



The Institute of  
Chartered Accountants  
of Pakistan

**CA**  
PAKISTAN

# IAASB QUALITY MANAGEMENT STANDARDS

**AUDITING STANDARDS & ETHICS COMMITTEE**

**JUNE 22, 2021**

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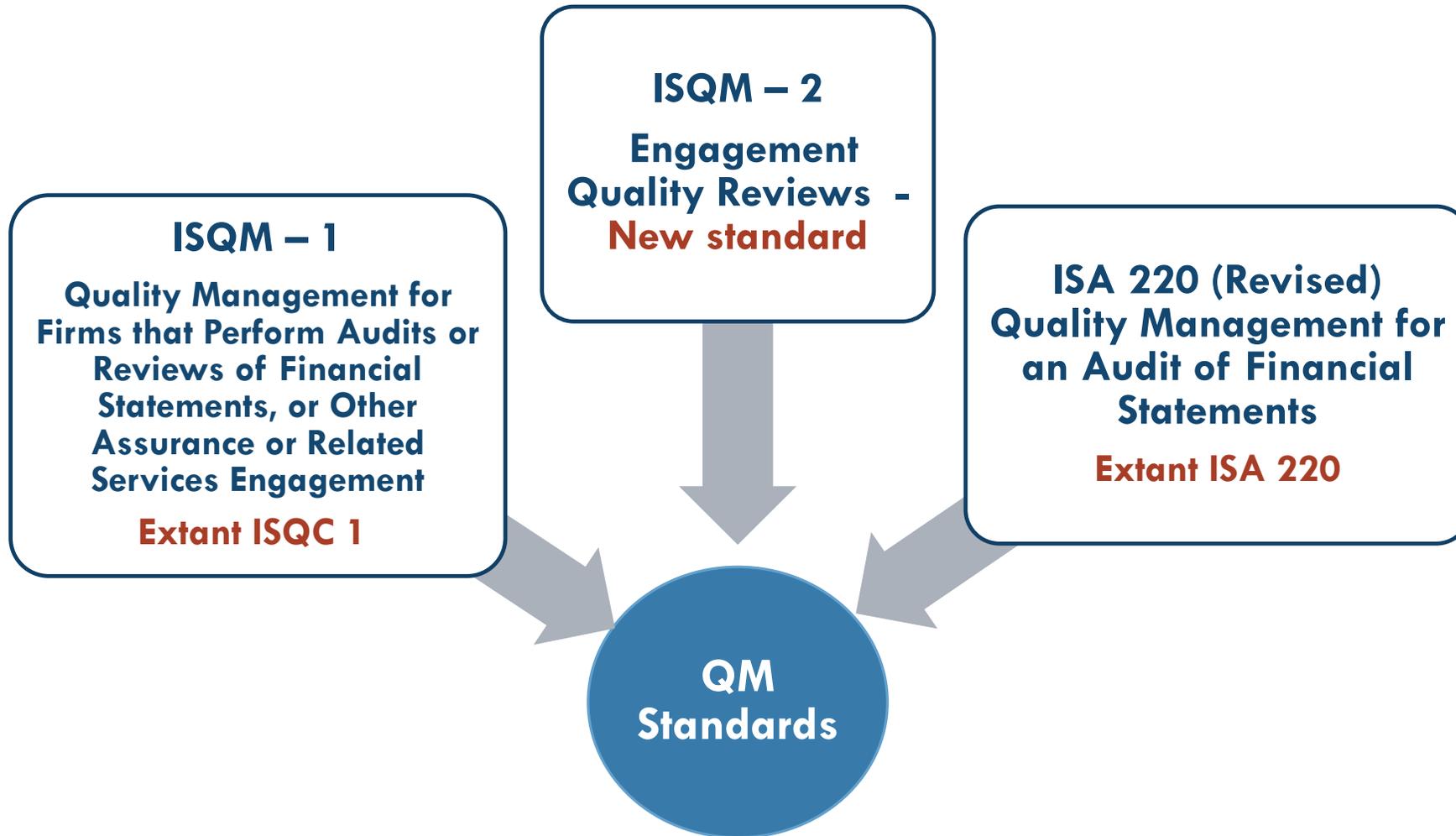
# BACKGROUND OF THE PROJECT

