

5 June 2019

Scientia Professor Simnett AO
Chair
Auditing and Assurance Standards Board
PO Box 204
Collins St West
Melbourne Victoria 8007
AUSTRALIA

Dear Professor Simnett

Explanatory Memorandum – ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the *Explanatory Memorandum - ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

The views expressed in this submission represent those of all Australian members of ACAG. ACAG's comments are primarily in the context of the public sector, which reflects ACAG's significant experience and involvement in the sector.

One of the more significant matters identified by ACAG relates to the interrelationship between the proposed suite of quality management standards and the IESBA Code (the Code). In particular the introduction and application of 'significant public interest entity' compared to the existing 'public interest entity' concept within the Code; and the requirement to rotate engagement quality reviewers already established within the Code not currently replicated in ED-ISQM 2.

ACAG also notes that the revised standard appears to be more prescriptive in nature than the existing suite of quality management standards (extant ISQC 1 and ISA 220) and questions whether this was the intent of the IAASB.

The attachment to this letter addresses the AUASB's additional specific requests for comments, in addition to the IAASB's requests for comments.

ACAG appreciates the opportunity to comment and trust that you will find the attached comments useful.

Yours sincerely



Andrew Richardson
Chair
ACAG Audit Standards Committee

AUASB Australian Specific Questions

Matters for further consideration in relation to the Quality Management Standards

16. Do you consider the definition of engagement teams has been consistently applied across the suite of Quality Management Standards?

ACAG believes the definition of engagement team has been consistently applied across ED-220 and ED-ISQM 1, however the term is not defined in ED-ISQM 2.

ACAG acknowledges the explanatory guidance in ED-220 (paragraphs A16 to A19) defines the engagement team to include individuals from service delivery firms or network firms and excludes the engagement quality reviewer. However, this is not made clear in ED-ISQM 1. ACAG recommends that ED-ISQM 1 include the same explanatory paragraphs or reference to specific paragraphs in ED-220 when discussing the engagement team to ensure consistent application.

17. In relation to engagement quality reviews:

(a) Do you agree with the definition of Engagement Quality Reviews/Reviewer and do you consider the term to be clear and capable of application in a consistent way across engagements?

Yes.

(b) Do you agree that engagement quality reviews should also be performed for audits of financial statements of entities that the firm determines are significant public interest entities?

Yes, subject to more clarity being provided in the standard on the intended scope of significant public sector entities.

(c) Is the term “significant public interest entity” clear and capable of application in a consistent way across engagements in Australia?

Refer to comments made in response to question 11.

Matters for further consideration in relation to ED – ISQM 1

18. Do you consider the requirements of ED – ISQM 1 are drafted appropriately to result in a principles-based standard? If no, what elements within the requirements are not principles-based?

ACAG notes that the quality objectives and responses required under the proposed standard are more prescriptive in nature than the existing suite of quality management standards (extant ISQC 1 and ISA 220) and questions whether this was the intent of the IAASB. The requirement to set prescribed objectives and responses as well as additional objectives and responses could be construed by regulators, and others using the standard to assess compliance, as a checklist that needs to be met. The extent of quality objectives, risk assessments and responses will result in increased documentation as to why prescribed objectives and responses are not applicable.

19. Do you consider that components of the System of Quality Management (SOQM) should be weighted / proportionate within the standard, that is, to have greater or lesser focus to assist in

meeting the overall objective of audit quality? How would you demonstrate proportionality of the components of SOQM?

No, each component contributes to the overall objective of audit quality and the proportionality will depend on the nature and circumstances of the entity. As part of the development of objectives and responses, each firm should focus on components that have a higher assessed quality risk. To implement the risk-based approach the weighting and proportionality will be responsive to the assessed risks. If weighting or proportionality of the components was prescribed within the standard, it may impact the firm's ability to tailor the SOQM to meet the overall objective of audit quality.

