IAASB Quality management – Exposure Drafts

Information and Discussion Session
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Quality management – ED-ISQM 1
Overview and background
Overview and background

Recap

1. Post implementation review of clarified ISAs (2013)
2. Issue of the ITC (2015)
3. IAASB approved quality management project (2016)
4. IAASB issued quality management exposure drafts (2019)

Findings indicated revisions, improvements or clarifications required
Overview and background

IAASB QM-EDs
• ED-ISQM 1
• ED-ISQM 2
• ED-220
• Deadline for comment 1 July 2019

SAICA activities
• Quality Control Reference Group
• Recordings
  – Video recordings
  – Voice recordings
• Articles
• Information session
• Survey
Overview and background

Relationship

ED-ISQM 1

ED-220

ED-ISQM 2
Overview and background

Effective date

- Anticipated - December 2021
Quality management – ED-ISQM 1

Introductory paragraphs
Introductory paragraphs

Scope
• Deals with firm’s responsibility to design, implement and operate a SOQM
• Includes
  – Audits or reviews of financial statements
  – Other assurance engagements
  – Related services engagements

Scalability
• Make standards practically useable by ALL firms
  – Nature and circumstance
• SOQM will change over time
  – In response to identified change
The firm’s SOQM

• Purpose
  – Support the consistent performance of quality engagements
  – Public interest role
  – Achieved by planning, performing and reporting in accordance with professional standards and legal and regulatory requirements

• Professional judgement and professional scepticism
  – Standards are principles-based
  – Required to be exercised to achieve the objective of quality engagements
The components of a SOQM

- Governance and leadership
  - Relevant ethical requirements
  - Acceptance and continuance
  - Engagement performance
- Resources
- Information and communication

Introductory paragraphs

Source: Explanatory Memorandum to ED-ISQM 1
Introductory paragraphs

Source: Explanatory Memorandum to ED-ISQM 1
Introduction paragraphs

Monitoring and remediation

1. Design and perform monitoring activities

2. Evaluate findings and identify deficiencies

3. Evaluate deficiencies

4. Respond to deficiencies

5. Communication

6. Evaluate the SOQM
Introductory paragraphs

Objective

• SOQM that provides the firm with reasonable assurance that
  – Firm and personnel fulfil their responsibilities
  – Issued reports are appropriate

• Consistent performance of quality engagements key to firm’s responsibility to act in the public interest
• Objective does not specifically mention public interest
• Link in paragraph 7 of ED-ISQM 1
Introductory paragraphs

Definitions
• Revisions made to this section

Changes worth noting
• New definition
  – Deficiency
• Revised definition
  – Engagement team
Introductory paragraphs

Requirements – Applying, and Complying with, Relevant Requirements

• Individuals must understand ED-ISQM 1 relevant to their responsibilities
  – Individual assigned ultimate responsibility and accountability for SOQM
  – Assigned operational responsibility

• Firms must comply with each and every requirement of ED-ISQM 1
Quality management – ED-ISQM 1
Governance and leadership
Governance and leadership

Why the need?
• Gap in requirements relating to leadership responsibilities

Overview of changes
• Based on the component *Leadership Responsibilities for Quality Within the Firm*
• Included as the first component in ED-ISQM 1
• Substantially enhanced to improve robustness of a firm’s governance and leadership
Governance and leadership

Comparison of changes

- Extant ISQC 1
  - Establish policies and procedures
  - Ultimate responsibility for a firm’s SOQC
    - Have sufficient and appropriate experience, ability and necessary authority

- ED-ISQM 1
  - Risk assessment process
    - Six prescribed quality objectives
    - Firm required to identify quality risks
    - Three prescribed responses
Governance and leadership

Source: Explanatory Memorandum to ED-ISQM 1
Governance and leadership

1. Firm’s culture
2. Firm’s leadership
3. Firm’s strategic decisions and actions
4. Organisational structure
5. Resources
6. Fulfillment of responsibilities

Quality objectives
Governance and leadership

- Assign ultimate responsibility
- Periodic performance evaluation
- Dealing with complaints and allegations

Required responses
Quality management – ED-ISQM 1
Risk assessment process
Risk assessment process

Source: Explanatory Memorandum to ED-ISQM 1
Risk assessment process

Why the need?

