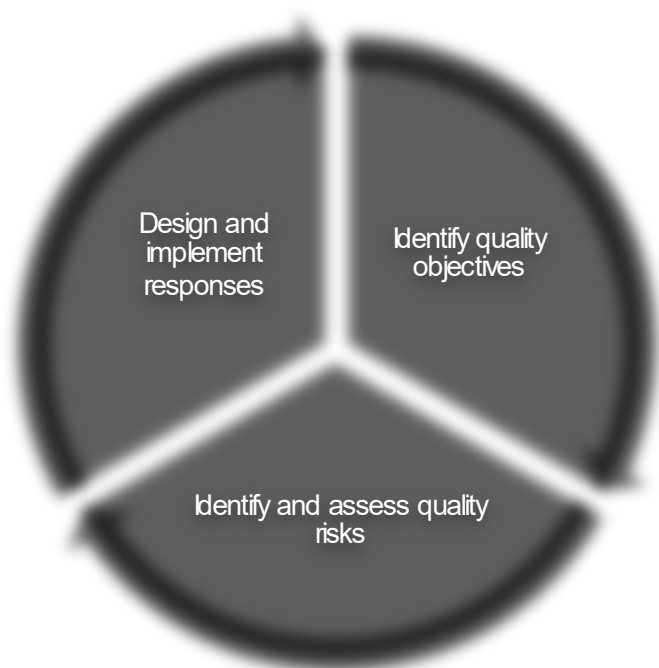# GUIDANCE 4: QUALITY RISK MANAGEMENT PROCESS

Quality risk management enables the SAI to focus its resources on matters that are of most significance to achieve audit quality. It allows SAI to develop and implement strategies even before a risk in quality materializes. It also helps the SAI to customise its system of audit quality management based on its quality needs. This process acts as the backbone of the system.

The SAI's quality risk management process involves three major steps – identification of quality objectives, identification and assessment of quality risks, and design and implementation of responses. Some SAIs may already have practices in place for identifying and assessing risks as part of the SAIs' strategic planning process. For example, under **the IDI's CRISP initiative**, SAIs are supported in strengthening their broader risk management systems, and some may already have designated functions covering wider risk considerations. Strategic risk assessment may have also been performed to set the priorities and select audit topics of the SAI.

The Playbook is not intended to impose new risk management process on these SAIs but rather provide support to further enhance the SAIs' practices by emphasising audit quality and relating the result to the SAIs' system for holistic management of quality. If a wider risk management system is already in place, the SAI can adapt its current methodologies and tools to incorporate quality objectives and related risks.

For instance, some SAIs maintain a central risk register that consolidates all organisational risks, supported by sub-registers that cover specific categories such as quality risks. Others may choose to manage everything in a single, comprehensive register. Where multiple registers exist, it is important that the SAI ensures clear linkages between them to maintain coherence and alignment across risk areas.

The quality risk management process operates in a non-linear and iterative manner. This implies that the process does not end when risks are assessed, or responses are implemented. When the SAI identifies new information or conditions which suggest that additional quality objectives, risks or responses need to be considered, or that initial assessments are no longer reflective of the current situation, the result of risk management needs to be modified accordingly. Similarly, during the conduct of each step, the SAI may still revisit and update previous step(s) as necessary.

Depending on the SAI structure and size, this exercise is participated by the Head of SAI together with a group of individuals with strategic and operational knowledge about the SAI.

- o The risk management may be conducted concurrently with the strategic planning (e.g., every 3 to 5 years or longer depending on the SAI's processes) but should be updated when the need arises (e.g., annually).

- o Depending on the SAI's structure and practices, the form of the risk management process may range from a well-documented process to a mere less-complex ad-hoc process. Irrespective of the manner how the risk management process is established in the SAI, it is more critical that there is sufficient documentation of the result, and that the assessment is made to the extent that the SAI effectively identifies and provides responses to significant quality risks that are expected to affect audit quality.

- o The SAI is encouraged to prepare documentation of its risk management from the identification of quality objectives up to the design (and implementation) of responses. This is to keep a trail for the succeeding risk management and provide basis and support for the significant decisions of the SAI relating to quality management.

