we believe the proposed framework will be a significant burden (in time and costs) for sole practitioners and SMPs to implement as they do not have the dedicated technical resources of a large firm. Stakeholders also noted it is unclear as to what the deficiencies are in extant ISQC 1 and how these proposals will improve quality.

In Australia, we conservatively estimate that there are over 10,000 accounting firms that are either sole practitioners or are 2-5 partner firms (SMP firms). Based on the stakeholder feedback, assuming it takes a senior person with a charge out rate of AUD 200 per hour approximately one week to develop a new ISQM Framework specific to the firm, this would result in a cost of AUD 8,000 per firm. When this cost is extrapolated across 10,000 sole practitioners and SMP firms in Australia (as each firm needs to develop a unique SQM), it will result in a cost of AUD 80 million.

APESB strongly encourage the IAASB to undertake a cost-benefit analysis, measuring expected improvements to quality compared to potential additional implementation costs of the proposed standards for sole practitioners and SMPs. The IAASB may even consider observing how it could be implemented on a test basis by SMPs.

- (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?

Response:

Requirements

APESB considers the proposals to be a significant shift from extant ISQC 1 requirements which will create a major compliance burden (most notably for sole practitioners and SMPs) in implementing the risk assessment process and ongoing monitoring, remediation and evaluation requirements. We are of the view that these ISQM proposals in their current form are not commercially viable in the SMP environment and will likely result in services being redirected to larger firms with extensive resources.

Implementation of the Risk Assessment Process

The proposed risk assessment process in ED-ISQM 1 aims to enable firms to design and implement a tailored SQM, scalable to the firm's circumstances and engagements. However, the standard is overly prescriptive, and APESB is concerned about the potential cascading effect of its requirements as follows:

- Firms must establish quality objectives for 7 of the 8 components in the standard (excluding the risk assessment process). There are 33 quality objectives stipulated and possibly others if required to achieve the overall objective of the standard.³ However, we note there could be fewer quality objectives if the firm determines they are not relevant.⁴ APESB estimates there could be 4 quality objectives on average per component;
- Firms must identify and assess their quality risks⁵ (none are prescribed), and APESB estimates there could be 3 quality risks to each quality objective; and
- Responses to address assessed quality risks are required to be designed and implemented beyond the 32 responses stipulated in the standard, as prescribed responses are identified as insufficient, and additional responses will be required.⁶ APESB estimates there could be 3 responses on average to each quality risk.

³ Paragraph 26 of ED-ISQM 1.

⁴ Paragraph 21 of ED-ISQM 1.

⁵ Paragraphs 28 & 29 of ED-ISQM 1.

⁶ Paragraph 10(c) of ED-ISQM 1.

The following table highlights the potential cascading effect of these ISQM proposals:

ED-ISQM 1 Framework	Number
Components	7 x
Average Quality Objectives (33 required)	4 x
Estimated Quality Risks per Quality Objective	3 x
Average Responses (32 required)	3 x
Total Responses?	252
Assume 50% Relevant Responses?	126

Even assuming certain quality objectives may be irrelevant, and responses may address two or more assessed quality risks, the cascading impact could be substantial. The IAASB's example for a small firm relates to 1 quality objective, providing potential quality risks and responses, which results in 3 pages of documentation.⁷ Extrapolating this to the 33 required objectives could result in 100 or more pages of tailored documentation for a small firm, which would be time-consuming and an extensive exercise. During our webinars, 76% of stakeholders estimated that it would take them 5 days or more to implement the risk assessment process.

Although the proposals seek to promote professional judgement and scalability, we believe they are highly prescriptive. For example, if the practitioner can exercise their professional judgement to determine the quality objectives, quality risks and the required responses, then it is contradictory to state that they are required to have 33 quality objectives and 32 mandatory responses in their SQM as a minimum. Also, it is unclear how the IAASB determined mandatory responses without the quality risks that the responses relate to in the SQM.

Further, firms may need to evaluate all potential quality objectives, quality risks and responses to determine if any requirements are not applicable. This will also add to the compliance burden, particularly for sole practitioners and SMPs, in understanding all requirements, establishing an SQM and documenting why certain requirements were not relevant to justify to a regulator, professional body or another monitoring body.

