

Guidance Note on the Review of the System of Quality Management under ISQM 1

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Introduction

With effect from 15 December 2022, a new International Standard on Quality Management 1 (referred to as “ISQM 1”) comes into force. Firms and sole practitioners are required by this standard to design, implement and operate a system of quality management. The scope of this standard includes audits or reviews of financial statements, or other assurance or related services engagements.

However, for the purpose of this Guidance Note other elements considered by ISQM 1 such as reviews, other assurance or related services engagements are not considered in this document. These require consideration by the firm or sole practitioner, in line with the requirements of ISQM 1, should these types of engagements be provided.

Thus, the purpose of this Guidance Note is to determine the review cycle to be adopted by firms and sole practitioners in its monitoring process which should be designed to test the relevance, adequacy and effective implementation of the quality management policies and procedures under ISQM 1. Such process is hereinafter referred to as the review of the system of quality management. Included as part of the review of the system of quality there is the inspection of a selection of completed audit engagements, which hereinafter are referred to as cold file reviews. The review cycle outlined in this document constitutes the minimum requirements that are expected to be addressed by firms and sole practitioners, however audit practices may adopt more stringent requirements. The review cycle is covered in Section 1 of this Guidance Note.

Section 2 of this Guidance Note identifies who can perform the review of the system of quality management under ISQM 1.

Section 1 – The Review Cycle

1.1 ISQM 1 on the Review Cycle

ISQM 1 includes a number of sections addressing monitoring requirements. This section will focus mainly on monitoring requirements addressing the frequency of the review cycle.

Review of the System of Quality Management:

In paragraph 9 of ISQM 1, the following is stated: *“This ISQM requires that, **at least annually**, the individual(s) assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluates the system of quality management and concludes whether the system of quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph 14(a) and (b), are being achieved. (Ref: Para. A5)”*

In addition, paragraph 13 states: *“Systems of quality management in compliance with this ISQM are required to be designed and implemented by December 15, 2022, and the evaluation of the system of quality management required by paragraphs 53–54 of this ISQM is required to be performed within one year following December 15, 2022.”*

Monitoring and Remediation Process:

Paragraph 35 of ISQM1 requires the following: *“The firm shall establish a monitoring and remediation process to:*

- (a) Provide relevant, reliable and timely information about the design, implementation and operation of the system of quality management.*
- (b) Take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.”*

In addition, the practice/firm is required to determine whether deficiencies exist and evaluate the severity and pervasiveness of identified deficiencies by determining root causes and evaluating the effect of such deficiencies on the system of quality management.

In response to this, the practice/firm is required to design and implement remedial actions to address the deficiencies identified in a manner that addresses the results of the root cause analysis. An evaluation is to be carried out by the individual(s) assigned operational responsibility for the monitoring and remediation process to assess whether the remedial actions have been appropriately designed and implemented as well as effectively addressed. If subsequent to evaluation it is noted that remedial actions are not sufficient, the individual(s) assigned operational responsibility is to modify remedial actions to ensure that deficiencies are effectively addressed.

Cold File Reviews:

Paragraph 38 of ISQM 1 addresses the frequency of cold file reviews and states: *“The firm shall include the inspection of completed engagements in its monitoring activities and shall determine*

which engagements and engagement partners to select. In doing so, the firm shall: (Ref: Para. A141, A151–A154)

- (a) Take into account the matters in paragraph 37;*
- (b) Consider the nature, timing and extent of other monitoring activities undertaken by the firm and the engagements and engagement partners subject to such monitoring activities; and*
- (c) **Select at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.***

The application material found in paragraphs 141-142 state that: *“The nature, timing and extent of the monitoring activities may also be affected by other matters, including:*

- The size, structure and organization of the firm.*
- The involvement of the firm’s network in monitoring activities.*
- The resources that the firm intends to use to enable monitoring activities, such as the use of IT applications.*

When performing monitoring activities, the firm may determine that changes to the nature, timing and extent of the monitoring activities are needed, such as when findings indicate the need for more extensive monitoring activities.”

