



IAASB - International Auditing and  
Assurance Standards Board  
529 Fifth Avenue  
New York, 10017  
USA

1 July 2019

## Comment letter relating to the IAASB's Quality Management Exposure Drafts

Dear Sirs,

1. The CEAOB appreciates the opportunity to comment on the IAASB's ("Board") consultation on *Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews* (hereinafter 'Quality Management standards') as issued in February 2019. As the organisation representing the audit regulators of the European Union and the European Economic Area, the CEAOB encourages and supports continuing improvement of professional standards for the audit profession.
2. The content of this letter has been prepared by the International Auditing Standards Subgroup and has been adopted by the CEAOB. The comments raised in the letter reflect matters agreed within the CEAOB. It is not intended, however, to include all comments that might be provided by the individual regulators that are members of the CEAOB and their respective jurisdictions.
3. The CEAOB strongly supports the IAASB's efforts to refine and strengthen the Quality Management standards. We have closely examined the proposals and have a number of areas on which we would like to provide input. Below, we provide some overarching comments as well as detailed comments in response to each of the three proposed standards.

### 1. Overarching comments

4. In line with our general support for the project, we support the related name change from International Standards on Quality Control to International Standards on Quality Management. It is important that the standards contain clear principles and provisions, which can be applied in a scalable way. We recognize and support the approach taken in respect of scalability and adaptability for varying practices depending on their particular circumstances. Whilst the approach to scalability is set out in the introductory paragraphs, we are of the view that the standards should elaborate more clearly on how this relates to the need to achieve the quality objectives and the requirements on the risk approach. We furthermore recommend clarification both on when the requirements may be not relevant to a firm and on what they may entail in terms of additional procedures for large and more complex firms.



5. Given the wide impact that quality management has on the quality of all engagements, the standards should clearly address public interest needs, and include clear and enforceable objectives and requirements. We urge the IAASB to perform a comprehensive review and consideration of the standards from the public interest perspective before finalizing them.
6. In our view, quality is an ongoing objective which should be actively managed by a firm while also focusing on continuous improvement of its quality management system. Whilst the Quality Management standards appear to embrace that notion, most of the requirements appear to focus on compliance with the standards. We recommend an increased focus on quality management, including the balance between preventive measures and enforcement activities (monitoring, remediation and follow-up, including sanctioning where needed).
7. There is a clear interrelationship between the three standards. We encourage the Board to elaborate more specifically on how these relationships should operate in practice. Currently paragraphs 4 of ISQM 2 and 2 of ISA 220 repeat the firm's quality objective from ISQM 1, and we recommend providing more direction on how that firm's objective impacts on the application of ISQM 2 and ISA 220 respectively.
8. We concur with the Board proposal for an eighteen month implementation period after final approval of the Quality Management standards. In our view this strikes a reasonable balance between the public interest in making improvements to quality management and the time necessary for firms and networks to adjust their systems and processes. The CEAOB would encourage firms and networks to early adopt the improvements where possible.

## 2. Comments on Proposed ISQM 1

9. We feel that the introductory paragraphs to ISQM 1 provide more insight and perspective on the ambitions and intent of the new standard than the actual content of ISQM 1. We therefore suggest that the requirements and application material should be amended to fully reflect the ambitions and intentions of the new standard. For example, while the importance of taking the public interest into account is mentioned in the explanatory memorandum as one of the key points, the public interest perspective does not appear to be reflected in the objective, and not sufficiently in the requirements of the standard (it only appears in par. 23c). In the same vein, we encourage the IAASB to review the material on the risk approach and include that in the requirements and application material sections of the standard itself. In particular, we are of the view that the explanation of the risk assessment process provided in paragraph 10 of the proposed standard should be moved to the requirements section.
10. In the requirement section, "The firm's risk assessment process" paragraphs follow the "Governance and leadership" paragraphs. We recommend moving the firm's risk assessment process to the start of the requirements section to aid the comprehensibility of the standard as it applies to all components of the system of quality management, including governance and leadership.



