

A New Approach to Quality Management for Audit Firms

by Emer Kelly

A new suite of three new quality management standards will become effective for audit firms later this year. These new standards will replace the current quality standard upon which the processes and procedures of Irish audit firms are based – ISQC1. The standards were issued by the Irish Auditing and Accounting Standards Authority (IAASA) and are based on the global standards issued by the International Auditing and Assurance Standards Board (IAASB).

The new standards represent a significant shift in focus for quality, providing for a more proactive and firm specific consideration of quality management.

Systems of quality management in compliance with this ISQM (Ireland) are required to be designed and implemented by December 15, 2022, and the evaluation of the system of quality management required by the standard is required to be performed within one year following December 15, 2022. Early adoption is permitted.

The three new standards are as follows:

- International Standard on Quality Management (Ireland) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements (ISQM 1).
- International Standard on Quality Management (Ireland) 2, Engagement Quality Reviews (ISQM 2).
- International Standard on Auditing (Ireland) 220 (Revised), Quality Management for an Audit of Financial Statements (ISA 220 Revised).

Audit firms should now consider what these changes will mean for their audit firms and start to plan accordingly.

What is different about the new standards?

The new standards represent a shift in focus from quality control to quality

management which is achieved by implementing a risk-based approach, i.e., managing risks to quality.

Under the new standard audit firms are required to proactively manage the quality of engagements performed by the firm.

ISQM 1 consists of eight components as follows:

a. The firm's risk assessment process

This section represents one of the most significant changes in the approach to quality management. It introduces a risk-based approach and requires firms to establish quality objectives, identify and assess quality risks and design and implement responses that address the quality risks.

ISQM 1 includes the quality objectives that firms are required to have, which are incorporated in the other components described below. However, ISQM 1 does not include the quality risks, as firms are expected to identify the quality risks that exist given their nature and circumstances. Similarly, there are no responses in ISQM 1, other than a few specified responses, such as engagement quality reviews. As a result, firms are expected to design and implement their own responses to identified risks.

b. Governance and leadership

Aspects covered by this component include the firm's commitment to quality through its culture, including reinforcing the firm's role in serving the public interest by consistently performing

quality engagements and addressing the importance of quality in the firm's strategic decisions and actions.

This component also covers the responsibilities and accountability of firm leadership for quality. Separate requirements in ISQM 1 deal with assigning leadership roles, the qualifications of the individuals assigned the roles and annual performance evaluations.

c. Relevant ethical requirements

This component requires firms to establish quality objectives that address the fulfilment of responsibilities in accordance with relevant ethical requirements, including those related to independence. It also deals with others external to the firm, such as a network, network firms or service providers, and the need for the firm to address relevant ethical requirements related to the firm and the firm's engagements that affect others external to the firm.

d. Acceptance and continuance of client relationships and specific engagements

This component requires the firm to establish quality objectives that address judgments by the firm about whether to accept or continue a client relationship or specific engagement. This includes that the financial (e.g., fees and firm profit) or operational (e.g. growth or strategic direction) priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

e. Engagement performance

The "Engagement Performance" component requires the firm to establish quality objectives that address the performance of quality engagements. It covers the responsibilities of the engagement team and engagement partner (including with respect to exercising professional judgment and professional scepticism), direction, supervision and review, consultation, differences of opinion, and the assembly and maintenance of engagement documentation.

f. Resources

This component expands the consideration of resources beyond that of human resources. It requires firms to establish quality objectives that address appropriately obtaining, developing, using, maintaining, allocating and assigning resources in a timely manner. It covers human resources, technological resources and intellectual resources needed to operate the system of quality management and perform engagements.

It also addresses the firm's responsibilities when it belongs to a network.

g. Information and communication

This section requires the establishment of quality objectives that address obtaining, generating, or using information regarding the system of quality management and communicating information within the firm and to external parties on a timely basis. It emphasizes the continual flow of information within the firm, and with engagement teams. It drives firms to establish an information system with processes to identify, capture and maintain information and addresses the need for firms to communicate externally.

h. The monitoring and remediation process

Monitoring activities should be tailored by the firm. There is a requirement that the firm monitor the system as a whole to provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management (a

shift in focus from engagement-level monitoring).

Monitoring activities are required to include inspection of completed engagements. Significantly, a new framework has been introduced for evaluating findings and identifying deficiencies, as well as evaluating the severity and pervasiveness of deficiencies, which includes investigating the root cause(s) of deficiencies. There are also enhanced requirements addressing the remediation of deficiencies.

