



## Insights

31 March 2025

### Initial insights from the thematic inspections on ISQM 1 at leading PIE audit firms

The Belgian Audit Oversight Board<sup>1</sup> (hereafter 'BAOB') carried out thematic inspections in 2024 on the implementation of International Standard on Quality Management (ISQM) 1 at a selection of leading PIE audit firms. The inspection focused on the design and implementation of:

- the risk assessment process;
- the 'Human Resources' component;
- the 'Governance and Leadership' component.

With a pedagogical and awareness-raising approach, the BAOB is gaining ever greater insight into the way in which PIE audit firms understand and apply the new standard, and how this contributes to the risk management of their audit firm (hereafter the 'firm') and the quality of their audit work.

The exploratory thematic inspections have yielded insights that the BAOB wishes to share in order to support the sector in their efforts to develop and strengthen their new office organization.

<sup>1</sup> Belgian Audit Oversight Board (Article 32 of the Law of 7 December 2016).

## 1. Introduction

ISQM 1 deals with firms' responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or for other assurance or related service engagements<sup>2</sup>.

The quality management system consists of eight interconnected components<sup>3</sup> that facilitate proactive quality management<sup>4</sup>. The firm must take a risk-based approach<sup>5</sup> for the design, implementation and operation of these components and:

- establish quality objectives<sup>6</sup>;
- identify and assess quality risks<sup>7</sup>; and
- Design responses to address quality risks<sup>8</sup>.

## 2. Notwithstanding network requirements, the firm bears ultimate responsibility for the quality management system

Each of the leading PIE audit firms inspected belongs to a network. In order to promote a uniform and consistently high-quality performance of audit engagements, the network to which the audit firm belongs may establish requirements regarding the firm's system of quality management, make services available or provide resources to support the firm<sup>9</sup>.

**Notwithstanding any network requirements or services, the firm retains ultimate responsibility for its system of quality management, including professional judgments made in its design, implementation and operation<sup>10</sup>.**

### Network requirements for the firm's risk assessment process

The network requirements can apply to the risk assessment process, for example regarding the establishing of quality objectives, the identification of quality risks, or the design and implementation of responses to address the quality risks.

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<sup>2</sup> ISQM 1.1.

<sup>3</sup> ISQM 1.6.

<sup>4</sup> ISQM 1.7.

<sup>5</sup> ISQM 1.8.

<sup>6</sup> ISQM 1.8, 24, 28-33.

<sup>7</sup> ISQM 1.8, 25.

<sup>8</sup> ISQM 1.8, 26.

<sup>9</sup> ISQM 1.A175.

<sup>10</sup> ISQM 1.48.

Where the network requirements concern the audit firm's risk assessment process, the firm is required to obtain an understanding of these network requirements and to evaluate<sup>11</sup>:

- how the network requirements are relevant to the firm's system of quality management, including how they are to be implemented;
- What changes or additions are needed (e.g., based on the nature and circumstances of the firm, its engagements, the legislation and regulations, the professional standards<sup>12</sup>).

The firm must document the above-mentioned work<sup>13</sup>. Elements that may contribute to **adequate documentation** shall include **appropriate explanations** of:

- the **local processes** carried out by the firm as a **basis for the evaluation of the network requirements**, together with the firm's **conclusions** about (i) the relevance of the network requirements for its system of quality management, (ii) the need for changes or additions to the network requirements or (iii) the feedback given by the firm to its network (for example, if it deems that specific network requirements are not relevant to its system of quality management);
- The **local procedures** that, in addition to any annual changes to the network, contribute to an **iterative risk assessment process**.

### Network requirements for the firm's monitoring process

If a network monitors a PIE firm's system of quality management, that firm must<sup>14</sup>:

- determine the effect of the monitoring activities performed by the network on the nature, timing and extent of the firm's monitoring activities;
- determine the firm's responsibilities in relation to the monitoring activities, including any related measures taken by the firm;
- Obtain the results of the monitoring activities from the network in a timely manner.