The SAI may develop separate manual, handbook, or guidance with tools during the implementation stage of SoAQM. These concepts can be integrated into any existing risk management system in the SAI if already existing. To learn more about the related support of IDI on wider risk management, you may visit: https://www.idi.no/work-streams/well-governed-sais/crisp

4.1. Establishment of Quality objectives

Quality objectives are the desired outcomes in relation to the components of the system of audit quality management to be achieved by the SAI. As compared with ISQM 1, ISSAI 140 only provides examples of quality objectives in the application material. As such, the playbook provides different options for establishing quality objectives. When the SAI chooses to identify its quality objectives either through collaboration with individuals within the SAI, brainstorming sessions with the risk management committee, benchmarking with other SAIs, or analysis of strategic and operational objectives of the SAI, the SAI may write the quality objectives considering the following:

- the statement must be clear as to the <u>outcomes</u> that must be achieved by the component of the system to achieve high-quality audit
- the statement must support and should be aligned with the overall objective of the system of audit quality management
- all the quality objectives taken as a whole must be complete to cover all the relevant components of the system of audit quality management
- the quality objectives must be relevant and applicable to the SAI's local context
- the statement must be measurable and observable (i.e. to help in the evaluation at the later stage)
- the statement must not be too broad which prevents in-depth analysis of a particular component, nor too specific which limits the scope of the quality risk assessment. This, however, does not prevent the SAI from creating a generic quality objective which is supported by several specific sub-quality objectives

Example:

Acceptance, Initiation and Continuance

Quality objectives:
- the SAI establishes measures to protect the credibility of the SAI for accepting/continuing <u>mandated</u> audit engagements that the SAI would otherwise accept had these audits were not mandated.
- the SAI will accept, initiate, and continue engagements, <u>other than those that are mandated</u>, only if the SAI:
  - is able to comply with ISSAIs and other relevant standards, applicable legal and regulatory requirements, and ethical principles;
  - acts within its legal mandate or authority; and
  - has the capabilities, including time and resources, to do so.

The above objectives showcase:
- how the SAI can customise the quality objective to become more relevant and applicable. Most SAIs cannot decline audits due to their mandate. As such, the quality objectives are realigned by focusing on what the SAI is expected to do (e.g. modifying the audit team's risk assessment and response) for mandated audits despite issues in the acceptance stage if any (e.g., management with integrity issues), and for additional audits that are not mandated. Take note that ISSAI 140 addresses this through the risk response instead of revision of the quality objectives. The example risk response relates to *"establishment of policies and procedures that address situations when SAI is obliged by legal mandate or request to accept an engagement"*
- clarity in the outcome as to the existence of the needed actions or mechanisms to protect the credibility of the SAI in performing its mandated and/or nonmandated audits
- that the objectives can be measured through the existence of responses for mandated audits, and conditions that must be met for nonmandated audits

Identification of Quality Risks

The SAI's understanding process to identify quality risks may cover the following areas:

complexity and other attributes of the organisational and operating environment – consider whether the structure, size of the SAI, and its legal and regulatory framework can affect achievement of quality objectives. For instance, determine whether the current structure and size of the SAI, or the SAI and its regional offices' locations can fully support the demand or requirements of the SAI's responsibilities.

its strategic and operational processes – consider whether the SAI's strategic and operational processes allow the SAI to focus on its priorities as set by its mandate and to meet stakeholders' expectations. Also, determine whether the process takes into account the current situation of the SAI, responsibilities are clearly defined, and whether there is a mechanism to evaluate the process to provide inputs in the next strategic or operational processes.

characteristics and management style of leadership – consider how the authority is distributed among leadership and how leadership encourages or motivates SAI personnel in promoting quality audits.

resources available to the SAI – consider the number of auditors and the competencies available in the SAI and those required by the audit, and whether there are audit methodologies and tools and technological resources available which need to be responsive to the current trends in auditing.

ISSAIs, laws, regulations and other relevant standards required in the environment the SAI operates – in addition to the review of the legal and regulatory framework of the SAI, the SAI needs to be aware of the potential impact when there are new legislations relevant to the SAI's audit. The review also needs to consider how the SAI adopts auditing standards, and, when the SAI develops its own standards, how the SAI ensures that the standards are up to date based on the INTOSAI Framework of Professional Pronouncements. The SAI also needs to determine whether there are sufficient support materials or application guidance for proper implementation of such regulations or standards.

any partnerships in the SAI operations – consider how external partnerships affect the SAI's auditing responsibilities and compliance with the relevant ethical requirements.

the nature of the audits and other work that is performed by the SAI – relate the types of audits the SAI performs with its available methodologies and tools, and audit standards.

the types of reports that are issued – review the required audit reports that the SAI needs to issue and whether there are mechanisms in place how the SAI ensures compliance with its reporting responsibilities.

the bodies that it audits – determine whether the audit universe reflect the required auditing bodies that need to be audited based on the SAI mandate, and whether the SAI has the competencies to audit different bodies which may require specialised skills.