- 2013-14: Findings from ISA implementation project, outreach with oversight bodies/regulators and respondents feedback through IAASB work program.
- 2015: Invitation to Comment (ITC) on ‘Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits’ was released for public comments.
- 2016: IAASB approved a project to revise extant ISQC 1 and ISA 220.
- 2019: Exposure Drafts on ISQM 1, ISQM 2 and ISA 220 were issued.
- 2020: Final QM standards were issued in Dec 2020

# ISSUES IDENTIFIED WITH EXTANT STANDARDS

- ISQC 1 addresses standalone elements of quality control
- Firm governance and leadership responsibility was missing
- Not scalable to fit needs of all firms
- Engagements level monitoring – not the monitoring of whole system
- Root causes of deficiencies in QM system and robust remedial actions
- Undue reliance on networks
- Only Human Resources
- Increase scope of engagement team, Clarity about Engagement Partner's responsibilities for appropriate direction, supervision and review
- Entities subject to EQRs, Review timings and EQ reviewer eligibility

# ABOUT QUALITY MANAGEMENT STANDARDS



# ABOUT QUALITY MANAGEMENT STANDARDS

- QUALITY “CONTROL” TO QUALITY “MANAGEMENT”

• INTEGRATED



• PROACTIVE

**Effective Date of  
QM standards**

**December 15,  
2022**

- SCALABLE TO THE NATURE AND CIRCUMSTANCES OF THE FIRM AND ITS ENGAGEMENTS

# KEY FEATURES OF QUALITY MANAGEMENT (QM) STANDARDS



# INTERACTION BETWEEN QM STANDARDS

QM standards are scalable and interrelated:

- **ISQM 1** – Firm to establish System of Quality Management (SOQM)
- **ISQM 2** – Separate standard for Engagement Quality Reviews
- **ISA 220 (Revised)** – Engagement Partner responsible for managing quality at the engagement level



# OVERVIEW OF ISQM 1

**QUALITY MANAGEMENT FOR FIRMS THAT PERFORM  
AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR  
OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENT**

# OBJECTIVE OF ISQM 1

*“The objective of the firm is to  
design, implement and operate a system of quality  
management for audits or reviews of financial statements, or  
other assurance or related services engagements performed by  
the firm”*

# OBJECTIVE OF ISQM 1

## SYSTEM OF QUALITY MANAGEMENT (SOQM)

*“A system designed, implemented and operated by a firm to provide the firm with reasonable assurance that:*

*(i) The firm and its personnel fulfill their responsibilities in accordance with **professional standards and applicable legal and regulatory requirements**, and conduct engagements in accordance with such standards and requirements; and*

*(ii) **Engagement reports** issued by the firm or engagement partners **are appropriate in the circumstances.**”*

# DIFFERENCE BETWEEN ISQC 1 AND ISQM 1

| ISQC 1  | ISQM 1  |
|---|---|
| <ul style="list-style-type: none"><li>• Compliance-based system and perceived as “tick box” exercise of establishing policies and procedures</li></ul>                                | <ul style="list-style-type: none"><li>• Risk-based approach</li></ul>   |
| <ul style="list-style-type: none"><li>• Not scalable to fit the needs of all firm size, complexities and circumstances.</li></ul>   | <ul style="list-style-type: none"><li>• More thought provoking and can be tailored SOQM to firm’s need and their engagements.</li></ul>   |
| <ul style="list-style-type: none"><li>• Not addresses risks to quality.</li></ul>   | <ul style="list-style-type: none"><li>• Proactive identification and response to identified risks to quality.</li></ul>   |
| <ul style="list-style-type: none"><li>• Addresses standalone six elements of quality control</li></ul>  | <ul style="list-style-type: none"><li>• Integration of 8 components of a system as a whole.</li></ul>   |
| <ul style="list-style-type: none"><li>• Addresses only monitoring</li></ul>   | <ul style="list-style-type: none"><li>• Enhanced monitoring and remediation process with focus on identification of deficiencies, root cause analysis and modification in QM system</li></ul> |
| <ul style="list-style-type: none"><li>• Outdated – factors are missing</li></ul>  | <ul style="list-style-type: none"><li>• Modernizing ISQM</li></ul>  |
| <ul style="list-style-type: none"><li>• Applies to all firms in respect of audits and reviews of financial statements, and other assurance and related services engagements</li></ul> | <ul style="list-style-type: none"><li>• Applies to all firms that perform audits or reviews of financial statements, or other assurance or related services engagements.</li></ul>            |