20. Are the introductory paragraphs and appendix necessary and do you find them helpful; or do you find the introductory paragraphs and appendix to be duplicative and the content addressed elsewhere within the requirements and application material?

As noted in response to question 3, there is an opportunity to incorporate content from the appendix into application material to avoid duplication.

21. Are the requirements and application material contained within paragraphs 10(c), 29 and A57 sufficiently clear? Is it clear what items may fall into this category and how you will demonstrate compliance?

As noted in the response to question 6(c), additional guidance regarding the risk assessment process would be helpful.

In relation to paragraph 10(c), it is not clear if a firm can tailor the nature and extent of a response required under the standard to address the firm's assessed quality risks, particularly if the risk is assessed as low.

There is a lack of clarity around what is a significant effect on the achievement of an objective. The risk assessment process will be a complex process given the number of prescribed quality objectives required by the standards.

22. Do you support the documentation requirements in paragraph 67, particularly those related to the monitoring and remediation process? Do you consider that the documentation requirements in relation to the monitoring and remediation process are proportionate relative to the remainder of the documentation requirements for other elements of the system of quality management? If yes, provide your reasons; if no, provide your reasons and suggestions.

Yes. The documentation related to the monitoring and remediation process are considered to be reasonable and in line with ACAG practice. While the documentation requirements do not prescribe required documentation for other specific components of the system of quality management, evidence of the responses will be required to be captured as part of the annual assessment.

23. Do you consider that the term service provider is clearly articulated in paragraph 64 and is capable of application in a consistent way across engagements? Do you agree with the examples of resources provided by a service provider as contained in paragraph A205 of the proposed standard?

It would be useful to include a definition for the term service provider, as the term is not clearly articulated in paragraph 64. The examples of resources provided by a service provider in A205 are

helpful for application. In the ACAG context, service providers will also include audits firms contracted to perform engagements on behalf of audit offices.

Considerations related to Australian Principles and Practices and Laws and Regulation

24. Are there any modifications to the extant ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Historical Financial Information, Other Assurance Engagements and Related Services Engagements which are still relevant to ED – ISQM 1?

Yes, the Aus paragraphs within the extant ASQC 1 will remain relevant to ED-ISQM 1. Of particular interest to ACAG are the paragraphs that refer to “public sector equivalents”, Aus A1.1, and Aus A68.1 that specifically relate to assurance engagements conducted in the public sector by Auditors General pursuant to legislation.

25. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?

No, as the AUASB has not considered Australian modifications to reflect Australian laws and regulations.

26. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?

As noted in extant ASQC 1 paragraph Aus A1.1 and acknowledged in A89 of ED-ISQM 1, Auditors-General conduct audits and engagements pursuant to legislation that may impact the application of requirements related to acceptance and continuance of client relationships and specific engagements.

27. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?

Overall, ACAG does not believe there are principles or practices that may or do prevent or impede the application of, or conflict with the proposed standard.

28. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:

(i) Where those costs are likely to occur;

Additional costs are expected in relation to new requirements such as the introduction of the root cause analysis. For firms who do not have existing methodology or processes in place to undertake root cause analysis, this will be time intensive as well as conducting the analysis itself.

There will be significant initial costs in developing the quality management framework in line with the proposed standard, including identification of quality objectives, identification and assessment of quality risks and development of responses in addition to those required under the standard.

(ii) The estimated extent of costs, in percentage terms (relative to audit fees); and

The extent of costs cannot be estimated across ACAG. It should not be significant in relation to audit fees.

(iii) Whether expected costs outweigh the benefits to the users of audit services?

The proposed quality management framework is expected to provide benefits to audit quality. A strong and robust quality management framework is a fundamental cornerstone of Offices of Auditors-General within ACAG and is critical to uphold the confidence of our primary users, Parliament. The benefits are expected to outweigh the costs.

29. Are there any other significant public interest matters that stakeholders wish to raise?

ACAG is not aware of any other significant public interest matters.

