

# Proposed International Standards on Quality Management – ED-ISQM 1 & ED-ISQM 2

**APESB Webinar**

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# Overview

- Australian Extant APES 320
- Proposed Standards – History, Issues, Proposals & Timeline
- Proposed ED-ISQM 1:
  - Objective
  - Components
  - Risk-Assessment Process
  - Monitoring & Remediation Process
  - Networks & Service Providers
- Interaction & Engagement Quality Reviews (ED-ISQM 2)
- Comparison to APES 320, Scalability & Impacts

# Poll Question

To assist the APESB to prepare a submission on the proposed standards, please indicate your firm's size:

- Sole practitioner
- 2 to 5 Partners
- 6 to 10 Partners
- 11 or more Partners
- Big 6
- Other (for example not in public practice)

# Extant APES 320 *Quality Control for Firms*

System of quality control including policies & procedures that address the following elements:

- a) Leadership responsibilities for quality within the Firm
- b) Relevant Ethical Requirements
- c) Acceptance and continuance of Client relationships and specific Engagements
- d) Human Resources
- e) Engagement Performance
- f) Monitoring

Establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element.

# Proposed Standards – Project History



- **2013-2014** – Feedback and concerns from ISA implementation project, outreach with regulators and audit oversight bodies and comments on public consultations.
- **2015-2016** – Public consultation on issues – Invitation to comment (ITC) issued in December 2015 addressing professional skepticism, quality control and group audits.
- **December 2016** Project proposal approved – to amend ISQC 1 and ISA 220 addressing quality control.

# Issues Identified with Extant Standards

- Firm governance and leadership responsibility/accountability for quality
- Monitoring process should address:
  - The whole system – not just completed engagements
  - Results of external inspections
  - Causal effects (root causes) and remedial actions
- Clarity about Engagement Partner's responsibilities for appropriate direction, supervision and review
- Undue reliance on networks
- Improve communication with external parties
- Improve scalability for SMPs
- Entities subject to EQRs and EQR reviewer eligibility

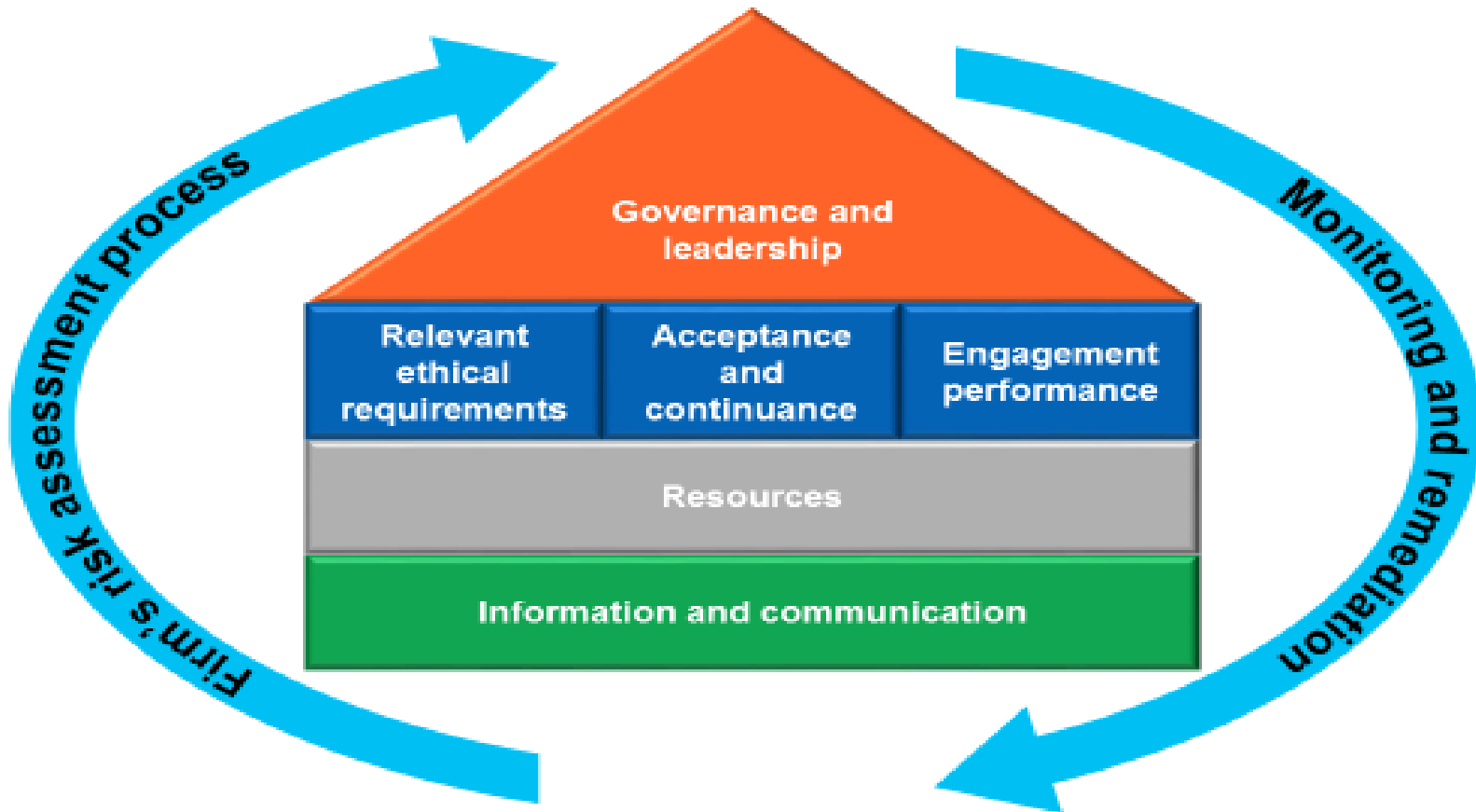
# IAASB's Proposals & Timeline

- February 2019 – Proposed International Standards:



- February to June 2019 – IAASB global outreach and consultation
- 12 June 2019 – comments to the APESB**
- 1 July 2019 – Submissions to IAASB (APESB making a submission)
- December 2021 – Proposed Effective Date

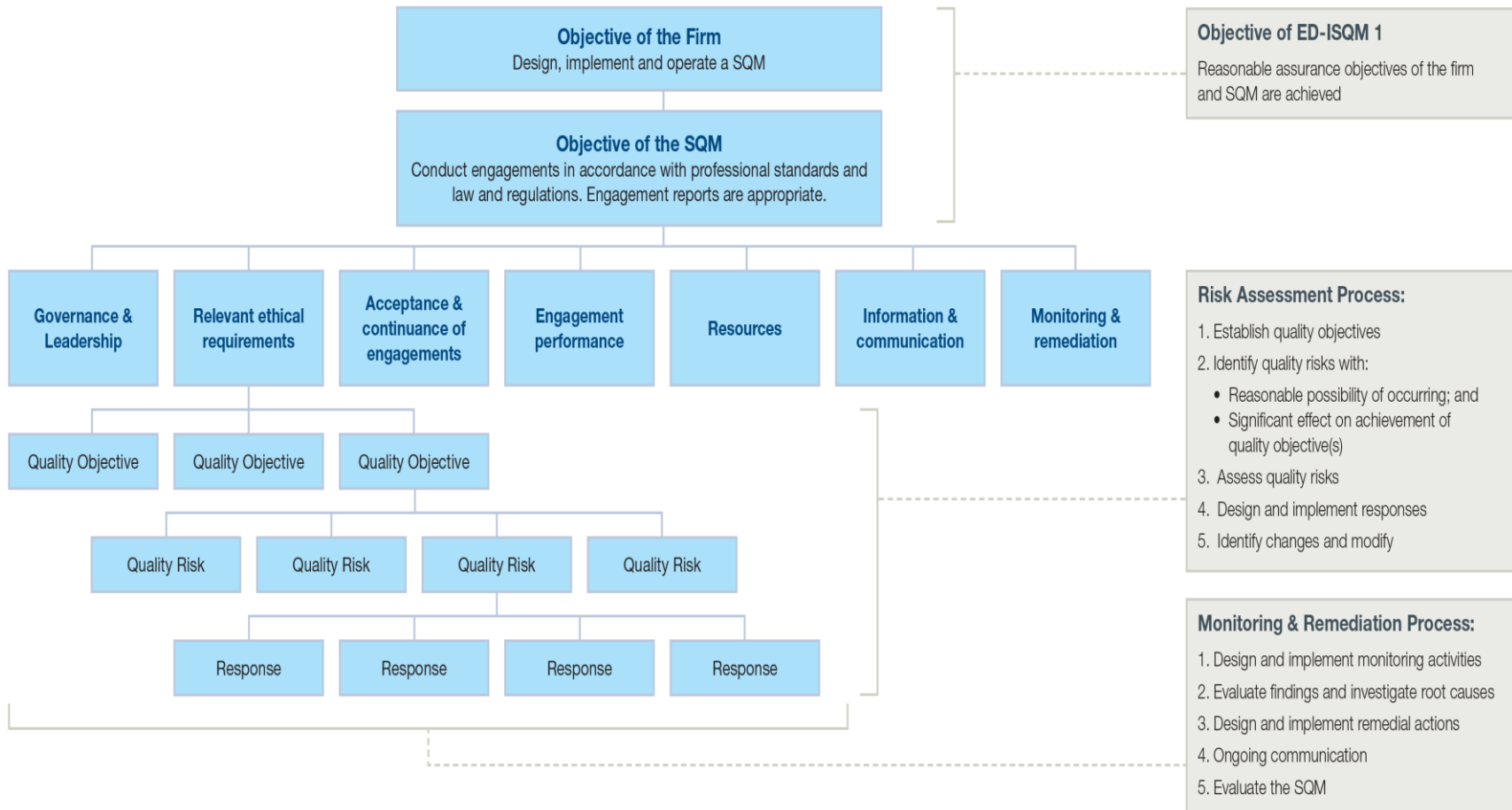
# System of Quality Management (SQM)<sup>1</sup>



1. Diagram from page 7 of IAASB Exposure Draft February 2019 Proposed International Standard on Quality Management 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Service Engagements*



# ED-ISQM 1 System of Quality Management (SQM)



# Objective of the SQM



# Governance & Leadership

Leadership to set the tone from the top:

- Responsible and accountable for quality
- Strategic decisions and actions – commitment to quality/public interest
- Establish structures, reporting lines and appropriate authorities and responsibilities
- Planning, obtaining and assigning resources
- Ultimate responsibility for SQM – can assign operational responsibility for system (in whole or specific aspects), independence and monitoring & remediation
- Appropriate qualifications and periodic performance evaluations
- Understanding of system relevant to responsibilities