Potential Ongoing Impacts

The proposals in ED-ISQM 1 for ongoing monitoring, remediation and evaluation intend to improve the SQM's robustness by including additional or enhanced requirements to those in extant ISQC 1.⁸ It is designed to be a "*continual and iterative process and is responsive to changes*"⁹, however, APESB is concerned this may lead to continuous re-evaluations as

⁷ The IAASB document *Draft Examples: How the nature and circumstances of the firm and the engagements it performs affect the implementation of proposed ISQM 1*, Scenario 2 pages 3 to 5.

⁸ Explanatory Memorandum to ED-ISQM 1, page 21, paragraph 63.

⁹ Paragraph 8 of ED-ISQM 1.

circumstances or risks change, for example, where a firm undertakes different engagement types or engagements in new industries. This is in addition to annually evaluating the effectiveness of the SQM and will add to the compliance burden placed on sole practitioners and SMPs.

APESB recommends the IAASB develop the SQM from the perspective of SMPs as presented in the Option below. Larger firms could then scale the SQM upwards to suit their firm's services given their access to extensive technical resources.

We respectfully suggest to the IAASB, that from a risk-based perspective, there are more commonalities than differences in respect of sole practitioners and SMPs. [APES 325 Risk Management for Firms](#) (APES 325) provides an example of a true risk-based standard which provides leeway for the firms, professional bodies and members to exercise their professional judgement to develop a risk management framework that suits their practice. This has enabled CPA Australia to develop a [Risk Management Framework Tool](#) to assist firms with their compliance with APES 325.

Option to Improve Scalability – Scaled back SQM

Reduce the requirements of the SQM to a base level for sole practitioners and SMPs with mechanisms to require firms to bolster their system with increasing firm size and complexity. The overarching structure and principles of ED-ISQM 1 could be maintained, including the standard's objective, the risk assessment and monitoring, remediation and evaluation processes with the following simplifications:

- Reduce requirements to that of a sole practitioners or SMP, for example, including base level:
 - Quality objectives, which could be one or more overarching principle-based quality objective(s) per component which are directly relevant to the component and the overall objective of the standard;
 - Quality risks (identified in the standard) to the achievement of the required quality objectives;
 - Responses to address the identified quality risks (including policies and procedures from extant ISQC 1 wherever possible);
- Maintain the overarching principle that firms need to assess the nature of their firm and engagements to determine whether additional quality objectives, quality risks and responses are required to achieve the overall objective of the standard;
- Reduce application and other explanatory material to pure application material (i.e., which directly address requirements) on the reduced requirements detailed above (also refer suggestions below regarding reducing the volume of this material); and
- Provide guidance for firms of varying sizes and complexity, including the framework of what the overall SQM consists of and potential additional quality objectives and responses extracted from the current ED-ISQM 1 as relevant.

For example, a:

- Simplified SQM for sole practitioners;
- Base level SQM for an SMP; and
- More detailed and complex SQM for larger firms highlighting areas where additional quality objectives, quality risks, and responses may be required.

Stakeholders who attended our webinars were primarily (59%) sole practitioners or from a 2-5 partner firm. The revenue range for these firms is from AUD 300,000 to approximately AUD 2 million per annum. These stakeholders consider there to be significant challenges in implementing ED-ISQM 1 in practice, in particular, the risk assessment process (95%) and the monitoring, remediation, and evaluation processes (89%). We also note that the majority of the stakeholders (54%) were of the view that the current proposals are not scalable. During our webinars, 76% of stakeholders estimated that it would take them 5 days or more to implement the risk assessment process, the responses were spread as follows:

- 5% - 1 day;
- 20% - 3 days;
- 22% - 5 days; and
- 54% - 10 days or more.

Application

APESB does not consider that the application material in ED-ISQM 1 is scalable. ED-ISQM 1 includes a significant amount of application and other explanatory material which has increased threefold from extant ISQC 1, consisting of 44 pages and 214 paragraphs (compared to approximately 70 application paragraphs in extant ISQC 1).

Some of the content repeats requirements, is often descriptive without providing information on how to apply the requirements it relates to and at times is more akin to guidance material or a basis for conclusions. For example, paragraph A21 repeats the requirements of paragraph 55 of ED-ISQM 1 and paragraphs A40 to A43 provide very descriptive ways for firms to undertake performance evaluations required by paragraph 24(b) of ED-ISQM 1, which could be extracted into guidance material. Stakeholders have expressed concern that this voluminous material will confuse and detract from the standard's requirements.

