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ISQM 1 and ISA 220

7 June 2022

Agenda: Quality Management Standards

Firm Level

— ISQM 1, Quality Management at the Firm Level

Engagement Level

— ISQM 2, Engagement Quality Reviews

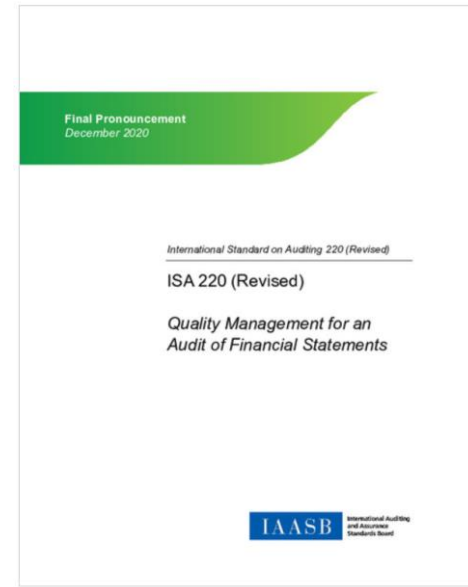— ISA 220, Quality Management at the Engagement Level

Results of information gathering and outreach activities

Standards need to address

- firm governance and leadership
- culture and tone at the top of the firms
- emergence of new trends
- concerns about undue reliance by firms on information received from networks

- small firm challenges in applying the standards;
- strengthening the Engagement Partners responsibilities
- improved robustness quality management at the firms

The IAASB Quality Management Standards

Final Pronouncement
December 2020

International Standard on Quality Management

International Standard on Quality Management 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

IAASB International Auditing and Assurance Standards Board

Final Pronouncement
December 2020

International Standard on Quality Management 2

International Standard on Quality Management 2

Engagement Quality Reviews

IAASB International Auditing and Assurance Standards Board

Final Pronouncement
December 2020

International Standard on Auditing 220 (Revised)

ISA 220 (Revised)

Quality Management for an Audit of Financial Statements

IAASB International Auditing and Assurance Standards Board

IAASB's publication "ISQM 1: First-time implementation guide" is helpful in making this project less daunting.

Effective Dates

Systems of quality management in compliance with ISQM 1 are required to be designed and implemented by December 15, 2022, and the evaluation of the system of quality management required by the ISQM is required to be performed within one year following December 15, 2022.

ISQM 2 is effective for:

(a) Audits and reviews of financial statements for periods beginning on or after December 15, 2022; and

(b) Other assurance and related services engagements beginning on or after December 15, 2022.

ISA 220 is effective for audits of financial statements for periods beginning on or after December 15, 2022.

Work backwards from the effective date and set milestones to meeting the deadline for implementation

IAASB First-Time Implementation Guide extract

Practical implementation examples

What is going to be my approach?

- A phased approach building up to the effective date. This lessens the impact of having many changes all at once. This would not be considered early adopting as only a portion of ISQM

- Commence operation of all new and revised policies at the effective date

- Pilot or test the new SoQM prior to the effective date where the SoQM would not be considered to be in operation until the firm has implemented and commenced operation of the new SoQM in its entirety.

ISQM 1, Quality Management at the Firm Level

IAASB First-Time Implementation Guide extract

JUNE 2021

FIRST-TIME IMPLEMENTATION GUIDE

International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

IAASB International Auditing and Assurance Standards Board

If the firm currently complies with ISQC 1, the firm will already have policies and procedures in place.

The policies and procedures may still be relevant and appropriate for the firm's new SoQM, or may need to be revised or enhanced such that they are appropriate for the new SoQM.

Although the existing policies and procedures may continue to be relevant and appropriate, the firm would still need to establish a SoQM that is compliant with ISQM 1.

IAASB First-Time Implementation Guide extract

JUNE 2021

FIRST-TIME IMPLEMENTATION GUIDE

International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

IAASB International Auditing and Assurance Standards Board

The firm, regardless of its size, is required to comply with ISQM 1, and if applicable, ISQM 2.

Engagement teams performing audits of financial statements are required to comply with ISA 220 (Revised).

For some aspects of the SOQM, a smaller firm may determine that there is no need to establish firm-wide responses, and the firm may instead design and implement responses that operate concurrently with the engagement-level quality management.

Scalability

Embedded in the requirements of SoQM 1:

- Quality objectives are outcome based. The firm determines how to achieve the Quality Objective.

- Quality risks are tailored to the firm. These would relate to the nature and circumstance of the firm and its engagements.

- Limited number of required specified responses required by the Standard. The Firm gets to design and implement its own responses to the other quality risks identified.

- Monitoring and remediation process requirements sets out what the firm is expected to have in place. How the firm implements that process is tailored by the firm.

Responsibility for the SoQM

Roles and responsibilities that the firm is required to assign to individuals

- Ultimate responsibility and accountability for the SOQM

- Operational responsibility for the SOQM

- Operational responsibility for specific aspects of the SOQM

Individuals assigned these responsibilities are required to have the appropriate experience, knowledge, time, influence and authority.

Although few individuals may be assigned responsibility, obtaining input from others in the firm will help to identify risk and design and implement responses.

ISQM 1: The System and Its Components

- New focus on quality management through a risk based approach

- A system that operates in an iterative and integrated manner

- A proactive approach, with a continual flow of remediation and improvement

- Scalable to the nature and circumstances of the firm and the engagements it performs

Do I understand how these interrelate in my firm?

IAASB First-Time Implementation Guide extract

JUNE 2021

FIRST-TIME IMPLEMENTATION GUIDE

International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

IAASB International Auditing and Assurance Standards Board

- The firm is required to meet all of the requirements within ISQM 1, including the requirements in the components.

- The firm is not required to organize its SOQM according to the eight components, and may choose to use different terminology or frameworks to describe the components of the SoQM.

Am I going with the IAASB's components or tailoring something for my firm?

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Governance and Leadership and overall responsibility for the system

Leadership

- Specified responsibilities

- Required to undertake an annual evaluation of the system and conclude thereon

- Appropriate qualifications, influence and authority

- Periodic performance evaluations of leadership

Focus on culture that demonstrates a commitment to quality, which permeates throughout the firm

- The firm's role in serving the public interest

- Links quality to the firm's strategic decisions and actions

Other matters

- Organizational structure and assignment of roles, responsibilities and authority

- Resources planning, including financial resources

How am I addressing the new and enhanced requirements?

The Firm's Risk Assessment Process

Establish quality objectives

— Quality objectives required by ISQM 1

— Additional quality objectives when necessary to achieve the objectives of the standard

Identify and assess quality risks

— Risks with a reasonable possibility of occurring and affecting the achievement of a quality objective

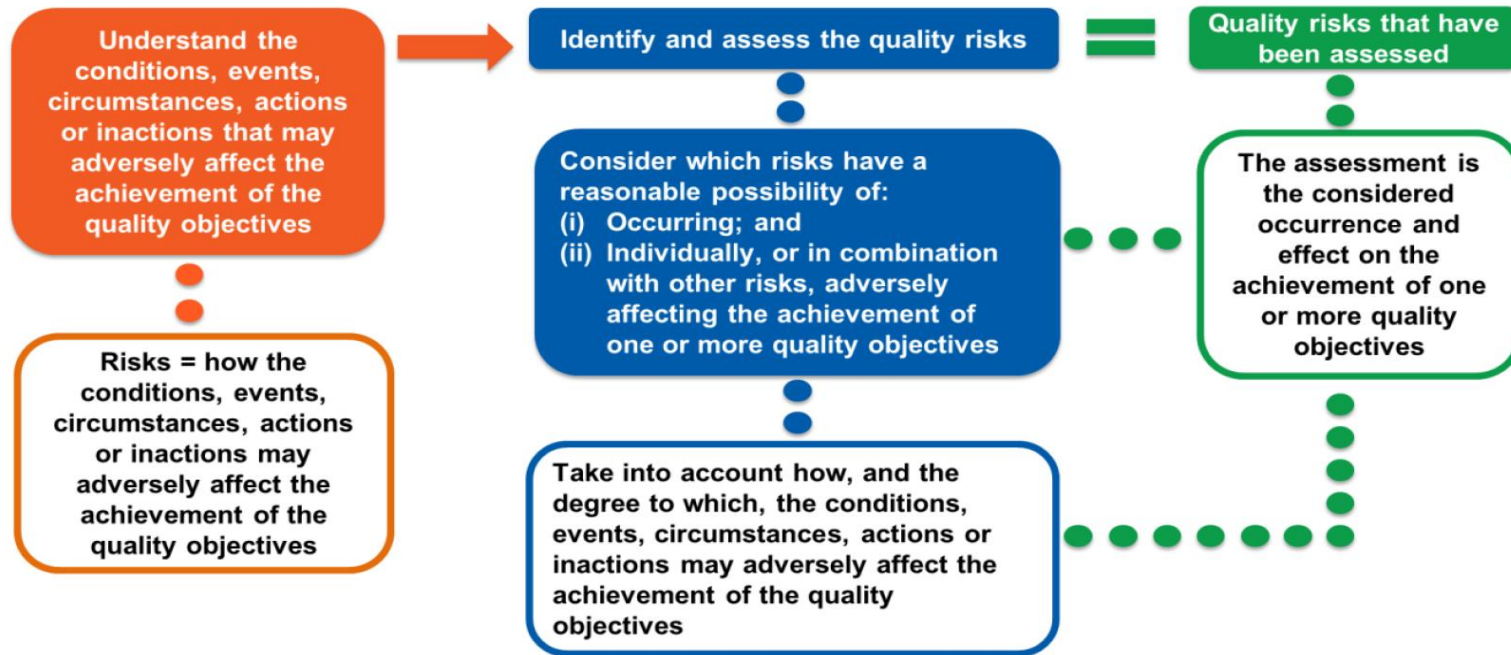— Understand conditions, events, circumstances, actions or inactions

Design and implement responses

— Design and implement firm's responses, and include certain responses specified in the standard

> Perform a gap analysis between current system and what new system you may need to have.

IAASB First-Time Implementation Guide extract

Practical implementation examples

FIRST-TIME IMPLEMENTATION GUIDE

International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

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Understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives

→

Identify and assess the quality risks

=

Quality risks that have been assessed

Risks = how the conditions, events, circumstances, actions or inactions may adversely affect the achievement of the quality objectives

Consider which risks have a reasonable possibility of:
(i) **Occurring; and**
(ii) **Individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives**

The assessment is the considered occurrence and effect on the achievement of one or more quality objectives

Take into account how, and the degree to which, the conditions, events, circumstances, actions or inactions may adversely affect the achievement of the quality objectives

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Resources

Human, technological and intellectual resources used in the system and in performing engagements

- Appropriateness of resources

- Obtain or develop, implement, maintain, and use of resources

    - *Includes obtaining external individuals if needed*

- Accountability of personnel and their commitment to quality

External service providers used in the system or in performing engagements

- Competent auditors from outside the firm's network

- Determine that the resources from the service provider are appropriate for use

Do I have an inventory of these resources and whether they meet the new and expanded requirements in relation to the SoQM?

Information and Communication

- Relevant and reliable information needed to operate the system
  - Information exchange embedded in culture of the firm
  - Establish an information system
- Internal and external communication
- Two-way communication
- Communication with external parties
  - All external communication about the system
  - Audits of listed entities – communicate about the system to those charged with governance
  - Firm addresses when it is otherwise appropriate to communicate with external parties
  - Specific information communicated, form of communication and nature, timing and extent of communication determined by the firm

Monitoring and Remediation

- Monitor the whole system

- Tailor monitoring activities

  - Depends on many factors, e.g., design of system, circumstances of the firm, changes in the system, information known about the system

- Inspect completed engagements

  - Increased focus on appropriate selection taking into consideration risk and other monitoring activities

  - Select engagement partners on a cyclical basis

- Framework for evaluating findings and identifying deficiencies, and evaluating severity and pervasiveness of deficiencies

  - Includes investigating the root cause(s) of deficiencies

- Appropriate remediation of deficiencies, and determining that remedial actions are effective

- Communication to leadership, engagement teams and others

The Firm's responsibilities when using a Network

- Network requirements/services – e.g., policies or procedures, methodology, IT applications

- Firm responsible for its own system; should not place undue reliance on network

- Requirements include:

  - Understand network requirements/services

  - Determine effect on the firm's system (e.g., adapt/supplement)

  - Determine effect of network-level monitoring activities on the firm's monitoring activities

  - Understand network-wide monitoring, including how the network determines that network requirements are implemented across the network

  - Exchange information with the network

Other components

- **Engagement performance**

  – Professional judgment and professional skepticism at the engagement level

- **Selection of engagements for engagement quality (EQ) review**

  – Expanded – includes focus on entities of significant public interest and when a review is appropriate based on risk

- **Relevant ethical requirements**

  – Principles-based approach

  – Includes others external to the firm (e.g., network firms or service providers) to the extent that the firm's relevant ethical requirements apply to them

Evaluating the SoQM

The evaluation is at a point in time and the conclusion is focused on whether the SOQM provides reasonable assurance that:

- The firm and its personnel are fulfilling their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and engagements are being conducted in accordance with such standards and requirements; and

- Reports being issued by the firm and engagement partners are appropriate in the circumstances.

3 possible conclusions:

1

The SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved

2

Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation and operation of the SOQM, the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved

3

The SOQM does not provide the firm with reasonable assurance that the objectives of the SOQM are being achieved

IAASB First-Time Implementation Guide extract

Evaluating the SoQM – Smaller firm consideration

In the case of a smaller firm, the information used by the firm to undertake the periodic performance evaluations of leadership may include the results of the firm's monitoring activities, and the evaluation of the SOQM. In a larger firm, there may be information in addition to the results of the firm's monitoring activities that is used by the firm in undertaking the periodic performance evaluations of leadership.

Documentation

ISQM 1 requires the firm to prepare documentation to achieve three principles:

Support a consistent understanding of the SOQM by personnel, including an understanding of their roles and responsibilities with respect to the SOQM and the performance of engagements	Support the consistent implementation and operation of the responses	Provide evidence of the design, implementation and operation of the responses, to support the evaluation of the SOQM by the individual(s) assigned ultimate responsibility and accountability for the SOQM

Documentation

ISQM 1 requires the firm to prepare documentation addressing specific matters.

- The quality objectives

- The quality risks; and

- A description of the responses and how the firm's responses address the quality risks. Paragraph A205 of ISQM 1 suggests that, in documenting how the firm's responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (i.e., the considered occurrence and effect on the achievement of one or more quality objectives).

Objective of ISQM 2

Requirements and application material related to the firms engagement quality reviews

— Criteria to determine which engagements should be reviewed

— Scope of engagements subject to review

— Objective of the review

— Eligibility of reviewers

— Reviewer's responsibilities

Relationship between ISQM 1 and ISQM 2

Establish quality objectives

- Quality objectives required by ISQM 1

- Additional quality objectives when necessary to achieve the objectives of the standard

Identify and assess quality risks

- Risks with a reasonable possibility of occurring and affecting the achievement of a quality objective

- Understand conditions, events, circumstances, actions or inactions

Design and implement responses

- Design and implement firm's responses, and include certain responses specified in the standard

- Specified Responses include EQ reviews and selection of engagements for EQ review:

  - Audits of listed entities
  - Required by law or regulation
  - Engagements for which the firm determines that EQ review is an appropriate response to address one or more quality risk(s)

Applicability of ISQM 2

Is an EQR required in accordance with ISQM 1?

NO → **ISQM 2 does not apply**

YES → **ISQM 2 applies**
* Appointment and eligibility of EQ reviewer
* Performance of EQ review
* Documentation of EQ review
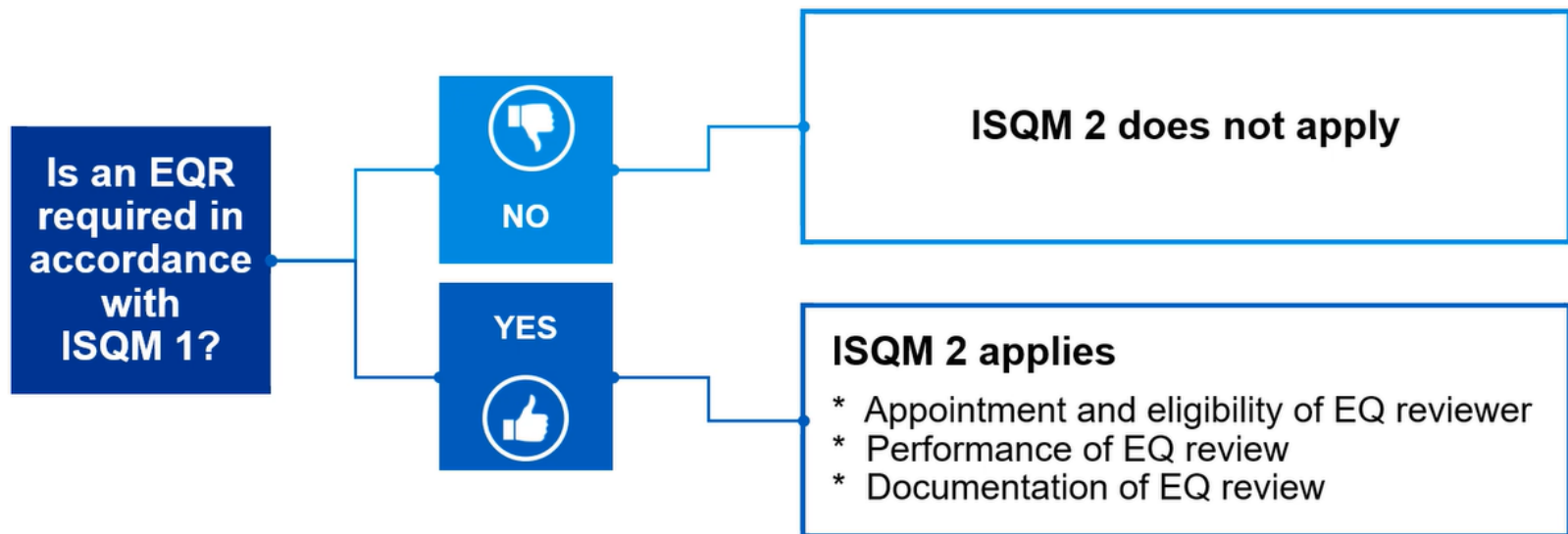
ISQM 2: An overview

Eligibility requirements for EQ reviewers	Performance of EQ reviews

- **Threats to objectivity:** 2-year cooling-off period for an engagement partner to serve as an EQ reviewer

- Sufficient time to perform an EQ review

- Permitted use of qualified external EQ reviewers and assistants

- Actions when eligibility of EQ reviewer is impaired

- Focus on significant matters and significant judgments

- Involvement of EQ reviewer at appropriate points in time throughout the engagement

- **Stand-back requirement:** whether performance requirements of ISQM 2 have been fulfilled

- Engagement partner precluded from dating engagement report until notification of completion from EQ reviewer

Relationship between ISQM 2 and ISA 220

– **Quality management concepts in ISQM 1 carried through at the engagement level.**

– **The engagement team may depend on the firm's policies or procedures, unless**

  – (i) they would not be effective or

  – (ii) they are not operating effectively.

  Engagement team should not blindly rely on the firm's system of quality management.

ISA 220: An overview

Engagement partner has overall responsibility for managing and achieving quality

- Sufficiently and appropriately involved throughout the audit

- Environment that emphasizes firm's culture and expected behavior of engagement team members

Engagement performance

- Tailor nature, timing and extent of direction, supervision and review to nature and circumstances of engagement and resources

- Clarity on what engagement partner needs to review

Human, technological and intellectual resources

- Revised definitions of engagement partner and engagement team

- Sufficient and appropriate resources for engagement

- Take appropriate action if resources are insufficient or inappropriate

Stand-back on overall responsibility for managing and achieving quality

Clarifying engagement partner's responsibilities

The engagement partner shall take responsibility for…

The engagement partner shall…

Definition of "engagement team"

All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, excluding an auditor's external expert and internal auditors who provide direct assistance on an engagement.

Implementation guidelines

Many things will be transferrable from ISQC1 systems to ISQM 1. Some things will be incremental, new or different.

Perform a gap analysis between current system and what new system you may need to have.

Responses will need to be tailored, and may need to be specific to address quality risks.

Determine how much time is needed to implement changes.

Start early and engage those involved at an early stage.

Consider the impact throughout the firm, including areas not typically involved in the current system or in performing engagements.

Consider what IT resources will be needed, such as IT systems to capture quality objectives, quality risks and responses.

Communicate the changes to support an understanding of the changes, why the changes are being made and the roles and responsibilities of individuals.

Engage with external support (i.e. service providers) at an early stage.

Expect that changes may go beyond areas traditionally involved in quality control processes.

Involve firm leadership in the process so they understand and are committed to the change

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Thank you