

2 July 2019

The Chair
International Auditing and Assurance Board
C/- The International Federation of Accountants
529 5th Avenue
New York New York
United States of America

Dear Sir

**Re: Exposure Drafts:
ISQM 1 Proposed International Standards on Quality Management 1
ISQM 2 Proposed International Standard on Quality Management 2
ISA 220 Proposed International Standard on Auditing (Revised)**

On behalf of the Institute of Public Accountants (IPA), I submit our comments on the following IAASB Exposure Drafts:

- Proposed International on Quality Management 1 (Previously International Standard on Quality Control 1) – *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ISQM1)
- Proposed International on Quality Management 2 – *Engagement Quality Reviews* (ISQM2), and
- Proposed International Standard on Auditing 220 (Revised) – *Quality Management for an Audit of Financial Statements* (ISA220).

The IPA is *unconvinced* that the ISQM 1 represents a significant improvement over the existing ISQC1. The IPA has the following concerns with the proposals.

1. Risk appetite and commercial considerations

The IPA believes the effectiveness of a risk-based approach to quality management are to some extent readily undermined by the commercial considerations. The recent Australian Hayne Royal Commission into Banking and the APRA review of the Commonwealth Bank demonstrated to us the override of risk management by commercial considerations. The IPA is concerned with less extensive regulatory oversight the effectiveness of risk-based quality system is readily susceptible to such override of commercial considerations.

Furthermore, a risk management needs to be considered in the context of risk appetite. The IPA is concerned that the outcomes of the proposed risk management approach to quality are susceptible to subversion by a firm's risk appetite.

The risk appetite setting of a firm may allow it to apply less rigorous responses to quality risks due to the firm's assessment of acceptable levels of risk in the context of their risk appetite statement. The IPA is aware of a publicised incident where a firm's risk appetite was used as a basis for the acceptance of an engagement with independence and conflict of interest issues.

2. Market discipline and public accountability

The IPA is of view that risk management practices of assurance service firms are not subject to sufficient public accountability and therefore lack a fundamental pillar of risk management – market discipline.

While ISQM 1 supports the concept of transparency reports by firms, the IPA is sceptical of the usefulness of current transparency reports, particularly in the absence of assurance on them. The absence of assurance reporting of transparency reports should necessitate an increased level of regulatory oversight.

3. Measurement of risk

Arguably, in an assurance context, quality systems are about managing operational risk, and to a lesser extent reputational and strategic risk. Unlike market observable risks (such as market and credit risk) is generally conceded that operational risk is harder to measure and there is less reliable data to support risk estimates.

As the GFC has demonstrated all risk models are subject to the robustness of the assumptions underlying these models. This can be partially be attributed to consistent underestimation of the likelihood and impacts of adverse events. In the case of operational risks, this is exacerbated by the increased use of unsupported judgements as to the likelihood and impact of adverse events. As such, the IPA believes the application of a risk management approach to quality control in an assurance context where there is little data available is prone to incorrect risk estimation and consequently an inadequate risk response.

4. Scalability

While a risk-based approach to quality systems may seem scalable, the IPA is sceptical that in a practical sense this will be effective. Firms without the resources to undertake a proper risk assessment process will either require the support of external assistance or more likely undertake a suboptimal risk assessment. The latter will result in inadequate risk responses.

As such the IPA is of the view that a more appropriate approach would be a “standardised” approach to quality risk responses with the option to rebut specific risks and associated responses. For those assurance firms with more sophisticated risk processes and quality systems risk response can be substituted by more appropriate responses.

5. Resources quality system component

The IPA is concerned about the absence of any mandatory responses in the resources component of the quality system. Critical to the quality of assurance engagements is the allocation of knowledgeable and experienced staff to the engagements. While this aspect is somewhat addressed by the engagement performance component of the quality system, the IPA is of view, that audit failure can often be attributed to engagement personnel having insufficient experience and knowledge to assess and respond to the issues arising during the course of the assurance engagement.

The IPA believes this failure can be ascribed to incomplete knowledge of accounting, auditing and industry specific considerations. These deficiencies are a function of inadequate resources being allocated to addressing these knowledge gaps exacerbated by the ineffective supervision by experienced and knowledgeable supervisors, managers, and engagement partners.

6. Engagement quality reviews (EQR)

With an increasing number of jurisdictions opting for joint audits, the IPA believes the IASB should be moving to pre-empt the practice by further enhancing the role of the EQR.

The IPA believes that joint audits are inefficient and can adversely affect audit outcomes by creating a “silo” approach to the audit (i.e. each firm being responsible for discrete components of the audit or financial statements).

Rather, the IPA believes a better outcome would be achieved by the IASB mandating EQR to be conducted by third party providers not associated with either the audit firm or the audit client. This would provide a more robust EQR process and with less cost and inefficiencies and an improvement in audit quality.