# Resources Component

## Information & Communication Component

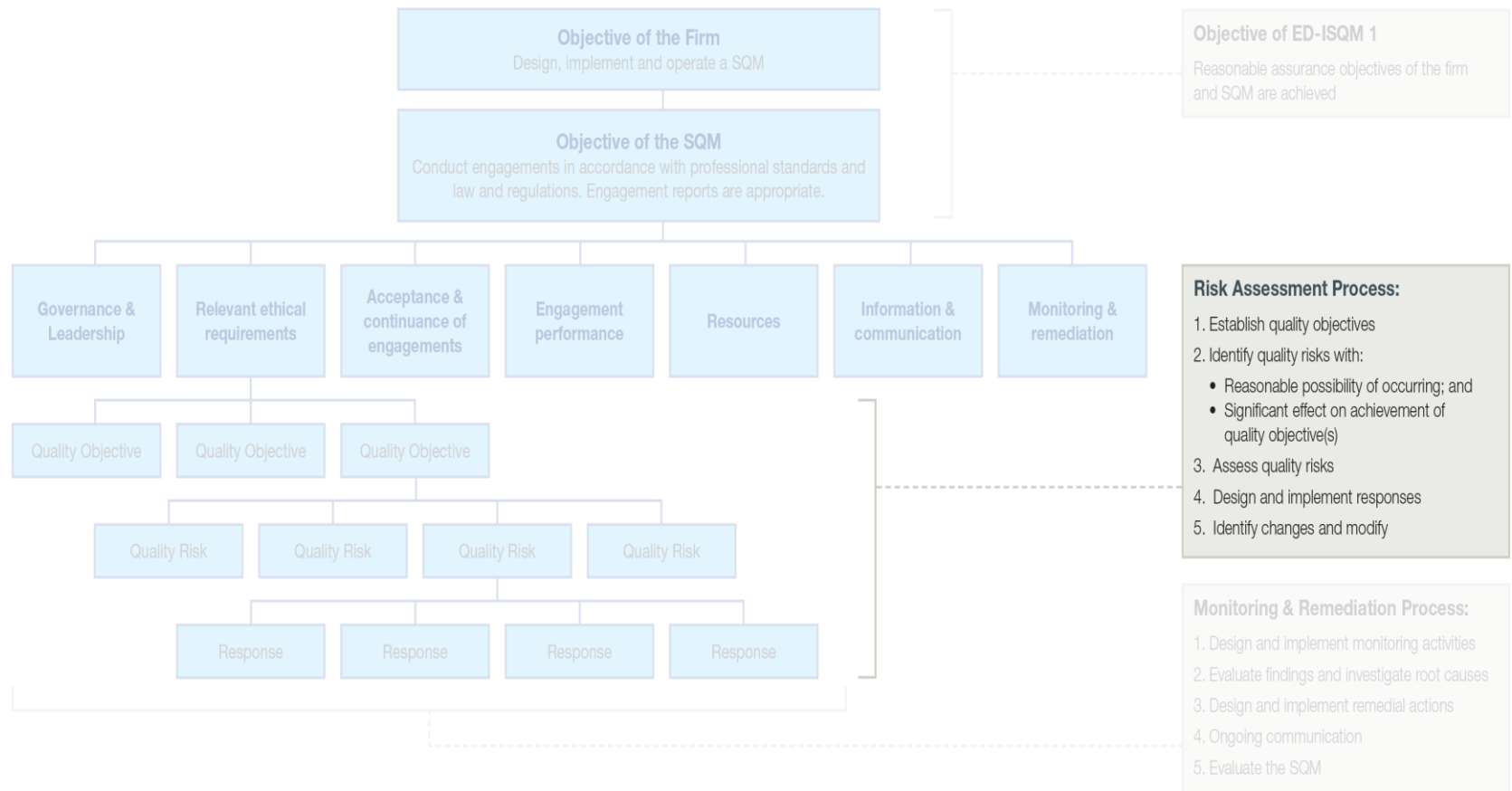
### Resources:

- Now includes human, technological and intellectual resources
- No required responses

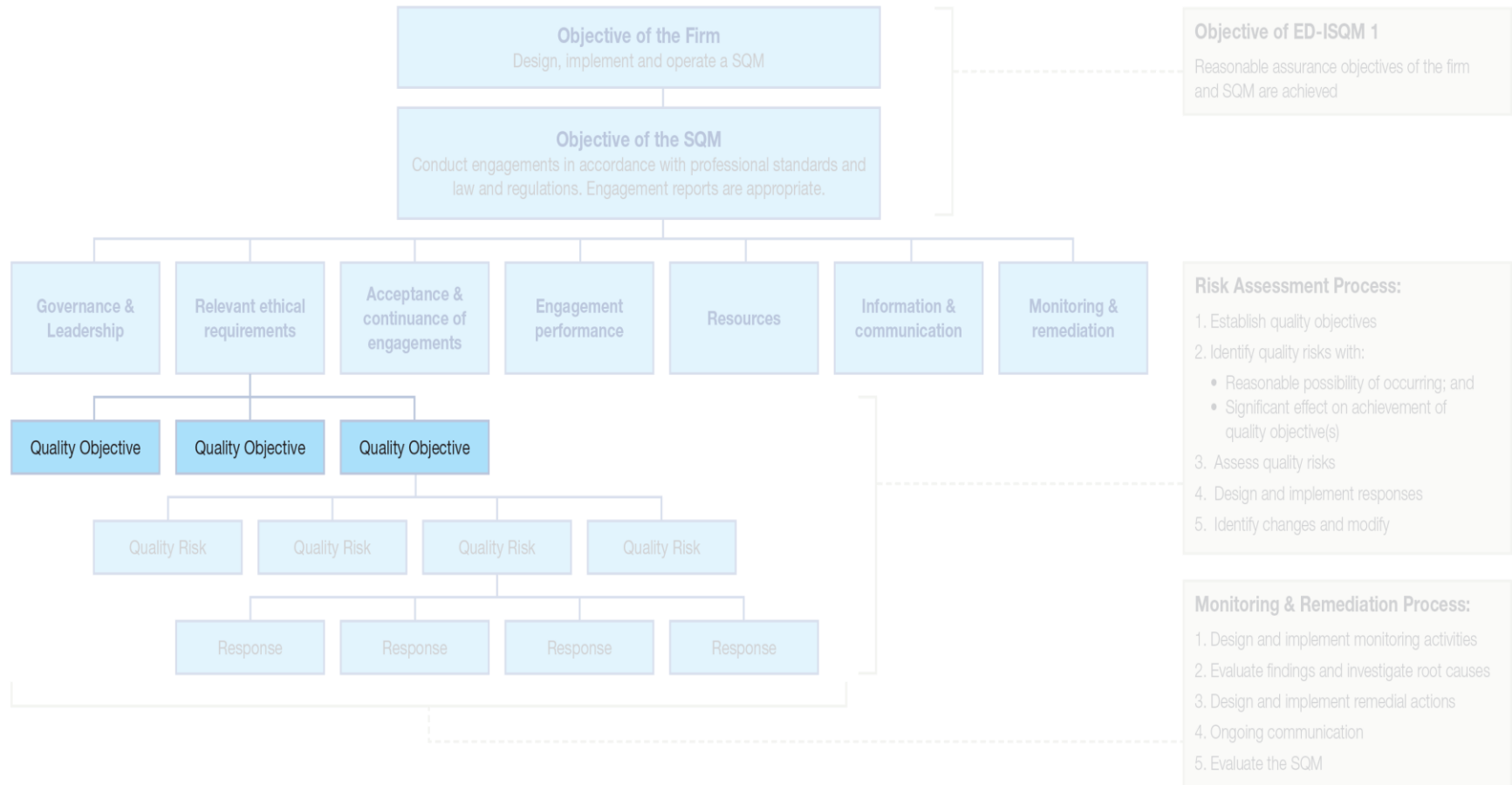
### Information & Communication (**new component**):