APESB strongly recommends the IAASB improve readability and scalability of the application and other explanatory material by removing duplication of requirements and extracting other explanatory material into a basis of conclusions or a guide to implementing the proposed standards, as appropriate. We recommend that drafting conventions adopted during the IAASB's Clarity Project during 2009/10 be revisited and strictly followed to streamline these ISQM proposals.

- 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?

Response:

APESB is of the view that there are several aspects of the standard that will create challenges for implementation, particularly for sole practitioners and SMPs. During stakeholder engagement, 95% of stakeholders indicated there would be challenges to aspects of the risk assessment process as follows¹⁰:

- 3% in the establishment of quality objectives;
- 14% in the identification and assessment of quality risks;
- 13% in the design and implementation of responses; and
- 65% in respect of all of the above.

In relation to aspects of the monitoring, remediation and evaluation process, 89% of stakeholders indicated there would challenges in practice, as follows:

- 9% in the design and implementation of monitoring activities;
- 13% in the evaluation of findings and investigation of root causes;
- 3% in the design and implementation of remedial actions;
- 3% in the annual evaluation of whether the SQM provides reasonable assurance; and
- 61% in respect of all of the above.

ED-ISQM 1 requires firms to exercise a significant amount of professional judgement.¹¹ While this is intended to enable the SQM to be tailored to the firm and promote scalability, it could lead to subjectivity and disparity in the design, implementation and operation of SQMs. Different firms may make very different risk assessments, and even firms with the same nature, circumstances and engagements will likely result in different SQMs.

Invariably, there will be a degree of subjectivity when a practitioner determines the quality objectives, quality risks and relevant responses. When the relevant practitioner's SQM is subject to review in the future, it is possible that the regulator, professional body, or another monitoring body may not share the same view, especially where firms determine requirements to be irrelevant.¹² As such, firms will likely need to develop, not only their SQM, but document reasons why requirements have not been implemented, adding to the compliance burden.

Currently, as there is an agreed quality control framework (extant ISQC 1), there is less likelihood of a dispute if an element does not exist or there is observed non-compliance with the framework.

¹⁰ Options presented in question 1(c) could assist in addressing these challenges.

¹¹ Paragraph A4 of ED-ISQM 1.

¹² Paragraph 21 of ED-ISQM 1.

With a variable quality management framework, the monitoring process will become very challenging and time-consuming in the future.

APESB is of the view that adopting the Option of enhancing extant ISQC 1 detailed above in question 1(b) to improve scalability would also reduce the subjectivity of the proposed standards.

- 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?

Response:

APESB is of the view that the application material is too voluminous, repeats requirements, includes non-application material and is at times inconsistent with the drafting conventions from the ISA Clarity Project, including removal of ambiguities, readability and understandability. For example:

- Paragraph A21 repeats the requirements of Paragraph 55, the start of paragraph A37 repeats the requirements in paragraph 24(a)(iii) and several other instances of repetition. APESB recommends the IAASB review the application material to remove repetition of requirements to reduce the overall volume of the standard.
- Paragraph 45 requires firms to undertake inspections of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm, whereas paragraph A169 refers to a three-year period for engagement partners performing audits and maybe longer periods for compilation reports. This may create expectations (albeit possibly too low) as to what should be done, including from a regulator's perspective.
- Paragraphs A40 to A43 provide very descriptive ways for firms to undertake performance evaluations required by paragraph 24(b). This (and other examples) does not represent true application material and could be extracted into a guide on how to apply ED-ISQM 1. APESB recommends the IAASB review the application material to remove non-application material to reduce the overall volume of the standard.

Specific Questions

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

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the eight components and the structure of ED-ISQM 1.

- 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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the objective of the standard and note it is very similar to the objective of extant ISQC 1. The firm's role relating to the public interest is made clear as they are required to demonstrate a commitment to quality and serve the public interest through the consistent performance of quality engagements.¹³

- 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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the overarching principles of a risk-based approach in the risk assessment process.

However, as noted previously, APESB is of the view that although the proposals seek to promote professional judgement and scalability, we believe they are highly prescriptive.

Firms are required to identify and assess quality risks to quality objectives being achieved and then design and implement responses to address the assessed quality risks. As responses are stipulated in the standard, firms may tailor quality risks to these responses, preventing them from undertaking a proper risk assessment based on the nature and circumstances of the firm and its engagements.