If the network undertakes monitoring activities across the network firms, PIE audit firms must additionally<sup>15</sup>:

- understand the scope of the monitoring activities that the network performs at those firms, including the monitoring activities intended to determine that network requirements have been appropriately implemented across the firms, and of how the network will communicate the results of its monitoring activities to the firms;
- At least annually, obtain information from the network about the overall results of the network's monitoring activities across the network.

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<sup>11</sup> ISQM 1.49

<sup>12</sup> ISQM 1.A179.

<sup>13</sup> ISQM 1.59.

<sup>14</sup> ISQM 1.50.

<sup>15</sup> ISQM 1.51.

**The audit firm must document the monitoring process of the quality management system<sup>16</sup>.**

The PIE audit firms that were inspected provided information about the evaluation of the monitoring activities of their network. For the most part, the firms had no access to the details of the procedures carried out by the network.

Partly on the basis of consultation with various European supervisory authorities, the BAOB considers that the following elements could contribute to a **good application of the ISQM requirement** as regards **documentation of the monitoring process**:

- documentation of the **consolidated monitoring plan**, including clear explanations of:
  - the extent and timing of the monitoring activities performed by the network and the firm;
  - the determination of the effect of the monitoring activities performed by the network on the nature, timing and extent of the firm's monitoring activities;
  - the coverage of the monitoring activities that indicate that the firm has tested all components at least annually;
  - the reasons for the nature, timing and extent of the firm's monitoring activities, for example where the firm decides on a specific selection approach for testing certain responses;
- documented **explanations of the nature, timing and extent of the network's monitoring activities**, such as information about:
  - the procedures performed and the results;
  - the methodology used;
  - the size of the samples;
  - the time period;
  - the actions following up on the monitoring activities;
  - The minutes of the meetings with the persons responsible for the system of quality management.

**3. If there are variations in the terminology used, the firm must demonstrate compliance with the ISQM 1 requirements**

**ISQM 1 requires that the audit firm establish quality objectives<sup>17</sup>, namely:**

- **the quality objectives specified in ISQM 1; and**
- **any additional quality objectives the firm considers necessary to achieve the objectives of the quality management system.**

The leading PIE audit firms that were inspected stated that they had implemented the quality objectives specified by ISQM 1 in their system of quality management. Most firms use the ISQM 1 terminology for defining their quality objectives.

<sup>16</sup> ISQM 1.58-59.

<sup>17</sup> ISQM 1.24.

The standard also allows for the possibility of using different terminologies or frames of reference to describe the components of the system of quality management<sup>18</sup>. A firm that does so must be able to demonstrate that it complies with the ISQM 1 requirements<sup>19</sup>, for example by providing **sufficiently clear documentation of the meaning of the firm's quality objectives**. A firm must ensure that its own specific terminology reflects sufficiently clearly the meaning of the quality objectives specified by ISQM 1. If not, this may result in incompletely or only partially defined quality objectives, which is an infringement of ISQM 1.

Some of the PIE audit firms inspected provided the BAOB with a **clear mapping between the quality objectives specified in ISQM 1 and the firm's quality objectives**, in order to indicate that they fulfil the requirements of ISQM 1. This is all the more important if the quality objectives specified in ISQM 1 do not correspond exactly to each of the firm's quality objectives.

#### 4. A high-quality identification and assessment of risks is essential for the design and implementation of the responses

**ISQM 1 requires that audit firms identify and assess quality risks to provide a basis for the design and implementation of appropriate responses<sup>20</sup>.**

For the identification of quality risks, the leading PIE firms that were inspected relied chiefly, as a starting point, on a list of quality risks of the network. The BAOB understands that these firms have, where necessary, assessed, adapted or supplemented their quality risks locally<sup>21</sup>.

These PIE firms have received support from the network for the assessment of quality risks, for example in the form of intellectual and technological resources such as risk assessment tools, methodologies or even certain suggestions for the quality assessment of inherent risks.