In addition, paragraph 153 of the application material sets out that: *“The inspection of completed engagements for engagement partners on a cyclical basis may assist the firm in monitoring whether engagement partners have fulfilled their overall responsibility for managing and achieving quality on the engagements they are assigned to.”* It also provides various examples of situations which should be considered when setting a policy in this regard. One of these examples include: *“Set forth the standard period of the inspection cycle, such as **the inspection of a completed engagement for each engagement partner performing audits of financial statements once every three years, and for all other engagement partners, once every five years;**”*

Network Reviews:

In the case, where firms are part of network and these networks carry our reviews of the local firm, paragraph 51(b) of ISQM 1 states: *“The firm shall:*

- (a) Understand the overall scope of the monitoring activities undertaken by the network across the network firms, including monitoring activities to determine that network requirements have been appropriately implemented across the network firms, and how the network will communicate the results of its monitoring activities to the firm;*
- (b) **At least annually, obtain information from the network about the overall results of the network’s monitoring activities across the network firms, if applicable, and:** (Ref: Para. A182–A184)
 - (i) Communicate the information to engagement teams and other individuals assigned activities within the system of quality management, as appropriate, to enable them to take prompt and appropriate action in accordance with their responsibilities; and*
 - (ii) Consider the effect of the information on the firm’s system of quality management.”**

On-going and Periodic Reviews:

Paragraph 139 of the application material found in ISQM 1 states: *“The firm’s monitoring activities may comprise a combination of ongoing monitoring activities and periodic monitoring activities. Ongoing monitoring activities are generally routine activities, built into the firm’s processes and performed on a real-time basis, reacting to changing conditions. Periodic monitoring activities are conducted at certain intervals by the firm. In most cases, ongoing monitoring activities provide information about the system of quality management in a timelier manner.”*

1.2 Interpretation on the Review Cycle under ISQM 1

Review of the System of Quality Management:

Under ISQM 1, the system of quality management should address eight components:

- 1) The firm’s risk assessment process;
- 2) Governance and leadership;
- 3) Relevant ethical requirements;
- 4) Acceptance and continuance of client relationships and specific engagements;
- 5) Engagement performance;
- 6) Resources;
- 7) Information and communication; and
- 8) The monitoring and remediation process.

Thus, the practice’s/firm’s review of the system of quality management should address each of these components and take into account results of other factors such as the result of regulatory reviews and network reviews when applicable. As each practice/firm is unique due to the type of services offered as well as the size and composition of the practice/firm, the system of quality management will also need to be scaled accordingly.

Based on the contents of ISQM 1 of which extracts have been included in Section 1.1 of this document, it is the Accountancy Board’s view that in all practice/firm structures, the review of the system of quality management should be carried out on an annual basis. This is in line with paragraph 9 of ISQM 1 requirements which requires that, **at least annually**, the individual(s) assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluates the system of quality management and concludes whether the system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved.

It is important to point out that the individual(s) assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm need(s) to **conclude** on whether the objectives of the system are being achieved. Thus, whether or not the review of the system of quality management and/or inspection of completed engagements are carried out either internally or externally, a conclusion should be made and documented by the individual(s) assigned ultimate responsibility and accountability for the system of quality management in this regard.

Cold File Reviews:

In regard to cold file reviews, the Accountancy Board has made no changes in its past interpretations under the International Standard on Quality Control 1 (referred to as “ISQC 1”).

Thus, sole practitioners will need to have another practising certificate holder in auditing not involved on the audit engagement to carry out a cold file review at a minimum of at least once every three years. In cases where the sole practitioner does not have any staff holding a practising certificate in auditing, an external reviewer must be appointed. However, when sole practitioners have staff holding a practising certificate in auditing, as long as that staff member was not involved in the audit, he/she may be permitted to carry out the cold file review.

In the case of an audit firm, each audit partner/principal of the firm should undergo a cold file review by another practising certificate holder in auditing not involved on the audit engagement at least once every three years. However, a cold file review needs to be carried out by the firm on an annual basis as part of its review processes. Furthermore, the decision of whether the firm uses an internal or external reviewer to carry out the cold file review is dependent on whether the audit firm has partners/principals/staff holding a practising certificate in auditing which were not involved on the audit engagement selected for a cold file review.

In all cases, the visit conducted by the Quality Assurance Unit does not act as a substitute for the monitoring process of the firm / sole practitioner.

