



INSTITUTE OF
SINGAPORE
CHARTERED
ACCOUNTANTS

60 Cecil Street, ISCA House,
Singapore 049709
TEL +65 6749 8060
FAX +65 6749 8061
www.isca.org.sg

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Willie Botha
Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, New York 10017
USA

Dear Sir,

RESPONSE TO THE INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD (IAASB) EXPOSURE DRAFTS (ED) – PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT (ISQM) 1, QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS, ISQM 2, ENGAGEMENT QUALITY REVIEWS AND PROPOSED INTERNATIONAL STANDARD ON AUDITING (ISA) 220 (REVISED), QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS

The Institute of Singapore Chartered Accountants (ISCA) appreciates the opportunity to comment on the above EDs issued by the IAASB in February 2019.

To solicit meaningful feedback for these topics, ISCA undertook the following initiatives to seek views from key stakeholders:

- (i) Conducted a one-month public consultation to seek feedback from its members;
- (ii) Organised a focus group discussion to engage key stakeholders to obtain their views on the EDs; and
- (iii) Discussed the EDs with members of the ISCA ISQM Sub-Committee and Auditing and Assurance Standards Committee.

Our comments to selected questions in the EDs are as follows:

ISQM 1 Overall Questions

- 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?

Additional guidance on new areas introduced in the standard, namely *Network Services* and *Service Providers* would be useful, both in understanding their respective scope and what is expected in complying with those requirements. Scalability should be achievable based on the nature and extent of the use of such services by firms. Additional guidance to clarify the nature and extent of *Network Services*, for example, through an illustrative list that is non-exhaustive, together with worked examples for both areas of requirements to illustrate their application, may help demonstrate this. For network firms in countries that adopt a different quality control standard from ISQM, one area of concern that may arise when using network services is assessing if the network firm has complied with the requirements of ISQM.

On the implementation front, we understand that firms have a transition period of 18 months from the issuance of the standard to set up their quality management systems. We would like to clarify if the transitional requirement is retrospective or prospective. For example, assuming that the date of issuance of the standard is 31 December 2019, our understanding is that relevant quality controls should be implemented by 30 June 2021, but the monitoring and attestation of the operating effectiveness of these controls is on a prospective basis (i.e. in the next twelve months commencing 1 July 2021). In this regard, the implementation guidance can be more specific. Also, considering that the standard is a major overhaul and will have significant impact to firms when issued, the Board can consider extending the transition period.

A main challenge that we foresee is that small firms will face difficulties finding resources to implement the revised standard. The time and costs associated with the initial implementation will be significant, as it would require an initial resource to establish quality objectives and ensure that potential associated risks are thoroughly considered and documented with appropriate responses, which may prove difficult for small firms. In our local scene, firm level findings will no longer be advisory in nature going forward, and this will have far-reaching implications to firms if they do not implement the revised ISQM properly.

Overall, more guidance and examples will be needed for implementation, especially for small firms. It may be useful to develop a toolkit to assist small firms to document quality objectives and risk assessments.

ISQM 1 Specific Questions

- 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?**

In reference to paragraph 18, the objective of the firm “to design, implement and operate a system of quality management” is worded like a strategy (i.e. how to achieve the objective) instead of an objective or goal. We suggest to re-define the objective and separate it from the strategy to keep the objective statement clear and precise.

The firm's objective should include its public interest role. An example of such an objective could be: “to fulfil professional duty and the public interest in providing effective, efficient and timely service”.

- 6) Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved? In particular:**

(a) Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?

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

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

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

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

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

In general, we agree that the application of a risk assessment process will drive firms to achieve the objective of the standard and should be applied across all ISQM 1 components. However, the extent of application to each component may differ.

In particular, we feel that the level of understanding required for components *Information and communication* and *Monitoring and remediation* may not necessitate as rigorous and detailed risk assessment as compared to the other components. In this respect, the guidance is not clear on the scalability of the risk assessment process when applied to each component. If such process is required to be applied across all components, the guidance should be expanded to explain how the application can be managed in respect of these two components.

While it is set out under paragraphs 10(a) and 26 that firms are expected to establish quality objectives that go beyond those required by the standard, it may be useful to give more prominence to this requirement by including it under each of the component sections. Similarly, the requirement set out under paragraph 10(c) to design and implement responses in addition to those required by the standard can be included under each of the component sections.

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

As a matter of providing a logical flow to the standard, we consider that it may be more appropriate to include the firm's risk assessment process, which explains the role of quality objectives, risks and responses, prior to the governance and leadership component. While we recognise the importance of the role of governance and leadership component with respect to the oversight of the system of quality management, we believe that reordering these components may aid understanding.

