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16 March 2020

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submitted via email to comments@pcaobus.org

Re.: PCAOB Rulemaking Docket Matter No. 046
Concept Release "Potential Approach to Revisions to PCAOB Quality Control Standards"

Dear Madam, dear Sir,

We would like to thank you for the opportunity to provide the PCAOB with our comments on the Rulemaking Docket Matter No. 046, Concept Release "Potential Approach to Revisions to PCAOB Quality Control Standards", hereinafter referred to as "the Concept Release".

In this letter, we provide some general comments on the Concept Release. We have chosen to respond to selected questions in the appendix to this letter.

Significant Acknowledgements of Recent Progress

The IDW welcomes the PCAOB's acknowledgement that some firms have significantly improved their focus on audit quality and have made notable advances in internal control, quality management and audit firm governance. We are equally pleased to note the PCAOB's observations from its oversight activities that have shown that improvements in quality control can enhance audit quality.

We are especially pleased to note the PCAOB's acknowledgement that since many firms are subject to quality control requirements of other standard setters such as the IAASB and AICPA it would not be practicable to require firms to comply with fundamentally different QC standards. We welcome the PCAOB's

sensitivity to the issue of unnecessary differences of QC standards as a key practical aspect, which we have consistently raised with the PCAOB in our previous comment letters.

Cost Implications

In terms of cost implications, we note the likely state of transition from quality control approach to quality management approach for firms in Germany in our response to q.5, which have already resulted in substantial expense for the firms.

In this context, whilst legally required specifics may be unavoidable, we fully support the Board's acknowledgement that requirements going beyond those of the international standards should be kept to a minimum.

Scalability

The IDW continues to believe that PCAOB standards should be scalable, especially given their impact on firms of all sizes, including those that even though they may not be required to register with the PCOAB, are impacted.

We agree that in taking appropriate account of both the firm's size and complexity as well as risks to quality, the proposals discussed in the Concept Release should allow scalability. Flexibility fosters firms' thinking about quality, whereas excessive prescriptiveness focuses effort on adherence, encouraging a box-ticking mentality.

We would be pleased to provide you with further information if you have any additional questions about our response, and would be pleased to be able to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Gillian Waldbauer
Head of International Affairs

541/584

Appendix

Responses to Selected Questions

Q1. Should PCAOB QC standards be revised to address developments in audit practices and provide more definitive direction regarding firm QC systems? Are there other reasons for changes to the QC standards that we should take into account?

The IDW supports the modernization of the now old PCAOB quality control standards, and in particular the adoption of the risk-based approach tailored to individual firms' circumstances and client portfolios.

We also support the PCAOB's stated intention to take note of good practices that have emerged in the intervening years and to draw on information on emerging risks and problems observed through its oversight activities.

Q2. Is it appropriate to use ISQM 1 as the basis for a future PCAOB QC standard? Are there alternative approaches we should consider?

In its comment letters to the PCAOB, the IDW has consistently supported alignment of the PCAOB's standards with international standards, pointing out the benefits in terms of firms' adherence success rates and thus improved focus on achieving quality from which dealing with the detail of differences in requirements might detract.

Subject to the satisfactory finalization of the IAASB's project on quality management, the IDW fully supports the PCAOB's proposal for using the IAASB's new quality management standards together with a revised ISA 220 as a basis for aligning to PCAOB's quality control standards.

Q3. Are the reasons provided for differences between ISQM 1 and a future PCAOB QC standard appropriate? Are there other potential reasons for differences that we should consider?

We support the PCAOB exploring the possibility of building on the requirements of ISQM 1 by adding or amending specific requirements.

In this context, we appreciate that changes will be needed to align with U.S. federal securities law, Securities and Exchange Commission (SEC) rules and other PCAOB standards and rules. Whilst it also makes sense to address

specific emerging risks and problems particular to the audit of U.S. issuers observed through the PCAOB's oversight activities, we are at a loss to understand what these might be. Therefore, we presume that this exercise would primarily involve changes aimed at fostering appropriate application where a clear need for clarification becomes apparent as opposed to the creation of additional requirements. The strength of a quality management approach lies in the firm giving serious thought to quality in determining the risks that it needs to address in its individual circumstances.

However as far as further differences are concerned, retaining requirements from current PCAOB standards should not necessarily be a given; instead we suggest a case by case consideration would be appropriate

Q4. Are there other developments affecting audit practices we should consider addressing in a future PCAOB QC standard?