Section 2 – The Reviewer

2.1 Relevant Extracts from ISQM 1 on the Reviewer

As per paragraph 39 of ISQM 1 the following is stated: *“The firm shall establish policies or procedures that: (a) Require the individuals performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and (b) Address the objectivity of the individuals performing the monitoring activities. Such policies or procedures shall prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: Para. A155–A156)”*

In addition, the application material found in ISQM 1 states the following:

“A155.The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs:

- *An inspection of an engagement was:
 - o *In the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period; or*
 - o *For all other engagements, an engagement team member or the engagement quality reviewer of that engagement.**
- *Another type of monitoring activity had participated in designing, executing or operating the response being monitored.*

A156.In some circumstances, for example, in the case of a less complex firm, there may not be personnel who have the competence, capabilities, time or objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities.”

2.2 Interpretation on the Reviewer under ISQM 1

ISQM 1 requires the firm to include policies and procedures in respect to the persons permitted to carry out the practice’s/firm’s monitoring procedures. Such policies and procedures include the requirement of persons performing such monitoring activities to have the both the necessary time to carry out such activities effectively as well as the necessary competences and capabilities. In addition, it is explicitly stated in the standard that members of the engagement team or the engagement quality control reviewer on a particular audit engagement file cannot perform such monitoring activities in respect to that particular cold file review. In such situations alternative persons must be selected. These persons should hold a practising certificate in auditing. Audit practices and firms may wish to enter into arrangements with other practitioners/firms to carry out such reviews or else engage staff members not involved in such audit engagements or else involve external reviewers.

Guidance Note on the Review of the System of Quality Management under ISQM 1

There are no changes in the interpretation of whom should be appointed as a reviewer when comparing ISQM 1 to ISQC 1 and the Accountancy Board interpretation of such requirements is as follows:

- **Sole practitioner with no staff** - the cold file review should be carried out by an external person, provided that such person had not acted as an engagement quality control reviewer on that audit. This person should hold a practising certificate in auditing.
- **Sole practitioner with staff** - the practitioner cannot carry out the cold file review by himself/herself but may make arrangements for an employee (who was not involved on the audit) to carry out the review as long as the staff member is a holder of a practising certificate in auditing, did not act as an engagement quality control reviewer on that engagement and is competent to carry out such review. Otherwise, such a sole practitioner should use an external reviewer, provided that such person had not acted as an engagement quality control reviewer on that audit.
- **Firm with no audit staff** – the cold file review may be carried out by other partners/principals within the firm as long as these persons were not involved in the audit engagement, did not act as an engagement quality control reviewer on that engagement, is competent to carry out such review and is a practising certificate holder in auditing. Otherwise, the firm will need to appoint an external review to carry out such cold file review.
- **Firm with audit staff** - the cold file review may be carried out by other partners/principals/staff within the firm as long as these persons were not involved in the audit engagement, did not act as an engagement quality control reviewer on that engagement, is competent to carry out such review and is a practising certificate holder in auditing. Otherwise, the firm will need to appoint an external reviewer to carry out such cold file review.

Executive Summary

In summary of Sections 1 and 2 a table is being included below to provide sole practitioners and audit firms with guidance on the Board’s interpretation of ISQM 1 requirements for implementation in line with the dates prescribed in ISQM 1 and as outlined in Section 1.1 of this document.

These are the minimum requirements which must be adhered to, but firms may apply more prescriptive policies and procedures based on the internal requirements of the audit firm or practice. The Quality Assurance Unit will be assessing the review of the system of quality management (including cold file reviews) carried out by practices and audit firms based on these minimum requirements.

Summary		Review of the System of Quality Management	Cold File Review
Sole practitioner – with no audit staff	Frequency	Annually	Once every 3 years (minimum)
	Reviewer	Internal or External ¹	External (not EQCR reviewer)
Sole practitioner – with audit staff	Frequency	Annually	Once every 3 years (minimum)
	Reviewer	Internal or External ¹	Internal or external (reviewer not involved on audit/EQCR)
Firm – with no audit staff	Frequency	Annually	Annually (each partner once every 3 years - minimum)
	Reviewer	Internal or External ¹	Internal or external (reviewer not involved on audit/EQCR)
Firm – with audit staff	Frequency	Annually	Annually (each partner once every 3 years - minimum)
	Reviewer	Internal or External ¹	Internal or external (reviewer not involved on audit/EQCR)

¹ In cases where an external individual/entity is appointed, it is still the responsibility of the individual(s) assigned with ultimate responsibility and accountability for the system of quality management, on behalf of the firm, to evaluate the system of quality management and conclude whether the system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved.