



Issue 45 (6 March 2023)

Dear members,

Monitoring Activities and SOQM Evaluation under HKSQM 1

Hong Kong Quality Management Standard (HKSQM) 1, [*Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*](#) came into effect on 15 December last year. It requires firms to establish a robust system of quality management (SOQM) that is tailored to the nature and circumstances of their own firm and the engagements conducted. HKSQM 1 consists of eight components that operate in an iterative and integrated manner as well as other requirements comprising the roles and responsibilities for the system; leadership's overall evaluation of the system; network requirements or network services and documentation.

After a firm's SOQM is tailored and implemented, it is important that continued efforts be made to ensure the relevance and effectiveness of the SOQM. Accordingly, HKSQM 1 puts forward enhanced requirements for monitoring and remediation (one of the eight components of HKSQM 1) to promote a proactive and continual SOQM as well as effective and timely remediation of deficiencies.

In [Alert Issue 43](#), it was mentioned that firms are required to evaluate their SOQM within one year of 15 December 2022. HKSQM 1 requires the firm's leadership to undertake an annual evaluation of the SOQM to provide the firm with reasonable assurance that the firm and its personnel fulfill their responsibilities and conduct engagements in accordance with standards and requirements, and issue engagement reports that are appropriate in the circumstances (i.e., the objective of HKSQM 1).

The purposes of this Alert is to highlight the following matters relevant to HKSQM 1:

- A. Monitoring and remediation process;
- B. Evaluation of the firm's SOQM; and
- C. HKSQM resources.

Unless otherwise stated, references in this Alert are to the corresponding paragraph(s) of HKSQM 1.

This Alert does not amend or override HKSQM 1, the text of which alone is authoritative. Reading the Alert is not a substitute for reading the standard.

A. MONITORING AND REMEDIATION PROCESS

The purpose of the monitoring and remediation process is to provide information about the design, implementation and operation of the firm's SOQM, and enable the firm to respond to identified deficiencies for timely remediation (paragraph 35).

Although HKSQM 1 does not specify who should perform the monitoring activities, paragraph 39 requires the firm to establish policies or procedures on the competence, capabilities (including sufficient time) and objectivity required from these individuals so that they could perform the monitoring activities effectively.

In HKSQM 1, the monitoring and remediation process involves the following steps:

1. Designing and performing monitoring activities
2. Evaluating findings and identifying deficiencies, and evaluating identified deficiencies
3. Responding to identified deficiencies
4. Ongoing communication related to monitoring and remediation

Step 1: Designing and performing monitoring activities

Firms shall design and perform monitoring activities that are tailored for the firm, taking into account the following factors in paragraph 37:

- The reasons for the assessments given to the quality risks;
- The design of the responses;
- The design of the firm's risk assessment process and monitoring and remediation process;
- Changes in the system of quality management;
- Previous monitoring activities; and
- Other relevant information, such as complaints/allegations, information from external inspections and those from service providers.

[ISQM 1: First-Time Implementation Guide](#), published by the International Auditing and Assurance Standards Board (IAASB), contains illustrative examples about how these factors may affect the nature, timing and extent of the monitoring activities.

Ongoing and periodic monitoring activities

Paragraph A139 explains that the firm's monitoring activities may comprise a combination of ongoing monitoring activities and periodic monitoring activities. This combination may enable effective monitoring as a whole.

- Ongoing monitoring activities are generally routine activities built into the firm's processes and performed on a real-time basis, reacting to changing conditions. They provide information about the SOQM in a timelier manner than periodic monitoring activities.
- Periodic monitoring activities are conducted at certain intervals by the firm.

Inspection of Completed Engagements

HKSQM 1 requires the firm to include the inspection of completed engagements in its monitoring activities (paragraph 39).

On a cyclical basis, the firm shall determine and select at least one completed engagement for each engagement partner for inspection. Paragraph A152 explains that the firm may consider the nature, extent and results of the firm's other monitoring activities in order to determine:

- Which completed engagements should be selected for inspection;
- Which engagement partners should be selected for inspection;
- The frequency of selecting an engagement partner for inspection; and
- Which aspects of the completed engagement should be covered in the inspection.

HKSQM 1 improves the focus on selecting engagements and engagement partners for inspection of completed engagements based on risk. Specifically, paragraph A153 demonstrates a scalable and proactive selection approach. It describes circumstances when an engagement partner may need to be selected more frequently due to risk, or less frequently because the firm has enough information about the engagement partner from other monitoring activities.

Other Types of Monitoring Activities

Only inspecting completed engagements would likely not provide sufficient and appropriate information to the firm about the SOQM. In general, firms should use a combination of monitoring activities to achieve the purpose of the monitoring and remediation process.

Examples of other types of monitoring activities include:

- Inspections of in-process engagements.
- Interviewing firm personnel, or undertaking formal surveys, to understand how personnel perceive the culture of the firm.
- Considering the consistency of leadership's communications and messaging, and whether they reflect the firm's values and focus appropriately on quality.
- Checking and evaluating IT applications used for functions related to the SOQM, such as independence systems or automated tools used for audits.
- Automated alerts, for example, automatic notifications when policies are not applied.
- Inspecting documentation and contracts supporting the engagement of service providers, to determine whether proper consideration was given to whether the service provider was appropriate for use.
- Checking records of attendance at training events.
- Inspecting time records for the number of hours spent by engagement partners and other senior personnel and assessing the sufficiency of such hours.

(Source: [IAASB First-Time Implementation Guide](#))

STEP 2: Evaluating findings and identifying deficiencies, and evaluating identified deficiencies

Not all findings from the monitoring activities will result in a deficiency. Findings must be evaluated to determine whether deficiencies exist (paragraph 40). The determination is a matter of professional judgment in the circumstances and depends on many quantitative and qualitative factors (paragraph A159).

Under paragraph 16, a deficiency in the context of HKSQM 1 exists when:

- A quality objective has not been established;
- A quality risk has not been identified or properly assessed;
- A response to reduce the likelihood of a quality risk occurring to an acceptably low level has not been designed, implemented or operating effectively; or
- Another aspect of the SOQM's being absent, or not properly designed, implemented or operating effectively.

When a deficiency has been identified, paragraph 41 requires an evaluation of its severity and pervasiveness through:

- Investigating the root cause(s) of the identified deficiencies, which involves exercising professional judgment based on evidence available (paragraph A165); and
- Evaluating the effect of the identified deficiencies on the SOQM.

STEP 3: Responding to identified deficiencies

Once deficiencies are identified and evaluated, firms shall design and implement remedial actions to address the matters. The actions should be responsive to the results of the root cause analysis (paragraph 42).

Firms shall also respond to findings which identify omitted procedures from engagement(s) or the report issued might be inappropriate (paragraph 45).

The nature, timing and extent of the remedial actions would depend on the severity and pervasiveness of the identified deficiency. The more severe and pervasive the deficiency, the more urgency is needed to design and implement remedial actions. In some cases,

- More than one remedial action is needed to address the root cause(s).
- An interim measure is implemented as a remedial action until the firm is able to implement more effective remedial actions.
- The remedial action may include establishing additional quality objectives, and adding or modifying quality risks or responses.

(Paragraphs A170 and A171)

Paragraph 43 also requires the firm to evaluate whether the remedial actions are appropriately designed and implemented, and are effective in addressing the identified deficiency. Otherwise, the remedial actions shall be appropriately modified such that they are effective (paragraph 44).

STEP 4: Ongoing communication related to monitoring and remediation

Paragraph 46 requires that the following be communicated to the individual(s) assigned ultimate responsibility and accountability of the firm's SOQM, and the individual(s) assigned operational responsibility for the firm's SOQM:

- A description of the monitoring activities performed;
- The identified deficiencies, including the severity and pervasiveness of such deficiencies; and
- The remedial actions to address the identified deficiencies.

The above matters shall also be communicated to engagement teams and other individuals with responsibilities with the SOQM for their prompt and appropriate action.

B. EVALUATION OF THE FIRM'S SOQM

The individual(s) assigned with the ultimate responsibility and accountability for the firm's SOQM is required to evaluate the SOQM as of a point in time and at least annually (paragraph 53). The first of these evaluations must be performed by 15 December 2023, i.e., within one year of the effective date of HKSQM 1.

The evaluation would use the results of the firm's monitoring and remediation process and consider the following:

- The severity and pervasiveness of identified deficiencies, and how they affect the achievement of the objectives of the SOQM;
- The design and implementation of remedial actions and their effectiveness up to the time of the evaluation; and
- Whether the effect of identified deficiencies have been appropriately corrected and further actions have been taken.

(Paragraph A190)

If the evaluation identifies matters that inhibit the fulfillment of the SOQM objectives, the firm shall take prompt and appropriate action and communicates the findings with engagement teams and other appropriate parties, to the extent relevant to their responsibilities and/or depending on whether the communication is required by the firm's SOQM.

C. HKSQM RESOURCES

- [HKICPA Quality Management Manual](#) offers steps to implement the SOQM under HKSQM 1. Among others, it provides checklists and templates to monitor and identify deficiencies in a SOQM for timely remediation.
- [HKICPA archived virtual workshops](#) aim to highlight the key requirements of the quality management standards and provide practical guidance specific to small- and medium-sized practices for their effective implementation.
- [HKICPA Quality Management Resource Centre](#) contains a collection of guidance and materials to help you navigate HKSQM 1.

Sincere regards,

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