5 June 2019

Mr Martin Baumann
Chair
International Auditing and Assurance Standards Board (IAASB)
529 5th Avenue
New York, New York 10017
UNITED STATES OF AMERICA

Dear Mr Baumann

Exposure Draft, proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the *Explanatory Memorandum - ISQM 1 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

The views expressed in this submission represent those of all Australian members of ACAG. ACAG's comments are primarily in the context of the public sector, which reflects ACAG's significant experience and involvement in the sector.

One of the more significant matters identified by ACAG relates to the interrelationship between the proposed suite of quality management standards and the IESBA Code (the Code). In particular the introduction and application of 'significant public interest entity' compared to the existing 'public interest entity' concept within the Code; and the requirement to rotate engagement quality reviewers already established within the Code not currently replicated in ED-ISQM 2.

ACAG also notes that the revised standard appears to be more prescriptive in nature than the existing suite of quality management standards (extant ISQC 1 and ISA 220) and questions whether this was the intent of the IAASB.

The attachment to this letter addresses the IAASB's requests for comments.

ACAG appreciates the opportunity to comment and trust that you will find the attached comments useful.

Yours sincerely



Andrew Richardson
Chair
ACAG Audit Standards Committee

Responses to IAASB Request for Comments

Overall Questions

1. Does ED – ISQM 1 substantively enhance firms’ management of engagement quality, and at the same time improve the scalability of the standard? In particular:

(a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?

Yes, ACAG supports the new quality management approach, which ACAG considers will enhance the management of engagement quality in combination with proposed ED-ISQM 2 and ED- 220.

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

Yes, ACAG believes that the proposals generally generate benefits for engagement quality through:

- The emphasis on organisational culture and leadership commitment to quality;
- The root cause identification of deficiencies identified through monitoring activities and targeted remedial actions to address the root causes of identified deficiencies; and
- Increased accountability and transparency.

If a firm or audit office establishes appropriate responses to meet the quality objective proposed at paragraph 36(b), considering the related application and other explanatory material at A94-97, this will assist in supporting the exercise of appropriate professional scepticism.

ACAG notes paragraph 36(b) states “professional judgement and, when applicable to the type of engagement, professional scepticism”. Is it the IAASB’s intention that there are types of engagements when exercising professional scepticism is not applicable?

(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?

Conceptually, the quality management framework designed to meet objectives, with responses tailored on a risk-based approach encourages scalability for firms of varying size, complexity and circumstances.

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?

The definition of responses in paragraph 19(t) includes policies implied through actions and decisions. An implementation challenge will be capturing the responses that are implied through actions or decisions and other responses that are informal in nature and not readily documented. The responses that are expected to create challenges for capturing relate to firm culture and leadership, for example, responses required under paragraph 24(a)(ii). These responses will include communication through staff meetings and in day-to-day actions and behaviours. A further implementation challenge will arise in the annual assessment of the system of quality management regarding capturing, measuring and assessing these responses.

Further guidance on how to measure and assess these implied responses demonstrated through actions, decisions and behaviours with examples of expected documentation would be useful.

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?

See responses to question 2, 6(c) and 11 regarding examples where additional guidance would be helpful.

ED-ISQM 1 is notably longer than the extant ISQC 1. There is an opportunity to incorporate the content from Appendix 1 into the application material to avoid duplication.

Specific Questions

4. Do you support the eight components and the structure of ED – ISQM 1?

AGAC supports the eight components and 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?

Yes, ACAG supports the objective of the standard, including the objective of the system of quality management. However, the objective does not explicitly link to the public interest role.

Notwithstanding, ACAG believes the public interest role should be fulfilled through achievement of the objective of the standard and conducting quality audits in compliance with professional standards, in particular ethical standards; and issuing audit reports that are appropriate in the circumstances.

ACAG notes that the public interest role will vary between private sector audit firms and public audit offices, as well as across engagement types. For Offices of Auditors-General, the public interest role and purpose is to support accountability and transparency in the Government sector through independent reporting to Parliament.