The thematic inspections indicate that the firms approached the identification and assessment of quality risks in different ways:

- the methodology used:
  - a. whether or not to assign formal risk ratings or scores (heat maps);
  - b. whether or not to use risk questionnaires as the guideline for risk assessment;
  - c. whether or not a firm's senior management is strongly engaged in the identification and assessment of quality risks.
- the comprehensive nature of the documentation of:
  - a. the local considerations of the conditions, events, circumstances, actions or inactions that may give rise to a quality risk;

<sup>18</sup> ISQM 1.A3.

<sup>19</sup> ISQM 1.A202.

<sup>20</sup> ISQM 1.25, 26, A49.

<sup>21</sup> The BAOB understands that the firms have taken account of their specific nature and circumstances and their engagements in order to gain an understanding of the conditions, events, circumstances, actions or inactions that could adversely affect the achievement of the quality objectives.

- b. the reasons for the quality risk assessment, taken into account of both the action and its effect;
  - c. the degree to which the responses appropriately address the quality risks.
- the level of investment in specific tools for documenting the system of quality management.

Although the firm may organize the identification and assessment of quality risks in different ways, the documentation must show<sup>22</sup>:

- that the firm has gained sufficient understanding of the circumstances, conditions, events, actions or inactions that may give rise to a quality risk;
- the reasons for the assessment of the quality risks, i.e., the occurrence and effect on the achievement of one or more quality objectives.

The following elements may contribute to better documentation thereof:

- identifying the quality risks at a **sufficiently granular level**;
- continually questioning the **completeness** of the quality risks, by for example:
  - a. carrying out a reconciliation between the quality risks in the quality management system and the risks in other risk models used by the firm (e.g., an ERM system<sup>23</sup>);
  - b. giving continual feedback on the results of the results of internal or external monitoring to the components of the quality management system<sup>24</sup>;
- providing a **methodology** to support the process of identification and assessment of quality risks, for example by means of:
  - a. a questionnaire to be used as a guideline for identifying or assessing the risks<sup>25</sup>;
  - b. a **risk assessment model** to support the risk ratings or scores (heat map), potentially with a few examples;
- sufficiently detailed documentation of how the responses address the quality risks<sup>26</sup>, taking into account the occurrence and the effect thereof;
- **minuting the validation** of the identification and assessment of the quality risks **by the firm's senior management**.

## 5. The monitoring and remediation process facilitates continual improvement of the quality

ISQM 1 requires that firms establish and implement monitoring processes that provide relevant, reliable and timely information. This information facilitates the timely identification and remediation of deficiencies and serves as the basis for the evaluation of the quality management system<sup>27</sup>.

<sup>22</sup> ISQM 1.A205.

<sup>23</sup> Enterprise risk management (ERM).

<sup>24</sup> This contributes to a timely identification of essential additions or changes to the quality management system.

<sup>25</sup> However, the firm may not limit the identification and assessment of the quality risks to the filling in of pre-defined risk questionnaires.

<sup>26</sup> ISQM 1.58.

<sup>27</sup> ISQM 1.35, A138.

A firm's monitoring activities may comprise a combination of **ongoing and periodic monitoring activities**<sup>28</sup>. Ongoing monitoring activities are generally routine activities.

The monitoring processes of the leading PIE audit firms that were inspected are often a combination of both; for example:

- a periodic ISQM 1 self-assessment as a basis for the identification of:
  - o the necessary additions or changes to the quality objectives, the risks and the responses;
  - o the need for additional resources or activities for a high-quality system of quality management;
  - o the observations or findings that may point to deficiencies;
- ongoing monitoring of the workflow<sup>29</sup> of the firm's engagements;
- ongoing monitoring of the quality of the firm's engagements;
- a combination of monitoring activities of the effect of the responses, whether or not with the assistance of specific monitoring tools.