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

On whether an individual should be separately assigned responsibilities for relevant ethical requirements, proponents to this proposal considered the following factors:

- There should be a consistent message communicated across the firm and network on ethical behaviour. Ethical behaviour may be influenced by different risk appetites of individuals, hence a separate individual in charge can help drive consistent messaging.
- While it is important to address ethical aspects in detail at the engagement level, ethical issues should be escalated to the firm level. It would be important to have a point of contact for such situations.

- The role of the managing partner, which also includes growing the firm's business, may conflict with his responsibilities over ethical requirements. In this respect, having a separate individual in charge, who may report directly to the firm's governance body, can circumvent such conflict of interest. However, this would only work in a bigger firm structure.

A different perspective on the proposal to assign the responsibilities to a separate person is the following:

- A sole proprietor or a small set-up would not have the capacity to allocate the roles to different individuals. Even if the role was allocated to a separate individual, there might not be any substance to the arrangement if decisions made by the assigned person can be influenced by his reporting officer.

While we note that there are merits to assigning such responsibility to a separate person, this decision should be determined by the firm according to its risk assessment. Smaller set-ups that deal with private entities and that do not provide non-audit services are expected to have lower risks compared to larger firms which deal with listed entities and are multi-disciplinary. For firms with lower assessed risk, it may not be critical to separate these roles.

Although we note that the proposed standard allows for scalability, it is not clear which part of the standard can be scaled. We suggest that more examples be provided to describe situations where a separate person might be required for ethical requirements.

On network requirements, the standard is clear on the independence responsibilities. Also, such requirements are separately addressed in the auditing standards, such as ISA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*.

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?

While ISQM 1 addresses the establishment and operation of a system of quality management, the requirement of paragraph 40(e) addresses external reporting, which has no bearing on the firm's system or impact on quality. It is therefore an output of the system rather than an element of a component of the system. As such, this requirement seems out of place, and may not be best located in this standard. This appears to be more of a matter for jurisdictional regulators.

Under paragraph 41(c)(iv)a, the firm is required to determine whether there are external parties who may use such information to support their understanding of the quality of the engagements performed by the firm. While it is not explicitly stated in the standard that such communication is mandatory, it can be challenging to justify otherwise. Specifically, the term "external parties" is too broad and we suggest for some criteria to be included in the standard to define it.

When determining such criteria to be included, it would be worthwhile to consider a cost-benefit analysis. While it is possible to put out much information about the firm's quality management, we should consider if such information would be relevant to the intended users.

We should also consider circumstances where publication of detailed quality information could be harmful. For example, jurisdictions with emerging markets may have less sophisticated investors and/or governance requirements generally, and disclosure of detailed information may in fact lead to lesser, rather than improved, trust in audit if the information is not understood in context.

In terms of the content of the communication, the application materials can provide guidelines on how to prevent bias in selecting the information to be included in such communication (e.g. selective inclusion of quality indicators that reflect a positive outlook). The application materials can also include requirements and guidelines on explaining how to interpret the indicators in such communication (e.g. indicators at a point in time may not be reflective of the firm's situation over a reporting period).

Another concern that we have is the inclusion of the suggestion to communicate through a "transparency report" or otherwise. The explicit inclusion of the term "transparency report" in the standard itself may be subject to misinterpretation that such a report is mandatory. Such an inclusion is also against the principle of scalability as smaller firms may not find it cost effective to put out such a communication when there are few or no specific users. As such, we suggest removing the term "transparency report" from the standard to prevent expectation gaps.

One implementation challenge that we foresee is that small firms might not understand how to apply scalability to this requirement unless there is a defined scope of assessment. For example, a small firm that does not perform any engagements for public interest entities may conclude that there are no external parties who will be interested in their quality management and hence, will not need to put out such communication. However, the small firm may require guidance on how to perform the assessment to arrive at this conclusion. Also, small firms would require assistance on how to document such thought process. In the event that they are required to make such communication, it would be helpful to provide more detailed guidance or sample reports for their reference.

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?

Paragraph 37(e)(ii) requires an engagement reviewer for audits of financial statements of entities that the firm determines are of significant public interest. The standard should define the term "significant public interest", especially to provide clarification on the description "significant", which is subjective.

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?**
- (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?**

We believe that further clarity is needed around the concept of "findings" and the expectations of the standard in addressing whether a finding constitutes a deficiency, as defined in the standard. Paragraph A172 describes a finding as "information accumulated" from monitoring activities. This is a very broad concept that without further clarity, could result in an unstructured and potentially infinite exercise. We believe that the intent is, from a "negative finding" perspective, to focus on findings that give rise to indicators of potential non-compliance or of a deficiency in the system of quality management. We suggest that this be clarified within paragraph A172. In determining whether a finding gives rise to a deficiency, we agree that the policies, procedures and processes for undertaking this exercise need to be determined by the firm, based on the nature of the firm and how it operates.