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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we agree the risk assessment process should be applied to the other components of the system of quality management.

¹³ Paragraphs 7 and 23(c) of ED-ISQM 1.

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

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1 and those listed below, we support the approach for establishing quality objectives.

In particular:

i. Are the required quality objectives appropriate?

Response:

APESB is of the view that the stakeholder concerns raised with the APESB stem from the fact that the proposals have been written from the perspective of a large multi-disciplinary firm with a focus on large complex Public Interest Entity (PIE) audits.

While the required quality objectives may be appropriate for large firms undertaking complex engagements, APESB is of the view that the level of prescription is too onerous for SMPs and firms undertaking less complex engagements. Further, firms may need to evaluate all potential quality objectives, quality risks and responses to determine if any requirements are not applicable.

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

Response:

APESB agrees that it is clear that firms are required to establish additional quality objectives beyond those stipulated in the standard, if necessary, to achieve the overall objective of the standard.¹⁴

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

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the process of applying the threshold requirements of a reasonable possibility of occurring and significant effect to determine quality risks that require responses. However, APESB is of the view that having separate steps for identification and assessment unnecessarily complicates the process and the delineation between the two steps is unclear. These steps could be combined into one process, be it either identification or assessment, to simplify implementation.

APESB is also of the view that the application material which notes that reasonable possibility is more than remote¹⁵, may be too low of a threshold and will unnecessarily increase the number of risks which then need to be applied against the second threshold.

¹⁴ Paragraph 26 of ED-ISQM 1.

¹⁵ Paragraph A55 of ED-ISQM 1.

- (d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the approach to require firms to design and implement responses to address assessed quality risks.

APESB strongly encourage the IAASB to map extant ISQC 1 requirements to those in ED-ISQM 1 and 2 or demonstrate how existing policies and procedures could be adapted as quality objectives or responses in the proposed quality management framework. This would indicate which existing requirements and guidance in the extant standard are incorporated into the new framework and highlight additional requirements or documentation to be developed.

Stakeholders have expressed a significant concern that without such mapping, firms may discard current systems or not understand the differences in requirements, potentially adding to implementation costs. The responses in the new framework require policies and procedures to address quality risks and extant ISQC 1 has relevant policies and procedures which have been in existence and implemented by firms of varying sizes for well over a decade.

It is neither effective or efficient for accounting firms globally to undertake this mapping exercise individually when it could be undertaken by the IAASB and provided as a useful tool for global use. This would be in the public interest and will have global application to firms who need to transition to the proposed SQM framework.

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?

Response:

APESB is of the view that the number and prescriptive nature of required responses may impact on firm's tailoring their systems in a way that is inconsistent with the principles of the standard. As stated in response to question 6 above, firms may tailor quality risks to the required responses and not undertake a proper risk assessment based on the nature and circumstances of the firm and its engagements.

- 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?

Response:

APESB is of the view that although it is clear that firms are required to design and implement responses in addition to those required in the standard¹⁶, there is a risk that

¹⁶ Paragraph 10(c) of ED-ISQM 1.

as there are so many prescriptive responses, firms will not develop any of their own responses beyond these.

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

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the increased emphasis on leadership responsibility and governance in the proposed 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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the requirement for firm's to assign ultimate responsibility and accountability for the system of quality management to the CEO, managing partner or managing board of partners.¹⁷ APESB supports the ability for the person(s) with ultimate responsibility and accountability to assign operational responsibility for the system of quality management to other individuals where appropriate.¹⁸ However, APESB is of the view that requiring firms to assign specific aspects, including compliance with independence requirements and the monitoring and remediation process¹⁹, is too prescriptive. Firms should be able to use professional judgement to determine how responsibility for aspects of the system are to be assigned or delegated.

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

Response:

APESB agrees that the requirements under relevant ethical requirements adequately covers responsibilities of the firm regarding independence of other firms or persons within a network.

¹⁷ Paragraph 24(a) of ED-ISQM 1.

¹⁸ Paragraph 24(a)(iii)a. of ED-ISQM 1.

¹⁹ Paragraph 24(a)(iii)b. of ED-ISQM 1.

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

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the introduction of requirements to establish quality objectives in respect of technological resources.²⁰ We encourage the IAASB to consider the likely future developments of technology and its impact on quality management and provide additional guidance on this for stakeholders.