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? 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?

Yes, ACAG supports the application of the risk assessment process across the components of the system of quality management. A risk-based approach to quality management should result in tailored responses that address the risks and circumstances of each firm.

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

(i) Are the required quality objectives appropriate?

ACAG supports the concept of establishing quality objectives.

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

Yes, paragraph 26 sets out the requirement to establish additional quality objectives beyond those required by the standard when necessary to achieve the objective of the standard.

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

Yes, however increased guidance regarding the assessment of quality risks would be helpful. In particular, how to assess the significance of the effect on the achievement of a quality objective, i.e. the factors that would indicate that the 'identified deficiencies are of a severity and pervasiveness that indicate that the system may not be providing reasonable assurance...'
(paragraph 56).

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

(i) Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?

The approach should result in firms designing and implementing responses tailored to address assessed quality risks.

(ii) Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?

Yes, paragraph 30 sets out the requirement to design and implement responses in addition to those required by the standard.

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

Yes, there is an appropriate level of focus on leadership and governance.

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?

ACAG supports the assignment of operational responsibilities within proposed paragraph 24(a)(iii). ACAG would support the assignment of responsibility for relevant ethical requirements, noting that relevant ethical requirements in the public sector include ethical requirements outside of those defined in auditing standards and the Code of Ethics for Professional Accountants (the Code), such as codes of conduct and gift policies.

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

Network requirements are not relevant to ACAG, no comment.

9. Has ED – ISQM 1 been appropriately modernised to address the use of technology by firms in the system of quality management?

In a general sense, ED-ISQM 1 has been modernised through referencing the use of technology in the system of quality management. Within the risk assessment process and development of tailored responses, the audit firm will be able to incorporate specific responses related to technology as necessary depending on assessed risks.

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?

Yes. From a public sector perspective, ACAG offices will need to consider which external parties it is appropriate to communicate with and in what format. Public sector audit offices are not currently required to produce transparency reports as is the case for large firms in the private sector.

11. Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?

Yes, ACAG supports the proposal addressing the scope of engagements that should be subject to an engagement quality review, subject to the standard providing clarity around the term significant public interest entity.

The introduction of the concept of a significant public interest entity without guidance on how this term relates to the established definition of public interest entities (PIEs) may result in inconsistent identification of financial statement audits that should be subject to an engagement quality review. It is not clear from the application material if an entity of significant public interest could include an entity not captured by the PIE definition within the IESBA Code or if it is “significant PIEs” i.e. only entities that meet the definition of a PIE that attract a significant level of public interest.

12. In your view, will the proposals for monitoring and remediation improve the robustness of firms’ monitoring and remediation? In particular:

(a) Will the proposals improve firms’ monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?

Yes, ACAG believes that the proposals will improve the robustness of firms’ monitoring and remediation, particularly through the introduction of the investigation of root causes of deficiencies. The identification of root causes should improve the design and evaluation of the remedial actions as well as the evaluation of the system of quality management as a whole. The application guidance provides useful examples of innovative monitoring techniques.

(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?

Yes.

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

Yes.

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

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

Yes.

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

ACAG agrees with the IAASB view outlined in the Explanatory Memorandum that performing a root cause analysis of positive findings should not be a requirement. The application material is useful in providing guidance on when performing a root cause analysis on positive findings may provide benefits to a firm or assist in determining the root cause of deficiencies through use of comparison. The use of root cause analysis on positive findings should be a matter of professional judgement.

(iii) 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?

No challenges identified.

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?

Network requirements are not relevant to ACAG, no comment.

14. Do you support the proposals addressing service providers?

Yes. In the public sector, the use of service providers is common including engaging audit firms to perform engagements on behalf of the audit office, purchase of audit methodology and IT infrastructure providers. The required responses under paragraph 64(a) – (c) will generally be addressed through procurement processes and evaluation of tender responses.

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?

ACAG is not a national standard setter or regulator, no comment.