11. We note that a significant volume of detail is provided in the application material to ISQM 1. Given that the requirements by themselves should provide clear direction for auditors, we suggest that the IAASB should carefully review whether some of the application material is of such importance to enable the understanding of the requirements that the content could provide additional clarity in the requirements section. For instance, we suggest the IAASB considers whether the concept of granularity in paragraph A49 may be included in paragraph 26 of the requirements section. Also we suggest elevating the provisions in paragraph A59, on responses to assessed quality risks, to a requirement. Given the importance of also considering positive quality instances, we feel that there should be a requirement for firms to evaluate positive quality instances as well (currently only suggested in paragraph A173).
12. We believe that learning and improving is not sufficiently included in the proposed standard. Whilst the proposals do include many welcome provisions regarding monitoring, the element of learning and improvements can be further elaborated upon. In our view, the ability to learn from mistakes and errors is an essential element of quality management. A learning/improvement-oriented environment has certain cultural requirements and behavioural aspects to it, which are not addressed in the current ED. We suggest including provisions on this.
13. In our view there would be merit in a firm's management confirming that their firm's quality management system has resulted in appropriately high quality (a 'quality control' statement). Also, we strongly support requiring further transparency on quality efforts and outcomes. We therefore suggest including a requirement that firms are to be transparent on their efforts to improve quality and the resulting outcomes, and that they issue a 'quality control' statement, unless that would not be appropriate in their jurisdiction. Whilst many jurisdictions (including all EU/EEA-jurisdictions) require transparency reporting, and whilst many firms are working on developing Audit Quality Indicators, neither of these are addressed in the standard.
14. With respect to the objective of ISQM 1, we question the statement that the quality management system should provide "reasonable assurance" to the firm that it (1) fulfils its responsibilities in accordance with the standards, (2) conducts engagements in accordance with the standards, and (3) reports are appropriate. We are of the view that stakeholders and the public interest would be better served with a more direct and stronger objective such as 'the objective of the firm is to ensure the appropriateness of engagement reports in the circumstances, and that the firm and personnel act in the public interest, in accordance with standards and legal/regulatory requirements.
15. In our view, the requirements in the current ED are mostly compliance driven. Whilst all legal and regulatory requirements must be met, quality and public interest perspectives may well require further work to be done and additional transparency to be given in an engagement report, for instance via the inclusion of additional detail in the auditor's report. We therefore suggest that the standards include a step-back requirement before issuing reports to specifically consider quality and the public interest perspective and determine

whether there is a need to perform additional procedures or a need for additional transparency.

16. We are supportive of the concept of quality objectives, and their adaptability so as to reflect, amongst other factors, a firm's size, complexity, structure, legal form and client base. As noted in paragraph 4 of this letter, we suggest including some of the provisions regarding scalability, which are currently part of the introductory paragraphs of the exposure draft, in the requirements section of the standard so as to better explain how the quality objectives, scalability and the risk approach are to be applied in practice and how factors such as size, complexity, structure, legal form and client base will impact a firm's quality management system. Additionally, as noted above, we think it is important for the standard to also address the need to learn from mistakes and errors and as a consequence we suggest adding a quality objective to 'be a learning organization', including the necessary requirements about an open culture and others as appropriate.
17. The language on non-relevance of requirements (paragraph 21) should be expanded to clarify to what extent it could occur. For instance, the fact that a firm is very small would not be an adequate reason for not performing periodic engagement inspections as part of its self-assessment of the quality management system. Such periodic engagement inspections can be performed by service organizations. The current language in the application material does not provide guidance on alternative ways for small firms to meet the quality objectives. Also, it should be stated that firms may need to refuse to accept certain engagements if they cannot meet public interest expectations regarding quality management. Pursuant to paragraphs 67(a) and (b), the firm shall document the work performed to achieve the quality objectives, we suggest also clarifying that the documentation should include an explanation of why requirements are not relevant under paragraph 21, unless that is self-evident.
18. We suggest including provisions aimed at creating a learning environment whereby auditors' experiences are evaluated and learned from. In that regard, we feel that tone-at-the-top should be expanded towards an integrated approach of culture and behaviour at all levels in the organization including appropriate behaviour (often described as 'practice what you preach').
19. In terms of the risk assessments that firms are expected to perform, we think it is important that firms are required to also consider risks arising from their own culture, their governance, including the network structure where relevant, and their business objectives. We suggest clarifying this in paragraph 27, and including further language as necessary.
20. We suggest that care is required in engagement performance to ensure that culture and behaviour sufficiently support the achievement of quality objectives both within the audit firm and at team level. Audit firms have informed us that culture plays a crucial role in underpinning professional scepticism and therefore we think that it is important to also emphasize the importance of culture in the firms' quality management system.