While we agree that root cause analysis would promote more effective monitoring, smaller firms voiced concerns about not having sufficient expertise to conduct the analysis. Such concerns extend to firms considering the need to engage external consultants to perform the analysis, which can be very costly to their business. In this respect, while the standard allows for scalability by not restricting the form that the analysis has to be performed, more guidance on the extent of the analysis and examples of how it can be conducted would be helpful to assist implementation in practice, as the term "root-cause analysis" is very broad.

On inspection of completed engagements, we welcome the change in requirement on the frequency to a cyclical basis, which allows firms to have the flexibility to tailor the frequency. In this regard, it would be useful for firms to undertake a risk-based approach, considering factors such as the risk portfolio of the partner, whether the partner has been subjected to other forms of monitoring, risk events happening to partner etc when determining the frequency of inspections. In addition to inspections, monitoring of ongoing engagements is critical for prevention of quality failure.

On the requirement for an annual evaluation of the quality management system, we are of the view that an evaluation at least on an annual basis is reasonable and allows for scalability depending on firm situation.

ISQM 2

- 5) Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer's procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?**
- 8) Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?**

Paragraph 22(c) states that “Based on the information obtained in (a) and (b), identify the areas involving significant judgments made by the engagement team...”. In this context, the usage of the phrase “identify” can be misinterpreted to mean that the EQR needs to identify and conclude on the significant judgement areas of the engagement.

We also have a specific concern that the proposed requirement in paragraph 22(f) for the EQR to “evaluate the basis for the engagement partner’s conclusion that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement” lacks sufficient context. This requirement needs to be clearly anchored to the consideration of the engagement partner’s involvement in the significant judgements that are within the scope of the engagement quality review. Without those clear boundaries, the EQR would not have a sufficient basis for making such an evaluation, as the EQR is not performing a second partner role and is not evaluating the sufficiency and appropriateness of the involvement of the engagement partner across the entirety of the engagement. We believe that the requirement should be amended to make the basis for the evaluation clear, with application material providing additional guidance on factors that the EQR may take into account when making the evaluation.

We also note that smaller set-ups, especially sole proprietors, may have difficulties meeting the rotation requirements. While the standard does not mandate that the EQR has to come from the same firm, it may be difficult for sole proprietors to find eligible alternatives. Locally, we observe smaller firms forming alliances for the purposes of peer review, but such collaborations are not common. However, we note that the engagements that are undertaken by smaller firms might not require an EQR, and such requirements should be considered by the firm during engagement acceptance.

ISA 220 (Revised)

4) Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

With regards to technology, one area which practitioners grapple with is the extent of work to be performed on evidence in electronic form. One common problem that practitioners face is the extent of work to be performed over authenticating electronic confirmations, where the expectation of rigorous authentication procedures may offset the efficiency benefits of obtaining them in electronic form. Also, engagement teams tend to file the hardcopy audit evidence in addition to the electronic evidence due to uncertainty over whether such electronic evidence will be challenged. In this respect, the auditing standards can provide more clarity.

We also believe that more guidance is needed to recognise the potential impact of technology on the execution and review of audit work and the importance of the firm's system of quality management in supporting the use of approved technology. For example, if the firm has developed an artificial intelligence tool for identifying higher risk transactions, the engagement team would likely need to place reliance on the firm's processes for developing and maintaining tools that are reliable and fit for purpose. It would be helpful to specifically recognise this linkage with the firm's system of quality management in the application material of this section.

We believe that paragraph A58, in particular, could be clarified to provide additional factors that an engagement partner may take into account in determining whether a particular technological resource is appropriate for use in the audit (when not addressed by the firm's policies and procedures). Relevant factors may consist of experience of past use by the team or other teams, including testing that the technology operates as intended, and considering its compliance with firm policies and procedures, including aspects relating to data handling and security.

5) Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)

Generally, the revised requirements reflect what is being performed in practice.

Some areas that we feel can be further clarified or addressed include:

- Roles and responsibilities of partners when the signing partner is not the engagement partner
- Responsibilities of outsourced functions, in particular, the level of oversight and involvement required by engagement teams who engage such services, can be included in the standard
- In group audit situations where component auditors are not from the same network, the level of oversight and involvement can be further addressed

Should you require any further clarification, please feel free to contact Ms Wang Zhumei, Manager, Technical: Audit & Assurance, at ISCA via email at zhumei.wang@isca.org.sg

Yours faithfully,

Ju May

Ms Ju May, Lim
Deputy Director
TECHNICAL: Financial & Corporate Reporting;
Ethics & Specialised Industries;
Audit & Assurance