Monitoring tools can be useful to firms, for example to assist with:

- a. the identification and documentation of the roles and responsibilities with respect to the system of quality management (e.g., those assigned ultimate responsibility for the responses, those who implement the responses and the persons who evaluate the design or effectiveness of the responses, etc.);
- b. the design of the quality management system (e.g., links between quality objectives, risks and responses; assignment of responsibilities for responses, etc.);
- c. the status of the implementation of the monitoring plan (e.g., deadlines, tests that are carried out late, the final date for the tests, etc.);
- d. the test results and their supporting documentation.
- **continual monitoring using audit quality indicators (AQI)**. All the leading PIE firms inspected have implemented AQIs, some of which are required by their network. Certain firms use the AQIs actively to monitor their quality objectives. They regularly measure, report on and discuss the AQIs with the leadership and take appropriate measures where necessary.

A firm's monitoring process can lead to findings in relation to the system of quality management. **The firm exercises professional judgment in evaluating the findings, determining whether or not the quality management system has any deficiencies<sup>30</sup> and evaluating the severe and pervasive effect of the identified deficiencies.** Regarding the severe and pervasive effect of the identified deficiencies, the firm must analyse the root cause of the identified deficiency, and evaluate the effect of that deficiency, both individually and in aggregate, on the system of quality management.

The leading PIE audit firms inspected have provided different types of documentation of their evaluation of the findings, the identified deficiencies and their root causes<sup>31</sup>.

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<sup>28</sup> ISQM 1.37, A139.

<sup>29</sup> The workflow of the engagements comprises the various phases of the engagement, such as the planning phase, the interim phase and the reporting phase.

<sup>30</sup> ISQM 1.40, 41, A159.

<sup>31</sup> ISQM 1.57, 58.

A high-quality professional judgment is essential for an effective monitoring process. The following elements can contribute to **good, sufficiently persuasive documentation that demonstrates the quality and consistency of the professional judgment**:

- a **methodology** with clear guidelines on the approach and the requisite documentation, such as:
  - a. the factors that the firm takes into account for the **evaluation of a finding and how the finding**, individually or in combination with other findings, **give rise to a deficiency**. Attention needs to be paid specifically to situations in which monitoring activities give rise to many findings that individually would not seem to give rise to deficiencies. The presence of many or recurring findings may point to a deficiency in one or more components of the quality management system.
  - b. the factors that the firm takes into account for evaluating the **severe and pervasive effect** of the identified deficiencies;
  - c. the factors that the firm takes into consideration when **investigating the root cause** of the identified deficiencies;
- the design of the **moderation panels** on which experienced and qualified persons, who are deemed to be objective, are to guarantee the consistent evaluation of the findings and deficiencies.

## 6. Certifications formalize the accountability of individuals assigned a role within the system of quality management

**ISQM 1 requires the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate, on behalf of the firm, the system of quality management. The evaluation must be performed at least annually<sup>32</sup>.**

Most of the leading PIE audit firms inspected support their annual evaluation with formal certifications of all those who hold responsibility within the system of quality management. The individuals<sup>33</sup> in question thereby confirm, for example:

- their understanding of the exercise of responsibilities;
- their confirmation that there are no other findings or deficiencies besides the ones reported;
- their compliance with the documentation requirements in ISQM 1.

**These formal certifications reflect the firm's commitment to quality and formalize the responsibility and accountability of all those who are assigned a role in the system of quality management.**

<sup>32</sup> ISQM 1.53, 54.

<sup>33</sup> Those with ultimate responsibility for the response, those who implement the response and those who evaluate the design or effectiveness of the response, etc.



## 7. The tone at the top is decisive for the firm's culture

The 'Governance and Leadership' component emphasizes the responsibility of the leadership for establishing an environment and culture that reflects the commitment to quality.

The firm must establish at least the five quality objectives<sup>34</sup> required under ISQM 1. The firm must therefore identify and assess quality risks to provide a basis for the design and implementation of responses<sup>35</sup>. The nature, timing and extent of the responses must be based on the reasons for the assessments of the quality risks<sup>36</sup>.