How should the firm approach the risk assessment process?

ISQM1 requires an audit firm to identify and assess quality risks to provide a basis for the design and implementation of responses. In doing so, it requires that the firm shall:

- a. Obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, including:
 - i. With respect to the nature and circumstances of the firm, those relating to:
 - a. The complexity and operating characteristics of the firm;
 - b. The strategic and operational decisions and actions, business processes and business model of the firm;
 - c. The characteristics and management style of leadership;
 - d. The resources of the firm, including the resources provided by service providers;
 - e. Law, regulation, professional standards, and the environment in which the firm operates; and
 - f. In the case of a firm that belongs to a network, the nature and extent of the network requirements and network services, if any.
 - ii. With respect to the nature and circumstances of the engagements performed by the firm, those relating to:
 - a. The types of engagements performed by the firm and the reports to be issued; and
 - b. The types of entities for which such engagements are undertaken.
- b. Take into account how, and the degree to which, the conditions, events, circumstances, actions, or inactions may adversely affect the achievement of the quality objectives.

Risk based approach focused on achieving the quality objectives

Establish Quality Objectives	Identify and Assess Quality Risks	Design and Implement Responses
<ul style="list-style-type: none"> ISQM1 prescribes outcome-based quality objectives in the components. The firm establishes additional quality objectives that the firm considers are necessary to achieve the objectives of the system of quality management. 	<ul style="list-style-type: none"> The firm understands the conditions, events, circumstances, actions, or inactions that could adversely affect the achievement of the quality objectives The firm focuses on the nature and circumstances of the firm and engagements it performs 	<ul style="list-style-type: none"> The firm designs and implements responses that address the quality risks ISQM1 also includes some specified responses.

What is ISQM 2 about?

ISQM 2, Engagement Quality Reviews is the second standard that forms part of this new approach to quality management.

It sets out how a firm should approach audit engagements that require an Engagement Quality Review (EQR). EQRs are provided for within ISQM1 as a specified response to risk.

An "Engagement Quality Control Review" is defined as a process designed to provide an objective evaluation, on or before the date of the audit report, of the significant judgments the engagement team made and the conclusions it reached in formulating the report.

The engagement quality control review process is required for audits of financial statements of listed entities, and those other engagements, if any, for which the firm has determined an engagement quality control review is required.

So, all firms even those that do not audit listed entities must consider the criteria for determining which of their engagements, if any, should be subject to an engagement quality control review. In making such a determination the following criteria should be considered;

- i. The nature of the engagement, including the extent to which it involves a matter of public interest.
- ii. The identification of unusual circumstances or risks in an engagement or class of engagements.
- iii. Whether laws or regulations require an engagement quality control review.

It may be appropriate to consider the following engagement types for an EQR:

- Engagements that involve a high level of complexity or judgment.
- Engagements on which issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremedied significant deficiencies in internal control, or a material restatement of comparative information in the financial statements.



- Engagements for which unusual circumstances have been identified during the firm's acceptance and continuance process (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).

For audit engagements, and the engagement quality reviews (EQRs) for those engagements, the engagements and EQRs (if any) will need to be performed under the new standards for periods commencing on or after December 15, 2022.

Revisions to ISA (Ireland) 220, Quality Management for an Audit of Financial Statements

ISA (Ireland) 220 has been revised to reflect this approach to quality management. The standard outlines the management of quality at engagement level and encourages a proactive approach at the engagement level. The standard emphasises the importance of professional scepticism and enhances the documentation of auditor's judgements.

Implementation Plan for Audit Firms

Firms should now review carefully and become familiar with the requirements of the new standards and plan for their implementation so that they are in place for December 2022.

This should be an exercise that is tailored to the circumstances and profile of the audit firm. The standards are designed to be scalable from the smallest of audit firms to the largest. So, firms with flat structures or sole practitioners may find that some of the value objectives, for example, such as

those relating to human resources are unlikely to be very complex.

Firms will already have in place policies and procedures that comply with ISQC 1 and these provide for an appropriate starting point for the exercise. The firm's risk assessment will be the driver for compliance with these new standards. Firms may find that expanding on existing policies and procedures and considering why they exist, may form a framework for the consideration of risk.

An off the shelf solution to these standards will not deliver the necessary risks and responses unique to the firm. Firms may find it useful to workshop these with audit staff internally. For starters there are some useful implementation guides and factsheets available from the IAASB which firms may find useful as they plan for a December implementation.

The key message is that firms should start preparing sooner rather than later for these new standards.



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