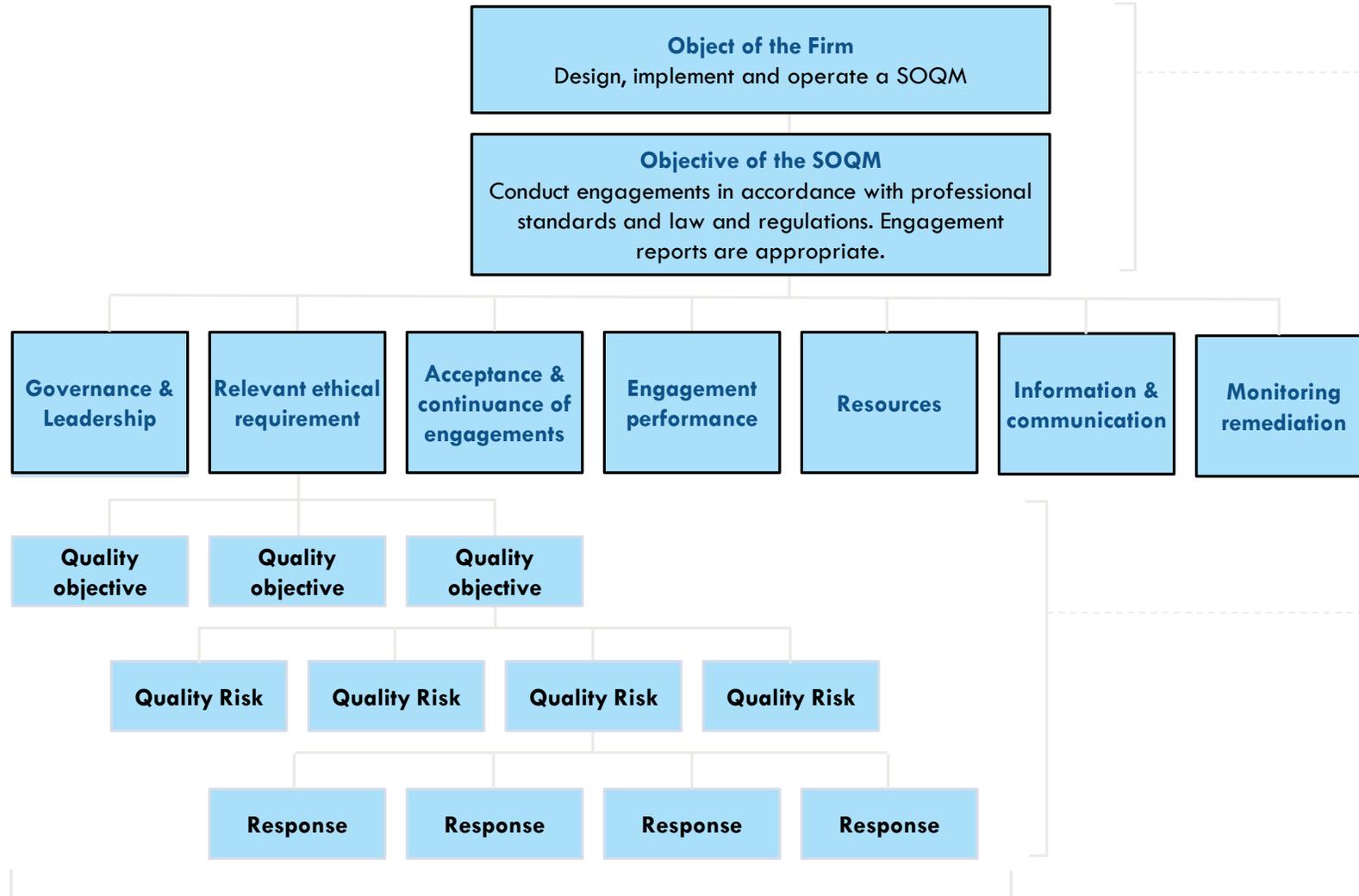
# OBJECTIVE OF ISQM 1

## HOW DOES THE RISK-BASED APPROACH WORK



# OBJECTIVE OF ISQM 1

## SYSTEM OF QUALITY MANAGEMENT (SOQM)



**Objective of ISQM 1**  
Reasonable assurance that objectives of the firm and SOQM are achieved

**Risk Assessment Process:**

1. Establish quality objectives
2. Identity quality risks with
  - Reasonable possibility of occurring; and
  - Significant effect on achievement of quality objective(s)
3. Assess quality risks
4. Design and implement responses
5. Identity changes and modify