We are not aware of any further developments that warrant consideration.

Q5. To the extent that audit firms are already updating or making enhancements to their QC systems to align with international developments, can you characterize the nature and extent of those changes and related efforts? What benefits do you anticipate from updates to QC systems?

Many of the larger German firms are already in the process of adapting their quality management to align with the expected IAASB quality management standards, and so further adaptions necessitated by the PCAOB would result in further costs. Medium-sized firms may not have started such an adaption process as yet, given the fact that the final IAASB standards are unavailable. However, recent changes to the relevant German standard (*IDW QS 1 "Anforderungen an die Qualitätssicherung in der Wirtschaftsprüferpraxis" [Requirements for Quality Assurance applicable to German Auditing Practices]*) governing quality control mean that German firms will generally have moved toward a quality management approach. The process of adaptation is both time and resource intensive.

Q7. Would the approach to quality control standards described in this concept release be preferable to the current PCAOB quality control standards?

Yes. The relevant German standard (IDW QS 1) follows a quality management approach, having moved form a quality control approach. In our view a proactive approach is superior to a reactive approach.

Q8. Would the objective of a quality management system provided in Proposed ISQM 1 be an appropriate objective for a QC system under PCAOB standards? Are there additional objectives that a quality control system should achieve?

We refer to our comment letter submitted to the IAASB is respect of ED ISQM 1 in which we expressly commented on this aspect of the exposure draft.

Q9. Would the potential revisions to PCAOB QC standards described in this concept release improve QC systems and audit quality?

We refer to our response to q7.

Q 16. Allocation of financial resources is one aspect of firm governance and leadership under Proposed ISQM 1. Should this be given greater emphasis in a future PCAOB QC standard than it is given in Proposed ISQM 1? For example, should a future PCAOB QC standard emphasize the importance of counterbalancing commercial interests that may lead to underinvestment in the audit and assurance practice, particularly in firms that also provide non-audit services?

In general, German auditing firms have recently invested heavily in their audit and assurance practices. An allocation of the level of investment between different areas of practice may not always be possible, since for example investments in certain areas such as technology may benefit e.g., consulting services as well as audit and assurance services. It is not feasible for a standard setter such as the PCAOB to set parameters for what should constitute an appropriate level of investment, not least because the circumstances and service lines will vary between firms. In addition to the impact of oversight authorities' inspection regimes, reputational considerations and market forces provide incentives to individual firms to ensure their respective levels of investment are appropriate.

Consequently, we believe that individual firms are best placed to determine their investment needs.

Commercial interests are likely to be less of an issue in Germany than in some other jurisdictions because of the legal requirements relating to the profession's ownership within firms. Therefore, from our perspective it would be inappropriate for the PCAOB to develop specific requirements to "force" investment in audit and assurance.

In our view the PCAOB might consider raising awareness of the potential impact on quality of underinvestment instead. More importantly, the PCAOB could advocate the importance of high-quality auditor services in its communication with investors, as they ultimately drive demand since it is also in their interests for audits of SEC issuers to be of high quality.

Q17. Should a future PCAOB QC standard incorporate mechanisms for independent oversight over firms' QC systems (e.g., boards with independent directors or equivalent)? If so, what criteria should be used to determine whether and which firms should have such independent oversight (e.g., firm size or structure)? What requirements should we consider regarding the qualifications and duties of those providing independent oversight?

We do not believe that a further mechanism along the lines discussed in the Concept Release is sensible, not least as such bodies are unlikely to possess sufficient competence in respect of such systems.

The information in respect of their quality management systems that German firms already provide by means of a publicly available "Transparency Report" together with the audit documentation available for inspection by the German auditor oversight authority (in conjunction with the PCAOB) works sufficiently well to alert a firm to potential deficiencies.

Q19. Are principles-based requirements sufficient to prompt firms to appropriately identify, assess, and respond to risks, or is supplemental direction needed? If supplemental direction is needed, what requirements would assist firms in identifying, assessing, and responding to risks?

We agree that principles-based requirements should be sufficient. However, as we have previously commented in the past, inclusion of appropriate guidance is generally helpful.

Q 20. Should a future PCAOB QC standard specify certain quality risks that must be assessed and responded to by all firms? If so, what should those risks be?