- Establish Information system
- 2-way communication
- Set responsibility for all personnel
- Encourages communication with external parties

# Risk Assessment Process



# Quality Objectives



# Establish Quality Objectives

## Quality Objectives:

- Collectively provide reasonable assurance SQM objectives achieved.
- Outcome-based – firm to determine how achieved.

## Shall establish quality objectives which are:

- Required by the standard (should be sufficient for most firms) – ranges from 3 to 7 per component (unless not relevant).
- Beyond standard requirements – only if required to achieve the SQM objectives.

# Quality Objectives

## Small Co – Independence Example<sup>2</sup>

Small Co operates in one location, performs compilations and reviews for local farming, manufacturing and retail businesses and establishes the following **required quality objective**:

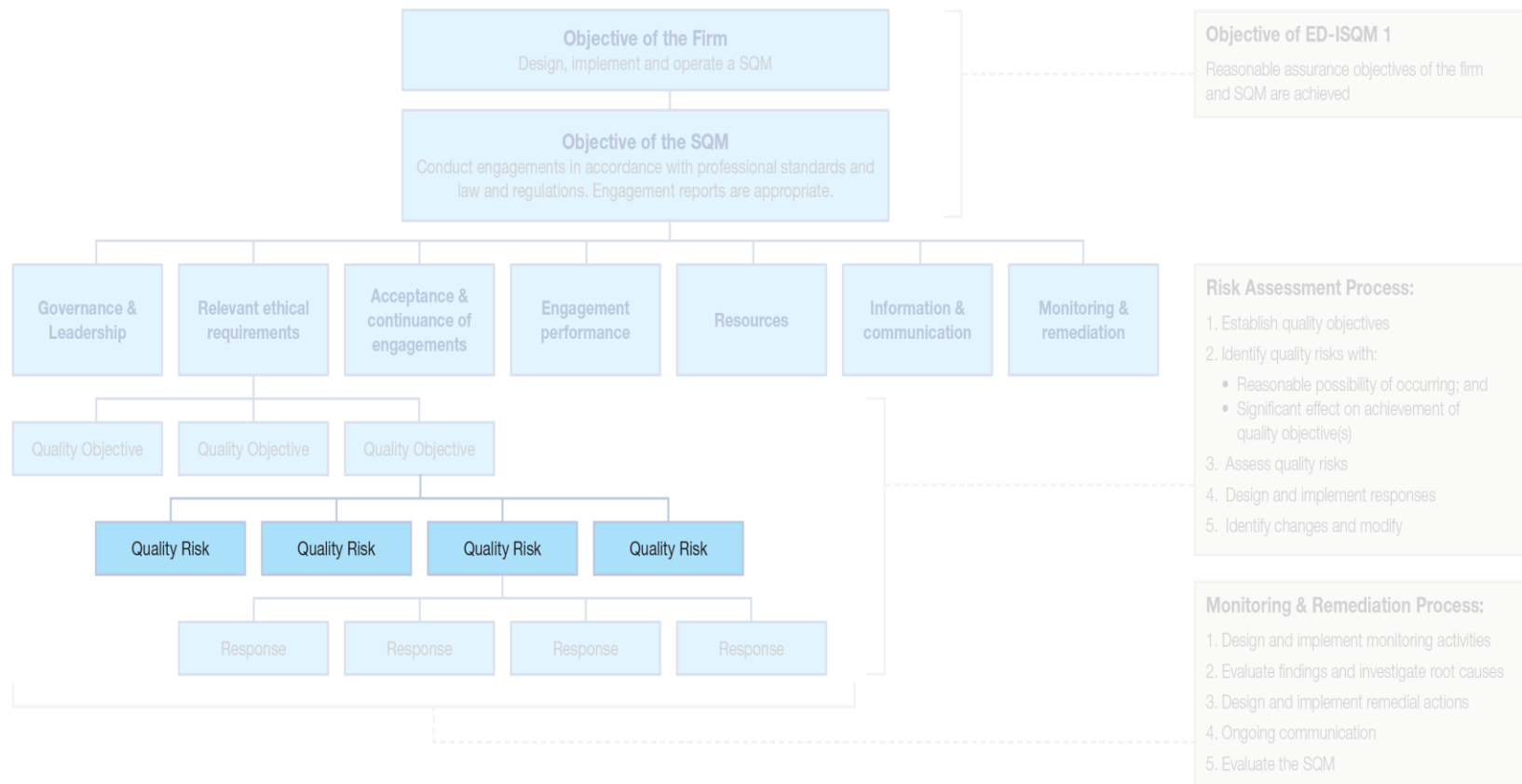
*The firm, its personnel and others subject to relevant ethical requirements fulfill their responsibilities in relation to the relevant ethical requirements, including those related to independence.*

Small Co also establishes a sub-objective for reviews (more granular):

*The firm, its personnel and others subject to relevant ethical requirements fulfill their responsibilities in relation to independence requirements.*



# SQM Quality Risks



# Identify & Assess Quality Risks<sup>3</sup>



# Quality Risks

## Small Co – Independence Example

Quality Risks	Likelihood	Effect
Non-compliance with independence requirements addressing financial interests, loans and guarantees.	<b>Reasonable possibility</b> – small town and personnel's family members may have financial interests in local clients.	<b>Significant impact</b> – breach independence requirements
Personnel's family member able to exert significant influence over the client's accounting records or financial statements.	<b>Reasonable possibility</b> – small town, client may employ personnel's family member.	<b>Significant impact</b> – breach independence requirements
Personnel used to work for client and was able to exert significant influence over the client's accounting records or financial statements.	<b>Reasonable possibility</b> – small town, limited availability of individuals with appropriate financial knowledge and experience.	<b>Significant impact</b> – breach independence requirements

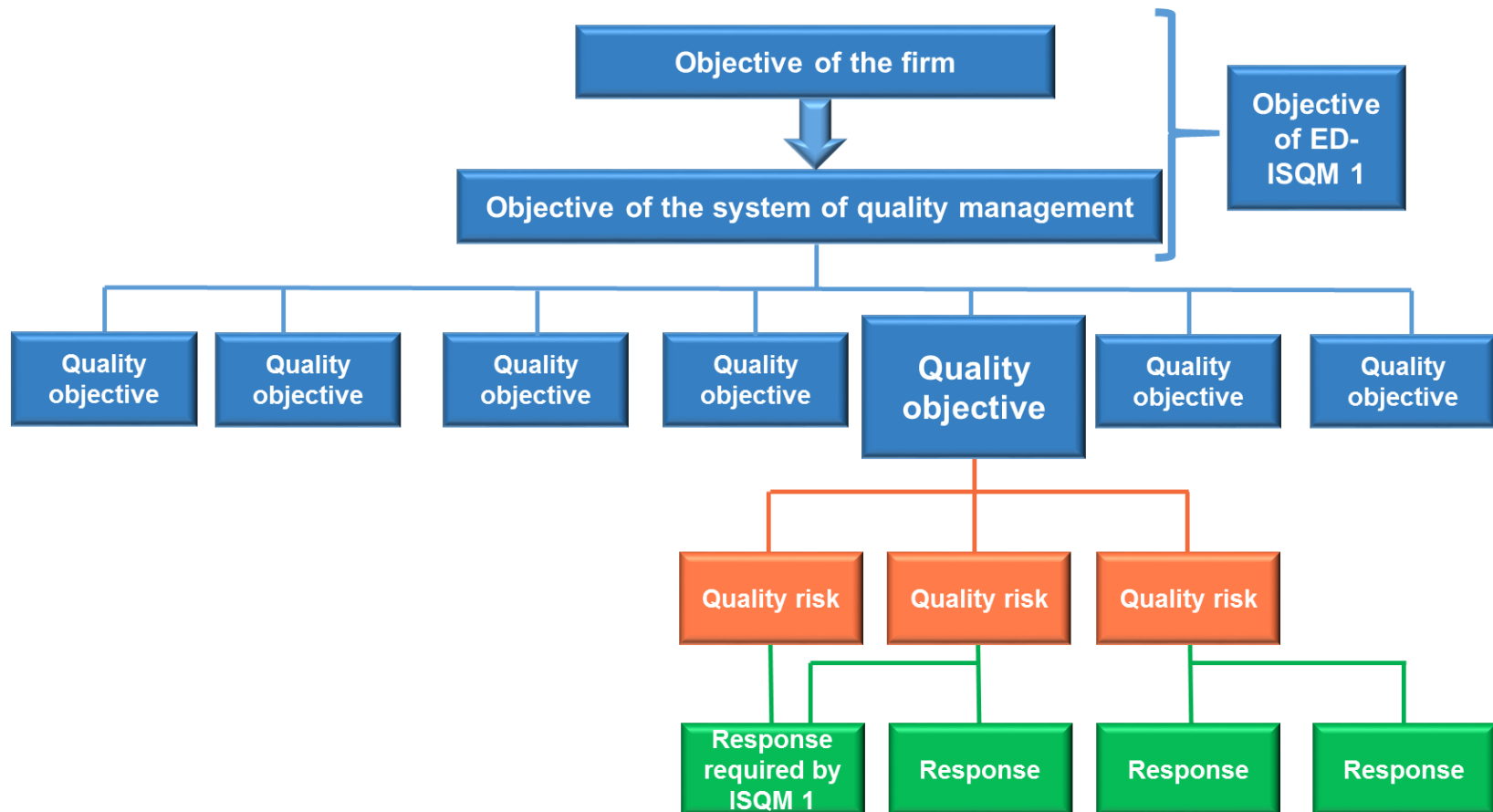
# Assess Quality Risks

## Small Co – Independence Example

Assessment is more precise than the identification:

- **Likelihood** – the firm may determine that quality risk 2 is more likely to occur than quality risk 1 or 3.
- **Magnitude of effect** – the firm may determine that the effects of each of these quality risks are approximately the same.

# Responses & Iterative Approach<sup>4</sup>



4. Diagram from page 15 IAASB Exposure Draft February 2019 Proposed International Standard on Quality Management 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Service Engagements

# Design & Implement Responses

**Design and implement responses** to address assessed quality risks, which are:

- Required by the standard (ranges from 1 to 14 mandatory responses per component and 32 in total);
- Based on the assessment of quality risks; and
- Additional to those required by the standard where necessary.

**Mandatory responses are NOT:**

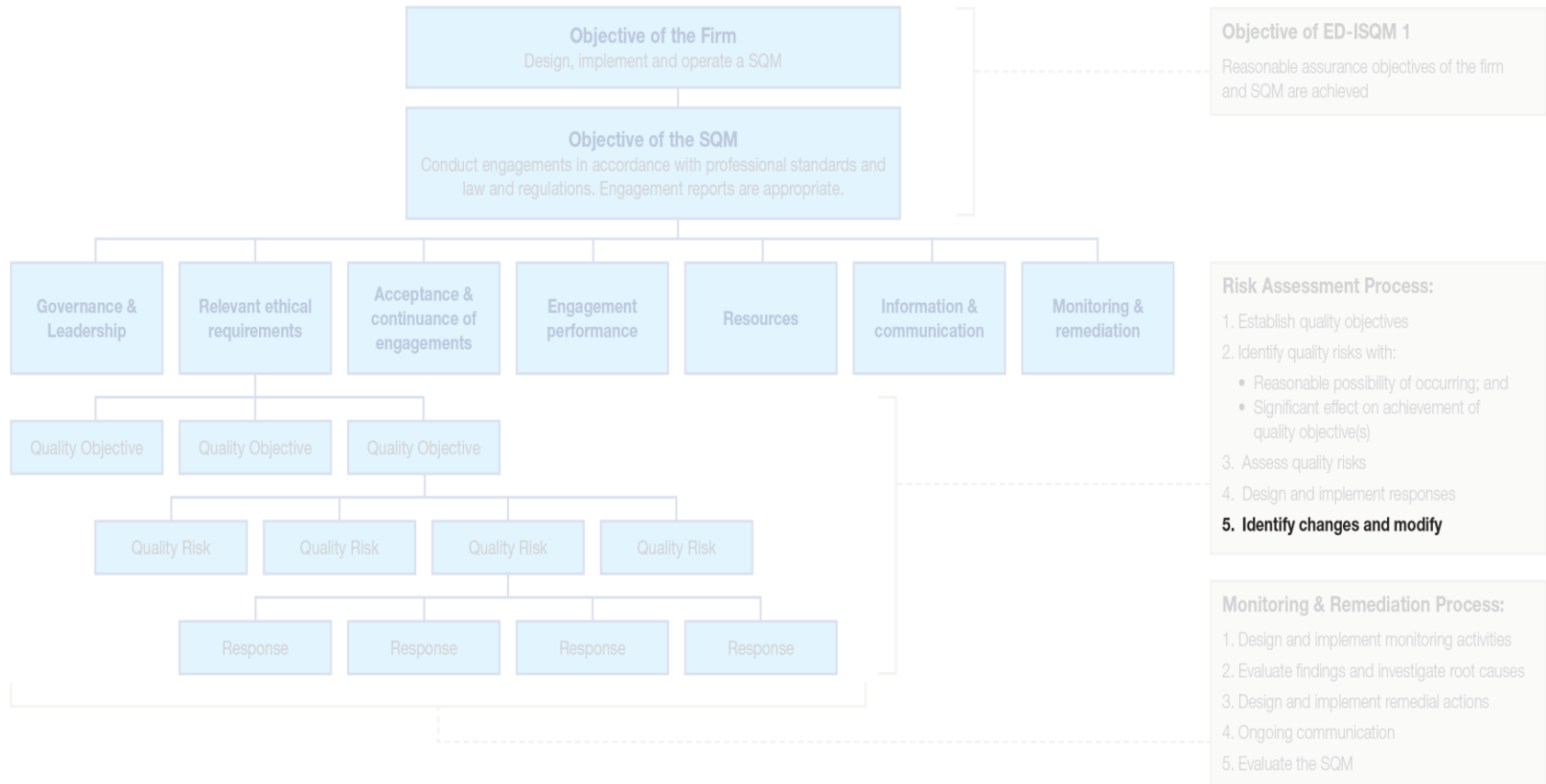
- Comprehensive or sufficient to address all assessed quality risks.
- Directly linked to quality objectives.

# Design & Implement Responses

## Small Co - Independence Example

1. Managing partner assigned responsibility for compliance with independence requirements.
2. Relevant ethical requirements identified as independence requirements in the Code and law.
3. Personnel the only individuals expected to comply with the relevant ethical requirements.
4. An annual written confirmation of compliance with independence requirements required.
5. Policy to not accept a client owned by personnel's family members.
6. Training on the relevant ethical requirements upon hiring and annual technical updates.
7. All personnel provided with a copy of the relevant ethical requirements.
8. Engagement team members required to confirm independence on each engagement.

# Modify & Change the Risk Assessment Process





# How Many Responses?

Components	7 x
Average Quality Objectives (33 required)	4 x
Estimated Quality Risks per Objective	3 x
Average Responses (32 mandatory)	3 x
<b>Total Responses?</b>	<b>252</b>
<b>50% Relevant Responses?</b>	<b>126</b>



**RISK ASSESSMENT?<sup>5</sup>**

5. Source <https://www.amazon.com/SmartSign-Notice-Closed-Maintenance-Plastic/dp/B00TZY6N76> adjusted for presentation.

# Poll Questions

Do you support the new system of quality management approach in ED-ISQM 1?

- Yes
- No

Are there any aspects of the risk assessment process that may create challenges in practice?

- Yes, the establishment of quality objectives
- Yes, the identification and assessment of quality risks
- Yes, the design and implementation of responses
- Yes, all of the above.
- No.