The different roles and level of knowledge of the participants of the SAI's quality risk management play a significant role in appropriately identifying quality risks relevant to the SAI. Quality risks are identified on these areas based on the appreciation and in-depth knowledge of the SAI structure, policies, processes and current needs.

Below are examples of quality risks identified through understanding and review of the SAI using the extracted portion of the quality risk management template. The quality objectives in application material to ISSAI 140 are used. The same example will be used in the assessment of risk and designing response and will be linked to the evaluation of the system.

Examples:

Conditions and events, circumstances, actions or inactions related to the SAI and its audit engagements	Identification of Quality Risks (QR)		
	QR No.	Description	Affected QO No.
Laws, regulations, and professional standards required in the environment the SAI operates The **SAI of Country X** is bound by its commitment to ensure audit quality and is devoted to adopting and implementing the INTOSAI pronouncements. Prior to the IFPP, the SAI created an ad-hoc working group to study the ISSAI Framework for the purpose of adopting and implementing ISSAIs. As a result, the SAI opted to adopt level IV ISSAIs for audits and developed audit methodologies	1	The SAI's existing audit methodologies and tools may not enable the auditors to fully comply with ISSAIs.	8, 14, 19

Conditions and events, circumstances, actions or inactions related to the SAI and its audit engagements	Identification of Quality Risks (QR)		
	QR No.	Description	Affected QO No.
and tools based on these pronouncements. Recently, the ISSAI Framework was migrated to IFPP and there were significant updates in the ISSAIs for financial auditing. In CY20X0, the results of monitoring at the engagement level showed that there were audit practices that are no longer aligned with the updates in ISSAIs (i.e., reporting standards and risk assessment).			
Resources available to the SAI & **The types of reports that are issued** The SAI has existing financial audit methodology that requires auditors to evaluate misstatements. In relation thereto, SAI also has policy in determining materiality levels that the auditor may use throughout the audit. However, there are no specific guidance on how the evaluation is performed. Recently, there is an increase in the political interest and publicity of the audit reports due to the upcoming election. The audit reports were used in comparing financial management of various political officials who signified interest to run for another term in the public post.	2	Audit opinion rendered may not be appropriate in the circumstances due to lack of consistent and standardized method in evaluating misstatements.	9, 19
Resources available to the SAI & **Management style of leadership** The SAI's performance audit manual prescribes the use of Design Matrix to assist the audit teams in planning the audit and documenting the results of such planning. While the manual clearly states that the contents of the Design Matrix can be updated as the audit progresses, there were increasing complaints received from the audit teams that frequent updates on the Design Matrix created negative implication on their annual performance evaluation in the reason that changes in the document are indicative of poor planning. SAI's protocol in updating contents of the audit planning template involves submission of the superseded document, revised document content, and justification for the updates. The approval of the revised content usually takes more than three weeks to be completed.	3	Actual performance audit results may not be aligned with/supported by the audit works and designed and approved procedures in the planning stage.	8
Resources available to the SAI The SAI recently issued policy on audit sampling. The scope of the policy, however, excludes compliance audit engagements. Currently, SAI has created a working group to study and develop sampling policy and procedures for compliance audit.	4	The audit conclusion rendered may not be appropriate in the circumstances on the basis of audit samples which may not be representative of the population to provide sufficient basis in determining whether the subject matter complies with the compliance audit criteria.	19
SAI's strategic and operational processes The SAI follows its established strategic planning process in identifying audit focus areas during the particular period, including	5	The SAI may select, prioritize and allocate resources to audit	5

Conditions and events, circumstances, actions or inactions related to the SAI and its audit engagements	Identification of Quality Risks (QR)		
	QR No.	Description	Affected QO No.
the types of audits that the SAI will perform. The focus areas are determined based on the SAI's audit mandate and available resources in the SAI. The selection criteria are not specified in the SAI's established processes. The strategic planning is conducted by the Head of SAI and the top management.		areas that are not relevant and/or value-adding.	

<extracts from the suggested Quality Risk Management Template; quality objectives in the suggested template based on ISSAI 140 were used for illustration purposes>

There could be instances wherein a single quality risk affects multiple quality objectives similar with our example. On the other hand, it is also possible that there are multiple quality risks in a single quality objective. The SAI can also identify multiple risks in one condition or event noted.

4.2.   Assessment of Quality Risks

In assessing the quality risks, the SAI considers one or more of the following factors:

Likelihood

o   how frequently the condition, event, circumstance, action or inaction is expected to occur;

Impact

o   how the condition, event, circumstance, action or inaction would affect the achievement of the quality objectives;

o   how long it would take after the condition, event, circumstance, action or inaction occurred for it to have an effect, and the speed of response required to mitigate the effect of the condition, event, circumstance, action or inaction; and

o   how long the condition, event, circumstance, action or inaction would affect the achievement of the quality objective once it has occurred.

SAI may use the suggested rating provided below in assessing quality risk. Professional judgment is exercised to determine whether the likelihood or impact of the quality risk is 'High', 'Moderate, or 'Low'. For the significant judgement made, the justification for the assessment is documented in the quality risk management template. Based on these assessments, an overall risk rating is determined to help SAI in prioritizing quality risks that need to be provided with responses. The risk decision table below can assist the SAI in identifying priority risks:

Likelihood	Impact		
High	Moderate	High	High
Moderate	Low	Moderate	High
Low	Low	Low	Moderate
	Low	Moderate	High

Overall Risk Rating

The SAI needs to prioritise all quality risks with high overall risk rating – with high likelihood of occurrence and with material impact on the achievement of quality objectives when the risks materialise. Depending on the SAI's resources, quality risks with moderate and/or low overall rating may also be addressed.

> SAI focuses on significant quality risks with high likelihood of occurrence and that could materially affect the achievement of quality objectives.
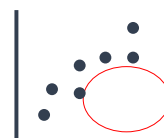
Examples:

Assessment of the identified quality risks

	Identification of Quality Risks (QR)		Assessment of Quality Risk		
QR No.	Description	Affected QO No.	Likelihood	Impact	Overall Risk Rating
1	The SAI's existing audit methodologies and tools may not enable the auditors to fully comply with ISSAIs.	8, 14, 19	☒ High ☐ Moderate ☐ Low	☒ High ☐ Moderate ☐ Low	☒ High ☐ Moderate ☐ Low
			Justification: There is a high likelihood of occurrence given that the SAI only created an ad-hoc working group involved in the study of the standards, and the activity did not continue after the adoption process. The risk also has a significant impact since auditors highly rely on the prescribed audit methodologies and tools in all their audits. The impact is expected to continue unless the SAI revisits the affected areas in the audit process. Also, there were already instances of non-compliance identified in the sample financial audits in the monitoring conducted in CY20X0.		
2	The audit opinion rendered may not be appropriate in the circumstances due to a lack of consistent and standardised method for evaluating misstatements.	9, 19	☐ High ☒ Moderate ☐ Low	☒ High ☐ Moderate ☐ Low	☒ High ☐ Moderate ☐ Low
			Justification: The likelihood of occurrence is assessed as moderate since reports undergo detailed review prior to issuance. Also, there were no deficiencies reported in the previous year. Given the lack of standardised guidelines which could make the reviews comparable, the impact is assessed as high since the risk affects the credibility of the SAI.		
3	Actual performance audit results may not be aligned with/supported by the audit works and designed and approved procedures in the planning stage.	8	☒ High ☐ Moderate ☐ Low	☐ High ☒ Moderate ☐ Low	☒ High ☐ Moderate ☐ Low
			Justification: The likelihood is assessed as High since the effectiveness of the auditor's planning strategy is included in the basic performance indicators assessed annually, thus, auditors are more likely to avoid making updates in the Design Matrix despite that there are changes in the audit circumstances to avoid the implication or notion of having poor planning. Although, analysis of the complaint cases shows that modifications to the Design Matrix are not indicative of poor planning, but are results of circumstances that are beyond the control of the audit teams. The impact is assessed as Moderate since actual audit results are expected to still reflect in the working papers in the conducting stage of the audit. The issue only affects the documentation requirement in the planning and approval of the planned procedures and strategy.		