The following are **examples of frequent responses** at the leading PIE firms inspected:

- the introduction of a code of conduct clarifying the firm's values, the behaviour of the staff and the possible sanctions in the event of infringements;
- **conducting anonymous surveys to measure the firm's quality culture**, such as:
  - a. a culture of free speech, as well as awareness of the internal reporting systems or channels to report unethical behaviour, breaches of training integrity and potential factors that may threaten quality;
  - b. the tone at the top and how staff members experience the commitment to quality in the actions and behaviours of the leadership;
  - c. the sufficiency of the resources for carrying out high-quality engagements, including:
    - i. sufficient time to perform the engagements;
    - ii. appropriate technological and intellectual resources.
  - d. the way staff members experience appreciation by the leadership for their performance of high quality engagements;
- the **implementation of the accountability framework** by the leadership in a way that takes into account, for instance:
  - a. the results of the internal and external monitoring activities;
  - b. a positive recognition of leaders who commit themselves to quality;
  - c. breaches of:
    - i. ethical requirements,
    - ii. procedures for the acceptance or continuation of client relationships or;
    - iii. specific tasks and internal risk management procedures;
  - d. the potential impact of the aforementioned points on the evaluation and/or bonus;
  - e. the quality improvement trajectory for the leadership, where needed.

<sup>34</sup> ISQM 1.28.

<sup>35</sup> Including the responses required under ISQM 1.

<sup>36</sup> ISQM 1.A49.

- the design and implementation of a **communication plan** that contributes to a culture that reflects the firm's commitment to quality. For example, communication via newsletters, webcasts and emails about:
  - a. a specific quality topic (or topics) such as new or amended laws and regulations, relevant ethical rules or professional standards,
  - b. the behaviour expected of the staff, such as integrity (training), professional objectivity, confidentiality, professional competence, precision, a critical spirit;
  - c. The deficiencies identified in the system of quality management and in engagements, the analysis of their root causes, and their remediation;
- the **assignment of clearly defined roles and responsibilities for quality** with:
  - a. a sufficiently high commitment of partners with appropriate authority, knowledge, experience and influence;
  - b. sufficient time allotted to performing high-quality engagements by the firm and of the assigned responsibilities in the system of quality management;
  - c. attention to separation of functions in order to prevent threats to self-reviews;
  - d. adequate visibility within the firm and on the organization chart;
  - e. specific roles and responsibilities, for example, for the performance of monitoring activities, the analysis of the monitoring results, the provision of training on quality, the point of contact for quality, and the assignment of specific roles and responsibilities do not relieve the responsibility of all staff members for quality.
- the design of a **strategic plan and budget** that clearly takes into account the qualitative factors or incentives, in addition to financial and commercial factors or incentives.

## 8. Qualified, experienced and quality-oriented staff are the basis for the performance of high-quality engagements

The 'Human Resources' (sub-)component<sup>37</sup> emphasizes the importance of competent and capable staff as a basis for the high-quality performance of the engagements.

The firm must in this context establish at least five quality objectives<sup>38</sup>. The firm must therefore identify and assess the quality risks to provide a basis for the design and implementation of responses<sup>39</sup>. The nature, timing and extent of the responses must be based on the reasons for the assessment of the quality risks<sup>40</sup>.

The following are **examples of frequent responses** at the leading PIE firms inspected:

- developing **hiring and retention procedures** that include, for example:

<sup>37</sup> The 'Resources' component is made up of four sub-components: 'Human Resources', 'Technological Resources', 'Intellectual Resources' and 'Service Providers'.

<sup>38</sup> ISQM 1.32.

<sup>39</sup> Including the responses required under ISQM 1.

<sup>40</sup> ISQM A.49.