# Poll Questions

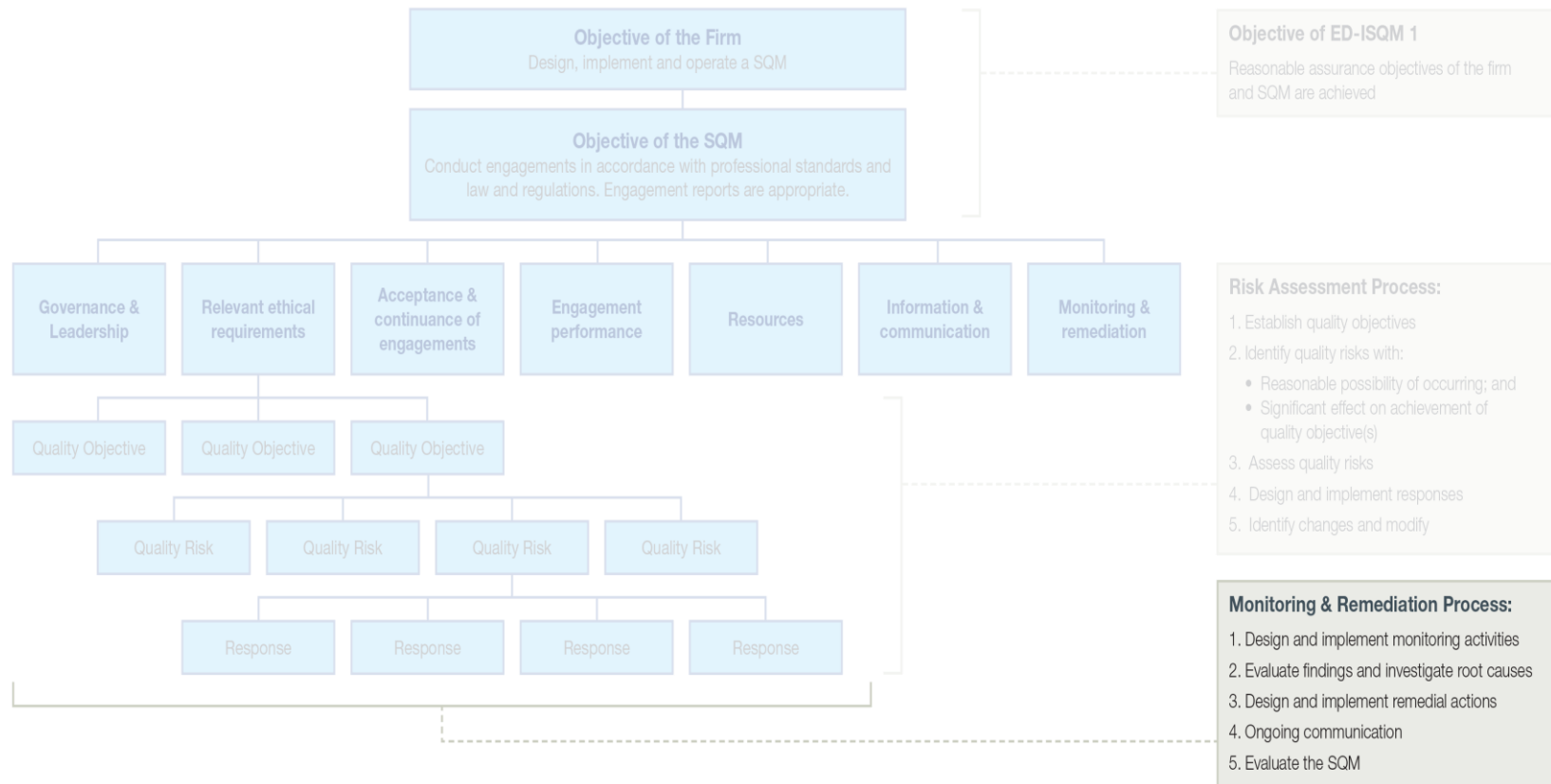
How long do you estimate it will take for your Firm to implement the risk assessment process of ED-ISQM 1?:

- 1 day
- 3 days
- 5 days
- 10 days or more

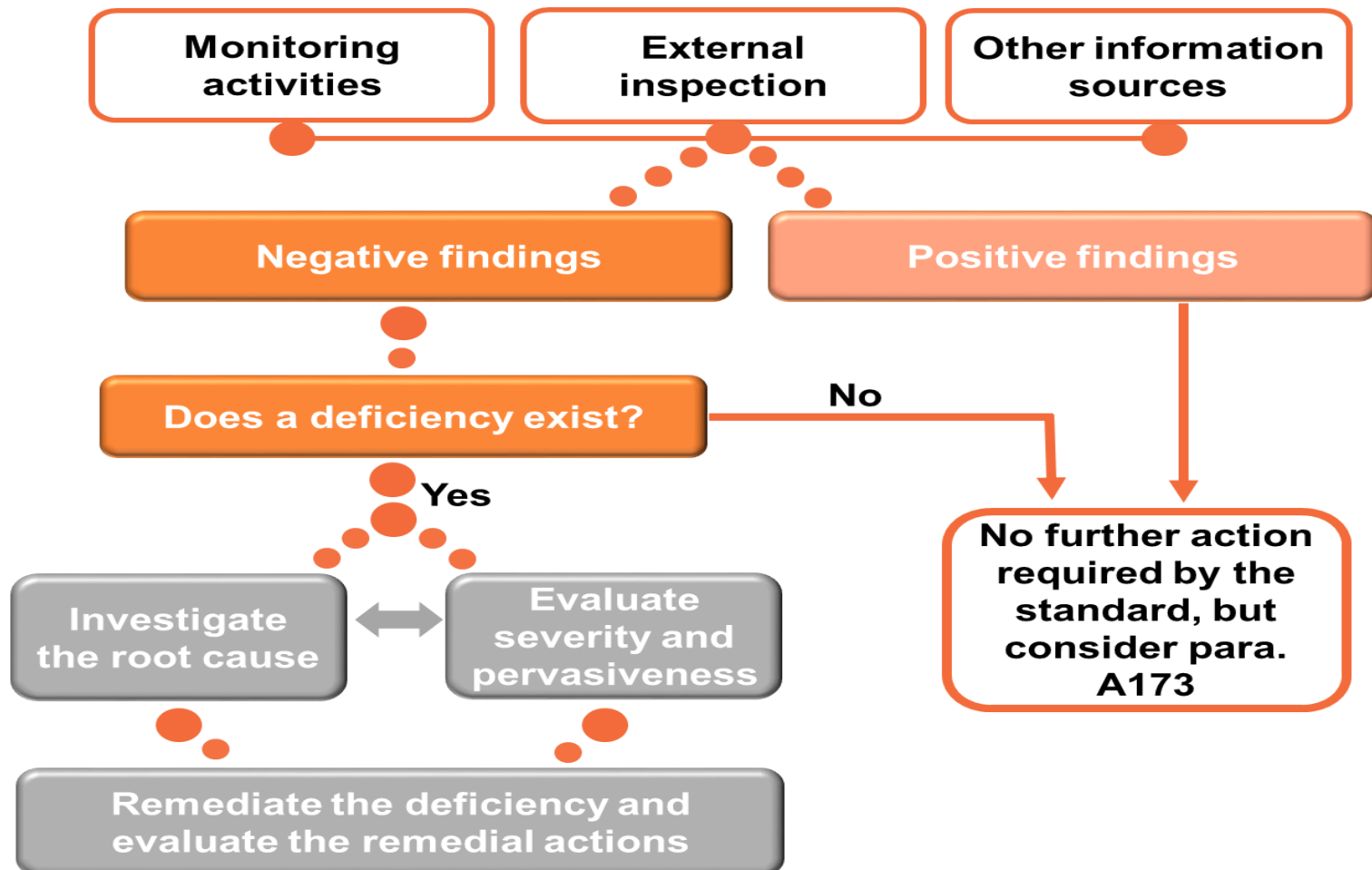
Do you consider the proposed effective date of December 2021 provides sufficient time to become compliant?:

- Yes
- No

# SQM Monitoring & Remediation



# SQM Monitoring & Remediation<sup>6</sup>



<sup>6</sup> Diagram from page 23 of IAASB Exposure Draft February 2019 Proposed International Standard on Quality Management 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Service Engagements*

# Poll Questions

Do you support the monitoring, remediation and evaluation process in ED-ISQM 1?

- Yes
- No

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
- Yes, the evaluation of findings and investigation of root causes
- Yes, the design and implementation of remedial actions
- Yes, annual evaluation of whether the SQM provides reasonable assurance
- Yes, all of the above
- No

# Networks & Service Providers

Network resources and services may be relevant or assist with compliance with the standard, however, the **firm remains responsible for its SQM.**

This includes evaluating the effect of network requirements or services on the firm's SQM and the risk assessment process and monitoring and remediation process.

**Service Providers** – Firm must determine if appropriate to use in SQM.

**SQM is at the firm level.**



# Poll Question

Do you support the proposals addressing networks to reduce undue reliance on network resources and services?

- Yes
- No

# Interaction of the Proposed Standards

Individually and collectively improve quality and address public interest issues, which are scalable and interrelated<sup>7</sup>:

- **ED-ISQM 1** – Firm to establish System of Quality Management
- **ED-ISQM 2** – Separate standard for Engagement Quality Reviews
- **ISA 220 (Revised)** – Engagement Partner responsible for managing quality at the engagement level



# ED-ISQM 2

## Engagement Quality Review (EQR)

**ED-ISQM 1** determines when an EQR is required as a response to quality risks relating to Engagement Performance – will lead to more EQRs including for “*entities of significant public interest*” (different to Public Interest Entities (PIEs)).

If an EQR is required, **ED-ISQM 2** is applicable which sets out:

- Appointments and eligibility for EQ reviewer, including new:
  - Requirements regarding sufficient time and compliance with relevant ethical requirements;
  - Enhanced application material on authority of the EQ reviewer.
- Performance of the EQR with new enhanced requirements; and
- Documentation for the EQR and application material increased and enhanced.

# Poll Question

Do you support a separate standard ED-ISQM 2 to cover appointment, eligibility, performance and documentation requirements for EQRs?

- Yes
- No

# ED-ISQM 1 Compared to APES 320/325

Extant APES 320	ED-ISQM 1
Policies and procedures required to establish SQC	<p>Tailor/customise design, implementation and operation of SQM:</p> <ul style="list-style-type: none"> <li>- Quality Objectives – may be extra</li> <li>- Quality Risks – Firm to determine</li> <li>- Responses – Establish policies and procedures to address risks</li> </ul>
Monitoring largely focused on inspections of completed engagements	<p>Monitoring requirements expanded to all aspects of the system                      Root cause analysis                      Assess effectiveness (at least annually)</p>
Higher level with limited application material and thus providing more flexibility	<p>Risk based approach – More complex, firms will need to invest time and resources to implement the standard initially, and on an ongoing basis. Potential benefit - over time will be more focused on quality risks.</p>
No specific prohibition on relying on Network policies and procedures	<p>SQM is at Firm level and cannot delegate reliance to Network</p>

# Potential Impacts of ED-ISQMs

- Will require significant investment of firm time and resources:
  - New set of complex requirements to understand, design and implement
  - Only comply with relevant requirements – navigate to determine relevance
  - Application material has grown threefold compared to the extant ISQC1
  - How and will quality improve?
  - Cost v Benefit analysis ?
- ED advocates use of professional judgement designed to promote scalability and ability to tailor the SQMs
- May lead to significant subjectivity and will depend on ability to justify why certain quality objectives were not chosen to the regulator or professional body
- Adds additional layers to quality management as the existing framework primarily addresses relevant responses (i.e. policies and procedures)

# Potential Impacts of ED-ISQMs

- Risk assessment:
  - No specific risks prescribed – promotes scalability and tailorability
  - All risks considered in the first instance – whole population
  - Only identify and assess those meeting threshold requirements
- Continual and iterative process responsive to change:
  - Results in continuous re-evaluations as circumstances or risks change
  - Annual evaluation of effectiveness of the SQM

# Poll Question

Do you consider ED-ISQM 1 is appropriately scalable (applicable to firms of varying size, complexity and circumstances)?

- Yes
- No

If not, how could scalability be improved?



# Purpose & Disclaimers

This set of PowerPoint slides has been developed by APESB Technical Staff based on Proposed International Standard on Quality Management 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Service Engagements* and Proposed International Standard on Quality Management 2 *Engagement Quality Reviews*, issued by the IAASB in February 2019.

These slides provide only an *overview* of the proposed standards on quality management and do not purport to present all the detailed proposed changes. The slides should be read in conjunction with the proposed standards, the text of which alone is authoritative. The slides do not form part of the proposed standards.

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