• Address key public interest issues
• Risk based approach
• Based on the nature and circumstances of the firm and the firm’s individual engagements
• Promoting continual improvement and responsiveness

Limitation

• SOQM provides reasonable and not absolute assurance
• Uncertainties and risks may exist that cannot be predicted
Risk assessment process

Overview of changes

• Integrated risk approach
• Professional judgment
• Focus on quality risks at both a firm and engagement level
Risk assessment process

Source: Explanatory Memorandum to ED-ISQM 1
Establishing quality objectives

Definition: Quality objectives – The objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management are achieved.

Source: Explanatory Memorandum to ED-ISQM 1
Risk assessment process

Identify and assess quality risks

Definition: Quality risks – Risks arising from conditions, events, circumstances, actions or inactions that may adversely affect the achievement of a quality objective(s).

Step 1:
Identify quality risks that:

• Have a reasonable possibility of occurring; and
• If they were to occur, may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective [ED-ISQM 1, par 28]

Step 2:
Assess the identified quality risks to provide a basis for the design and implementation of the related responses [ED-ISQM 1, par 29]
Risk assessment process

Source: Explanatory Memorandum to ED-ISQM 1

Identify and assess quality risks

Step 1: Identify the quality risks

- Quality risks (the whole population)

  Is there a reasonable possibility of the risk occurring?

    Yes

    Would the quality risk *individually* have a significant effect on the achievement of a quality objective(s)?

      No

      Yes

      Would the quality risk *in combination with other quality risks* have a significant effect on the achievement of a quality objective(s)?

        No

        No required further action

        Yes

Identified quality risk that is required to be assessed:
Assess the quality risk to provide a basis for the design and implementation of the related responses. In doing so, assess the possibility of the quality risk occurring and the effect on the achievement of a quality objective(s).
Risk assessment process

Design and implement responses

Definition: Response (in relation to a system of quality management) –
Policies or procedures designed and implemented by the firm to address an assessed quality risk

ED ISQM 1, paragraph 30
The firm shall design and implement responses to address the assessed quality risks, including the responses required by this ISQM.

The design of the responses shall be based on, and responsive to, the reasons for the assessments given to the quality risks.
Risk assessment process

Design and implement responses
Risk assessment process

Changes in nature and circumstances

The firm shall identify changes in the nature and circumstances of the firm or its engagements and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes [ED-ISQM 1, par 31] as a result of:

- Information arising from the firm’s monitoring activities;
- Changes in the nature and circumstances of the firm and / or its engagements
DRAFT EXAMPLES: HOW THE NATURE AND CIRCUMSTANCES OF THE FIRM AND THE ENGAGEMENTS IT PERFORMS AFFECT THE IMPLEMENTATION OF PROPOSED ISQM 1¹
Quality management – ED ISQM 1
Relevant Ethical Requirements
Relevant ethical requirements

Why the need?

• The rules of the game
• South African experiences
  – IRBA inspections report

“Many of the audit deficiencies identified during inspections can be attributed to a lack of independence as an underlying root cause...”
Relevant ethical requirements

Overview of changes

• Continues to be framework-neutral
• Updated to align with restructured and revised IESBA Code
• Principles-based approach

• ED-ISQM 1
  – Consideration of law, regulation or other ethical requirements
  – Risk assessment process
    • Three prescribed quality objectives
    • Firm required to identify quality risks
    • Four prescribed responses
Relevant ethical requirements

Quality objectives

WHO?
- Firm
- Personnel
- Others

WHAT?
- Understand the rules
- Play by the rules
- Respond to breaches
Relevant ethical requirements

Specific considerations

• Establish policies or procedures to
  – List the rules
  – Identify threats
  – Identify breaches
  – Communicate threats and breaches
  – Respond to threats and breaches
  – Obtain annual confirmations
Relevant ethical requirements

Integration with other components

Governance and leadership

• Aspects of the SOQM shall include operational responsibility for compliance with independence requirements

Communication and information

• Communication of independence matters
• Not specifically required in Relevant Ethical Requirements
• Addressed by the broader requirements Information and Communication
Relevant ethical requirements

Required responses

Identify relevant ethical requirements and determine the applicability

Establish policies or procedures

- Identification and evaluation of threats
- Identification, communication, evaluation and reporting

Annual confirmation of compliance with independence
Quality management – ED ISQM 1
Acceptance and Continuance of Client Relationships and Specific Engagements
Acceptance and continuance

Why the need?

• Recent international experiences
• South African experiences
  – IRBA inspections report

“Numerous issues have been identified, including firms not sufficiently weighing up the risks in relation to the perceived benefits of taking on an audit client; commercial interests outweighing audit quality considerations; the risk of association with clients whose integrity may be lacking; and a general risk of damaging the reputation of not only the firm but also the profession as a whole.”
Overview of changes

• New requirements
  – Financial and operational priorities do not inappropriately influence acceptance and continuance
  – Firm to determine whether it has access to information/persons

• ED-ISQM 1
  – Risk assessment process
    • Four prescribed quality objectives
    • Firm required to identify quality risks
    • Prescribed responses
      – The firm shall include policies and procedures
Acceptance and continuance

Quality objectives

Firm obtains sufficient appropriate information about

- nature and circumstances of the engagement
- client integrity and values

Firm’s ability to perform the engagement appropriately, including

- Required resources
- Access to information / persons

Firm’s financial and operational priorities

Firm responds appropriately

Judgements appropriate
Acceptance and continuance

Specific considerations

• How did the client get to us? Do you insist on referrals?
• Acceptable financial reporting framework?
• Do we accept any financial condition?
• Any industry or sectors you avoid?
• Any tax conditions?
• State of accounting records?
• Does the partner have the skills, experience and time?
• Access to those charged with governance
Quality management ED-ISQM 1

Engagement performance
Engagement performance

Source: Explanatory Memorandum to ED-ISQM 1
Engagement performance

Why the need?
• In general
  – Maintain and enhance robustness of standard
  – Principles-based versus previous rule-based
  – Scalability
• Professional scepticism project

Overview of changes
• Change in terminology from EQCR to EQR
• EQR
  – firm-level response to quality risk(s) in ED-ISQM 1
• Engagements requiring EQR
  – proposed to strengthen
• Eligibility criteria and review requirements now in ED-ISQM 2
## Engagement performance

### Comparison of changes

<table>
<thead>
<tr>
<th>Extant ISQC1</th>
<th>Para</th>
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<td></td>
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<td>and scepticism</td>
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</tbody>
</table>
Engagement performance

Comparison of changes

• Includes requirements from extant ISQC 1 addressing
  – direction, supervision and review,
  – consultation,
  – differences of opinion,
  – retention and maintenance of documentation
• Addresses exercise of professional judgement and professional scepticism by engagement teams
• Required response for firm to perform EQRs

• ED-ISQM 1
  – Risk assessment process
    • Three prescribed quality objectives
    • Firm required to identify quality risks
    • Six prescribed responses
Engagement performance

Quality objectives

- Personnel understand and fulfill their responsibilities
- Engagement team exercises appropriate professional judgement and, where applicable professional scepticism
- Engagement documentation appropriately assembled and retained
Engagement performance

Required Responses

Includes requirements from extant ISQC 1 addressing

- direction, supervision and review
  - ED-ISQM 1 establishes overarching requirements
  - ED-ISA 220 builds on these requirements
- communication, consultation, differences of opinion, and retention and maintenance of documentation

Required response for firm to perform EQRs

New EQR requirement: Significant public interest
Engagement performance

Significant public interest

Large number and wide range of stakeholders

ED-ISQM 1: Application material describing the characteristics

Nature and size of the business

May include financial institutions and certain not-for-profit organisations
Quality management – ED-ISQM 1

Resources
Resources and Information and Communication

Source: Explanatory Memorandum to ED-ISQM 1
Resources

Why the need?

• Extant ISQC 1 only addresses human resources
• Increased use of technology in
  – Performing engagements
  – Facilitating operation of systems of quality management
• Intellectual resources essential to enabling performance of quality engagements

Overview of changes

• New principles-based requirements included for
  – Technological resources
  – Intellectual resources
## Resources

### Comparison of changes

<table>
<thead>
<tr>
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<td></td>
<td></td>
<td>Intellectual resources</td>
<td>38(f)-(g)</td>
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</table>
Resources

Comparison of changes

• Extant ISQC 1 only addresses human resources
  – Establish policies and procedures
    • Engagement performed in accordance with applicable standards
    • Reports issued are appropriate
    • Identification and role of EP communicated to TCWG
    • Assign appropriate personnel with necessary competencies and capabilities
  – Assign responsibility for the engagement to the EP
    • Has appropriate competence, capabilities and authority
    • Responsibilities of the EP are clearly defined.

• ED-ISQM 1
  – Risk assessment process
    • Seven prescribed quality objectives
    • Firm required to identify quality risks
    • Prescribed response
      – Firms required to design and implement responses to address identified and assessed risks
Resources

Quality objectives

**Human resources**

- Enhanced requirements for attracting, developing and retaining personnel with the appropriate competence and capabilities to fulfill their functions, and assigning personnel to engagements
- New requirements addressing evaluation of personnel and personnel’s compensation, promotion and other incentives, which are linked to quality

**Technological resources**

- New requirements for obtaining or developing, implementing and maintaining technological resources
- IT terminology aligned with proposed ISA 315 (Revised)

**Intellectual resources**

- New requirements for obtaining or developing, implementing and maintaining intellectual resources
- Includes methodology, guidance or other support tools
Resources

Required responses

None specified
Firm to design and implement
Application material for quality objectives
Quality management – ED-ISQM 1
Information and communication
Information and communication

Why the need?
• Extant ISQC 1 does not
  – Address the broader need for information and communication
  – Acknowledge the nature of two way communication

Overview of changes
• New component
  – Information system / platform
  – Effective two-way communication within firm
  – Responsibility of all personnel
  – Robust communication during engagements

• Communication with external parties
  – All forms of communication with external parties
  – Aims to promote exchange of valuable information about firm’s SOQM with stakeholders
  – Transparency reports, not required but encouraged
## Information and communication

### Comparison of changes

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<thead>
<tr>
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<tr>
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<td>Information and communication</td>
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<tr>
<td>Relevant ethical requirements</td>
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<td>Human Resources</td>
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<td></td>
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<td>Responses</td>
<td>41(a)-(c)</td>
</tr>
</tbody>
</table>
Information and communication

Comparison of changes

• Extant ISQC 1 does not include a separate Information and Communication element

• Addressed in other elements
  – Relevant ethical requirements
  – Human resources
  – Monitoring

• ED-ISQM 1
  – Risk assessment process
    • Five prescribed quality objectives
    • Firm required to identify quality risks
    • Three prescribed responses
Information and communication

Quality objectives

New requirement to have an information system / platform that supports the SOQM

- Information system may be less sophisticated in the case of an SMP

New requirement to ensure robust, two way communication

- Firm communicates relevant and reliable information, sufficient to enable personnel to understand and carry out their responsibilities
- Personnel communicate relevant and reliable information to the firm

New requirement for all personnel to take responsibility for exchange of information and communication

New requirements addressing external communication on the firm’s SOQM
Information and communication

Required responses

- Establish communication policies or procedures
- Communicating responsibility for implementing firm’s responses to personnel
- New requirements addressing external communication
  - Principles-based approach
  - Addresses communication with networks, service providers and other external parties
  - Transparency reports not required, firms encouraged
QUALITY MANAGEMENT – ED ISQM 1

Monitoring and remediation process
Monitoring and remediation process

Why the need?

- Monitoring of the entire system, not only engagement inspections
- Addressing the results of external inspections
- Understanding the root cause of findings, implementing remedial actions to respond to findings, and monitoring the effectiveness of remedial actions
Monitoring and remediation process

Source: Explanatory Memorandum to ED-ISQM 1
Monitoring and remediation process

Designing and performing monitoring activities

- Monitoring activities should cover the system as a whole
- More focus on tailoring the nature, timing and extent of monitoring activities to the circumstances of the firm
- Less prescriptive (firm has to design own monitoring activities)
- More flexibility in terms of monitoring of completed engagements
- Enhanced requirements addressing eligibility of those performing monitoring activities
Monitoring and remediation process

Evaluating findings and identifying deficiencies

- Evaluating findings from internal monitoring activities, external inspections and other information sources
- Positive findings require no further action
- Distinguish between negative findings and a deficiency
- Definition for deficiency
Monitoring and remediation process

Evaluating identifying deficiencies

- Investigate the root cause (taking into account the nature and severity of the deficiency)
- Evaluating the severity and pervasiveness of the identified deficiency
Monitoring and remediation process

Responding to deficiencies

• Less prescriptive (firm has to design own remedial actions)
• Evaluate the remedial actions
Monitoring and remediation process

Communication related to monitoring and remediation

- Internal
  - Firm leadership and relevant personnel

- External Network
  - Service providers and other stakeholders
Monitoring and remediation process

Evaluating the system of quality management

- Individual with ultimate responsibility has to evaluate
- At least annually
- If it is not effective, leadership required to take prompt and appropriate action
Monitoring and remediation process

Link to risk assessment process

- Continuous improvement
  - Key aspect of the quality management approach
- Trigger to revisit quality objectives, quality risks and responses
  - Information arising from the firm’s monitoring activities
Quality management – ED-ISQM 1

Networks
Service providers
Networks

Why the need?
• Networks can be instrumental in enhancing quality across firms
• Concerns raised
  – firms place undue reliance on network requirements or network services

Overview of changes
• ED-ISQM 1
  – New separate section
    • Separate concept
    • Increased prominence
  – New requirements
    • Improve robustness of firm’s responsibilities for network requirements / services
    • Firms to understand network requirements / services & effect on firm’s SOQM

• Firm responsible for own SOQM
## Networks

### Comparison of changes

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<td>Monitoring &amp; remediation process</td>
<td>60-63</td>
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Networks

Comparison of changes

Extant ISQC 1

• Networks included under Monitoring

ED-ISQM 1

• No requirements for networks themselves
• New requirements to address the firm’s responsibilities:
  – Understand the network requirements or network services and the firm’s responsibilities
  – Determine the effect of the network requirements and network services on the firm’s system of quality management
  • Determine whether they need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management
Networks

Comparison of changes

ED-ISQM 1

• Determine the **effect of network level monitoring activities** on the firm’s monitoring activities **and the firm’s responsibilities** in relation to such monitoring activities
• Enhanced requirements addressing **matters to be communicated between the firm and the network**
• Requirements for networks apply to the **network, network firms or another structure or organisation in the network**
Networks

Overview of requirements

The firm shall understand

- Requirements established by the network
- Any services/resources provided by the network
- The firm’s responsibilities

Risk assessment process

- The firm shall determine the effect of the network requirements/services on the risk assessment process

Monitoring

- The firm shall determine the effect of network monitoring activities on the firm monitoring activities
- Determine the firm responsibilities
- Obtain results of monitoring activities from the network
Networks

Overview of requirements

Remediation

- The firm shall, at least annually obtain information from the network
- Consider the effect of such information on the nature, timing and extent of monitoring activities of the firm
- Communicate information to personnel
- The firm shall communicate any deficiencies identified in the network requirements

Identified deficiencies, the firm shall

- Understand the planned remedial action by the network
- Understand whether the network remedial actions address the identified deficiency
- Determine the supplementary actions needed
Service providers

Why the need?
• Firms may use service providers in a SOQM
• Service provider
  – Resource
  – Therefore firms need to assess if appropriate to use that resource in SOQM

Overview of changes
• Responsibility of firm, but
  – Likely to also have effect on service providers
## Service providers

### Comparison of changes

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<td>Deficiencies in resources provided by service provider</td>
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Service providers

Overview of requirements

New requirements that apply to circumstances when the firm uses **resources from an external party**

- Includes using an external party in the performance of engagements
- Service from the network, network firms or another structure or organization in the network form part of network requirements or network services

Similar concepts to those relating to networks:

- The firm needs to **understand the services and determine that they are appropriate for use** by the firm
- Where **deficiencies** are identified, the firm must understand **planned remedial actions by service provider** and determine **firm’s supplementary remedial actions**
QUALITY MANAGEMENT – ED
ISQM 1

Documentation
Documentation

Two-step approach

- **Principles-based requirement** for documentation to be sufficient to support understanding of SoQM, consistent implementation and evidence to support the evaluation of the SoQM

- **More specific requirements** addressing:
  - Quality objectives, quality risks and responses
  - Monitoring and remediation
  - Networks and service providers
Thank you