Our comments and responses to the questions in the exposure drafts are set-out in the following appendices to this letter:

- Appendix A – ISQM 1
- Appendix B – ISQM 2, and
- Appendix C – ISA 220.

If you would like to discuss our comments, please contact me or our technical advisers Mr Stephen La Greca (stephenlagreca@aol.com) or Mr Colin Parker (colin@gaap.com.au) GAAP Consulting.

Yours sincerely

Vicki Stylianou
Executive General Manager, Advocacy & Technical
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CC Chair, AUASB

About the IPA

The IPA is a professional organisation for accountants recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 35,000 members in Australia and in over 65 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice.

Through representation on special interest groups, the IPA ensures the views of its members are voiced with government and key industry sectors and makes representations to Government including the Australian Tax Office (ATO), Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) on issues affecting our members, the profession and the public interest. The IPA recently merged with the Institute of Financial Accountants of the UK, making the new IPA Group the largest accounting body in the SMP/SME sector in the world.

Appendix A – ISQM 1

Overall Questions

Question 1

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

- (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?*
- (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional scepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?*
- (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?*

IPA response

As noted in our covering letter, ISQM 1 does not adequately address all the components of a risk management system especially the impact of risk appetite, commercial overrides and the lack of market discipline.

The IPA is also concerned that given the inherent difficulties in the assessment of likelihood and magnitude of operational risks, the proposed ISQM 1 will result in an inconsistent approach to quality management when compared to the existing ISQC 1.

The IPA recommends a “standardised” approach to quality risk responses with the option to rebut specific risks and associated response. For those assurance firms with more sophisticated risk processes and quality systems risk response can be substituted by more appropriate responses. This approach would need to be coupled with a robust market discipline requirement i.e. an audited transparency report which specially disclose quality risk disclosures and risk responses.

Question 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?

IPA response

As noted in our covering letter and our response to Question 1, the IPA is of the view that the estimation of likelihood and magnitude of risk are likely to be subjective and create suboptimal quality risk responses. In addition, ISQM 1 makes no consideration for the impact of risk appetite and commercial overrides on risk response.

Question 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?

IPA response

As noted in our overing letter and responses to Questions 1 & 2, the IPA does not believe the proposed ISQM 1 will result in a consistent application of effective quality management by assurance firms. The IPA would prefer a “standardised” approach to quality risk responses with the option to rebut specific risks and associated response, supported by appropriate market disciplines.

Specific Questions

Question 4

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

IPA response

The IPA supports the eight components of the system of quality management.

Question 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?

IPA response

The IPA supports the objective of the standard including the objective of the system of quality management. While the IPA supports the content on public interest, without audited transparency reports, the IPA is of the view firms will tend pay “lip-service” to the concept of public accountability.

Question 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?*

IPA response

For the reasons stated in our covering letter, the IPA is sceptical that the introduction of risk-based approach to quality management as espoused in ISQM 1 will provide a consistent response to risks to audit quality.

The IPA is unconvinced that firms will identify additional quality objective beyond ISQM 1 and approach ISQM 1 as a mere compliance exercise to be met as quickly as possible with the lowest operational impact.

As noted previously, the IPA supports “standardised” approach to quality risk responses with the option to rebut specific risks and associated response, supported by audited transparency reporting.

Question 7

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

IPA response

The IPA supports the content in ISQM 1 addressing firm governance and leadership.

The IPA is of the view without robust audited transparency reporting, governance and leadership are not subject to the public accountability and market disciplines required to ensure their effectiveness.

Question 8

With respect to matters regarding relevant ethical requirements:

- (a) *Should ED-ISQM1 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?*

IPA response

The IPA supports assigning both the responsibility for ethical requirements and independence to an individual within a firm.

While the IPA believe ISQM addresses the responsibilities for independence of firms and individuals in a network, the IPA believes the application guidance should be more extensive, particularly in relation circumstances where independence considerations may arise in a network firm environment.

Question 9

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

IPA response

The IPA considers ISQM 1 appropriately addresses the use of technology for systems of quality management.

Question 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?

IPA response

As noted in our covering letter, the IPA believes public accountability and risk management are linked via market discipline. The IPA believes the requirements in ISQM 1 in relation to reporting to external parties are weak. The IPA recommends guidelines introduced into the nature of external reporting to third parties and consideration of including an assurance requirement for transparency reporting.

Question 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?

IPA response

The IPA broadly supports the proposals for engagement quality reviews (EQRs). However, the IPA proposes enhancements:

- Paragraph 37(e)(ii) specifically include PIES as defined under IESBA standards, and

- Paragraph 37(e)(iii) be expanded to specifically include those entities where inherent risk has been identified in relation to multiple financial statement areas and assertions.

The IPA is concerned that in the absence of the above enhancements, firms will narrowly define public interest and not require EQRs over higher risk audits.

Question 12

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

- 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?*
- 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?*
- Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?*
- Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:*
 - Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?*
 - Is the manner in ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?*
- 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?*

IPA response

The IPA broadly supports the proposed approach in ISQM 1 in relation monitoring and remediation but has the following concerns:

- the cycle for review for each engagement partner of one completed engagement (paragraph 45(b)) should have a minimum specified of two or three years depending on the relevant factors identified in paragraph 45(a), and
- that there is no mention of failure to comply with auditing or accounting standards in the definition of a deficiency or in determining a negative finding (paragraph A175).

The IPA supports the inclusion of root cause analysis in relation to investigating deficiencies.

Question 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?

IPA response

The IPA is unconvinced that the proposals in ISQM 1 will have a substantive impact on the reliance on network requirements or network services. The IPA is concerned that network firms will continue to adopt network response to quality requirements as this fundamental to the nature and benefits of network firms.

Question 14

Do you support the proposals addressing service providers?

IPA response

The IPA supports the proposals in addressing service providers.

Question 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?

IPA response

The IPA is unaware of any significant difficulties in adopting the title “ISQM” at a jurisdictional level.

Appendix B - ISQM 2

Question 1

Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

IPA response

The IPA supports a separate standard EQRs covering the nature and extent of the review with ISQM 1 dealing with the identification of which engagements require EQRs.

Question 2

Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?

IPA response

The IPA considers the linkages between ISQM 1 and ISQM 2 clear.

Question 3

Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?

IPA response

The IPA sees little benefit from the change of terminology from “engagement quality control review/reviewer” to “engagement quality review/reviewer”. The IPA is unaware of any jurisdictional impediment to using the terms “engagement quality review/reviewer”.

Question 4

Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

- (a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling off” period for that individual before being able to act as the engagement quality reviewer?*
- (b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?*

IPA response

The IPA supports the proposed requirements in relation to eligibility of the EQR in ISQM 2.

In relation to “cooling-off” periods, the IPA supports a two-year “cooling-off” period for previous engagement partners. While the IPA recommends that this provision to be include in the IESBA code, the IPA is comfortable with the requirement being included in ISQM 2.

Question 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)?

IPA response

The IPA agrees with the requirements of ISQM 2 in relation to the nature, timing and extent of the EQR procedures. However, the IPA believes that in respect of timing of EQR procedures, there should explicit requirement for engagement planning to be reviewed by the EQR before the commencement of field work.

Question 6

Do you agree that the engagement quality reviewer's evaluation of the engagement team's significant judgements includes evaluating the engagement team's exercise of professional scepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional scepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

IPA response

The agrees the EQR should be evaluating significant judgements and the exercise of professional scepticism. The IPA does not believe any further guidance is required in relation to the EQR consideration of the engagement teams exercise of professional scepticism.

Question 7

Do you agree with the enhanced documentation requirements?

IPA response

The IPA supports the enhanced documentation requirements of ISQM 2.

Question 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?

IPA response

Other than the ability to use third parties to undertake the EQR, the IPA is the view that the EQR is inherently non-scalable.

Appendix C - ISA 220

Question 1

Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11-13 and 37 of ED-220) as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?

IPA response

While the IPA supports the focus on the involvement of the engagement partner, the IPA is concerned that insufficient emphasis is placed on detailed level of review the total file(s) by senior experienced personnel.

While paragraph A30 acknowledges the role of other members of the engagement team, ISA 220 is not sufficiently robust in relation to the need for an overall file review and ideally a multi-level review (i.e. a review by an “in-charge” and a subsequent manager review”). The IPA is strongly of the view that a strong review process is critical to audit quality.

Question 2

Does the ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures?

IPA response

The IPA agrees there are appropriate linkages between ISA 220 and the ISQMs.

The IPA supports the requirement to follow the firm’s policies and procedures and under what circumstances the engagement partner may rely on the firm’s policies and procedures.

Question 3

Do you support the material on the appropriate exercise of professional scepticism in managing quality at the engagement level? (See paragraph 7 and A27-A29 of ED-220).

IPA response

The IPA support the material on the exercise of professional scepticism in managing quality at the engagement level.

Question 4

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

IPA response

The IPA believes ISA 220 should explicitly deal with the offshoring of audit work, the relationship with ISA 600 and the audit quality implications including review requirements.

Question 5

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

IPA response

The IPA broadly supports the review requirements of ISA 220, however as noted in our response to Question 1, the IPA is of the view that ISA 220 is not sufficiently robust in relation to the need for an overall file review and ideally a multi-level review.

Furthermore, the IPA believes ISA 220 does not explicitly address the self-review issue and should provide comment on the necessity for an independent review of all assurance work performed. It should be noted that were a partner undertakes and prepares working papers related to assurance work, that the EQR is not an appropriate substitute for a review of those working papers.

Question 6

Does ED-220 together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?

IPA response

The IPA supports, the proposed documentation requirements in ISA 220.

Question 7

Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?

IPA response

The IPA is of the view the ISA 220 is appropriately scalable.