- 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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the introduction of the new component on information and communication.

- 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?

Response:

We note the proposed standards refer to entities of '*significant public interest*'²¹, which is considered to be a comparable term to PIE to identify entities in respect of which EQRs should be performed. We do not support this proposal as we believe that the adoption of such a term instead of the PIE definition will cause market confusion.

We note that in some jurisdictions, such as Australia, the relevant National Standards Setter have issued additional guidelines on the IESBA Code's definition of a PIE. We respectfully suggest that entities which require EQRs are likely to be the same entities that need to comply with the stricter auditor independence requirements of the IESBA Code, such as audit partner rotation requirements. This presents an opportunity for the IAASB to align the applicability of the EQR requirements with the IESBA Code by having one definition in respect of PIEs.

APESB recommends that the IAASB uses PIE rather than entities of '*significant public interest*' as the engagements that require an EQR are likely to be the same engagements which are required to apply the stricter auditor independence requirements, and this will also achieve consistency with the IESBA Code.

²⁰ Paragraphs 38(e) & (g) of ED-ISQM 1.

²¹ For example, paragraph 37(e)(ii) of ED-ISQM 1.

- 12) In your view, will the proposals for monitoring and remediation improve the robustness of firms' monitoring and remediation?

Response:

During stakeholder engagement, 87% supported the overall monitoring, remediation and evaluation process. However, as noted in response to question 2 above, 89% of stakeholders consider there to be challenges in implementing all aspects of the process. APESB recommends the IAASB develop guidance to assist firms, particularly for sole practitioners and SMPs, on how to implement the monitoring, remediation and evaluation process in practice.

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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we believe the proposals will likely improve the system of quality management as a whole.

- (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?

Response:

Subject to the concern raised in question 3 above in respect of application material, APESB supports retaining the requirement for inspection of completed engagements.

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

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the definition of deficiencies and believe that the framework for evaluating findings and identifying deficiencies is clear.

- (d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the requirement to investigate the root cause of deficiencies. However, this process is likely to be foreign to many firms, particularly SMPs, and it may require additional guidance and education to enable firms to undertake this appropriately and efficiently.

In particular:

- i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we believe that the nature, timing and extent of the procedures to investigate root causes is sufficiently flexible.

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

Response:

APESB is of the view that ED-ISQM 1 appropriately addresses positive findings.

- (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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to annually evaluate its effectiveness. However, due to the complexities of the standard highlighted throughout this submission, determining this may create challenges in practice including a requirement to understand all aspects of the standard which will be onerous, particularly for sole practitioners and SMPs.

- 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?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the proposals addressing networks and consider they will appropriately address the issue of firms placing undue reliance on them. This was also supported by APESB stakeholders.

- 14) Do you support the proposals addressing service providers?

Response:

Subject to APESB's significant concerns about the current form, scalability and prescriptive nature of the proposed ED-ISQM 1, we support the proposals addressing service providers. The standard is clear that when a firm uses a service provider, it is responsible for understanding the provider, nature and scope of services, whether the resource is appropriate, and the firm remains responsible for the SQM. This is consistent with APESB's [GN 30 Outsourced Services](#).

- 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?

Response:

APESB understands the change in terminology from engagement quality control review to EQR is due to the shift in focus from quality control to quality management and to ensure consistency of terminology in the suite of standards. This change in terminology will require changes in Australia, including legislative instruments such as ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*. It will also impact the APESB in respect of updating standards (the Code and APES 320) and all relevant member firms in updating their existing quality control documentation.

APPENDIX 4

Response Template: Proposed ISQM 2

Note to respondents:

- The questions below are from the exposure draft of proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*, which is available at www.iaasb.org/quality-management.
- Respondents are asked to respond separately to each of the exposure drafts and the overall explanatory memorandum.
- We request that comment letters do not include tables as they are incompatible with the software we use to help analyze respondents' comments.

General Comments on Proposed ISQM 2

[Please include here comments of a general nature and matters not covered by the questions below.]

Questions

- 1) 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?
Response:

APESB supports the approach taken by the IAASB to have ED-ISQM 1 address the engagements for which an Engagement Quality Review (EQR) is required and for ED-ISQM 2 to address eligibility criteria and performance and documentation requirements for EQRs.¹ The separation improves scalability because if a firm determines under ED-ISQM 1 that an EQR is not a required response, it does not need to consider ED-ISQM 2.