21. Similarly, we suggest that there should be an increased focus on both the competence and culture/behaviour of personnel in the resources section.
22. With regards to information and communication, we think that the standard should focus more on the intention and outcome of information and communication. The current language lacks clear requirements that the firm clearly communicates all relevant information to partners and staff, and also that a firm should focus on the key issues and avoid unnecessary detail in communications. Additionally, there should be a focus on what can be done to improve the power of messaging to ensure that partners and staff react appropriately to the information and communication in their actual (day-to-day) behaviours.
23. The requirements regarding Monitoring and Remediation appear to focus mainly on the firms' periodic inspection process and addressing errors that have been observed in that process. We note that the Application Material also provides that monitoring of positive quality occurrences should take place so as to learn which root causes contributed to higher quality. We are of the opinion that the requirements should strike a better balance between remediation of negative quality occurrences and learning from positive quality occurrences. We are also of the view that the standard should be clearer on who is responsible for action to identify root causes and respond to deficiencies as well as for oversight of thereof, including the requirements applying to them such as objectivity.
24. We recommend providing more specific guidance on the extent of engagement inspections in paragraph 45. The proposed language is vague and is likely to lead to inconsistency in its application.
25. We support that ISQM 1 also addresses the role of the networks to which many audit firms belong/are affiliated with. The nature and extent of resources provided by the networks to the audit firms has become increasingly significant, as has their impact on objective setting, governance and policies/procedures as well as the level of oversight by networks of their member firms. Given that increasing significance, we are of the view that it is important that the provisions concerning networks be further expanded. We recommend requiring that audit firms take a proactive role with regard to their network and that, where possible, they are involved in target and objective setting by the network, and that they ensure that policies and procedures developed by the network are only implemented at firm level where they contribute to the firm's responsibility and objectives for quality. We also recommend that the IAASB considers whether the standards should distinguish between local networks and international networks. This is because a firm's role and influence in a local network is likely to have a greater impact.
26. Additionally, we recommend requiring that firms document how resources provided by the network (e.g. audit tools, independence systems etc.) support their quality objectives and are compliant with local laws and standards. This is especially important with respect to key tools and methodologies developed by the networks which their Member Firms have to implement. Given the responsibility for quality management at Member Firm level, they should be able to demonstrate how they have satisfied themselves that, and document

how, the methodology and tools (audit software, data analytics tools) contribute to performing quality audits.

27. The documentation requirements in paragraph 66 should specify that the quality management documentation should be understandable by a reasonably informed third party.
28. The status of the information regarding the eight components of a quality management set out in Appendix 1 is unclear i.e. whether it is intended to be guidance/application material or is it to be regarded as integral part of the standard.

### 3. Comments on Proposed ISQM 2

29. Paragraph 10 states: ‘The objective of the firm is to perform an engagement quality review for the engagement’. In our view, this requires expansion to focus on the outcome of the engagement quality review (“EQR”) i.e. that it is an objective evaluation of the significant judgements made and conclusions reached by the engagement team to provide the firm with assurance that the engagement report is appropriate in the circumstances. As noted in our overarching comments, we also recommend explaining in more detail how this standard relates to ISQM 1, rather than repeating ISQM 1’s objective in the introductory paragraphs.
30. The application material in paragraph A8 on the eligibility criteria for the engagement quality reviewer should be strengthened to provide that an individual who has been an engagement partner on an engagement where significant deficiencies were identified (whether through an EQR, the firm’s monitoring activities, an external inspection or otherwise) shall not be eligible to be appointed as an engagement quality reviewer given that he/she shall not be regarded as having the required competency to perform an EQR.
31. In our view, ISQM 2 does not provide sufficient requirements and related application material on the work efforts required for an Engagement Quality Review. Whilst we do not object to the approach taken and to what has been included in the draft standard, we feel that the standard needs to be clearer on what an EQR should encompass and the level of detail required to document that work. For example, the requirement of the current ISA 220 (paragraph 20(d)) for the reviewer to evaluate the conclusions reached in formulating the auditor’s report and consider whether the proposed audit report is appropriate should be included in paragraph 22 of ISQM 2. In the same vein, we suggest incorporating the language on reviewing the independence assessment in paragraph 38(a) of the extant ISQC1.
32. We recommend that the IAASB liaises with the IESBA to consider whether the current ethical requirements include sufficiently robust requirements for the reviewer and the assistants to the reviewer, including independence and cooling-off requirements.
33. We are of the opinion that the nature of direction and oversight of the assistants to the EQR by the reviewer should be clarified in the standard. At present, this is limited to the requirement in paragraph 18 for the firm to establish policies and procedures that require



the reviewer to take responsibility for the performance of the EQR including the work of individual assistants.