- a. designing accurate staff budgets based on clear criteria such as:
    - i. the firm's strategy, such as budgeted strategic growth;
    - ii. the actual time spent on engagements in the previous year, including budget overruns;
    - iii. the workload for each category of staff;
    - iv. the expected rate of staff turnover;
    - v. the need for additional specific resources, such as in the context of new legislation such as the CSRD<sup>41</sup>;
  - b. the recruitment criteria and procedure for assessing candidates' quality;
  - c. the onboarding process for new staff members, including the signing of the code of conduct and the statement of independence.
- drawing up a **training programme**, with, for example:
- a. the assignment and description of roles and responsibilities, in particular where the network requires the implementation of a general training programme;
  - b. a training plan that distinguishes between:
    - i. mandatory training for each category of staff on the relevant ethical requirements, the firm's procedures for the acceptance and continuation of client relationships and specific tasks, legislation and regulations, professional standards, and so on;
    - ii. additional training depending on the identified needs for certain staff members based on their evaluation or as a function of the types of tasks they perform;
  - c. the procedure guaranteeing the quality of the in-house training at the audit firm, such as verification of the content of the training and train-the-trainer programmes;
  - d. the procedure, processes and organization designed to ensure the integrity of training and testing, such as:
    - i. regular communication by senior management about the importance of (training and test) integrity and potential sanctions for any infringements;
    - ii. mandatory validation of the understanding of the ethical requirements and the expected conduct at the beginning of e-modules or training programmes;
    - iii. providing for built-in participative elements during training sessions by means of opinion polls and test questions;
    - iv. taking attendance at various points in time during e-learning modules. The firm may, for example, check attendance by scanning the barcodes at the start of the training session, in the course of the session and at the end;
    - v. ruling out the possibility of going through e-learning modules at a faster pace, skipping slides or taking 2 training sessions at the same time;
    - vi. testing that there are adequate guarantees of integrity;
  - e. measuring compliance with the training plan, for example by means of audit quality indicators (AQIs);
  - f. measuring the effectiveness of the training by requiring that participants achieve a minimum score on a test at the end of the training session;

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<sup>41</sup> Corporate Sustainability Reporting Directive (CSRD).

- implementing a **procedure for staff accountability and recognition of commitment to quality**, for example with:
  - a. the assignment and description of the roles and responsibilities for the evaluation and promotion process;
  - b. implementing quality objectives and indicators for all levels of staff;
  - c. timely evaluations as a basis for:
    - i. continual feedback and focus on quality;
    - ii. identifying training needs;
    - iii. recognizing positive behaviour and commitment to quality;
    - iv. determining the bonus;
  - d. an accountability framework for staff<sup>42</sup>;
  - e. a recognition programme to highlight exceptional performance with regard to quality and compliance and thereby to reinforce staff commitment to quality;
  - f. guidelines and criteria for promotion that take account not only of competence but also of qualitative factors such as the performance of high-quality engagements;
- setting up an **approval and evaluation process for staff that the firm received from external sources**<sup>43</sup>, including:
  - a. the assignment and description of the roles and responsibilities for the evaluation of the work carried out by external sources;
  - b. the annual confirmations of compliance with ISQM 1 for service delivery centers;
- **establishing a procedure, processes and tools for the assignment of resources based on clear criteria**, with:
  - a. an assignment and description of the roles and responsibilities;
  - b. an analysis of the portfolio with a view to assigning more experienced partners to complex or risky engagements;
  - c. a process for confirming the assignment of members of the engagement team and resolve any scheduling conflicts;
  - d. the estimation of and planning for the need for specialized resources or specific types of technical support;
  - e. a regular reassessment of the planning, for example on the basis of continual measurement of, among other things:
    - i. the workload, in order to identify staff who may have insufficient time to perform high-quality engagements;
    - ii. staff turnover and hirings, in particular where these diverge from what the firm had budgeted for;
  - f. the security measures for engagements with insufficient aggregate level of competence or time due to unexpected circumstances. The firm may in such cases require a higher level of involvement on the part of the engagement partner.

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<sup>42</sup> See also 'accountability framework' for senior management.

<sup>43</sup> External sources of the network, another network firm or of a service provider.