In this context, we support close alignment to ISQM 1. Whilst certain risks will be common to all firms, individual firms' circumstances dictate the level of risk and risk assessment serves to focus the firm on addressing the quality aspects as needed for that firm.

A rebuttable presumption approach to the most common risks might be an appropriate approach to consider, but we would caution against measures that detract firms' attention from a proper evaluation of their own quality risks.

Q 21. Should firms be required to establish quantifiable performance measures for the achievement of quality objectives? If so, how should such measures be determined and quantified (see also Question 46)?

Currently various firms report a number of different KPIs, some of which may be helpful, others less so. Some KPIs are open to various interpretations e.g., just counting hours charged etc. Others do not allow users to draw proper conclusions.

On balance, we are not convinced that establishing KPIs would necessarily be truly helpful.

Q 22. Is the approach to relevant ethical requirements appropriate (i.e., use of ISQM 1 requirements as a starting point, with incremental or alternative requirements)? Are changes to the approach necessary for this component?

As one such example, we believe that the proposal (ref. page 21) to revise a requirement (assigned responsibility for independence) currently applicable to a senior-level partner to accommodate a qualified individual with appropriate knowledge is a meaningful development that is capable of being equally effective in practice, when applied appropriately.

Q23. Should a future PCAOB QC standard extend detailed requirements for independence quality controls (formerly SECPS member requirements) to all firms? How would this affect the costs and benefits of a QC system?

In our opinion, the PCAOB should not extend these requirements to all firms. Whilst the list of requirements on page 20 partially reflects current practice for many German firms, not all have e.g., established automated systems, which, were this required for all firms, would result in considerable costs.

Q32. Should a future PCAOB QC standard continue to expressly address technical training on professional standards and SEC requirements? Are there other subjects for which training should be expressly required? Which firm personnel should be covered by the training requirements? Should the standards set minimum requirements for the extent of training? If so, what should those requirements be based on?

We do not see the need for additional precision within (new) requirements, as these could not generally be expected to enhance audit quality. An individual's unique training needs need to be determined for that individual, not prescribed by requirements.

Q 37. Should a future PCAOB QC standard expressly address how the firm's incentive system, including compensation, incorporates quality considerations? If so, how?

In our view this is a matter of independence and so should not be addressed in a future quality control standard.

Q 39. Should a future PCAOB QC standard require public disclosure by firms about their QC systems? If so, what should be the nature and timing of such disclosures (e.g., information about the firm's governance structure)? (see also Question 46)

Q 46. Should firms be required to report to the Board on their annual evaluations of QC system effectiveness? If so, what should be included in the report? Should firms be required to disclose any performance measures that were important to their conclusion about their QC system's effectiveness? Should firm reports be publicly available (see also Question 39)?

German firms already publish information about their quality control/ management systems within Transparency Reports as required in accordance with European legislation.

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submitted electronically through the IAASB website

Re.: Exposure Draft: International Standard on Quality Management, Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control 1)

Dear Willie,

We would like to thank you for the opportunity to provide the IAASB with our comments on the IAASB Exposure Draft “International Standard on Quality Management, Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control 1)” hereinafter referred to as “the draft”.

We have provided our responses to the questions posed in the Consultation Paper in the Appendix to this comment letter.

However, we would like to make the following overall observations about the draft.

Although we support the move from “quality control” to “quality management” and the introduction of a risk-based approach to such management, we are deeply concerned about the direction the project on quality management has taken at the IAASB. The IDW introduced the concept of quality management and a risk-based approach to the IAASB at National Standard Setters meetings and at an IAASB meeting several years ago prior to the issuance of the IAASB’s “Invitation to Comment” with the objective of both having the IAASB issue standards to improve the management of quality at firm level so as to contribute to the maintenance and improvement of quality at engagement level and providing greater scope for scalability of the management of quality at firm level. We have concluded that the current draft will not meet any of these objectives

and worse, will likely lead to a misallocation of resources in firms due to the draft leading to the treatment of quality management as a compliance exercise. We support the introduction of quality management at firm level through an ISQM, but do not believe that the current draft properly reflects a real quality management system.

Our main concerns with the draft – and our proposed solutions to these concerns – can be summarized as follows:

1. Quality Management should be based on suitable quality objectives

As noted, we support the change to "quality management" from "quality control" but are concerned that ED ISQM 1 does not appropriately adopt a true quality management approach. In our view, what is needed is a holistic approach to quality management **integrated into the firm's strategy** as its starting point. The draft lacks the connection to, or extension of, the quality management approach by setting objectives derived from the firm's overall strategy.

2. Quality objectives should be focused on the expectations of stakeholders

2.1. Overall Quality Objective

The standard does not define a reasonable overall quality objective for firms. Firms of professional accountants provide services involving trust and credibility. Stakeholders are supposed to trust in the credible ability of firms to perform their services to meet their expectations, including compliance with legal requirements and professional standards.

Stakeholder expectations include (objective) expectations regarding compliance with legal requirements and professional standards, as well as (subjective) expectations of certain stakeholders taken into account in the firm's overall strategy and derived the firm's service level agreements with some stakeholders. However, only reasonable stakeholder expectations need to be considered in the firm's strategy. Consequently, the overall objective of the firm needs to be related to its developing and maintaining the capabilities needed to deliver its services to fulfill reasonable stakeholder expectations in relation to quality. A prerequisite for establishing and maintaining such capabilities is for the firm to obtain the

appropriate resources needed to develop and maintain such capabilities. It should also be recognized that stakeholder expectations relate not only to the present, but also to the future. To this effect, a system of quality management is only a means to this end.

Hence, in the context of ISQM 1 the objective of the firm should be *to obtain and develop the capabilities of the firm needed to obtain reasonable assurance that the firm performs audit or reviews, or other assurance and related services engagements, in accordance with professional standards and applicable legal and regulatory requirements and meets reasonable stakeholder expectations in relation to the quality of those engagements.*

Such capabilities include, in particular, a quality culture, appropriately qualified and motivated personnel, and appropriate technology and processes. Operational quality objectives can be derived from the capabilities needed. How these quality objectives ought to be achieved and measured should be the responsibility of the firm's leadership given the applicable circumstances, including those arising from legal and regulatory requirements and professional standards.

2.2. Operational quality objectives

Our **main concern** with the draft relates to the proposed approach to setting quality objectives: the draft requires firms to set many detailed quality objectives (as specified in the draft) as well as additional quality objectives (see paragraph 26) when needed beyond those set forth in the draft in order for the firm to achieve the overall objectives of the standard.

We are convinced that the proposed quality objectives are too granular: we believe that they actually represent requirements or procedures used to respond to risks of not achieving quality objectives, rather than representing quality objectives themselves. What is needed are "real" quality objectives **derived from the overall quality objective that are integrated into the firm's strategy by linking such quality objectives to quality drivers.**

By not setting suitable quality objectives, the draft impairs the process by which firms identify quality risks and design responses to those risks. This results in the quality objectives not specifying what should be achieved through the implementation of certain responses. In this context, the requirement to set quality objectives in addition to the granular quality objectives set forth in the draft does not make logical sense because there is no integration of operational quality objectives into the firm's strategy.

We believe that an appropriate solution would be to set quality objectives by focusing on the main drivers for achieving the overall quality objective. To this effect, we suggest developing quality objectives along the following lines:

Elements	**Suggested operational quality objectives**
Quality culture	The firm's leadership cultivates a firm culture that fosters appropriate quality.
Relevant ethical requirements	The firm's leadership and personnel have a clear understanding of relevant ethical requirements and fulfil them.
Acceptance and continuance	Only clients and engagements as set forth by professional standards and applicable legal and regulatory requirements are accepted or continued.
Engagement performance	Engagements are performed in accordance with professional standards and applicable legal and regulatory requirements.
Resources	The firm has the resources needed (including human resources, technological resources an intellectual resources) to enable the performance of engagements in accordance with professional standards and applicable legal and regulatory requirements to design, implement and operate an appropriate quality management system.

2.3. Suitable quality objectives are the prerequisite for scalability

Higher level operational quality objectives as suggested above that are applicable to every firm would also be a prerequisite for the scalability of the standard for SMPs because objectives that are too granular would hinder scalability for SMPs. In particular, the way the draft is written with such granular quality objectives, SMPs would need to document why certain objectives and responses are not relevant to their firm's quality management.

3. Quality Management should be integrated into the firm's business processes rather of being managed in a separate compliance process and function

The draft as written leaves the impression that quality is managed through a separate process by one or more partners responsible for quality management with a focus on coordinating, monitoring and documenting a quality management system.

In contrast, in most larger firms, quality management is – under the leadership of the CEO or equivalent – the responsibility of those responsible for functional areas and who are in charge of the business processes relevant to achieving the quality objectives in their functional areas. For example, the individual responsible for the human resources functional area would be responsible for hiring appropriate people and for designing and implementing an effective learning program. Those responsible for business processes in their functional area would be required to identify the risks of not achieving their quality objectives and design and implement appropriate risk responses. For example, a quality risk in the human resources functional area could be that training needs are not appropriately identified, or that firm leadership is not providing the budgets necessary to implement the designed IPD or CPD program needed to obtain the appropriate competencies among firm personnel.

A quality management system organized and operated separately from the relevant business processes used to implement a firm's strategy would not adequately focus on the drivers of quality because these are actually managed through the firm's business processes.

Consequently, the standard should acknowledge that in larger firms, quality management would need to be integrated into the relevant business processes and those responsible for functional areas and the related

business process need to be responsible for achieving the quality objectives relevant to their functional area.

4. The quality management process should reflect best practice frameworks, which promote a series of interrelated processes which encompass a foundation, core processes and supporting processes.

4.1. Elements of a quality management process

The draft seems to confuse the components of a system of quality management with elements of processes, content-related aspects, and elements that form the foundation of an effective quality management system.

For example, the requirements for compliance with professional obligations and for the retention of suitable personnel for performing services (content-related aspects) are placed on the same level as the implementation of a firm's risk assessment process, an information system or the monitoring and remediation process. Network resources, documentation and communication are relevant in all process steps and are not separate aspects of the quality management system.

One reason for this shortcoming in the structure and content of the elements of a quality management process is the use of COSO Internal Control – Integrated Framework, which is designed for a markedly different purpose (financial reporting systems). We firmly believe that COSO ERM (2017) or ISO 31000 would have provided a more appropriate basis for describing the components of a quality management system.

For these reasons, we suggest that a quality management system be described as a series of interrelated process encompassing:

Elements	**Quality drivers**	**Responsibility**
Foundation	1. Cultivate a firm culture that fosters appropriate quality	Firm leadership
	2. Integrate quality into the firm's strategy and quality management into the firm's business processes	Firm leadership and those responsible for functional areas and related business processes
Core processes	3. Define quality objectives for quality drivers in this section	Firm leadership
	3.1. Ethics	Individual responisble for ethics function
	3.2. Clients and engagements	Those responsible for business and risk management
	3.3. Resources	HR leader
	3.3.1. Human resources	Individual responsible for HR function
	3.3.2. Technological resources	Chief Information Officer
	3.3.3. Intellectual resources	Those responsible for the firm's delivery of different engagement types (e.g., audit leader, assurance leader etc.)

	3.4. Resource management	Chief Operating Officer
	3.5. Engagement Performance	Those responsible for the firm's delivery of different engagement types (e.g., audit leader, assurance leader etc.)
	4. Identify and assess quality risks	Leadership and those responsible for business processes
	5. Design and implement risk responses	
	6. Monitor the design and the effectiveness of items 1 – 11 above, including the achievement of quality objectives, analyzing monitoring results and performing root cause analysis and implementing remedial actions to address identified deficiencies	
Support processes	7. Information and communication management	
	8. Documentation	

To this effect, we suggest that the quality management system be presented in ISQM 1 as follows:

- At the beginning of ED ISQM 1 (Introduction), how a quality management system should be established for a firm should be described
- There should be a requirement that the firm's leadership is responsible and accountable to implement an effective quality management system as described in the introduction (see first bullet).
- The quality management process (objective-setting, risk assessment, risk response) does not need to be repeated within the requirements for every content-related aspect (e.g., clients and engagements). Rather, there should be a single quality objective for every content-related aspect and, if deemed necessary, minimum requirements for responses.

4.2. Identifying quality risks

The required threshold for risk identification (see paragraph A55: "There is

a reasonable possibility of a quality risk occurring when the likelihood of its occurrence is more than remote"), which is also proposed for ISA 315 (Revised) and is used by the PCAOB is too low. Indeed, this threshold is not as clear as it should be, since the requirement refers to reasonable possibility of occurrence with application material essentially "defining" this term. This is exacerbated by the fact that quality risks must be identified and assessed for all (far too granular) quality objectives.