Identification of Quality Risks (QR)			Assessment of Quality Risk		Overall Risk Rating
QR No.	Description	Affected QO No.	Likelihood	Impact	
4	The audit conclusion rendered may not be appropriate in the circumstances on the basis of audit samples which may not be representative of the population to provide sufficient basis in determining whether the subject matter complies with the compliance audit criteria.	19	☐High ☐Moderate ☒Low	☒High ☐Moderate ☐Low	☐High ☒Moderate ☐Low
			Justification: The likelihood is assessed as Low since the SAI has a wide practice of conducting 100% examination in almost all its compliance audits. Although the SAI is studying how compliance audits can benefit from audit sampling to properly manage its limited resources. The impact is assessed as High given that the audit conclusion communicated to stakeholders is involved affecting SAI's credibility.		
5	The SAI may select, prioritise and allocate resources to audit areas that are not relevant and/or non-value-adding.	5	☒High ☐Moderate ☐Low	☒High ☐Moderate ☐Low	☒High ☐Moderate ☐Low
			Justification: The likelihood is assessed as High since the selection criteria are not specified in the strategic planning which may result in inconsistencies of the basis and approaches in the selection. The impact is assessed as High since inappropriate selection of audit focus affects the overall direction of the SAI's audits and affects the audit impact.		

<extracts from the suggested Quality Risk Management Template>

4.3. Responses to the Assessed Quality Risks

The nature, timing and extent of the responses depend on the nature of the quality risk and should consider how the impact of the risk will be minimized. The SAI may design and implement multiple responses to address the assessed risks, however, it is the appropriateness of these responses which is critical.

In designing the response, the SAI considers the following:

o the nature, timing and extent of the response required <u>to ensure a proportionate response to mitigate the risk;</u>

o whether the response to the risk needs to be systematic across the institution, and/or at the level of individual engagements; and

o if the response needs to be documented and communicated to ensure consistent implementation.

When defining the nature of the response, the SAI considers whether one or combination of detective, preventive or corrective measures are needed to mitigate the risks. Description of the responses should be clear as to how they can address the quality risks. The responsible individual or group, and the specific circumstances need to be clearly identified.

The timeline of the response needs to be specified for proper monitoring, and whether the responses require continuous implementation. Quality risks affecting different areas in the SAI may need different responses with different timeline.

The extent to which the responses will be applied to SAI needs to be determined, whether the response will be implemented at the organisational level or at the audit level. Organisational level responses may require development or enhancement of existing SAI policies and procedures.

The implementation of the designed responses can be monitored using the suggested quality risk management template. Take note that the success of the implementation of responses to mitigate the risk will affect the evaluation of the risk assessment component.

ISSAI 140 provides examples of responses, which are not a comprehensive list of responses, as follows:

o establishment of policies and procedures for:

   o identifying, evaluating and addressing threats to compliance with the relevant ethical requirements; and

   o identifying, communicating, evaluating and reporting of any breaches of the relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner;

o obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent;

o establishment of policies and procedures for receiving, investigating and resolving complaints and allegations about failures to perform work in accordance with relevant requirements;

o establishment of policies and procedures that address situations when SAI is obliged by legal mandate or request to accept an engagement;

o establishment of policies and procedures that identify if and when an engagement quality review is an appropriate response to address one or more quality risks. These policies and procedures may address matters such as:

o   identification of specific engagements or types of engagements that require engagement quality reviews;

o   eligibility to serve as an engagement quality reviewer;

o   impairment of the engagement quality reviewer's eligibility to perform the engagement quality review; and

o   performance of the engagement quality review.

The concepts and process that can be followed in Engagement Quality Review can be found in Guidance No. 8.

Examples:

By following the example as shown below, the designed responses involve multiple actions by the SAI with different timelines to address effects experienced by the SAI and are expected to create additional issues in the future operations of the SAI:

Identification of Quality Risks (QR)		Risk Responses			
QR No.	Description	Description of Response	Target Timeline	Assigned to	Implementation Status
1	The SAI's existing audit methodologies and tools may not enable the auditors to fully comply with ISSAIs.	Disseminate the monitoring results to all engagement supervisors/audit directors in relation to their responsibilities in paragraph 39 of the revised ISSAI 2220, and require all affected engagement teams to obtain clearance that applicable deficiencies are addressed prior to issuance of the report.	Immediate – Prior to issuance of audit report (CY20X1)	All Audit Directors and engagement supervisors	☐Full ☐Partial ☒Not implemented
		Conduct a review of financial, compliance and performance audit manuals to identify the extent of potential revisions needed.	Within 2months (CY20X1)	Monitoring Teams	☐Full ☐Partial ☒Not implemented
		Enhance the affected portions in the audit manuals and conduct pilot testing prior to finalisation.	Enhancement – within 1 year (CY 20X2) Pilot and finalisation – within 1 year after revision (CY 20X3)	SAI's Technical Working Group Selected audit teams	☐Full ☐Partial ☒Not implemented
2	The audit opinion rendered may not be appropriate in the circumstances due to a lack of consistent and standardised method for evaluating misstatements.	Develop policy and guidelines including audit template in evaluating misstatements in relation to the SAI materiality policy.	Development of policy - within 6 months Pilot and finalisation – within 6 months	SAI's Technical Working Group Selected audit teams	☐Full ☐Partial ☒Not implemented
		Conduct training after adopting the SAI policy on evaluating misstatements.	Within 1 month after the adoption of the SAI policy.	All auditors Training Department	☐Full ☐Partial ☒Not implemented