APESB believes there is also an opportunity to expand the scope of engagements that should be subject to an EQR. APESB recommends that where a firm prepares a public document to raise funds from the public (for example, through the issue of shares or debt instruments), then these engagements should also be subject to an EQR.

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

Response:

APESB agrees that the linkages between the requirements for EQRs in ED-ISQM 1 and ED-ISQM 2 are clear.

¹ Explanatory Memorandum to ED-ISQM 1, page 20, paragraph 58.

- 3) 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?

Response:

APESB understands the change in terminology from engagement quality control review to EQR is due to the shift in focus from quality control to quality management and to ensure consistency of terminology in the suite of standards. This change in terminology will require changes in Australia, including legislative instruments such as ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*. It will also impact the APESB in respect of updating standards (the Code and APES 320) and all relevant member firms in updating their existing quality control documentation.

- 4) 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?

Response:

Subject to the comments in (a) and (b) below, APESB supports the additional requirements added in ED-ISQM 2 for the eligibility of an engagement quality reviewer, including the requirement to ensure that the engagement quality reviewer has the “*competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review*”.²

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

Response:

APESB is concerned that the IAASB propose a cooling-off period for a previous Engagement Partner (EP) before they become an Engagement Quality Reviewer³ and the application material suggests a minimum period of two years for listed entities.⁴

We believe this is inconsistent with the requirements of the IESBA Code which takes into account the possibility of multiple Key Audit Partner (KAP) roles (EP, Engagement Quality Control Reviewer (EQCR) or other KAP) and has rules in place where a combination of roles occur. APESB does not consider it best practice in standard setting to have an aspect of rotation rules outside of the IESBA Code. We are strongly of the view this matter should be considered by the IESBA and addressed in the IESBA Code as:

- (i) KAP rotation is comprehensively dealt with in the IESBA Code;
- (ii) There is no current prohibition in respect of movement between EP and EQCR, as long as, collectively the practitioner adheres to the applicable time on and time off periods when they perform a combination of KAP Roles. Further, if there is an independence threat for an EP moving to EQCR role, then it is dealt with by the conceptual framework of the IESBA Code; and

² Paragraph 16(a) of ED-ISQM 2.

³ Paragraph 16 of ED-ISQM 2.

⁴ Paragraph A5 of ED-ISQM 2.

- (iii) Audit partner rotation relates to ethical obligations, and it is advisable for all such ethical obligations to be dealt with in one place (the IESBA Code).

APESB recommends the proposed cooling-off period for a previous EP before they become an Engagement Quality Reviewer be considered by the IESBA and if applicable be included in the IESBA Code. We are supportive of the existing audit partner rotation roles in the IESBA Code which take into consideration the performance of a combination of roles.

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

Response:

Refer response to question 4(a) above. APESB does not support the inclusion of this guidance in ED-ISQM 2.

- 5) 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)?

Response:

APESB supports the requirements relating to the nature, timing and extent of the engagement quality reviewer's procedures. However, APESB does not comment in respect of whether the responsibilities of the engagement quality reviewer are appropriate given the revised responsibilities of the engagement partner in the proposed ISA 220 as this is a matter for AUASB.

- 6) 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 skepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

Response:

APESB agrees ED-ISQM 2 adequately addresses the Engagement Quality Reviewer evaluating professional skepticism of the engagement team as it is specifically required when evaluating the engagement team's basis for making significant judgements.⁵ Members undertaking audit or other assurance engagements are required to exercise professional skepticism under IAASB standards and the IESBA Code. As such, APESB is of the view that whilst Engagement Quality Reviewers are not part of the engagement team, they are subject to professional skepticism requirements. However, APESB is not opposed to a specific requirement being included in ED-ISQM 2 for engagement quality reviewers to exercise professional skepticism.

- 7) Do you agree with the enhanced documentation requirements?

Response:

⁵ Paragraph 22(d)(i) of ED-ISQM 2.

APESB supports the enhanced documentation requirements. However, guidance on what this documentation should consist of would be beneficial to firms that are subject to these requirements.

- 8) 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?

Response:

APESB is of the view that ED-ISQM 2 is scalable for firms of varying size and complexity.

Editorial Comments on Proposed ISQM 2

[Please include here comments of an editorial nature.]