The definition of risks and which risks are to be identified should be based on recognized frameworks for risk management processes, e.g., COSO ERM (2017).

It is conceptually questionable to refer to a risk identification threshold defined in ED ISA 315 (Revised) which is designed for a markedly different purpose (audit of financial statements). Furthermore, the low threshold will result in the identification of too many minor risks that would need to be assessed.

We suggest that the IAASB consider whether to have the quality management process identify risks of significant departures from quality objectives that are unlikely to be at most acceptably low. These identified risks would then need to be assessed to conclude whether or not they are acceptably low. If assessed as being acceptably low, no further response is required.

Overall Conclusion:

The main objectives of the project on ISQM 1 were to provide the accounting profession with a modernized and robust standard to actively manage the quality of engagements performed by firms and to improve scalability. Given the fundamental concerns that we have identified above, we conclude that the main objectives of the project will not be achieved. In our opinion, the significant conceptual and practical issues we identified will lead to a misallocation of the firms' resources and the performance of ineffective and inefficient activities to comply with the new requirements will result in little, if any, positive impact on the quality of engagements: the draft reduces quality management to a "compliance exercise". In summary, the draft involves "form over substance" that will lead to a compliance driven mentality instead of focusing on quality improvements. We therefore suggest the draft not be issued without fundamental changes. Such fundamental changes would then require re-exposure.

We would be pleased to provide you with further information if you have any additional questions about our response and would be pleased to be able to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Wolfgang Böhm
Director Assurance Standards,
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Appendix:

Response to Questions Posed in the Exposure Draft

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:

We do not believe that the draft substantively enhances firms' management of engagement quality and improve the scalability of the standard. Please refer to the body of the letter for our reasoning.

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

We support a new quality management approach in principle, but we do not support how the draft approaches quality management. We refer to the body of the comment letter for our reasons.

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?

We do not believe that the proposals will generate benefits for engagement quality as intended. We refer to the body of the comment letter for our reasons. In particular, we note:

- The quality objectives are far too granular and actually represent requirements or responses that are not suitable for managing quality at firm level;
- The low threshold for risk identification in combination with quality objectives that are far too granular will lead to a time-consuming documentation, including the risk of losing sight of the important quality risks.

As outlined in paragraph 24 of the Explanatory Memorandum, professional skepticism is relevant to judgements made in performing assurance engagements (including audits and reviews) but not to judgements made about the quality management system. We also note

that the exercise of professional skepticism is not applicable for all services in scope of the draft (e.g., agreed-upon procedures engagements and compilation engagements). Consequently, the draft should be clear about when professional skepticism is applicable (assurance engagements only).

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?**

We do not believe that the requirements and application material of the draft are scalable such that they can be applied by firms of varying size, complexity and circumstances. We refer to the body of the comment letter, which addresses our main concerns with the draft, which have an impact on scalability. In particular, we note:

- The problem with the top down approach taken in the draft is that every practitioner will need to understand the entire standard, determine what is not applicable in their circumstances, and then potentially need to document their justification for not applying a non-relevant requirement. This would lead to excessive documentation, which is particularly unhelpful for SMPs and would detract smaller firms' focus on issues that can improve quality.
- We are concerned that SMPs cannot easily navigate the standard to determine which requirements are not relevant to their circumstances. Paragraph A20 describes two examples of requirements that may not be relevant for some SMPs. This may give the false impression that very few requirements may not be relevant. We believe that all such requirements should be reworded so that it is clear that they are conditional. The requirement in paragraph 24(a) (iii) (b) is a good example of a requirements that could be written as a conditional requirement, since the assignment of responsibilities to the degree contemplated in the draft may be unnecessary or even impossible for some SMPs.
- We also believe that by setting less granular quality objectives as we suggest in the body of our comment letter, these would be relevant for all firms, and SMPs can focus on those areas relevant to their circumstances when managing quality risks.

2) Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?

We believe that the use of inappropriate quality objectives that are far too granular, the fact that the quality management process is not integrated into firm business processes, and the inappropriate description of quality management elements will create challenges to implementation. We refer to the body of our comment letter. In particular, we would like to note that we are concerned that the ED's approach will lead to firms using considerable resources to perform ineffective and inefficient activities simply to comply with new requirements that have little or no positive impact on the quality of the engagements performed.

However, we support paragraph 79 in the Explanatory Memorandum that the firms are held solely responsible for their QMS and not the network.

We would also like to address the definition of listed entity in paragraph 19 (i), which has caused significant difficulty in implementation worldwide. The way the definition is currently worded, it does not cover those entities that are not yet publicly listed but have taken concrete measures to become so. Furthermore, the definition as worded includes situations where third parties (e.g., brokers) choose to trade a security on a platform that meets the definition of "being marketed under the regulations of … other equivalent body" without any knowledge of the entity whose security is being traded. The former situation results in audit of financial statements of entities not being subject to heightened independence and quality management measures when they are needed; the latter results in heightened independence and quality management measures when the entity has not even sought to be a listed entity and those measures can be regarded as disproportionate.

We suggest that this situation could be ameliorated by having the definition read as follows:

"An entity that has or had taken concreate measures such that its shares, stock or debt are, or are expected to be, quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or equivalent body".

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?

We believe that the draft is, in general, overly complex and the application material is very extensive. We would rather that the IAASB write clearer requirements (including writing the requirements in conditional form) than seeking to explain when requirements are not relevant in the application material.

We note two instances where the introduction or the application material refers to possibilities that are not governed by the standard: Paragraph A152 (encouragement for firms to report externally regarding their network affiliations) and paragraphs 12 and A178 (analyzing the root causes for positive inspection results). We agree these matters should not be a requirement but question the appropriateness of including this type of application material in IAASB standards.

Specific Questions

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

No, we do not support the eight components and structure of the draft as noted in the body of our comment letter. Please refer to the comment letter for the reasons.

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?

No, we do not support the objective of the standard as noted in the body of our comment letter, to which we refer.

We do agree that the standard appropriately explains the firm's role relating to the public interest because the purpose of writing an ISQM is to serve the public interest. There is therefore a presumption that, unless there are indications to the contrary, firms that comply with ISQM 1 have met their public interest role. It would be entirely inappropriate to seek to enshrine the

public interest role within the objectives or requirements as this would be unenforceable in most jurisdictions of which we are aware because the courts would take the view that laws, regulations and professional standards are written with due consideration of the public interest and therefore firms cannot be expected to "second-guess" these in seeking to fulfill their public interest role. Therefore, meeting the objective of the standard (as appropriately revised as we suggest) would lead to the presumption that the firm has fulfilled its public interest role.

6) **Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved?** We do believe that the application of a risk assessment process would drive firms to identify appropriate quality risks and design appropriate responses to those risks, such that the objective of the standards is achieved. However, as we note in the body of our comment letter, the objectives set forth in the draft are too granular, and asking firms to design further objectives would make them far too granular, which defeats the purpose of the risk assessment process.

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?**

No, we do not agree that the firm's risk assessment process should be applied to the other components of the system of quality management. As can be seen from part 4.1 of the body of our comment letter, the foundation and support processes are not subject to risk assessment: only the items 3.1. to 3.5. are subject to quality risk assessment. The other items, however, are subject to monitoring and remedial action should deficiencies be detected through monitoring or other sources.

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

As noted in the body of our comment letter, we do not support the approach for establishing quality objectives, which leads to quality

objectives that are too granular and actually represent quality risks or responses to quality risks.

i. **Are the required quality objectives appropriate?**

As noted above in our response to (b) and in the body of our comment letter, we do not believe the required quality objectives to be appropriate.

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

As we note in the body of our comment letter, operational quality objectives should be derived form a firm's strategy. This means that depending upon a firm's size and the complexity of its organizational structure, the number of quality objectives that are needed and their granularity ought to vary.

That being said, a requirement to establish additional quality objectives to the very granular quality objectives set forth in the standard makes no sense without being integrated into the firm's strategy.

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

We refer to section 4.2 of the body of our comment letter. In this vein, we believe that the process for the identification of quality risks is inappropriate for two reasons:

- First, the threshold used to identify risks is too low
- Second, there needs to be some form of "materiality concept" for the risks of departure from a quality objective (i.e., a significant departure).

Unless these issues are appropriately resolved (we note that the threshold issue has not yet been resolved for ISA 315 (Revised) as yet either), we do not believe that the process for the identification of quality risks can be appropriate.