Identification of Quality Risks (QR)		Risk Responses			
QR No.	Description	Description of Response	Target Timeline	Assigned to	Implementation Status
3	Actual performance audit results may not be aligned with/supported by the audit works and designed and approved procedures in the planning stage.	Revisit and revise the Key Performance Indicators in the Performance Evaluation Framework of the SAI to enhance the performance indicators to the extent that these indicators do not conflict with the objectives of the audit.	Within 3months (CY20X1)	Human Resource Department	☐Full ☐Partial ☒Not implemented
		Issue auditing alerts to all auditors containing information about the requirement in updating audit planning templates, circumstances when the need to update arises, approval process, and planned enhancement in the related key performance indicators.	Within 1 month (CY20X1)	IT Department Audit Department Heads	☐Full ☐Partial ☒Not implemented
4	The audit conclusion rendered may not be appropriate in the circumstances on the basis of audit samples which may not be representative of the population to provide sufficient basis in determining whether the subject matter complies with the compliance audit criteria.	Provide additional support, as necessary, to the study and development of sampling policy and procedures for compliance audit.	Development of policy - within 1 year Pilot and finalisation – within 2 years	SAI's Technical Working Group Head of SAI	☐Full ☐Partial ☒Not implemented
5	The SAI may select, prioritize and allocate resources to audit areas that are not relevant and/or non-value-adding.	Revisit the criteria used in the selection of audit focus. Determine the extent to which the stakeholder's expectations and emerging issues are considered in the selection. Determine the need to identify replacements for those topics that are not relevant or non-value-adding, if any. Consider specifying the selection criteria in the SAI's strategic planning process.	Review of selection - Within 1 month Enhancement of Strategic Planning Guidelines – Within 3 months	Strategic Planning Committee	☐Full ☐Partial ☒Not implemented

<extracts from the suggested Quality Risk Management Template>

Quality Risk No. 1

- The first response represents a corrective measure which targets other audit engagements with similar conditions to those sample audits subjected to monitoring. To ensure that similar existing deficiencies are addressed prior to the issuance of audit reports in the subsequent year (CY20X1), audit teams need to secure clearance that all applicable deficiencies are addressed. The second response acts as a detective measure to identify the potential extent of the effect of the risk in future audits. This monitoring will be done at the organisational level since it covers the intellectual resources of the SAI (i.e. audit methodologies and

tools). The result of this response will provide inputs to the third response. The third response is considered corrective and preventive measures since this response targets the root cause of the risk. If the audit manuals are updated to ensure compliance with the revisions and new pronouncements, it is expected that the risk will be minimised, if not eliminated in future audits.

Quality Risk No. 2

- For the second quality risk, two responses were provided. Given that the SAI already has a policy on materiality, the supposed policy on the evaluation of misstatements needs to supplement the former. For proper implementation, training is also needed since the evaluation may introduce new concepts which may not be consistent with the previous practices in the SAI.

Quality Risk No. 3

- The first response is a corrective measure that will address the cause of the risk. Once corrected, the risk of having outdated planning documents is not expected to transpire. While the revision is ongoing, issuing auditing alerts to top management performing the evaluation and all concerned auditors will help prevent the occurrence of the risk through the dissemination of relevant information.

Quality Risk No. 4

- Since the quality risk was assessed as "Moderate", the SAI does not prioritise the risk. In addition, the SAI already has an existing effort that will resolve the risk, thus the response provided is limited to additional support for such effort.

Quality Risk No. 5

- The first response is detective and corrective as it allows SAIs to correct deficiencies in the selection and provides information on whether the second response is needed which is a preventive measure.

The SAI needs to monitor the implementation of these responses based on the target timeline, and the quality risk management template needs to be revisited as needed to determine if there are new quality risks.

Documentation:

The entire risk assessment and response processes should be documented. The SAI may use the suggested template. To promote accountability, the documentation should be signed and approved by the risk assessment team or in accordance with the SAI policy.