34. We recommend that the documentation requirement be made clearer. It is essential that the documentation not only shows that an EQR was done, but also what was done, the follow-up that was required and how that follow-up was performed, how the EQR was performed, etc.
35. It would be useful to ensure full alignment of this ED with the requirements in EU Regulation 537/2014, in particular article 8 (engagement quality control review) and from a quality perspective we think it would be useful to elevate these to global requirements in the standard. We also suggest to clarify the engagement quality reviewer's responsibility for the review of the report to those charged with governance, and the work of experts. We also note that compliance with laws and regulations is only addressed in relation to eligibility of the reviewer (paragraph 16(c)) and in relation to ethical requirements (paragraph 17(b)). We recommended making it clear in the standard that the EQR needs to be performed in compliance with all relevant aspects of laws and regulation.
36. Some of the detail in the current ISA 220 on EQCR (for instance that on finalizing an engagement that is subject to EQCR) do not appear to have been included in ISQM 2. We suggest ensuring that all extant requirements are included in ISQM 2 or are only omitted based on a clear rationale.
37. In line with our comment relating to ISQM1, the language on non-relevance of requirements (paragraph 13) should be expanded to clarify to what extent it could occur.

#### **4. Comments on ISA 220**

38. We urge the Board to carefully review and revise the objective. It currently states: 'the objective of the auditor is to manage quality... to obtain reasonable assurance that quality has been achieved such that (a) the auditor has fulfilled his/her responsibilities... and (b) the auditor's report is appropriate...'. In our view the objective to manage quality to achieve quality appears circular. Also, and in line with our comment on the objective of ISQM 1, we are concerned with the lack of clarity regarding reasonable assurance at engagement level, and we feel that the stakeholder/public interest perspective has not been adequately reflected. In our view, reasonable assurance as an expression of the level of assurance provided by the auditor is a difficult but widely accepted concept. Reasonable assurance over quality in the proposed ISA 220 uses the same language but is different. Given that this standard is aimed at the engagement level, we would suggest that it can be made more specific by stating that the objective is to ensure that the audit is of high quality, performed in the public interest and meets all legal and regulatory requirements.
39. As part of ensuring overall quality throughout the engagement, the auditor may need to use work of other auditors/teams (either within the firm, within the network or outside of the network), service providers and/or experts, some of whom are part of the engagement team whilst others are not. It is important that the standard clarifies the auditor's responsibility for ensuring the quality of the work that these other parties perform. More



specifically, the standard should expand on the measures and procedures that the auditor is required to undertake to ascertain that the work he uses meets the necessary quality requirements. We also suggest that the Board liaises with the IESBA as to ensure appropriate alignment of the relevant requirements in both the ISAs and in the Code of Ethics.

40. In line with our overarching comments, the relationship between the objectives of ISA 220 and ISQM 1 should be further explained in the standard itself. We note that paragraph 10 and subsequent paragraphs of the Explanatory Memorandum address this relationship, but we urge the Board to clarify in the standard how the relationship between the firm's overall responsibility for quality and the engagement partner's responsibility for quality at the engagement level should be understood and applied in practice.
41. We recommend expanding the leadership requirements at engagement level to also encompass behavioural aspects, such as 'practice what you preach' and 'lead by example'.
42. We are of the view that the responsibility of the engagement partner for ethical matters is too limited. Ethical requirements, which include independence and objectivity, are a fundamental prerequisite of an audit for which the engagement partner is responsible. Therefore, the requirements to have an "understanding" of the ethical requirements as set out in paragraph 14 and to "determine" that the team members have been "made aware" of relevant requirements as set out in paragraph 15 appear to be insufficient. We urge the Board to strengthen the language to better express the responsibilities of and expected actions by the engagement partner.
43. We are of the view that the subject of ethical requirements in group audits (which can often be across borders with differing legal and regulatory requirements as a result) merits specific attention and detail, given the difficulty thereof and the fact that independence requirements in particular often give rise to issues in group audits. We suggest that the Board considers where best to address this particular topic, for instance in the requirement or application material of this standard or in ISA 600 on group audits.
44. Where insufficient or inappropriate resources are assigned to an audit engagement, paragraph 25 of the standard requires the engagement partner to take appropriate action including to communicate with 'appropriate personnel in the firm'. We urge the Board to review whether the term 'appropriate personnel' is sufficient to signify the level(s) of responsibility of those that the engagement partner will need to discuss resource issues with.
45. We recommend placing an increased focus on on-the-job training and timeliness of supervision and review in the requirements dealing with engagement performance.
46. We recommend including a requirement for a more active role by the engagement partner when dealing with monitoring and remediation. It currently appears that the auditor can await the outcome of the firm's monitoring and remediation activities instead of taking proactive responsibility for quality. We recommend that the Board clarifies that the





engagement partner should also apply professional judgement and professional scepticism in this area.

47. The requirement in paragraph 37 for the engagement partner to determine that the engagement partner has taken overall responsibility for managing and achieving quality is unclear as a result of the circular reference. We urge the Board to clarify this requirement.

Please do not hesitate to contact me or the Chair of the CEAOB International Auditing Standards Subgroup, if you have any questions on the content of this letter.

Yours faithfully,

Ralf Bose

Chairman