Using the statement in the application material in paragraph A54 "…not every quality risk needs to be identified and further assessed…" to seek

to limit those risks that are identified that need not be further assessed without solving the risk threshold and "materiality" issue is not appropriate. Furthermore, the threshold and materiality issues require further clarification because the diagram on page 13 of the Explanatory Memorandum and the definition in the draft indicate that the whole population of quality risks does need to be considered at the start of the identification process (see paragraph 28) and only those risks failing this 2-step threshold test on preliminary consideration would subsequently be assessed using a more detailed consideration of the same 2-step threshold test (see paragraph 29). In our view, not only the threshold issues and materiality need to be clarified, but also the difference between "preliminary consideration" and "more detailed consideration" needs to be made much clearer if this approach is to work in practice.

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

We do not support the approach that requires the firm to design and implement responses to address all assessed quality risks because the firm may assess some risks as being acceptably low, and therefore no responses are required for those risks. The draft does not appropriately deal with this issue.

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?

We do believe that the approach will result in the firm designing and implementing responses that are tailored to and appropriately address assessed quality risks – our issue is that not all assessed quality risks need to be responded to (see our response to (d) above).

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?

Unfortunately, we believe it is clear that in all circumstances the firm is expected to design and implement responses in addition to those

required by the standard. However, as we note in our responses above, not all risks need to be responded to. Furthermore, we also believe that in some circumstances (particularly for simple SMPs), the responses required by the standard may suffice. For this reason, we do not believe it to be appropriate that in all cases firms are expected 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?

We refer to section 4.1. in the body of our comment letter, which explains why we do not believe that the draft appropriately addresses governance and the responsibilities of firm leadership. Our response in the body of our comment letter also explains the changes needed.

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?

Firms should assign responsibility for quality management over the understanding and fulfillment of relevant ethical requirements to an individual in the firm. However, it would be entirely inappropriate to hold a single individual responsible for every ethical violation perpetrated within a firm because many of the preventative measures undertaken by the firm will have only limited effectiveness and other measures relate to after-the-fact detection and mitigation. As long as the individual responsible for quality management over the understanding and fulfillment of relevant ethical requirements has established and maintained an appropriately designed and effective system of quality management for that matter (which can only provide reasonable – not absolute assurance), then that individual has fulfilled his or her responsibilities under a quality management standard.

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

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

10) Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so?

We believe that 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. We also believe that the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so. We do not believe it to be appropriate to further harden the requirements to make such communication mandatory in any way because such requirements would be unenforceable in many jurisdictions.

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?

As noted in our response to ISQM 2, we believe that there are other quality management instruments available other than engagement quality reviews when, for example, in an audit the quality risks are concentrated in a particular area (e.g., going concern) rather than across the entire audit. Requiring an EQR when subject matter reviews or consultation on specific matters suffice may be ineffective and inefficient. ISQM 1 needs to recognize this and not appear to leave the impression that engagement quality reviews are a "cure-all" for all quality management issues at engagement level.

Consequently, we believe that a firm should determine at engagement acceptance as to which type of quality instrument (engagement quality review, subject matter review, consultation, etc.), if any, might be needed in a particular instance and reconsider the matter as the engagement progresses.

For these reasons, we believe that an engagement quality review should be mandatory only for engagements of listed entities and for engagements for which an engagement quality review is prescribed by law or regulation.

Hence, the requirement in the draft requiring an engagement quality review for audits of significant public interest entities (paragraph 37 (e) (ii)) and the respective application material describing the term 'significant public interest' should be deleted. Public interest in the sense of investment by the public is sufficiently covered through the requirement for listed entities. In addition, the legislation in many jurisdictions (for example, in the EU) require an engagement quality review for public interest entities (as defined in that legislation).

In our view, an engagement quality review due to assessed quality risks is already covered by paragraph 37 (e), (iii) (b), which would likely cover most other entities of significant 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?

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?

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

We do not agree with the definition of a deficiency because it fails to address a "materiality concept" in relation to departures from quality objectives and consequently would result in very departure from a quality objective being regarded as a deficiency. We suggest considering the concept of "significant deficiency", which would be those deficiencies resulting from departures that would be significant to those responsible for the system of quality management.

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

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

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

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?**

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?**

We support paragraph 79 in the explanatory memorandum that the firms are held solely responsible for their QMS and not the network. However, this thought needs to be laid down in the standard, preferably in the application material.

14) Do you support the proposals addressing service providers?

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?

No, in our jurisdiction the change in title to ISQM will not cause any difficulties.