



Financial Reporting Council

# Feedback Statement And Impact Assessment

*Adoption of ISQM (UK) 1 Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements, ISQM (UK) 2 Engagement Quality Reviews, and ISA (UK) 220 (Revised July 2021) Quality Management For An Audit Of Financial Statements*

July 2021

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# Introduction

1. The Financial Reporting Council (FRC) is committed to acting as a proportionate and principles-based regulator, and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit.
2. The ISAs (UK) are based on the corresponding international standards issued by the International Auditing and Assurance Standards Board (IAASB). Where necessary, the international standards have been augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural and business context.
3. In December 2020, the FRC issued a public consultation on the proposal to adopt International Standard on Quality Management (UK) 1 *Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements*<sup>1</sup> and International Standard on Quality Management (UK) 2 *Engagement Quality Reviews*, and revise International Standard on Auditing (UK) 220 (Revised November 2019) *Quality Control For An Audit Of Financial Statements*, to reflect recent revisions to the international standards on auditing issued by the IAASB.<sup>2</sup> The consultation closed on 19 March 2021.
4. The FRC has considered the responses received together with views expressed by stakeholders in webinar outreach events. We are now issuing the final revised standards which, as proposed in the consultation, are effective from 15 December 2022 with early adoption strongly encouraged. A small number of changes have been made to address matters raised in the consultation, which are explained below. These changes do not introduce any substantive new requirements to those proposed in the consultation.
5. The three standards will, individually and collectively, improve the quality of engagements through addressing key public interest issues related to the management of quality at a firm and engagement level and the performance of engagement quality reviews.

<sup>1</sup> Previously International Standard on Quality Control (UK) 1 (Revised June 2016) *Quality Control For Firms That Perform Audits And Reviews Of Financial Statements, And Other Assurance And Related Services Engagements*.

<sup>2</sup> IAASB is a committee of the International Federation of Accountants (IFAC). The IAASB's constitution and due process is described in its 'Preface to the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements'.

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# Background

6. In September 2020, the IAASB approved the final versions of ISQM 1 *Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements*, ISQM 2 *Engagement Quality Reviews*, and ISA 220 (Revised) *Quality Control For An Audit Of Financial Statements* and relating conforming amendments to other ISAs. In December 2020, the Public Interest Oversight Board approved the due process.
7. ISQM (UK) 1 and ISQM (UK) 2 replace ISQC (UK) 1, the extant standard that deals with a firm's responsibilities for its system of quality control. These standards introduce a new quality management approach that is focused on proactively identifying and responding to risks to quality. Unlike extant ISQC (UK) 1, the new approach requires a firm to customise the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs. The new approach also requires the firm to transition from policies and procedures that address standalone elements, as required by extant ISQC (UK) 1, to an integrated approach that reflects upon the system as a whole.
8. This new approach is expected to generate multiple benefits for firms' systems of quality management that support the consistent performance of quality engagements, including:
  - A system that is tailored for the nature and circumstances of the firm and the engagements it performs, thereby improving the robustness and effectiveness of activities undertaken by the firm to address engagement quality. A tailored system of quality management may also result in improved utilisation of firm resources.
  - Facilitating a proactive response by the firm to changing circumstances and proactively managing or mitigating risks, and promoting continual improvement and responsiveness. This new approach will also aid in keeping the standard fit for purpose and adaptable to a changing environment.
  - Increased emphasis on monitoring the system as a whole and timely and effective remediation, to promote ongoing improvement and consideration of the appropriateness of the system, including whether it is effective in supporting engagement quality.
  - Improved integration of the components of the system, thereby promoting an ongoing process of improvement, and consideration of the effect of decisions across the system.

In addition, this approach is intended to be adaptable to the size and nature of a firm or the services it provides.

9. The FRC response<sup>3</sup> to the IAASB's consultation on the quality management standards was strongly supportive of the aims of the IAASB. It identified several proposals we were particularly supportive of and would want to be retained in the final standards, as well as some areas where we believed that the proposals could be further enhanced. We are satisfied that the changes made by the IAASB in finalising the revised international standards were appropriate and that they can be adopted without the need for significant further FRC supplementary material.

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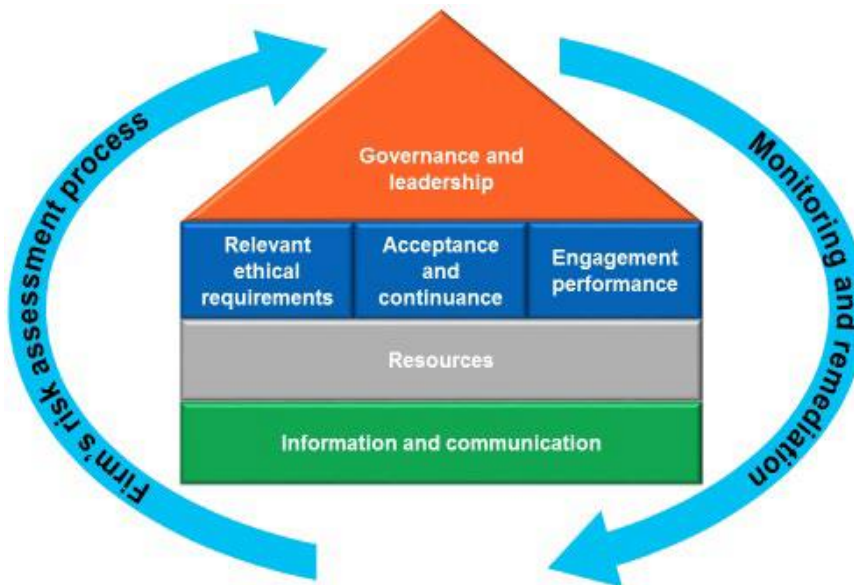
<sup>3</sup> <https://www.frc.org.uk/getattachment/85eae035-fbad-4e49-88a9-638e91c4349b/UK-FRC-Response-IAASB-ISQM1-and-2-and-ISA-220.pdf>

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# Explanation Of Key Changes

## ISQM (UK) 1

10. As noted above, ISQM (UK) 1 introduces a new approach to quality management at the firm level that emphasises the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide.
11. The key components of a system of quality management are:



12. ISQM (UK) 1 requires the firm to design and implement a risk assessment process to:
  - Establish quality objectives
  - Identify and assess quality risks; and
  - Implement responses to address those quality risks.
13. Paragraph 34(f) requires the firm to establish policies and procedures that require an engagement quality review for certain engagements. For clarity, we expanded this requirement to include the following engagements in the UK:
  - Audits of financial statements of public interest entities;
  - Public reporting engagements carried out in accordance with the Standards of Investment Reporting (SIRs); and
  - Engagements for which an engagement quality review is required by the FRC's *Providing Assurance on Client Assets to the Financial Conduct Authority* standard (the CASS standard).

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## ISQM (UK) 2

14. In developing the quality management approach, the IAASB concluded that it would be better to place the more detailed requirements and related application material for engagement quality reviews in a separate standard.
15. Accordingly, ISQM (UK) 2 addresses the appointment and eligibility of an engagement quality reviewer and their responsibilities relating to that review. The revisions include:
  - Extending the requirement for an engagement quality review to engagements in addition to audits of financial statements.
  - Enhancing the eligibility criteria for an individual to be appointed as an engagement quality reviewer.
  - Enhancing the requirements and application material regarding the engagement quality reviewer's responsibilities, including the nature, timing and extent of the engagement quality review procedures performed.
  - Consideration of the effect of engagement quality reviews, and other forms of engagement reviews, on the appropriate exercise of professional scepticism by engagement teams.

## ISA (UK) 220

16. ISA 220 has been significantly revised by the IAASB, and with the relocation of those requirements relating to engagement quality reviews, resulting in a clear delineation of the responsibilities of the engagement partner and engagement team in relation to managing and achieving quality at the engagement level. There is also increased focus on taking into account the nature and circumstances of the audit engagement in managing quality at the engagement level.

## Conforming amendments

17. There are also conforming amendments to other ISAs (UK), reflecting those made by the IAASB to the corresponding international standards.

## Effective Date

18. The effective date of the standards is 15 December 2022. This applies to the individual standards as follows:

ISQM (UK) 1	ISQM (UK) 2	ISA (UK) 220
Systems of quality management in compliance with this ISQM (UK) are required to be designed and implemented by 15 December 2022 and the evaluation of the system of quality management required by paragraph 53-54 of this ISQM (UK) is required to be performed within one year following 15 December 2022.	This ISQM (UK) is effective for: a) Audits and reviews of financial statements for periods beginning on or after 15 December 2022; and b) Other assurance or related services engagements beginning on or after 15 December 2022.	This ISA (UK) is effective for audits of financial statements for periods beginning on or after 15 December 2022.

## Responses To The Consultation

19. The FRC's consultation closed on 19 March 2021. We received 15 responses<sup>4</sup> but not all respondents answered all 5 questions asked in the consultation document. A list of the respondents is included in the Appendix to this Feedback Statement.
20. The distribution of responses is as follows:

Type of respondent	Number
Audit Firm (AF)	11
Professional Body (PB)	3
Investors and Analysts (INV)	1
<b>Total</b>	<b>15</b>

### Other outreach

21. The FRC hosted a public webinar<sup>5</sup> on the revision of quality management standards for UK audit firms consultation and held further outreach events with investors and audit committee members.
22. A summary of the responses received to the specific questions asked in the consultation, and the FRC's responses, are set out below.

<sup>4</sup> Copies of the responses can be seen at: <https://www.frc.org.uk/consultation-list/2020/consultation-and-impact-assessment-on-proposal-to>

<sup>5</sup> A recording of the webinar can be accessed at: <https://vimeo.com/510154444/832e92655f>

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# **Q1. Do you agree that ISQM (UK) 1, ISQM (UK) 2, and the revised ISA (UK) 220 should be adopted in the UK, alongside the related conforming amendments to other ISAs (UK)? If not, please give your reasons.**

## **Summary of responses**

23. All fifteen respondents agreed that the new and revised quality management standards should be adopted in the UK, with many commenting on how the changes to the standards should drive higher and more consistent quality of engagements.
24. Two respondents (1 AF; 1PB) commented that smaller firms may find it challenging to implement the new quality management system required by the standards and it is important that they are provided with sufficient time and implementation guidance to assist them.

## **Implementation guidance and support**

25. The IAASB have published a Quality Management Implementation Support Plan.<sup>6</sup> This includes first time implementation guidance which will guide firms through the process of implementing a system of quality management for the first time and understanding some of the detail around this such as how to set quality risks, how to filter those risks and designing appropriate responses.<sup>7</sup> This will be followed by Frequently Asked Questions, Fact Sheets and Videos to further support firms.
26. The FRC does not propose to issue additional guidance at this time, but will keep this under review.

# **Q2. If you agree that the ISQMs (UK) and ISAs (UK) should be revised to adopt the revisions to the underlying international standards, do you agree that the proposed UK supplementary material is appropriate? If not, please give your reasons and explain what further additions or subtractions should be made.**

27. ISQC (UK) 1 (Revised November 2019) included over 25 requirements which originally derived from the implementation of the EU Audit Regulation and Directive and were transposed into UK legislation. The UK plans to maintain equivalence with the EU and so these requirements are being retained in the new or revised standards.
28. However, the quality management framework as set out in ISQM (UK) 1 is different to ISQC (UK) 1 and therefore consideration has been given as to where these requirements should be situated in the new and revised standards. These requirements are, in the main, responses to address quality risks and therefore they have been aggregated into a new requirement, organised by components of the quality management system, at paragraph 34-1.
29. Some of the extant requirements relating to an engagement quality review that were previously included in ISQC (UK) 1 and ISA (UK) 220 (Revised November 2019) have been revised and relocated to ISQM (UK) 2. This

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<sup>6</sup> <https://www.iaasb.org/publications/implementation-plans-quality-management-standards>

<sup>7</sup> <https://www.iaasb.org/publications/isqm-1-first-time-implementation-guide> and <https://www.iaasb.org/publications/isqm-2-first-time-implementation-guide>



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helps to clarify and reinforce the function of the engagement quality review as a firm-level activity that is undertaken by an individual who is acting on behalf of the firm

function of the engagement quality review as a firm-level activity that is undertaken by an individual who is acting on behalf of the firm.

## Summary of responses

30. Overall, the respondents were supportive of the proposed UK supplementary material. Several respondents commented that any supplementary requirements should be restricted to matters relevant to UK legislation and regulations only.
31. As set out in the Scope and Authority of FRC Audit and Assurance Pronouncements,<sup>8</sup> the FRC's policy is, where necessary, to augment the international standards with additional requirements that address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural and business context.

### UK pluses derived from EU Audit Directive and Legislation

32. Two respondents (2 AF) queried whether it is still necessary to retain these UK pluses given the significant revisions in the quality management standards. They expressed concern that retaining a list of requirements that mandates a firm to implement policies and procedures risks undermining the risk-based approach set out in ISQM (UK) 1.
33. As noted above, there are a number of requirements that originate from the EU Audit Directive and Regulation that have been transposed into UK legislation ('EU requirements'). This legislation specifies that the FRC, as the competent authority, must incorporate these EU requirements into auditing standards, procedures or requirements. We took the view – both in the original consultation in 2015 and now – that as these EU requirements derive from legislation, they are mandatory and must be included as requirements in the auditing standards. Therefore, it would not be appropriate to either move these requirements to application and other explanatory material or to remove these requirements altogether.
34. Further, given that these EU requirements cover similar requirements to those already existing in the auditing standards, we continue to believe that there is a compelling argument to retain these requirements in the quality management and auditing standards and provide auditors with a one-stop shop for general requirements applicable to auditing.

### Ultimate responsibility and accountability and operational responsibility for the firm's system of quality management

35. Two respondents (2 AF) commented that there is a potential conflict between paragraph 20 of ISQM (UK) 1 and paragraph 34(f)(ii) which requires that where the firm undertakes audits of financial statements that responsibility for the internal quality control system lies with a person who is eligible for appointment as a statutory auditor.
36. Paragraph 20 of ISQM (UK) 1 requires that the firm assigns ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer or managing partner or, if appropriate, the firm's managing board of partners.

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<sup>8</sup> <https://www.frc.org.uk/getattachment/a157aed8-608f-4b1d-98bc-a478e2458d0e/Scope-and-Authority-of-FRC-Audit-and-Assurance-Pronouncements-June-2016.pdf>

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37. Clearly, where an audit firm's CEO or managing partner is not eligible for appointment as a statutory auditor this would potentially not meet the requirements of ISQM (UK) 1. In this situation, ultimate responsibility and accountability for the system of quality management would need to be assigned to the firm's managing board of partners, of which at least one of those individuals would need to be eligible for appointment as a statutory auditor

38. To clarify this, the requirement in paragraph 34(f)(ii) has been moved to new requirement 21-1 in the *Responsibilities* section (paragraphs 20-22) and reworded to make it clear that at least one individual who is eligible for appointment as a statutory auditor is assigned both:

- Ultimate responsibility and accountability; and
- Operational responsibility

for the system of quality management.

### **Monitoring the monitoring and remediation activities**

39. There were three comments made (3 AF) relevant to the additional application material added to paragraph A144 of ISQM (UK) 1, with one firm suggesting that the IAASB text already indicated the purpose of undertaking monitoring and remediation activities and therefore was unnecessary, and another firm suggesting that further clarification is needed as this appeared to suggest that monitoring of monitoring would be required.

40. One firm commented that "absent a deficiency in a system of quality management, it follows that the system of quality management is delivering quality engagements consistently". However, this is not true as it could also be that the monitoring and remediation system has not been designed appropriately and fails to identify deficiencies.

41. Therefore, the purpose of the additional sentence is to make it absolutely clear that a firm is required to undertake monitoring activities in order to determine whether the monitoring and remediation process is achieving its purpose of:

- Providing relevant, reliable and timely information about the design, implementation and operation of the system of quality management; and
- Enabling the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

In other words, the firm is required to monitor the monitoring and remediation system.

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### **Q3. Is the proposed effective date, which is consistent with the effective date of the IAASB's revised ISQMs and ISAs, appropriate? If not, please give reasons and indicate the effective date that you would consider appropriate.**

42. In the FRC's response to the IAASB's consultation on the quality management standards, we strongly supported an 18-month implementation period and were disappointed with the IAASB's decision to opt for a 24-month implementation period from the date of PIOB approval.
43. However, we accept that, particularly given the impact of the COVID pandemic on firms, it is not practicable for the UK to adopt an earlier implementation date and therefore the same effective date as the IAASB's standards has been adopted: 15 December 2022.

### **Summary of responses**

44. Eleven respondents (9 AF; 2PB) were supportive of this effective date, whilst three (2 AF; 1PB) were in favour of delaying the date by between 6 and 12 months and one (1 INV) was in favour of bringing it forward by a year.
45. The respondents who argued for a delayed implementation date cited the complexity of the requirements in the quality management standards, the climate and circumstances in which the firms are currently operating (for example, the COVID pandemic; recent auditing standard changes such as ISA (UK) 570, ISA (UK) 315 and the proposed ISA (UK) 240; the impact of the wider audit reform programme in the UK,) and a shorter implementation period than that provided by the IAASB due to the time delay in issuing the UK standards.
46. We are not persuaded by the argument that the issuance of these standards only provides firms with an 18-month implementation period. These standards have been in the international pipeline for several years and the FRC undertook outreach both during the IAASB's consultation period in 2019 and during the FRC's exposure draft period earlier this year. It is our belief that firms should therefore be versed in the upcoming changes and should already be starting to plan their implementation.
47. Equally, whilst we sympathise with the comment made by the UK Shareholders Association and ShareSoc's joint response that the effective date should be a year earlier than proposed in the interests of improving audit quality, it is not practicable for firms to implement a system of quality management to the scale of the changes necessary given current operating factors such as the COVID pandemic.
48. Accordingly, we agree with the IAASB that an effective date of 15 December 2022 "appropriately balances the urgency of the reforms and the risks incurred in a rushed implementation."<sup>9</sup>
49. However, we recognise that the adoption of a system of quality management should bring significant improvements in the quality of engagements and therefore, we continue to strongly encourage early adoption.

#### **Early adoption strongly encouraged**

50. Several respondents commented that they did not believe, given the timescales, that early adoption would be achievable.
51. The FRC is not mandating early adoption and it will not be detrimental to a firm if they are only able to achieve full implementation on the effective date of 15 December 2022. However, we want to ensure that firms are

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<sup>9</sup> Paragraph 158 of IAASB's ISQM 1 Basis for Conclusions available for download here: <https://www.ifac.org/system/files/publications/files/IAASB-ISQM-1-Basis-for-Conclusions.pdf>

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starting their implementation processes now in order to start to reap the benefits of a system of quality management that leads to improved engagement quality.

52. As firms start to move through the implementation process, it may be possible to put into place responses appropriate to the risks identified that mean that improvements in quality management can be advanced and we would strongly encourage firms to do so.
53. The FRC welcomes an update of a firm's progress of the implementation of their system of quality management in their annual Transparency Report(s).

#### **Q4. ISQM (UK) 1 requires the auditor to establish a monitoring and remediation process that identifies, evaluates and responds to findings that result in one or more deficiencies in the firm's system of quality management. Do you agree with this approach or should the standard include requirements for firms to also identify, evaluate and respond to positive outcomes and opportunities? Please give reasons for your response.**

54. ISQM (UK) 1 focuses on those findings that indicate that one or more deficiencies may exist and requires the establishment of a monitoring and remediation process that identifies and deals with any deficiencies. However, there may be "positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management"<sup>10</sup> that are identified as part of the monitoring and remediation process which it would be beneficial for the firm to investigate further. Where positive outcomes or opportunities are identified as part of this process, application material to the standard encourages, but does not require, the firm to evaluate and respond to them.
55. Our consultation included a question for respondents to explore the advantages and disadvantages of requiring firms to investigate findings that have positive outcomes or opportunities as well as those that result in one or more deficiencies.

#### **Summary of responses**

56. 13 respondents (11 AF; 2PB) supported the position that ISQM (UK) 1 only mandated firms to investigate findings that resulted in one or more deficiencies. Two respondents made no comments in respect of this question (1 PB; 1 INV).
57. Respondents cited that an approach whereby firms were required to investigate such positive outcomes or opportunities might be onerous for smaller firms with limited resources and may lead to a diversion of resources from identifying and dealing with deficiencies. One respondent commented that "as quality improves a requirement to identify, evaluate and respond to positive outcomes and opportunities is likely to become increasingly burdensome". Further, this would be over and above the requirements of the IAASB's standards and therefore an additional cost, perhaps without a correspondingly significant benefit.
58. We were persuaded by the argument that mandating all firms to also evaluate positive findings would be disproportionate to the public interest benefit. Instead, as set out in the application and explanatory material to

<sup>10</sup> ISQM (UK) 1, paragraph A158.

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ISQM (UK) 1, we would encourage firms to investigate these positive outcomes and opportunities where appropriate in order to assist with the root causes of deficiencies or to highlight opportunities for the firm to enhance the system of quality management.

**Q5. The requirements in ISQM (UK) 2 are currently applicable to all engagements for which an engagement quality review is required to be performed. Do you believe that ISQM (UK) 2 could be enhanced through further requirements and/or application material for non-audit assurance engagements. If so, please give your detailed reasons and explain how ISQM (UK) 2 could be enhanced, in the context of a non-audit assurance engagement.**

59. The requirements in ISQM (UK) 2 apply to all engagements for which an engagement quality review is required to be performed. This includes audits of listed entities and public interest entities, as well as non-audit assurance engagements such as those performed in accordance with the Standards for Investment Reporting (SIRs) and the FRC's *Providing Assurance on Client Assets to the Financial Conduct Authority* standard (CASS standard) where an engagement quality review is specifically required.
60. As part of our consultation, we included a question for respondents to consider whether the requirements in ISQM (UK) 2 are able to be fully applied to non-audit assurance engagements as well as audits of financial statements.

## **Summary of responses**

61. 12 respondents (10 AF; 2PB) responded that they did not see the need for further requirements and/or application material for non-audit assurance engagements. One respondent (1 AF) called for additional material primarily in respect of application to the UK specific standards that the FRC has included in scope. Two respondents (1 PB; 1 INV) had no comment in respect of this question.
62. As there was only one general call for additional material, the FRC has taken the view that no further action is required. In the fullness of time, however, we will update the relevant performance standards issued by the FRC (i.e. SIRs, CASS standard and other UK assurance standards) etc to refer to the new and revised quality management standards appropriately.

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# Impact Assessment

As a matter of policy, the FRC's auditing standards are based on the corresponding international standards issued by the IAASB. Where necessary the international standards are augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural and business context. We believe that the suite of quality management standards introduce changes compared to the current ISQC (UK) 1 and ISA (UK) 220 (Revised November 2019) that are appropriate and proportionate to address issues that have been identified since the current standards were issued.

We propose to maintain the FRC's supplementary material, where appropriate, from the current standards. This should not result in additional work effort.

The revised standards have been designed to be scalable. We believe that benefits in the public interest of enhancements to the quality of audit, although not quantifiable, will outweigh the costs of changes that may be necessary to audit firms' systems of quality management.

**Financial Reporting Council**  
**July 2021**

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# Respondents To The Consultation

# Appendix

BDO LLP

Chartered Accountants Ireland (CAI)

Crowe UK LLP

Deloitte

Grant Thornton UK LLP

Institute of Chartered Accountants in England and Wales (ICAEW)

Institute of Chartered Accountants of Scotland (ICAS)

KPMG LLP

Mazars LLP

MHA MacIntyre Hudson

Moore Kingston Smith LLP

PricewaterhouseCoopers LLP

RSM UK Audit LLP

Saffrey Champness LLP

UK Shareholders Association / ShareSoc (*Joint Response*)



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