**Monitoring & Remediation Process:**

1. Design and implement monitoring activities
2. Evaluate findings and investigate root clauses
3. Design and implement remedial actions
4. Ongoing communication
5. Evaluate the SQM

## QUALITY OBJECTIVES

The desired outcomes in relation to the components of SOQM to be achieved by the firm

## QUALITY RISK

A risk that has a reasonable possibility of:

- (i) Occurring; and
- (ii) Individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

## RESPONSE (IN RELATION TO SOQM)

Policies or procedures designed and implemented by the firm to address one or more quality risk(s).

# COMPONENTS OF ISQM 1

## ISQM 1

ISQM is based on following **eight components**:

- a) The firm's risk assessment process; **(New)**
- b) Governance and leadership; **(Adapted)**
- c) Relevant ethical requirements; **(same as ISQC 1)**
- d) Acceptance and continuance of client relationships and specific engagements; **(same as ISQC 1)**
- e) Engagement performance; **(same as ISQC 1)**
- f) Resources; **(Adapted)**
- g) Information and communication; **(New)**
- h) Monitoring and remediation process **(Adapted)**

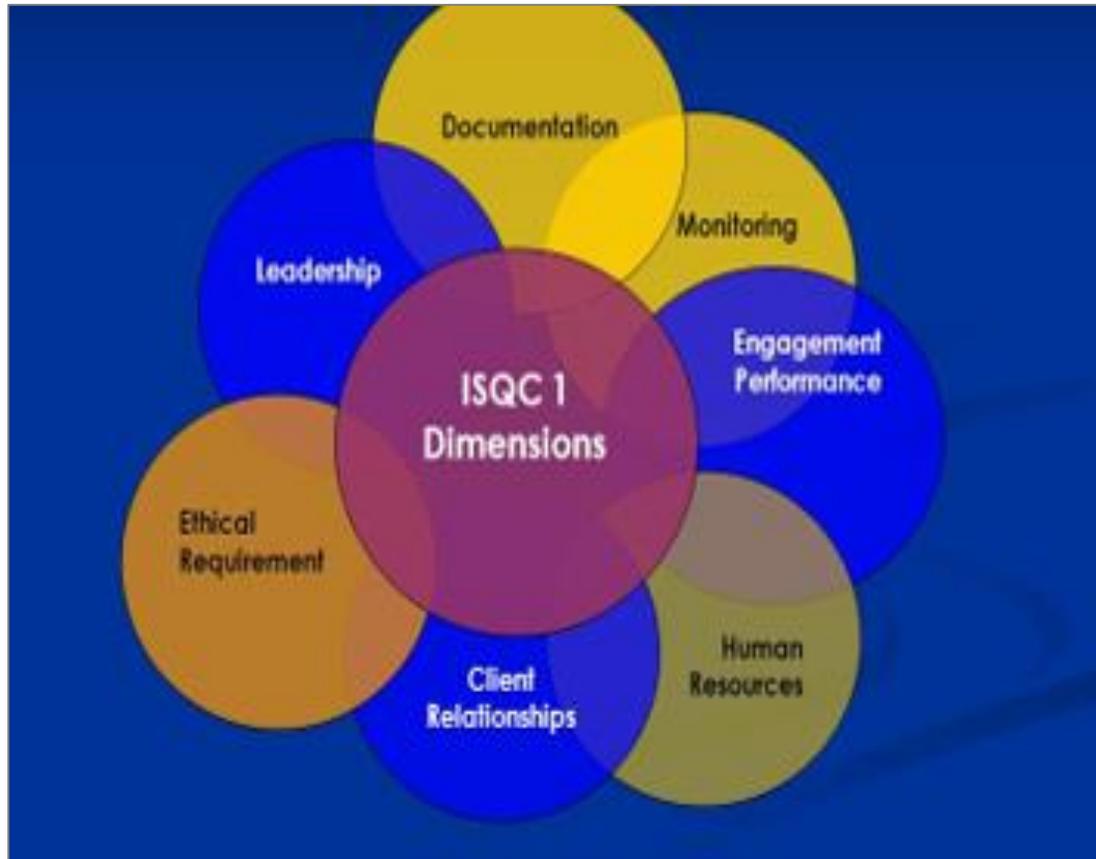
## ISQC 1

ISQC 1 includes **six elements**:

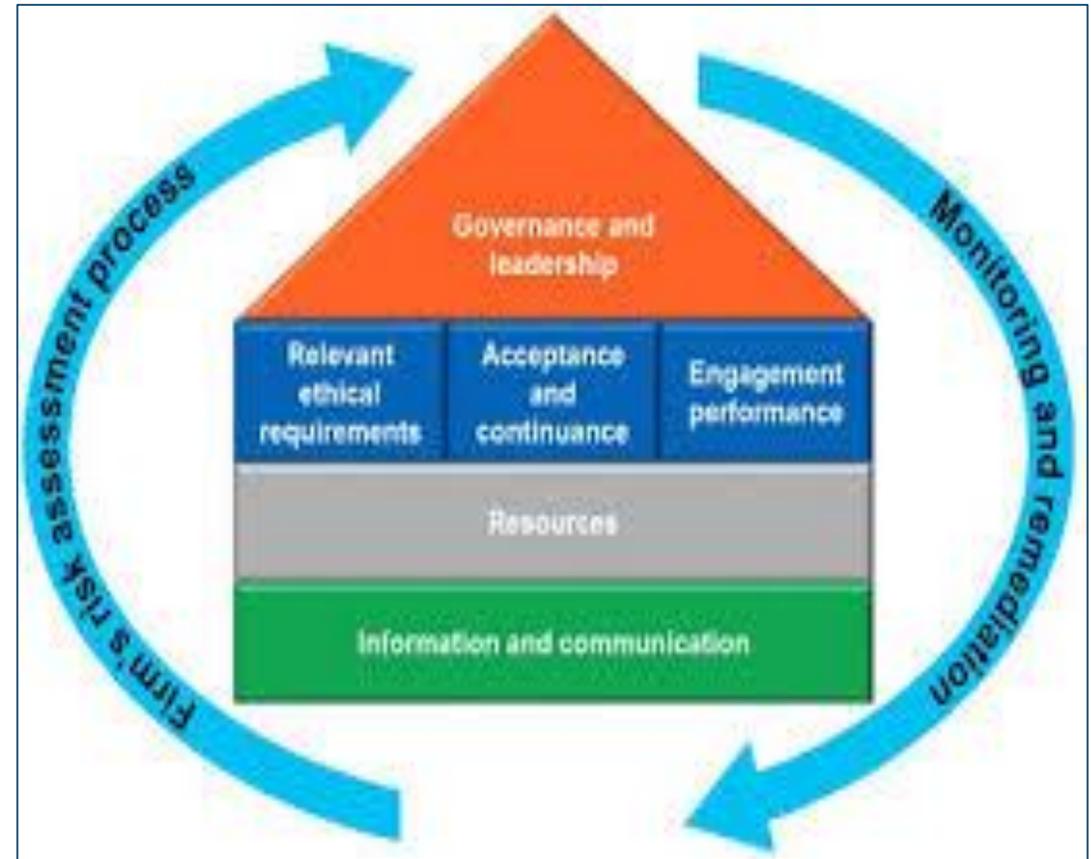
- a) Leadership responsibilities for quality within the firm.;
- b) Relevant ethical requirements.;
- c) Acceptance and continuance of client relationships and specific engagements;
- d) Human resources;
- e) Engagement performance;
- f) Monitoring.

# DIFFERENCE BETWEEN COMPONENTS OF ISQC 1 & ISQM 1

## ISQC 1



## ISQM 1



# DIFFERENCE BETWEEN COMPONENTS OF ISQC 1 & ISQM 1

| ISQC 1   | ISQM 1   |
|--|--|
| <ul style="list-style-type: none"><li>• Discussion on leadership responsibilities</li><li>• Only discusses about Human resources</li></ul> | <ul style="list-style-type: none"><li>• More Focus on Governance and Leadership responsibility – requires evaluation of firm’s QM system at least annually.</li><li>• More emphasis on adequate and appropriate Resources:<ol style="list-style-type: none"><li>1. human resources,</li><li>2. technological resources, and</li><li>3. intellectual resources.</li></ol></li></ul> <p>It also deals with resources from service providers.</p> |
| <ul style="list-style-type: none"><li>• No discussion on communication</li></ul>   | <ul style="list-style-type: none"><li>• More emphasis on information system and active two-way communication within and outside the firm - those charged with governance in case of listed entities.</li></ul>   |

# DIFFERENCE BETWEEN COMPONENTS OF ISQC 1 & ISQM 1

| ISQC 1   | ISQM 1   |
|--|--|
| <ul style="list-style-type: none"><li>• Concept of timely remediation and root cause analysis is not covered</li></ul> | <ul style="list-style-type: none"><li>• More emphasis is on identification of deficiencies and investigate the root cause of identified deficiencies.</li><li>• Timely/ effective remediation.</li></ul> |
| <ul style="list-style-type: none"><li>• No discussion on network requirements</li></ul>                                | <ul style="list-style-type: none"><li>• Addresses firm's responsibility towards their network requirements and their effect on firm's QM system.</li></ul>   |

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# IDENTIFY & ASSESS QUALITY RISKS

Step 1:  
Identify Quality risks

Step 2: Assess  
Quality risks

Quality risks (the whole population)

Is there a reasonable possibility of the risk occurring?

Yes

Would the quality risk individually have a significant effect on the achievement of a quality objective(s)?

No

Yes

Would the quality risk *in combination with other quality risks* have a significant effect on the achievement of a quality objective(s)?

Yes

No

No

No required further action

**Identified quality risk that is required to be assessed:**

Assess the quality risk to provide a basis for the design and implementation of the related responses.

# DESIGNS AND IMPLEMENTS RESPONSES

- ISQM 1 requires the firm to design and implement responses that properly address the quality risks.
- In doing so, assess the possibility of occurrence of the quality risk and its effect on the achievement of a quality objective(s).
- In order to properly address the quality risks, the firm needs to think about the reasons for the assessments given to the quality risks.
- **Scalability of Responses**
- Smaller and less complex firms are likely to have different quality risks than larger and more complex firms, thereby requiring a different response.

# HOW A RESPONSE MAY DIFFER BETWEEN A SMALLER AND LARGER FIRM

|                     | <b>SMALL FIRM WITH A SINGLE LOCATION AND SINGLE INDIVIDUAL LEADERSHIP</b>   | <b>LARGE FIRM WITH MULTIPLE LOCATIONS, MULTIPLE LAYERS WITHIN THE LEADERSHIP STRUCTURE</b>  |
|---------------------|---|---|
| <b>QUALITY RISK</b> | Daily actions and behaviors may have a significant effect on the firm's culture.  | Consistent culture is not permeated throughout the firm.  |
| <b>RESPONSE</b>     | <ul style="list-style-type: none"><li>• Independent coaching of firm leadership</li><li>• Anonymous feedback periodically</li><li>• Clear understanding of how leadership's actions and behaviors may be improved to achieve the desired culture.</li></ul> | <ul style="list-style-type: none"><li>• Firm code of conduct</li><li>• Undertake firm-wide formal communications</li><li>• Formal periodic culture assessments</li><li>• Regular leadership meetings – discussion on key messages, decisions and actions.</li></ul> |

# SCALABILITY EXAMPLES TO DEMONSTRATE HOW THE FIRM'S RISK ASSESSMENT PROCESS MAY DIFFER

## IN A LESS COMPLEX FIRM

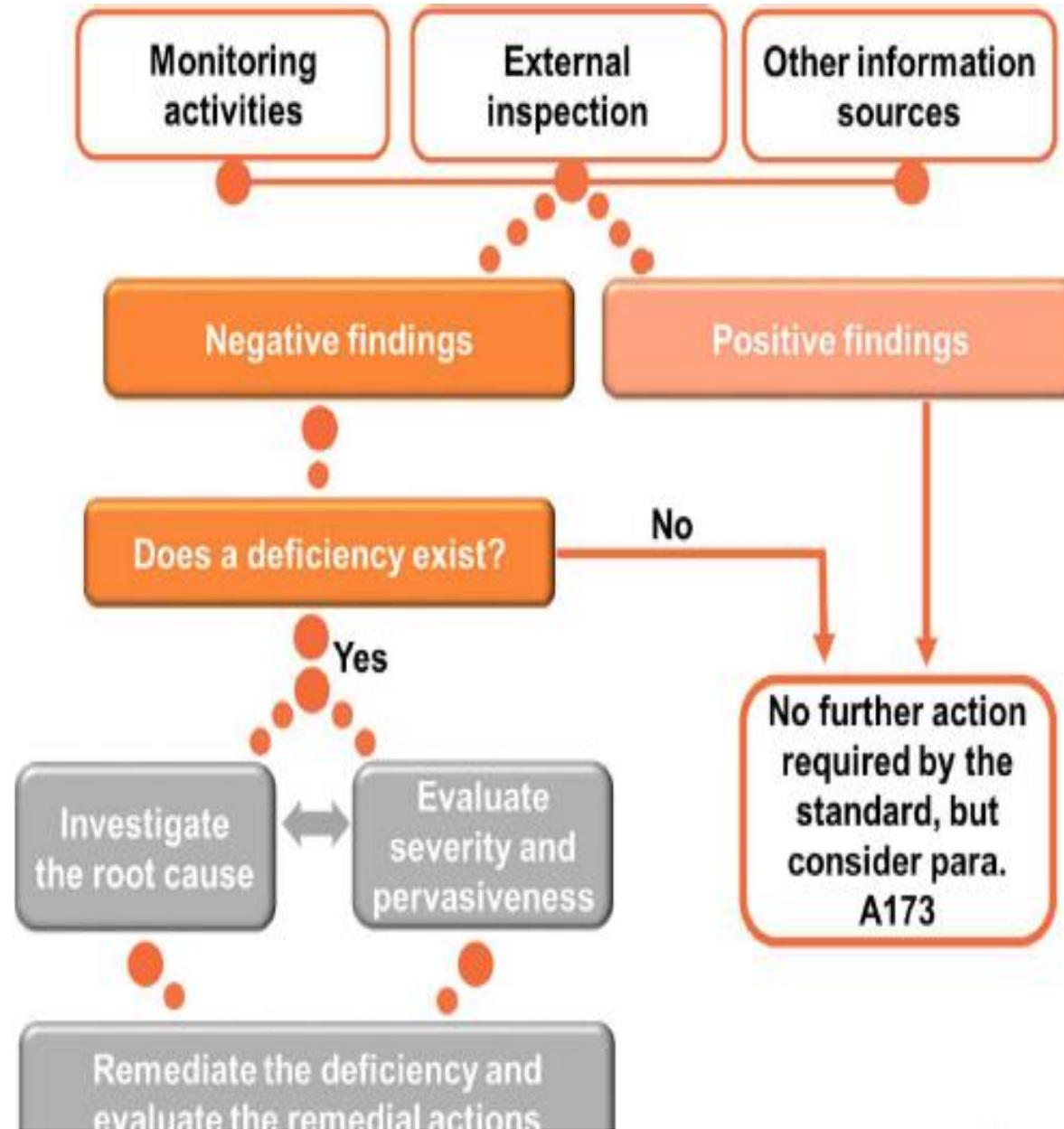
- The individual(s) can be assigned operational responsibility for the SOQM.
- May have a sufficient understanding of the firm and its engagements to undertake the risk assessment process.
- Documentation of the quality objectives, quality risks and responses may be less extensive (e.g., may be documented in a single document).

## IN A MORE COMPLEX FIRM

- Formal risk assessment process, involving multiple individuals and numerous activities.
- The process may be centralized for all business units, functions and service lines; or
- Decentralized for business unit with the outputs combined at the firm level.
- The firm's network may also provide the firm with quality objectives, quality risks and responses to be included in the firm's SOQM.

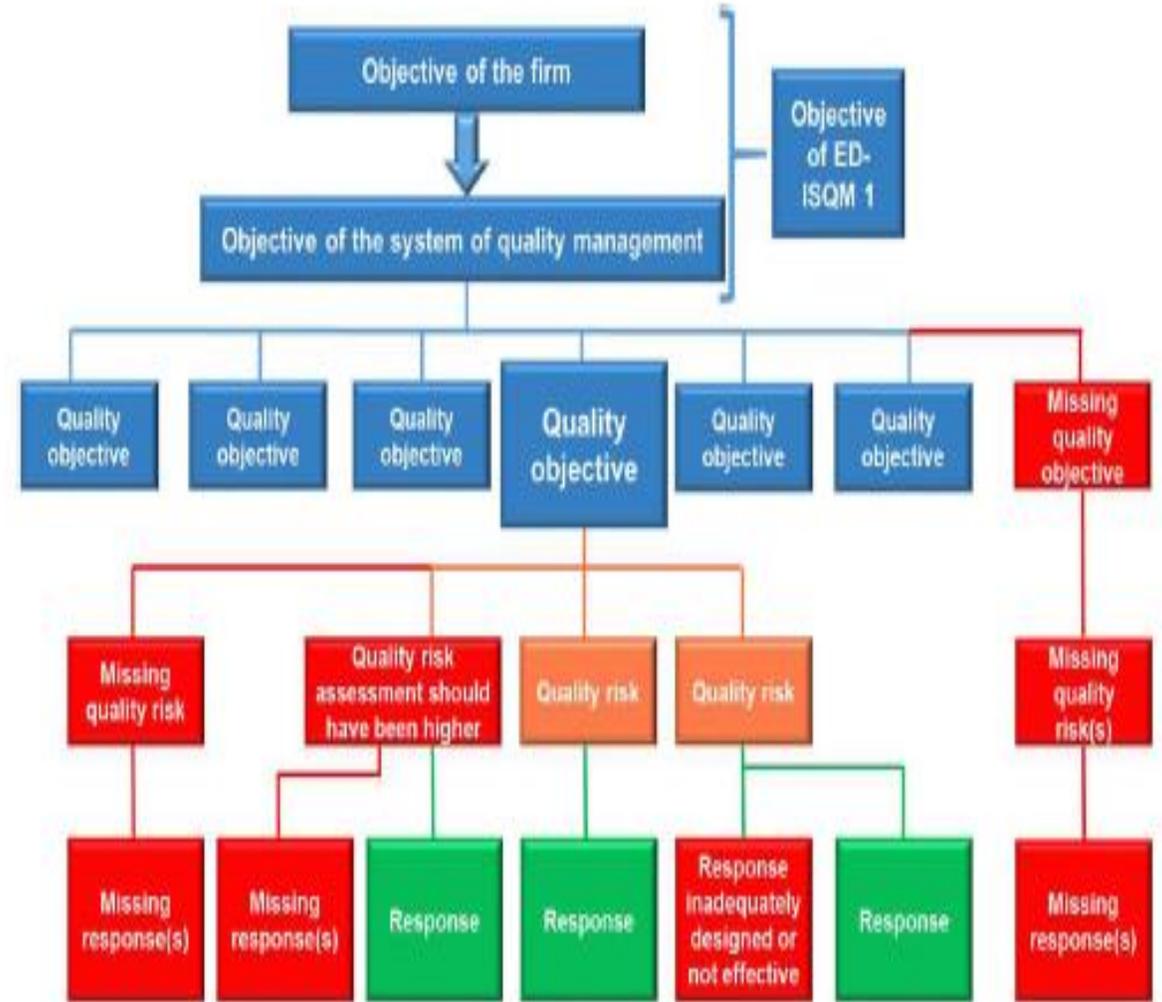
# MONITORING AND REMEDIATION

- Various new and improved requirements
  - More proactive and effective monitoring process to ensure effectiveness of SOQM
  - Acknowledges variety of sources
  - Findings vs deficiencies - Root cause analysis
  - Determine effectiveness of remedial actions
- Cyclical inspection of engagements
- Monitor the monitoring and engagement process
- Evaluate the SOQM, at least annually



# DEFICIENCY IN THE FIRM'S SOQM

- This exists when:
  - (i) A quality objective is not established;
  - (ii) A quality risk, or combination of quality risks, is not identified or properly assessed;
  - (iii) A response, or combination of responses, does not reduce to an acceptably low level (the likelihood of a related quality risk occurring because the response(s) is not properly designed, implemented or operating effectively); **OR**
  - (iv) An other aspect of the SOQM is absent, or not properly designed, implemented or operating effectively, such that a requirement of this ISQM has not been addressed.



# WHERE ISQM 1 REQUIREMENTS MAY NOT BE RELEVANT

- Sole Practitioner
- Firm who only performs related services engagements

**THANK YOU**