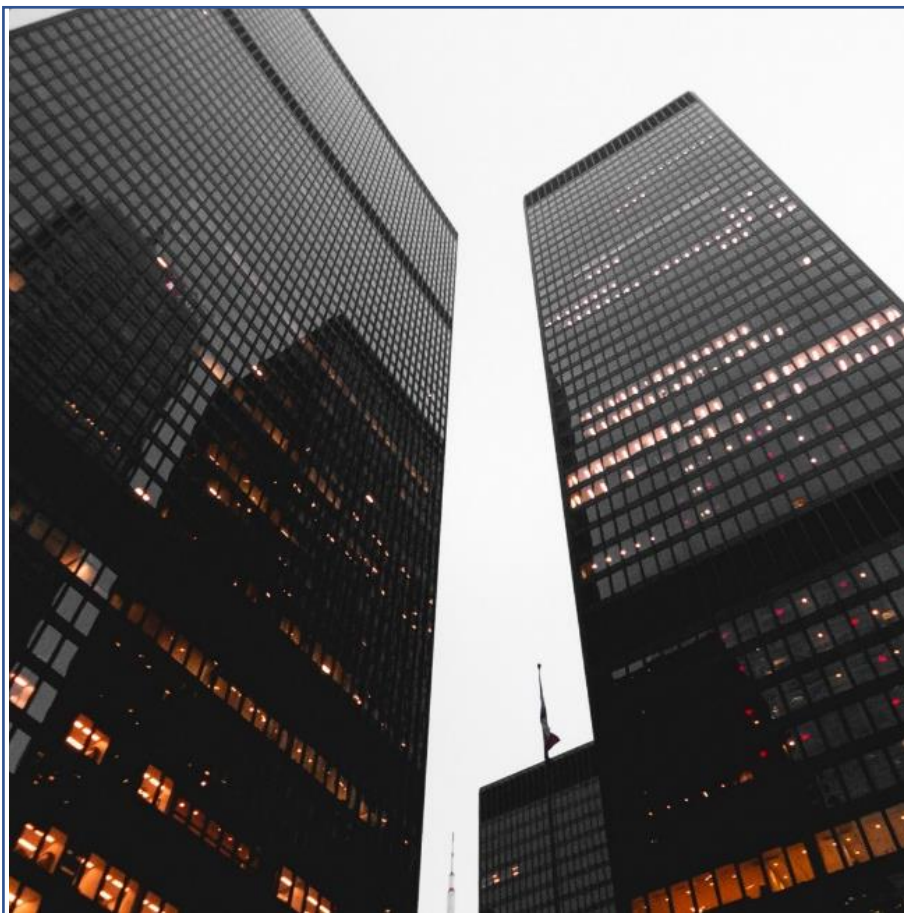


# Newsletter

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## In this issue

International Standard on Quality Management (ISQM) 1, which is effective beginning December 15, 2022, replaces International Standard on Quality Control (ISQC) 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements.

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# INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 1, QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS

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## BACKGROUND

ISQM 1 deals with the firm's responsibility for having a **System of Quality Management (SOQM)**. The SOQM is the mechanism that creates an environment that enables and supports engagement teams in performing quality engagements. It helps the firm in achieving consistent engagement quality because it is focused on how the firm manages the quality of engagements performed.

ISQM 1 replaces the existing standard **ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements**, which was focused on quality control, while a quality management system is necessary to create an environment that enables and supports engagement teams in performing quality engagements.

## SCOPE

ISQM 1 applies to all firms that perform audits or reviews of financial statements, or other assurance or related services engagement and requires a firm to apply a **risk-based approach** in designing, implementing, and operating the components of the SOQM in an interconnected and coordinated manner such that the firm proactively manages the quality of engagements thereby performed.

## OBJECTIVES

Paragraph 14 of ISQM 1 states the following objectives of:

1. **The firm** – to design, implement, and operate a SOQM for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm
2. **SOQM** – to provide the firm with reasonable assurance that:
  - a) 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
  - b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

ISQM 1 explains that reasonable assurance is not an absolute level of assurance, because there are inherent limitations of a SOQM. Such limitations include the fact that human judgment in decision making can be faulty and that breakdowns in the SOQM may occur, for example, due to human error or behavior or failures in information technology (IT) applications.

## EFFECTIVE DATE

The firm is required to have the SOQM designed and implemented in compliance with ISQM 1 by December 15, 2022. The evaluation of the SOQM required by paragraphs 53–54 of ISQM 1 is required to be performed within one year following December 15, 2022.

This means that by December 15, 2022, the firm is expected to:

- (a) Establish the quality objectives, identify and assess the quality risks and design and implement the responses; and
- (b) Design and implement the monitoring activities.

The operation of the responses and monitoring activities is only required to commence from December 15, 2022 onwards.

Early adoption of ISQM 1 is permitted, however the firm is required to adopt all three quality management standards at the same time.

*In cases when a firm is new to the market and only begins performing engagements after the effective date of ISQM 1, the firm is required to have its SOQM designed and implemented by the time the firm commences work on the engagements performed under the IAASB's Engagement Standards. The operation of the responses and monitoring activities would commence from that date onwards.*

Examples of how the firm may practically implement ISQM 1:

- The firm may take a phased approach to implementation, building up to the effective date. For example, this may entail designing and implementing policies or procedures for certain components and commencing the operation of those policies or procedures at various stages before the effective date. In this case, the firm would establish its own effective date for each of the policies or procedures.
  - This approach may lessen the impact of many changes all at once.
  - Although the firm would have implemented policies or procedures before the effective date, the firm would not be considered as “early adopting” ISQM 1 because only a portion of the new SOQM has been implemented.
- The firm may commence operation of all the new and revised policies or procedures at the effective date.
- The firm may pilot or test the new SOQM prior to the effective date. The pilot, or testing, may be on certain areas of the SOQM, or by a selection of engagements teams.
  - The SOQM would not be considered to be in operation until the firm has formally implemented and commenced operation of the new SOQM in its entirety.

*If the firm currently complies with ISQC 1, the firm will already have policies and procedures in place. The policies and procedures may still be relevant and appropriate for the firm’s new SOQM, or may need to be revised or enhanced such that they are appropriate for the new SOQM. Although the existing policies and procedures may continue to be relevant and appropriate, the firm would still need to establish a SOQM that is compliant with ISQM 1.*

## THE STRUCTURE OF ISQM 1 AND THE COMPONENTS

ISQM 1 comprises of:

- Eight interrelated components that deal with the key aspects of the SOQM; and
- Other requirements that address specific topics.

The firm is required to meet all of the requirements within ISQM 1, including the requirements in the components. The firm is not required to organize its SOQM according to the eight components and may choose to use different terminology or frameworks to describe the components of the SOQM.

Below is a comparison between the components of ISQM 1 and extant ISQC 1:

NEW ISQM 1	EXTANT ISQC 1
The Firm’s Risk Assessment Process	<i>Not addressed</i>
Governance and Leadership	<i>Leadership Responsibilities for Quality within the Firm</i>
Relevant Ethical Requirements	<i>Relevant Ethical Requirements</i>
<i>Acceptance and Continuance of Client Relationship and Specific Engagements</i>	<i>Acceptance and Continuance of Client Relationship and Specific Engagements</i>
Engagement Performance	<i>Engagement Performance</i>
Resources	<i>Human Resources</i>
Information and Communication	<i>Not addressed</i>
Monitoring and Remediation Process	<i>Monitoring</i>

ISQM 1 has eight components. The components in ISQM 1 are aligned to the elements in extant ISQC 1 and includes two new components which are the **firm’s risk assessment process**, and **information and communication**.

## EIGHT (8) COMPONENTS OF ISQM 1

### 1. The Firm's Risk Assessment Process

The firm's risk assessment process is a new component of ISQM 1 that comprises the process the firm is required to follow in implementing the risk-based approach to quality management. It consists of establishing quality objectives, identifying and assessing quality risks to the achievement of the quality objectives and designing and implementing responses to address the assessed quality risks

### 2. Governance and Leadership

Deals with matters such as the firm's culture, leadership responsibility and accountability, the firm's organizational structure, assignment of roles and responsibilities and resource planning and allocation.

ISQM 1 provides substantial enhancements to improve the robustness of firms' governance and leadership. In particular, it addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership and holding leadership accountable through performance evaluations. The standard also now addresses the importance of quality in the firm's strategic decisions and actions — including financial and operational priorities — as well as firm leadership's ability to influence decisions about the firm's resources.

The firm is required to assign responsibilities and accountabilities to designated individuals as discussed at the latter part of this issue.

### 3. Relevant Ethical Requirements

These relate to relevant ethical requirements which ordinarily comprise of the provisions in the International Code of Ethics for Professional Accountants (IESBA) (including International Independence Standards) to which the firm and its engagements are subject. The IESBA Code sets out the fundamental principles of ethics that establish the standard of behavior expected by firms and practitioners, including requirements addressing independence.

### 4. Acceptance and Continuance of Client Relationships and Specific Engagements

These address judgments by the firm about whether to accept or continue a client relationship or specific engagement based on;

- information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, (those charged with governance) that is sufficient to support such judgments; and
- the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.

ISQM 1 states that the financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

### 5. Engagement Performance

Deals with the firm's actions to promote and support the consistent performance of quality engagements, including through direction, supervision and review, consultation and differences of opinion. It includes how the firm supports engagement teams in exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism.

### 6. Resources

Deals with obtaining, developing, using, maintaining, allocating and assigning resources in a timely manner to enable the design, implementation and operation of the SOQM. It includes technological, intellectual and human resources, and addresses service providers.

Extant ISQC 1 addresses only human resources. ISQM 1 expands this to address all resources that the firm needs both to operate the system and to perform engagements. These resources cover the following:

- Technological Resources - For example, audit tools or IT applications used by the firm for independence monitoring.
- Intellectual Resources - For example, the firm's methodology, guidance, templates or tools.
- Human Resources - This may include people outside the firm used in engagements, including component auditors or EQ reviewers who are external to the firm.

## 7. Information and Communication

This is also a new component of the ISQM which underscores the importance of a continuous flow of information and communication by linking the exchange of information to the firm's culture, so that it is driven from top leadership throughout the firm.

It deals with obtaining, generating or using information regarding the SOQM, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the SOQM.

The standard stipulates that the firm must set up an information system with procedures to identify, capture, process and maintain information, while also acknowledging that less complicated businesses with fewer employees and direct leadership involvement may achieve the same goal with less stringent or in-depth policies and procedures.

The standard addresses both internal and external communication. It emphasizes the need of effective communication within the company from an internal standpoint. From an internal standpoint, the standard encourages businesses to disclose their SOQM to third parties in a timely, innovative, and proactive manner, reinforcing a critical public interest issue.

## 8. Monitoring and Remediation Process

The process that provides the firm with relevant, reliable and timely information about the design, implementation and operation of the SOQM and addresses taking appropriate actions to respond to deficiencies such that deficiencies are remediated on a timely basis.

The focus is shifted from engagement level monitoring to monitoring the full SOQM using ISQM 1, which improves monitoring activities. Through a greater emphasis on adapting the monitoring operations so that they can serve as a foundation for the firm to evaluate the SOQM, the standard encourages more proactive and effective monitoring activities. Instead of prescribing such activities, the new requirements emphasize factors that firms should take into account in designing monitoring activities

The nature, timing and extent of monitoring activities will be driven by many firm-specific factors, including the following:

- How the underlying system is designed
- The nature and circumstances of the firm and engagements it performs
- The extent of changes to the system
- The results of previous monitoring activities or external inspections

## ROLES AND RESPONSIBILITIES

Roles and responsibilities that the firm is required to assign to individuals:

- *Ultimate responsibility and accountability for the SOQM*
  - Assigned to either the chief executive officer (or equivalent), managing partner (or equivalent) or, if appropriate, the managing board of partners (or equivalent)
  - Expected to have an understanding of ISQM 1.
  - Ultimately responsible and accountable for the firm achieving the objective of ISQM 1.
  - Responsible for evaluating and concluding on whether the SOQM is achieving the objectives of the SOQM, which is important to holding them directly responsible and accountable for the SOQM.
- *Operational responsibility for the SOQM*
  - Expected to have an understanding of ISQM 1.
  - Responsible and accountable for the design, implementation, and operation of the SOQM.
- *Operational responsibility for specific aspects of the SOQM*
  - Compliance with independence requirements:
    - Responsible for overseeing all matters related to independence
  - The monitoring and remediation process:
    - Responsible for overseeing monitoring and remediation.
    - The individual(s) is required to take actions related to the remediation of deficiencies and communicate matters related to monitoring and remediation.
  - Other specific aspects, as determined by the firm.

Individuals assigned to these responsibilities are required to have the appropriate experience, knowledge, time, influence and authority.

## THE KEY CHANGES FROM THE CURRENT STANDARD, ISQC 1

A more proactive and tailored approach to managing quality, focused on achieving quality objectives through identifying risks to those objectives, and responding to the risks.

- Enhanced requirements to address firm governance and leadership, including increased leadership responsibilities.
- Expanded requirements to modernize the standard and reflect factors affecting the firm's environment, including requirements to address technology, networks, and the use of external service providers.
- New requirements addressing information and communication, including communication with external parties.
- Enhanced requirements for monitoring and remediation to promote more proactive monitoring of the SOQM as a whole, and effective and timely remediation of deficiencies

Sources:

[FIRST-TIME IMPLEMENTATION GUIDE International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements](#)

[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](#)

### **Our View:**

*The adoption of ISQM 1, which uses a "risk-based approach" to quality management, will unquestionably enhance the operations and engagement performance of sole practitioners and audit firms since we will be compelled to carefully assess and evaluate the specific risks that may have an impact on our engagement quality based on the enhanced requirements prescribed by ISQM 1.*

*The current ISQC 1 only addresses human resources. ISQM 1 broadens its scope to include technological and intellectual resources, addressing all resources firms need both to operate the system and to perform engagements. This promotes the use of sophisticated technologies and advanced tools that may enhance the quality of our audits. Smaller firms that decide not to invest in audit technology, in the long run, may find themselves unable to conduct the most rigorous audits of the most complicated entities. However, simply investing in technology does not necessarily guarantee that audit quality will improve.*

*Some inspections are carried out by regulatory bodies such as the Quality Assurance Review (QAR) of the Board of Accountancy (BOA), which determines whether the quality management system is in place and is operating effectively. Consequently, it is critical to implement a SOQM that adheres to ISQM 1.*

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Comments and suggestions are welcome.

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