NZ AUDITING AND ASSURANCE STANDARDS BOARD

Board Meeting Agenda

13 February 2018
9.15 am to 5.00pm

XRB Offices, Level 7, 50 Manners Street, Wellington

Est. Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
10.15 am	*Morning tea*				
B: PUBLIC SESSION					
10.30 am	**3**	**Service Performance Information**			
	3.1	Board meeting summary paper	Note	Paper	31
	3.2	NZ AS 1 (Mark-up)	Consider	Paper	32
	3.3	NZ AS 1 (Clean)	Approve	Paper	97
	3.4	Signing memorandum	Approve	Paper	159
	3.5	Explanations for decisions made	Approve	Paper	164
11.15 am	**4**	**ED NZ SRE 2410**			
	4.1	Board meeting summary paper	Note	Paper	178
	4.2	Invitation to comment	Approve	Paper	180
	4.3	Exposure draft	Approve	Paper	193
11.45 pm	**5**	**Meet with the Auditor-General**			
	5.1	Board meeting summary paper			246
12.45 pm	*Lunch*				
1.30 pm	**6**	**Update on Living Standards Framework**			
	6.1	Board meeting summary paper	Note	Paper	247
2.30 pm	**7**	**Alternative Engagement Project**			
	7.1	Board meeting summary paper	Note	Paper	249
	7.2	Issues paper	Consider	Paper	251
	7.3	Review vs IE	Note	Paper	247
3:15 pm	*Afternoon tea*				
3:30 pm	**8**	**IAASB's Quality management exposure drafts**			
	8.1	Board meeting summary paper	Note	Paper	264
	8.2	Proposed covering explanatory memorandum (EM)	Note	Paper	267
	8.3	Proposed ISQM 1 EM	Note	Paper	304
	8.4	Proposed ISQM 2 EM	Note	Paper	406
	8.5	Proposed ISA 220 (Revised) EM	Note	Paper	437
	8.6	Outreach plan (LATE PAPER)	Consider	Paper	-
4:15 pm	**9**	**Environmental Scanning**			
	9.1	International monitoring update	Note	Paper	487

Est. Time	Item	Topic	Objective		Page
	9.2	Domestic monitoring update	Note	Paper	503
	9.3	Academic update	Note	Paper	506
C: NON-PUBLIC SESSION					

Next meeting: 10 April 2019, Wellington

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	3.1
Meeting date:	13 February 2019
Subject:	NZ AS 1 The Audit of Service Performance Information
Date:	January 2019
Prepared by:	Misha Pieters

X	**Action Required**		**For Information Purposes Only**

Agenda Item Objectives

To approve the issue of NZ AS 1 *The Audit of Service Performance Information.*

Background

1. In October the NZAuASB agreed to revert back to the term "service performance criteria". An amended draft of NZ AS 1 was provided to the Office of the Auditor-General (OAG) who provided detailed comments. The mark up of amendments made subsequent to the October meeting has not yet been considered by the Board in detail (although where included, but not marked up, in the feedback received from the OAG).

2. The NZAuASB considered the OAG's detailed comments at the December meeting.

3. Agenda item 3.2, the mark-up of NZ AS 1, includes both the changes made subsequent to the October Board meeting, largely to revert back to service performance criteria. In addition, it incorporates the amendments suggested by the OAG which the Board agreed to in December, highlighted in yellow). For those suggestions that the Board did not agree to, staff have provided feedback to the OAG staff to explain the rationale of the Board.

Next steps

4. The Board is asked to approve:

- NZ AS 1 for issue;
- The draft signing memorandum;
- The explanations for decisions made.

Material Presented

Agenda item 3.1	Board Meeting Summary Paper
Agenda item 3.2	Mark up reflecting October and December discussion
Agenda item 3.3	NZ AS 1 (Clean)
Agenda item 3.4	Draft signing memorandum
Agenda item 3.5	Draft explanation for decisions made

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NEW ZEALAND AUDITING STANDARD 1

The Audit of Service Performance Information

Issued [date]

This Standard was issued on [*date*] by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [*date*].

An auditor that is required to apply this Standard is required to apply it for audits of service performance information included in the general purpose financial report for periods beginning on or after 1 January 2021. However, early adoption is permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued as a result of the issue of financial reporting requirements in New Zealand that require the inclusion of service performance information within general purpose financial reports that are subject to audit.

DRAFT

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ISBN xxx

NEW ZEALAND AUDITING STANDARD 1

THE AUDIT OF SERVICE PERFORMANCE INFORMATION

Issued by the New Zealand Auditing and Assurance Standards Board

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Appendix 1: What Constitutes the General Purpose Financial Report

Appendix 2: ~~The Selected Service Performance and Methods Used to Measure, Describe, Aggregate, Present and Disclose the~~ Service Performance Criteria

Appendix 3: Flowchart of the Audit of Service Performance Information included in the General Purpose Financial Report

Appendix 4: Illustrative Engagement Letter Including Service Performance Information

Appendix 5: Illustrative Representation Letter Including Service Performance Information

Appendix 6: Illustrative Auditor's Report Including Service Performance Information

Appendix 7: Illustrations of Auditor's Reports with Modifications to the Opinion with Respect to the Service Performance Information

Conforming Amendments to Other Pronouncements

Accompanying Attachment: Conformity to International and Australian Standards on Auditing

New Zealand Auditing Standard (NZ AS) 1, *The Audit of Service Performance Information*, should be read in conjunction with ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*.

History of Amendments

Table of pronouncements – NZ AS 1 *The Audit of Service Performance Information*

This table lists the pronouncements establishing and amending NZ AS 1.

Pronouncements	Date approved	Effective date
New Zealand Auditing Standard 1		This NZ AS is effective for audits of service performance information included in the general purpose financial report for periods beginning on or after 1 January 2021.

Introduction

Scope of this NZ AS

1. This New Zealand Auditing Standard (NZ AS) deals with the auditor's responsibilities with respect to service performance information when an auditor is engaged to audit the general purpose financial report. The auditor performs the audit of the service performance information concurrently with the audit of the financial statements. (Ref: Para. A1)

2. This NZ AS establishes requirements and provides guidance not addressed by other International Standards on Auditing (New Zealand) (ISAs (NZ)) with respect to service performance information. (Ref: Para. A2)

3. This NZ AS applies when the auditor is required by law or regulation or is otherwise engaged to audit the general purpose financial report, that is, engaged to audit both the financial statements and the service performance information. For purposes of this NZ AS, the financial statements and the service performance information are collectively referred to as the general purpose financial report. (Ref: Para. A3-A5, Appendix 1)

4. This NZ AS is not applicable when a review engagement is to be performed on the general purpose financial report.

Effective Date

5. This NZ AS is effective for audits of service performance information included in the general purpose financial report for periods beginning on or after 1 January 2021. Early adoption is permitted.

Objectives

6. The objectives of the auditor are:

   (a) To understand the process applied by the entity to select what and how to report on its service performance;

   (b) To evaluate whether the ~~selected service performance and the methods used to measure, describe, aggregate, present and disclose the~~ entity's service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework;

   (c) To obtain reasonable assurance about whether the service performance information included in the general purpose financial report is free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on the service performance information;

   (d) To report, in accordance with the auditor's findings, about whether the service performance information included in the general purpose financial report is prepared, in all material respects in accordance with the applicable financial reporting framework; and

   (e) To communicate further as required by the ISAs (NZ) and this NZ AS, in accordance with the auditor's findings.

Commented [MP1]: Suggest FAQ to deal with the difference between service Performance (the subject matter) and service performance information (the subject matter information).

It may not be necessary to draw out selection as the definition of criteria covers the "what" (goods and services) and the "how" (measure describe…)

Definitions

7. For the purposes of this NZ AS, the following terms have the meanings attributed below:

   (a) General purpose financial report – Comprise the financial statements and service performance information and, where applicable, entity information, prepared in accordance with the applicable financial reporting framework. The general purpose financial report may be referred to as a Performance Report. (Ref: Appendix 1)

   (b) Long-form report – Auditor's report including information and explanations that are intended to meet the information needs of intended users but not to affect the auditor's opinion. (Ref: Para. A69–A71)

   (c) Misstatement – A difference between the selection, measurement, description, aggregation, presentation, or disclosure of service performance information and the selection, measurement, description, aggregation, presentation or disclosure that is required for the information to be in accordance with the applicable financial reporting framework. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions. Misstatements can arise from error or fraud.

   (d) Other information – Financial or non-financial information (other than the financial statements, service performance information, entity information, if applicable and the auditor's report thereon) included in an entity's annual report. (Ref: Para. A5, Appendix 1)

   (e) Risk of material misstatement – The risk that the service performance information is materially misstated.

   (f) ~~Methods to measure, describe, aggregate, present and disclose the entity's service performance – the applicable criteria[1] used to measure or evaluate the entity's service performance. The methods are entity specific, developed to tell the entity's own performance story. The methods are required to be in accordance with the principles of the applicable financial reporting framework.~~Service performance criteria – The selection of goods and/or services being reported on, and the performance measures and/or descriptions used to evaluate the entity's service performance for a particular engagement. ~~Suitable criteria include criteria for presentation and disclosure.~~ (Ref: Para. A6–A8)

Commented [MP2]: I think this is ok still

Commented [MP3]: Include in application material as it relates to what is suitable rather than what the criteria means. See A8.

Requirements

Conduct of the Engagement in Accordance with ISAs (NZ)

8. The auditor shall apply the ISAs (NZ) and this NZ AS when auditing service performance information, as appropriate. Where an entity is required to include entity information within the general purpose financial report, and the auditor is engaged to audit the general purpose financial report, the auditor shall also apply the ISAs (NZ) and this NZ AS to the entity information, as appropriate. (Ref: Para. A9–A12, Appendix 1)

9. The auditor shall not represent compliance with this NZ AS unless the auditor has complied with the requirements of both this NZ AS and the ISAs (NZ).

~~[1] EG Au1A *Framework for Assurance Engagements*, paragraph 42~~

General Principles of an Audit of the General Purpose Financial Report

10. The auditor shall plan and perform the audit by exercising professional judgement and with an attitude of professional scepticism, recognising that circumstances may exist that cause the service performance information to require a material adjustment for it to be prepared in all material respects, in accordance with the applicable financial reporting framework.

Agreement on Audit Engagement Terms

11. The terms of the audit engagement shall include:[2] (Ref: Para. A13)

    (a) The responsibilities of the auditor with respect to the service performance information:

        i. To obtain an understanding of the process applied by the entity to select what and how to report its service performance;

        ii. To evaluate whether the ~~selected service performance and the methods used to measure, describe, aggregate, present and disclose the service performance~~service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework;

        iii. To evaluate the overall presentation, structure and content of the general purpose financial report and whether the general purpose financial report represents the underlying transactions, events and service performance in accordance with the applicable financial reporting framework.

    (b) The responsibilities of those charged with governance, including that they acknowledge and understand their responsibility on behalf of the entity for:

        i. The preparation of service performance information in accordance with the applicable financial reporting framework;

        ii. ~~The selected service performance and the methods used to measure, describe, aggregate, present and disclose the entity's service performance~~Service performance criteria that are suitable in order to prepare service performance information in accordance with the applicable financial reporting framework;

        iii. Such internal control as those charged with governance determine is necessary to enable the preparation of the service performance information that is free from material misstatement, whether due to fraud or error;

    (c) Reference to the expected form and content of the auditor's report, including whether it will be a long-form report, including additional information about the ~~selected service performance, or the methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria, detailed findings or recommendations to meet the needs of the intended users.

Documentation

12. The auditor shall document the nature, timing and extent of the audit procedures performed

Commented [MP4]: In Dec the Board agreed to retain this order reflecting that the applicable financial reporting framework is the overarching umbrella

[2] ISA (NZ) 210, paragraph 9-10

to comply with this NZ AS.[3] (Ref: Para. A14)

13. The audit documentation shall, as far as possible, provide evidence of the correlation between the audit evidence obtained related to the financial statements and the service performance information.

Laws and Regulations

14. The auditor shall obtain an understanding of:

    (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and, in particular, laws and regulations that specify the form, content, preparation and audit of service performance information; and

    (b) How the entity is complying with that framework.

15. The auditor shall obtain sufficient appropriate audit evidence that the entity has complied with laws and regulations that have a direct effect on the reporting of service performance information.[4]

Communication with Those Charged with Governance

16. The auditor shall communicate the following matters with those charged with governance:[5]

    (a) The auditor's views about significant judgements made in reporting the entity's service performance information, including any significant deficiencies or areas for improvement~~. For example, why the auditor considers the selected service performance or methods used to measure, describe, aggregate, present and disclose the service performance are not suitable to the circumstances~~; (Ref: Para. A15)

    (b) Matters involving non-compliance with laws and regulations with respect to service performance reporting obligations; and

    (c) Deficiencies in internal control with respect to the service performance information that, in the auditor's professional judgement, are of sufficient importance to merit attention.

Commented [MP5]: Move to application material

Planning

17. The auditor shall develop the audit plan to concurrently cover the financial statements and the service performance information so that the audit is performed in the most effective manner and reflects the correlation between the service performance information and the financial statements.[6]

18. In establishing the overall audit strategy, the auditor shall:

    (a) Obtain an understanding of the applicable financial reporting framework relevant to service performance information;

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[3] ISA (NZ) 230, *Audit Documentation*, paragraphs 7-16

[4] ISA (NZ) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

[5] ISA (NZ) 260 (Revised), *Communication with Those Charged with Governance*, paragraph 14-17

[6] ISA (NZ) 300, *Planning an Audit of Financial Statements*, paragraph 7

(b) Obtain an understanding of the entity's process for ~~understanding~~ identifying ~~who~~ the intended users, ~~are~~ and the decisions that may be influenced by the service performance information;

(c) Consider the factors that, in the auditor's professional judgement, are significant in directing the engagement team's efforts in respect of the audit of service performance information.

19. The auditor shall discuss with those charged with governance where and how the entity intends to report its service performance information. (Ref: Para. A16)

20. When planning the audit of the service performance information~~If the entity intends to report service performance information about service performance provided by other entities~~, the auditor shall~~, where applicable~~:

(a) Where a service organisation is used, ~~O~~obtain an understanding of the nature and significance of the services provided by the~~a~~ service organisation and their effect on the user entity's internal control relevant to the audit of the service performance information, sufficient to identify and assess the risks of material misstatement and design and perform audit procedures responsive to those risks in accordance with ISA (NZ) 402.[7] (Ref: Para. A17)

(b) Where the service performance information relates to a group, ~~O~~obtain sufficient appropriate audit evidence regarding the service performance information of the components and the consolidation process to express an opinion on whether the group's service performance information is prepared, in all material respects, in accordance with the applicable financial reporting framework.[8] (Ref: Para. A17)

(c) Where the service performance information includes information upon which another practitioner has expressed an opinion, ~~C~~communicate clearly with the other practitioner, when the auditor intends to use the work of another practitioner, about the scope and timing of the work and findings of the other practitioner and evaluate the sufficiency and appropriateness of evidence obtained and the process for including related information in the service performance information. (Ref: Para. A18)

~~when planning the audit of the service performance information~~.

Commented [MP6]: Drafting edits discussed in Dec to address clarity concern of OAG.

Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing Risks of Material Misstatement

Obtaining an Understanding of the Entity and Its Environment

21. The auditor shall obtain an understanding of: (Ref: Para. A19–A24)

(a) The service performance of the entity and the context in which the entity operates;

(b) The entity's process for identifying what ~~service performance to report on~~ and how to report on ~~the methods used to measure, describe, aggregate, disclose and present~~ its

[7] ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

[8] ISA (NZ) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

service performance, as well as what other options were considered;

(c) Whether the ~~selected service performance and the methods used to measure, describe, aggregate, disclose and present its~~ service performance criteria will generate service performance information that is consistent with and clearly linked to the entity's overall purpose and strategies;

(d) How much discretion the entity has in selecting ~~what service performance to report on and the methods used to measure, describe, aggregate, present and disclose~~ the service performance criteria~~in accordance with the applicable financial reporting framework~~;

(e) The extent to which consultation with intended users influenced the ~~selection of service performance and the methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria; and (Ref: Para. A22–A24)

(f) The judgements made in deciding when to provide comparative narrative and descriptive information.

Suitability

22. The auditor shall evaluate whether the ~~selected service performance and methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework, in that they exhibit the following characteristics: (Ref: Para. A25-A30)[9]

(a) Relevance (Ref: Para. A31)

(b) Completeness (Ref: Para. A32)

(c) Reliability (Ref: Para. A33)

(d) Neutrality (Ref: Para. A34)

(e) Understandability (Ref: Para. A35).

23. The auditor shall evaluate whether:

(a) ~~Whether, if~~ I~~i~~n the auditor's judgement, significant aspects of service performance have been excluded, that have been, or could readily be, measured and/or described, ~~whether~~ and if such exclusions are reasonable in the circumstances; or (Ref: Para A36~~9~~–A38~~41~~)

(b) ~~Whether~~ T~~t~~he service performance information inappropriately attributes service performance to the entity.

Commented [MP7]: Superfluous reference to FRS 48

Commented [MP8]: Agreed to retain in December. Consider is needed and makes sense in the lead in obtain an understanding of the judgements made....

Commented [MP9]: NZAuASB agreed to re-order and to refine at the October meeting.

[9] The applicable financial reporting framework may describe different qualitative characteristics to these characteristics which align with the characteristics referred to in Appendix 2 of ISA (NZ) 210. The application material in paragraphs A39-A43 may need to be tailored to the applicable financial reporting framework. This is illustrated in Appendix 2.

Availability

24. The auditor shall evaluate whether the ~~entity's methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria are available to intended users so as to enable intended users to understand ~~the methods~~ how the service performance information has been prepared, including~~and~~ any underlying assumptions. ~~underlying the information, for example, disclosed in the judgements reported as part of the service performance information or by cross reference.~~ (Ref: Para. A3~~96~~–A41~~38~~)

25. If the entity has changed ~~what service performance it reports on or the methods used to measure, describe, aggregate, present and disclose~~ its service performance criteria from the prior period, the auditor shall evaluate whether the changes are suitable in the circumstances, have been approved appropriately, and are explained within the service performance information.

Communication

26. If the auditor considers that all or some of the entity's service performance information:

    (a) Fails to comply with the applicable financial reporting framework;

    (b) Is prepared using ~~methods to measure, describe, aggregate, present and disclose the~~ service performance criteria that are not suitable; or

    (c) Otherwise fails to provide a reasonable basis for fairly reporting the service performance of the entity;

    the auditor shall discuss the matter with those charged with governance as soon as ~~possible~~practicable. (Ref: Para. A42)

27. The auditor shall determine:

    (a) Whether the matter can be resolved to the auditor's satisfaction;

    (b) Whether further audit procedures can be performed with respect to the service performance information; or (Ref: Para. A43)

    (c) Whether, and if so, how to communicate the matter in the auditor's report where the matter is not resolved to the auditor's satisfaction.

28. In the circumstances described in paragraph 26, the auditor shall consider the implications for the audit, the auditor's report and the opinion and shall express a qualified, adverse, or a disclaimer of opinion, as appropriate in the circumstances, with respect to the service performance information. (Ref: Para. A73–A79)

29. In the circumstances described in paragraph 28, the auditor is not required to withdraw from the audit of the general purpose financial report but shall consider the impact of the modified opinion with respect to the service performance information on the opinion on the financial statements.

Obtaining an Understanding of the Entity's Internal Control

30. The auditor shall: [10]

Commented [MP10]: Consider covered in application material – A41

Commented [MP11]: A42 already explains that the purpose is to enable improvements in a timely manner so no further application material needed.

[10] ISA (NZ) 315 (Revised), paragraph 12

(a) Obtain an understanding of internal control relevant to the audit over the preparation of the service performance information; and

(b) Evaluate the design of those controls and determine whether they have been implemented as designed. (Ref: Para. A44)

Materiality in Planning and Performing the Engagement

31. The auditor's consideration of materiality shall include both an evaluation of:

(a) Whether the ~~judgements made by the entity in selecting what service performance to report on and the methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria are suitable as required by paragraph 22; and (Ref: Para. A31–A35, A45–A48, ~~A31–A35~~)

(b) Individual and collective misstatements in the reported service performance information, that based on the auditor's judgement, are likely to significantly influence the decisions of the intended users based on the information. (Ref: Para. A49–A53)

32. The auditor shall determine and document materiality levels and/or materiality factors to be applied to the service performance information for the purpose of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.[11] (Ref: Para. A48–A53)

33. The auditor shall revise the judgements made in determining materiality for the service performance information if matters come to the auditor's attention during the audit that would have caused the auditor to have determined different materiality levels or materiality factors initially.

Identifying and Assessing Risks of Material Misstatement

34. The auditor shall identify and assess the risks of material misstatement, whether due to fraud or error: [12]

(a) At the service performance information level; and

(b) At the assertion level for performance measures, descriptions or disclosures where there is a reasonable possibility of material misstatement

through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement in accordance with ISA (NZ) 315 (Revised).[13] (Ref: Para. A51, A54–A56)

[11] ISA (NZ) 320, *Materiality in Planning and Performing an Audit*, paragraph 10 and 14

[12] ISA (NZ) 315 (Revised), paragraph 25

[13] ISA (NZ) 315 (Revised), paragraph 5

The Auditor's Responses to Assessed Risks

35. The auditor shall design and perform procedures whose nature, timing and extent[14]:

    (a) Are responsive to assessed risks of material misstatement at the service performance information level and at the assertion level; and

    (b) Allow the auditor to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement. The auditor's procedures shall include obtaining sufficient appropriate audit evidence as to the operating effectiveness of the relevant controls over the service performance information when:

        (i) The auditor's assessment of the risk of material misstatement includes the expectation that controls are operating effectively, or

        (ii) Where procedures other than tests of controls cannot provide sufficient appropriate audit evidence. (Ref: Para. A57–A59)

36. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for ~~each~~ all material ~~performance measure, description, and disclosure~~service performance information.[15]

Commented [MP12]: Suggest refer to SPI generically – to include the contextual information.

Audit Evidence

37. The auditor shall obtain sufficient appropriate audit evidence to reduce the risk to an acceptably low level of expressing an inappropriate opinion when the service performance information is materially misstated, correlating, as far as possible, with the audit evidence obtained in the audit of the financial statements. [16] (Ref: Para. A60–A62)

38. The auditor shall consider the relevance and reliability of the information to be used as audit evidence. If:

    (a) Evidence obtained from one source is inconsistent with that obtained from another; or

    (b) The auditor has doubts about the reliability of information to be used as evidence,

    the auditor shall determine whether additional procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

39. The auditor shall obtain sufficient appropriate audit evidence about whether any disclosures of judgements related to service performance information are reasonable in the context of the requirements of the applicable financial reporting framework.

Analytical Procedures

40. When designing analytical procedures, the auditor shall evaluate the service performance information through analysis of plausible relationships among both financial and non-

[14] ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

[15] ISA (NZ) 330, paragraph 18

[16] ISA (NZ) 500, *Audit Evidence*, paragraph 6

financial information, where relevant. [17]

Written Representations

41. The auditor shall request written representations from those charged with governance, with appropriate responsibilities for and knowledge of the service performance information, that they have fulfilled their responsibility:

    (a) For the preparation of service performance information in accordance with the applicable financial reporting framework.

    (b) To select service performance ~~and use methods to measure, describe, aggregate, present and disclose the service performance~~criteria that are suitable in order to prepare service performance information in accordance with the applicable financial reporting framework.[18] (Ref: Para. A63)

Using the Work of an Auditor's Expert

42. The auditor shall determine whether specialised skills or knowledge are required regarding the service performance information and whether to use the work of an auditor's expert. [19] (Ref: Para. A64)

Forming an Opinion and Reporting

43. The auditor shall form an opinion on whether the service performance information is prepared, in all material respects, in accordance with the entity's ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria in accordance with the applicable financial reporting framework. [20] (Ref: Para. A65)

44. The auditor shall conclude whether, in view of the applicable financial reporting framework:

    (a) The service performance information will assist users in forming assessments about an entity's accountability for service performance, and in influencing decisions based on the service performance information.

    (b) The entity has selected service performance ~~and used methods to measure, describe, aggregate, present and disclose the service performance~~criteria that are suitable ~~so as to result in service performance information in accordance with the applicable financial reporting framework~~.

    (c) The service performance criteria ~~assumptions underlying the service performance information are explicit, the methods used in preparing the service performance information and the factors and circumstances that support any opinions expressed or disclosures made~~ are available to intended users. (Ref: Para. A66–A67)

Commented [MP13]: Unnecessary as intro sentence refers to applicable financial reporting framework

Commented [MP14]: Consider moving to application material – refer A67

[17] ISA (NZ) 520, *Analytical Procedures*, paragraph 6

[18] ISA (NZ) 580, *Written Representations*, paragraph 9

[19] ISA (NZ) 620, *Using the Work of an Auditor's Expert*

[20] ISA (NZ) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 10

(d) When the general purpose financial report is prepared in accordance with a fair presentation framework[21], the service performance information achieves fair presentation, including whether:

(i) The overall presentation of the service performance information has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed;

(ii) The overall presentation, structure and content of the service performance information represents the service performance of the entity in a manner that achieves fair presentation; and

(iii) The disclosure of the judgements made in reporting the service performance information, if applicable, is reasonable.

45. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance. That conclusion shall take into account:

(a) Whether sufficient, appropriate audit evidence has been obtained;

(b) Whether uncorrected misstatements are material, individually or collectively;

(c) The auditor's evaluation of whether the service performance information is prepared, in all material respects, in accordance with the applicable financial reporting framework.

46. The auditor shall consider:

(a) Any matters arising during the course of the audit of the financial statements that may affect the auditor's evaluation of the service performance information.

(b) The impacts of any matters arising during the audit of the service performance information that may affect the auditor's evaluation of the financial statements.

Report Content

47. The auditor's report on the service performance information shall be included in a single report on the general purpose financial report and shall include the elements required by ISA (NZ) 700 (Revised) as applicable to the service performance information. (Ref: Para. A68–A69)

48. The opinion section of the auditor's report shall:

(a) Identify the service performance information;

(b) State that the service performance information has been audited;

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[21] Examples of a fair presentation framework include:

- Public Benefit Entity Standards (PBE Standards);
- Public Benefit Entity Standards Reduced Disclosure Regime (PBE Standards RDR);
- Public Benefit Entity Simple Format Reporting – Accrual (Public Sector) (PBE SFR – A (PS));
- Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit) (PBE SFR – A (NFP)).

(c) Identify or refer to the ~~methods used to measure, describe, aggregate, present and disclose the~~ service performance ~~information~~criteria; and (Ref: Para. A70–A72)

~~(d) Include the auditor's opinion on the service performance information prepared in accordance with the applicable financial reporting framework.~~

Commented [MP15]: Not needed - opinion is covered below. This (d) is not covered by the equivalent para in ISA (NZ) 700 (Revised).
OAG suggestion led to staff suggestion to delete.

49. When expressing an unmodified opinion on the service performance information prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

(a) In our opinion the accompanying general purpose financial report presents fairly, in all material respects, the service performance for the year then ended in accordance with the entity's ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria in accordance with [*the applicable financial reporting framework*]; or

(b) In our opinion the accompanying general purpose financial report gives a true and fair view of the service performance for the year then ended in accordance with the entity's ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria in accordance with [*the applicable financial reporting framework*].[22]

50. In addition to the requirements addressing financial statements in ISA (NZ) 700 (Revised), the auditor's report shall:

(a) State, in the basis for opinion section, that the audit of the service performance information was conducted in accordance with International Standards on Auditing (New Zealand) and New Zealand Auditing Standard 1;

(b) Describe, in the responsibilities for the general purpose financial report section, the responsibilities of those charged with governance:

- For the preparation of service performance information in accordance with the applicable financial reporting framework;
- To select service performance ~~and use methods to measure, describe, aggregate, present and disclose the service performance~~criteria that are suitable in order to prepare service performance information in accordance with the applicable financial reporting framework;
- For such internal control as those charged with governance determine is necessary to enable the preparation of service performance information that is free from material misstatement, whether due to fraud or error.

When the general purpose financial report is prepared in accordance with a fair presentation framework, the description of responsibilities for the general purpose financial report in the auditor's report shall refer to "the preparation and fair presentation of the service performance information" or the "preparation of service

[22] If the applicable financial reporting framework includes requirements for entity information, the opinion may be required by law, regulation or otherwise to cover the entity information.

performance information that gives a true and fair view," as appropriate in the circumstances.

(c) In the "Auditor's Responsibilities for the Audit of the General Purpose Financial Report" section:

- Describe the audit of the service performance information by stating that, in accordance with the ISAs (NZ) and this New Zealand Auditing Standard, the auditor's responsibilities are to evaluate:

  i. Whether the selected service performance ~~and the methods to measure, describe, aggregate, present and disclose the service performance~~criteria are suitable so as to result in service performance information that is in accordance with the applicable financial reporting framework;

  ii. The overall presentation, structure and content of the general purpose financial report, and whether the general purpose financial report represents the underlying transactions, events and service performance in accordance with the applicable financial reporting framework, including where relevant its fair presentation; and

Key Audit Matters

51. The auditor may be required, or may voluntarily report key audit matters in the auditor's report.[23] If reported, key audit matters shall include matters related to the audit of the service performance information where, in the auditor's judgement, such matters were of most significance to the audit of the general purpose financial report.

Modifications to the Opinion in the Independent Auditor's Report

52. The auditor shall modify the opinion, with respect to the service performance information, when: [24]

    (a) The auditor concludes that the selected service performance ~~and methods to measure, describe, aggregate, present and disclose its service performance~~ criteria are not suitable resulting in service performance information that is not in accordance with the applicable financial reporting framework; (Ref: Para A31–A35)

    (b) The auditor concludes, based on the audit evidence obtained, that the service performance information is not individually or collectively free from material misstatement; or (Ref: Para. A73–A78)

    (c) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the service performance information as a whole is free from material misstatement.

53. When the auditor modifies the opinion with respect to the service performance information, the auditor shall consider the effects of the modification on the opinion on the financial statements. (Ref: Para. A79)

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[23] ISA (NZ) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

[24] ISA (NZ) 705 (Revised), *Modifications to the Opinion in the Independent Auditors Report*

54. When the auditor modifies the audit opinion with respect to the service performance information only, the audit opinion shall clearly indicate that the opinion on the financial statements is not modified. The auditor shall use the headings "Qualified Opinion on the Service Performance Information", "Adverse Opinion on the Service Performance Information" or "Disclaimer of Opinion on the Service Performance Information" as appropriate. The opinion with respect to the financial statements shall use the heading "Opinion on the Financial Statements".[25]

55. If the auditor modifies the opinion on the financial statements, the auditor shall consider the effect of the modification on the opinion on the service performance information.

Emphasis of Matter Paragraphs and Other Matter Paragraphs

56. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the service performance information, that in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the service performance information, the auditor shall include an Emphasis of Matter paragraph in the auditor's report. [26]

57. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the service performance information, that in the auditor's judgement, is relevant to user's' understanding of the audit of the service performance information, the auditor shall include an Other Matter paragraph in the auditor's report.[27]

Comparative Information

58. Where the entity presents a comparison of published prospective service performance information with the service performance information, the auditor shall evaluate whether the prospective service performance information presented in the general purpose financial report agrees with the information presented in the published prospective service performance information.

Other Information

59. The auditor shall read the other information and consider whether there is a material inconsistency between: [28]

    (a) The other information and the service performance information; and

    (b) The other information and the auditor's knowledge obtained in the audit of the general purpose financial report. (Ref: Para. A80–A81)

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[25] Where appropriate, the heading may refer to the entity information.

[26] ISA (NZ) 706 (Revised)

[27] ISA (NZ) 706 (Revised)

[28] ISA (NZ) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

Application and Other Explanatory Material

Scope of this NZ AS (Ref: Para. 1–3, 7(d))

A1. Service performance information is information about what the entity has done during the reporting period in working towards its broader aims and objectives, together with supporting contextual information, prepared in accordance with the applicable financial reporting framework.

Commented [MP16]: Every time SPI is referred to we consider that this covers the contextual information. Maybe consider making it clear here that this is the information identified as prepared in accordance with the applicable financial reporting framework?

A2. Work performed in the audit of the financial statements can often be used for the purpose of the audit of the service performance information. By highlighting matters that are common to both the financial statements and the service performance information, this NZ AS assists the auditor to accept, plan, perform and report in an effective manner, as well as highlighting areas where there are differences. This is to enable the auditor to perform the audit concurrently, effectively and in an all-encompassing manner.

A3. Some public benefit entities are required by the applicable financial reporting framework to prepare service performance information as part of the general purpose financial report. Appendix 1 illustrates what constitutes the general purpose financial report.

A4. Principles and requirements for the reporting of service performance information are specified within the applicable financial reporting framework as follows:

(a) For Tier 1 and Tier 2 public benefit entities, *PBE FRS 48 Service Performance Reporting*.

(b) For Tier 3 public benefit entities, PBE Simple Format Reporting – Accrual.

(c) For Tier 4 public benefit entities, PBE Simple Format Reporting – Cash.

The Tier 3 and Tier 4 requirements also require entity information to be reported as part of the general purpose financial report. These requirements refer to the general purpose financial report as a performance report. ~~For the purposes of this NZ AS, references to service performance information shall be taken to include service performance information and entity information, for Tier 3 or Tier 4 entities.~~

A5. Some entities that are required by the applicable financial reporting framework to include service performance information in the general purpose financial report, may not be required by law or regulation to have the general purpose financial report audited or reviewed. For example, non-large and non-medium Tier 3 registered charities, and all Tier 4 registered charities may have no statutory assurance requirements. Where the service performance information is not within the scope of the audit engagement, the auditor's responsibility for the service performance information is limited to following the requirements in ISA (NZ) 720 (Revised).

Definitions (Ref: Para. 7(f))

A6. The applicable financial reporting framework includes principles to guide an entity through a process to select what service performance to report on and ~~what methods to use~~how to measure and/or~~,~~ describe its service performance and ~~,~~ aggregate, present and disclose its service performance information to implement the applicable financial reporting framework. The entity will apply the process, as appropriate to the entity's circumstances,

to select what service performance to report on, ~~what methods to use~~how to measure and/or describe that service performance, how to structure the information and how the information is related to each other and the entity's overall purpose and strategies. The entity's service performance criteria refers to how the entity applies the qualitative characteristics and pervasive constraints of information if required by the applicable financial reporting framework, applicable to its circumstances, with logical links to the entity's overall purpose and strategies.

Commented [MP17]: OAG suggested moving from definition to application material.

Commented [MP18]: if instead of "of"

A7. Even for the same underlying service performance there can be different ~~methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria~~,~~ which will yield a different measurement or description. For example, an entity might select, as one of its performance measures, the levels of satisfaction using a rating scale on a survey; another entity might select to report the number of complaints received. These are both examples of how the entity evaluates its service performance.

A8. The service performance criteria also address presentation and disclosure. Disclosures comprise explanatory notes or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework. Presentation refers to whether the service performance is appropriately aggregated or disaggregated and clearly described.

Commented [MP19]: Removed protocols

Conduct of the Engagement in Accordance with ISAs (NZ) (Ref: Para. 8)

A9. The ISAs (NZ), which are based on the International Standards on Auditing (ISAs), are written in the context of an audit of financial statements by an auditor. Although service performance information is considered to be an integral part of an entity's general purpose financial report, the nature of the underlying subject matter included in the service performance information includes non-financial information which is not part of the financial statements as defined in the ISAs (NZ). However, the requirements of the ISAs (NZ) apply equally to an audit of the entire general purpose financial report, prepared in accordance with the applicable financial reporting framework, where that financial reporting framework also incorporates requirements to prepare service performance information.

A10. The ISAs (NZ), together with this NZ AS, covers all aspects of the audit of the general purpose financial report and therefore there is no requirement for the auditor to apply ISAE (NZ) 3000 (Revised)[29] to the service performance information.

A11. This NZ AS supplements the ISAs (NZ). It expands on how the ISAs (NZ) are to be applied to the service performance information. This NZ AS includes specific requirements for the service performance information that are not dealt with by the ISAs (NZ) or where the application of the ISAs (NZ) differs as a result of the nature of the service performance information.

[29] ISAE (NZ) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

A12. The relevance of each of the ISAs (NZ) to the service performance information requires careful consideration. For example, ISA (NZ) 240,[30] ISA (NZ) 540,[31] ISA (NZ) 550[32] and ISA (NZ) 570 (Revised)[33] are, in principle, relevant. This is because the service performance information could be misstated as a result of fraud, misstated estimates as a result of measurement that is subject to estimation uncertainty, the effect of related party transactions, or the incorrect application of the going concern basis of accounting under the applicable financial reporting framework.

Agreement on Audit Engagement Terms (Ref: Para. 11)

A13. The terms of the audit engagement for the audit of the general purpose financial report include references to the service performance information. An example of an audit engagement letter for an audit of the general purpose financial report including service performance information is set out in Appendix 4.

Documentation (Ref: Para. 12)

A14. The following are examples of matters that the auditor may consider to be appropriate to include in the audit documentation:

- Planning: The overall engagement strategy, the engagement plan, capturing the nature of the plan, reflecting plans to make connections between the financial statements and service performance information, and any significant changes made during the engagement, and the reasons for such changes;
- Materiality: The materiality levels or materiality factors for the service performance information and matters considered in their determination;
- Risks of material misstatement: Key elements of the understanding obtained regarding the entity and its environment specified in paragraph 21, and the risks of material misstatement for which, in the auditor's professional judgement, further procedures were required;
- Procedures: The nature, timing and extent of the further audit procedures performed, the linkage of those further audit procedures with the risks of material misstatement, and the results of audit procedures;
- Evaluation of misstatements: Misstatements identified during the engagement and whether they have been corrected, the auditor's conclusion as to whether uncorrected misstatements are material, individually or collectively, and the basis for that conclusion.

Communication with Those Charged with Governance (Ref: Para. 16)

A15. The preparation of service performance information is highly judgemental. As a result, the

[30] ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

[31] ISA (NZ) 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

[32] ISA (NZ) 550, *Related Parties*

[33] ISA (NZ) 570 (Revised), *Going Concern*

auditor's views on the judgemental areas of reporting the entity's service performance may be particularly relevant to those charged with governance in discharging their responsibilities for the preparation of the service performance information. For example, why the auditor considers the service performance criteria are not suitable to the circumstances. Open and constructive communication including feedback on the maturity of the entity's process to ~~select~~ prepare the~~what~~ service performance information~~to report on~~, the suitability of its ~~methods used to measure, describe, aggregate, present and disclose its~~ service performance criteria or how the information compares to other entities may drive improvements in reporting over time. This may include comments about, for example, judgemental aspects of what service performance to report on, concerns regarding management bias or the quality of the presentation of the information.

Commented [MP20]: Consider moving to application material from requirements - OAG keep requirements short and sweet.

Commented [SvD21R20]: Could one link this here to evidence? Where there is no sufficient and appropriate evidence to support the suitability of the criteria, for example, where it is not clearly linked to the objectives of the entity. i.e not relevant? Maybe this could be dealt with in FAQ.

Just a thought!.

Commented [MP22R20]: Add in FAQs – have just moved text here.

Planning (Ref: Para. 19–20)

A16. Information required to be included in the financial statements by the applicable financial reporting framework may be incorporated therein by cross-reference.[34] Such information is part of the financial statements. Service performance information that is incorporated into the general purpose financial report by cross-reference is part of the general purpose financial report and is subject to the audit in accordance with this NZ AS.

A17. The applicable financial reporting framework may allow flexibility in where and how an entity reports its service performance information. It may be appropriate for an entity to report service performance information about service performance provided by other entities. ISA (NZ) 402[35] may be relevant to the audit of the service performance information, if the user entity makes use of a service organisation for the preparation of service performance reporting with another entity or where the entity outsources aspects of their business to organisations that provide services ranging from performing a specific task under the direction of the entity to replacing an entity's entire business units or functions that are significant to the service performance information. Alternatively, ISA (NZ) 600[36] may be relevant, adapted as necessary to the circumstances, when the auditor involves other auditors in the audit of the service performance information where the service performance information includes information about goods and services provided by other entities.

A18. The service performance information may include information upon which another practitioner may have expressed an opinion. The auditor may decide to use the evidence on which that other practitioner's opinion is based to provide evidence regarding the service performance information included in the general purpose financial report. The work of another practitioner may be used in relation to service performance information that falls outside the boundary of the reporting entity. Such practitioners are not part of the engagement team. Relevant considerations when the engagement team plans to use the work of another auditor may include:

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[34] ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*, paragraph A2

[35] ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

[36] ISA (NZ) 600, *Special* Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

(a) Whether the auditor understands and complies with the requirements of Professional and Ethical Standard 1 ~~(Revised)~~.

(b) The other practitioner's professional competence.

(c) The extent of the engagement teams' involvement in the work of the other practitioner.

Commented [MP23]: Restructured Code will be in effect.

Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing Risks of Material Misstatement (Ref: Para. 21–29)

Obtaining an Understanding of the Entity and its Environment

A19. The entity may follow its own process to identify what and how to report its service performance to implement the applicable financial reporting framework applicable to its circumstances. Without suitable ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria, the entity does not have an appropriate basis on which to prepare the service performance information and the auditor is unable to meet the objectives of the audit. Without the frame of reference provided by transparent assumptions and preparation ~~methods~~protocols, any conclusion is open to individual interpretation and misunderstanding. The suitability of what and how to report service performance is context-sensitive, that is, it is determined in the context of the entity's circumstances.

Commented [MP24]: Consider in lieu of methods

A20. The selection of what service performance to report on and how to measure or describe that service performance, and then aggregate, disclose and present the information is more judgemental than reporting on financial information. An entity may have a wide variety of performance frameworks, guidance, or codes (or a combination thereof) to choose from in the preparation of this information.

~~A20.~~A21. The entity will need to interpret the applicable financial reporting framework and either select pre-existing external service performance ~~reporting methods~~criteria, including pre-established performance measures and/or descriptions from guidance, standards, or laws or regulation, or it may need to apply judgement to develop its own internally developed service performance ~~methods~~ criteria for measuring or describing its service performance. The need for such judgement makes the preparation of the service performance information inherently more susceptible to the risk of management bias.

~~A21. In the example in paragraph A7 where an entity identifies stakeholder satisfaction as the underlying service performance to report on, the entity identifies the most suitable method to measure or describe this performance in the context of the entity.~~

Commented [MP25]: Consider deleting – avoid method and may be read as providing guidance to the preparer which is not the role of the auditing standard. A7 sufficient. Have split the para above therefore renumbering not needed – and makes the previous para less dense.

A22. The application of professional scepticism by the auditor is particularly important when assessing the neutrality and completeness of the service performance ~~selected and the methods used to measure, describe, aggregate, present and disclose the entity's service performance~~criteria due to the level of judgement to be exercised by the entity. This is particularly important if the entity's ~~methods~~ service performance criteria are not substantially based on established service performance ~~methods~~ criteria generally used in the entity's sector, or are inconsistent with such ~~methods~~ criteria~~and assumptions~~. The auditor may need to apply significant professional judgement in the assessment of the suitability of the ~~selected information and the entity's methods to measure, describe, aggregate, present and disclose its~~ service performance criteria in situations where a well-designed due process is not followed or where the intended users were not involved in the

selection of what service performance to report on and/or ~~the development of the methods~~ how to evaluate the underlying service performance~~to be used~~.

A23. The process applied by the entity to determine what to report on and how to report its service performance may affect the work that the auditor carries out. The level of potential management bias in selecting what and how to report its service performance directly correlates with the amount of work that the auditor may need to perform when considering the design of the entity's ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria. For example, use of performance measures specified by external benchmarks, industry guidance, or developed in consultation with intended users may require less work than internally generated performance measures as external guidance reduces the risk of management bias. Transparency about the entity's process to select what and how to report its service performance and the entity's consideration of materiality may also affect the work that the auditor carries out.

A24. Factors that the auditor may consider in obtaining an understanding of the entity's process for identifying what and how to report its service performance include:

- Whether there are factors that are outside the control of the entity or there are long time frames that are required to make assessments of the entity's service performance.
- Examples of the impact of the source of the ~~methods used to measure, describe, aggregate, present and disclose its~~ service performance criteria:
  - The scope of what service performance to report on or ~~the methods used to measure, describe, aggregate, present and disclose its~~how to evaluate such service performance may be embodied in law or regulation specific to the entity, industry or sector in which the entity operates and, in particular, with laws and regulations that specify the form and content of service performance information or which describe the entity's accountability. In the absence of indications to the contrary, such ~~methods~~ service performance criteria are presumed to be suitable and are publicly available.
  - The entity may use a well-established performance framework, theory of change or intervention logic model to explain how its service performance during the reporting period relates to its broader aims and objectives or may have described predetermined objectives or specific performance goals or targets in agreements with key stakeholders, for example, a local authority's Long-Term Plan, statement of intent, charter, recent plans and strategies or in funding contracts or agreements with key funders. ~~Methods to measure, describe, aggregate, present or disclose s~~Service performance criteria that have been pre-agreed with key stakeholders may have a lower risk of management bias.
  - Guidelines developed and issued collectively by a group or published in journals or results of benchmarking studies, for example, central agencies may provide guidance or establish requirements for the preparation of service performance information. The auditor may need to evaluate the suitability of these guidelines to the entity's circumstances and how these align to intended users' needs. ~~A~~ M~~m~~ore detailed ~~set of methods to measure, describe, aggregate, present or disclose~~ service performance criteria may be more appropriate.
- Results of surveys, e.g., satisfaction surveys, or other evidence of stakeholder

consultation, e.g., feedback, complaints, targeted interviews or stakeholder workshops, providing information about who the intended users are and what information they may find helpful to assess the performance of the entity. A well-designed process in developing ~~what service performance to report on and the methods used to measure, describe, aggregate, present or disclose~~ service performance criteria with involvement of intended users lowers the risk of management bias.

- Other external requirements or agreements with external parties that influence the entity's service performance accountability.
- Other contextual information, including strategic and operational objectives. For example, an entity's constitution, trust deed, mission statement, recent plans and strategies.
- How the entity assesses its service performance for the purposes of internal decision making.
- Whether the entity's ~~methods to measure, describe, aggregate, present or disclose~~ service performance criteria have been validated through research conducted to be well correlated with what they are intended to measure or describe.
- Changes from the prior period in the nature or extent of operations.
- Whether it is appropriate to report on information that falls outside of the boundary of the reporting entity.

Commented [MP26]: Note reference to contextual information here for OAG

Suitability

A25. When evaluating whether the ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria are suitable, the auditor is evaluating the judgements made by the entity in applying the qualitative characteristics referred to in the applicable financial reporting framework. The qualitative characteristics described in some of the applicable financial reporting frameworks are similar to the characteristics of suitable criteria described in paragraph 22 but may differ in the words used. Appendix 2 illustrates the similarities. The characteristics in paragraph 22 are framework neutral.

Commented [MP27]: There are no QCs for tier 4.

A26. The characteristics are not mutually exclusive, and the relative importance of each characteristic varies according to the circumstances. The entity may exercise significant judgement to select what and how to report its service performance to meet the qualitative characteristics. The auditor applies professional scepticism recognising that circumstances may exist that cause the ~~selection and use of methods~~service performance criteria to be biased, incomplete or otherwise contrary to the qualitative characteristics required by the applicable financial reporting framework.

A27. The auditor's role is to evaluate whether the entity has appropriately applied the qualitative characteristics and pervasive constraints as required by the applicable financial reporting framework in preparing the service performance information. In doing so, the auditor evaluates whether the ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria are suitable. This evaluation is based on a consideration of the process adopted, and choices and trade-offs made by the entity in determining the most appropriate manner to tell its service performance story.

A28. The ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria are suitable when:

(a) The entity has appropriately applied the qualitative characteristics and pervasive constraints to enable users to make an informed assessment of the entity's service performance; and

(b) Include reasonable quantitative or qualitative measures or descriptions of service performance against which the entity's service performance may be assessed and are of particular value or importance for accountability and decision-making purposes.

A29. When evaluating the suitability of the ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria as required by paragraph 22, the auditor may consider:

(a) The intended users of general purpose financial reports and the types of decisions that may be influenced on the basis of the service performance information,

Commented [MP28]: Not sure this made sense? Think it is a separate point?

~~(a)~~(b) ~~w~~Whether users were involved in the selection of ~~what to report on or development of the methods used~~the service performance criteria and if not, reasons why not;

~~(b)~~(c) How the qualitative characteristics applied by the entity have influenced the selection of what service performance to report on and how to measure or evaluate that performance (e.g., service performance information must be relevant, but the overall volume of information must also be accessible in order for it to be understandable);

~~(c)~~(d) The various components of the entity's service performance and check for credible links, internal logic and consistency with the financial information;

~~(d)~~(e) How the entity plans to present and disclose its financial statements and service performance information that is material;

~~(e)~~(f) The complexity of the underlying service performance;

~~(f)~~(g) Other potentially more suitable ~~methods to measure, describe, aggregate, present or disclose the entity's~~ service performance criteria that could have been used and reasons why those were not considered;

~~(g)~~(h) Potential misunderstanding of the resultant service performance information ~~generated after application of the selected service performance and methods to measure, describe, aggregate, present or disclose service performance~~ by intended users;

~~(h)~~(i) Knowledge of other similar entities reporting format; and

~~(i)~~(j) Open source searches.

A30. The evaluation required by paragraph 22 may be iterative and may require re-evaluation as the auditor's understanding of the entity or the types of decisions that may be influenced on the basis of the service performance information by intended users grows, if the entity makes changes to its ~~selection of service performance to report on or the methods used to measure, describe, aggregate, present or disclose~~ service performance criteria or as the auditor gathers audit evidence.

A31. Factors that the auditor may consider when evaluating relevance include:

- The rationale for the selection of what service performance to report on, for example, whether the service performance relates to a significant risk to the public (e.g., the purity of water supply) or that could have a positive or negative effect on social, economic, or environmental wellbeing.
- Whether the service performance information is likely to meet the needs of intended users so as to be useful for decision making, for example, is of significant community interest or interest to the public.
- The extent to which consultation with users has influenced the selection of what service performance to report and ~~the methods used to measure, describe, aggregate, present or disclose~~how to evaluate the entity's service performance.
- Information that could significantly affect the reputation of the entity.
- Whether the service performance information shows clear and logical links between the service performance to be measured or evaluated and the entity's overall purpose and strategies so that the rationale for their selection is evident.
- Whether the ~~methods used to measure, describe, aggregate, present or disclose service performance generate~~ service performance information ~~that~~ is clearly linked with the financial information for example, relates to service performance that is financially material; or relates to a performance measure that may have a significant effect on management performance rewards.

A32. Factors that the auditor may consider when evaluating completeness include whether:

- All significant aspects of service performance that would enable the user to make an informed assessment are included;
- The service performance information includes negative aspects of performance or areas where there is a significant risk of performance failure by the entity.

Completeness relates more to a balanced reflection of service performance rather than an overly comprehensive and extensive set of performance measures which can result in too much information, reducing the relevance of the report.

A33. Factors that the auditor may consider when evaluating reliability include whether:

- The service performance is capable of measurement or description in a consistent manner from period to period;
- The process is well defined and there is likely to be evidence to support the information generated;
- The service performance information is capable of validation by the auditor and will not result in unsubstantiated claims, including whether there is a robust and reliable collection process;
- The ~~selection of service performance and the methods to measure, describe, aggregate, present or disclose~~ service performance criteria are likely to result in service performance information that is free from material misstatements, including omission of fact, or misrepresentation of trend;
- The ~~methods to measure, describe, aggregate, present or disclose~~ service performance

criteria are consistent with industry benchmarks, where these are available.

A34. Factors that the auditor may consider when evaluating neutrality include whether:

- The ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria are balanced, and are likely to result in information that is aggregated, where appropriate, and covers all important aspects, with suitable emphasis, to fairly reflect the significance to the entity's service performance;
- The selected service performance criteria cover~~s~~ both favourable and unfavourable aspects of the entity's service performance in an unbiased manner;
- The selected service performance ~~and methods used to measure, describe, aggregate, present and disclose the service performance~~criteria are not changed arbitrarily to remove negative aspects of performance year on year.

Special care may be necessary to evaluate neutrality where, for example, there are no ~~methods to measure, describe, aggregate, present or disclose service performance established~~ externally established service performance criteria, no predetermined performance measures established with key stakeholders or no guidelines developed by an external industry group.

A35. Factors that the auditor may consider when evaluating understandability include whether:

- The format adopted is clearly laid out and presented in a way that will enable the user to identify the main points of the entity's service performance in that year;
- The assessment of service performance is coherent, easy to follow, and will result in service performance information that is clear and logical;
- The service performance information is concise and aggregated where appropriate;
- The information is explained and presented in a way that makes its significance clear.

A36. In the early stages of reporting service performance information, the entity may not have developed an appropriate process, supported by internal controls, to identify what and how to report its service performance and may therefore be unable to include certain aspects of its service performance in its service performance information. The auditor exercises professional judgement to conclude on the impact of any such omissions (including those for which the entity has provided reasons or explanations). This is particularly relevant since entities may be at varying stages of maturity in respect of preparing service performance information.

Commented [MP29]: Moved application as NZAuASB agreed to re-order requirements at the October meeting.

Commented [MP30]: Reference to need for developed internal controls to support the preparation of SPI.

A37. For example, in the early stages of an entity generating service performance information, an entity may focus its reporting on a particular area of service performance because reporting systems have not yet been established and implemented for other areas. The auditor may still be able to conclude that the service performance criteria are suitable if there are:

(a) Clear disclosures in the service performance information of the facts and reasons surrounding the exclusion of some service performance. However, if the entity makes no progress in developing reporting systems over time or continues to exclude service performance once reporting systems are established and implemented, the auditor may no longer be satisfied that the service performance criteria are suitable; and

(b) The auditor concludes that the disclosures provided will assist intended users in their decision making.

~~A36.~~A38. Service performance information reported because it is readily quantifiable may not be suitable and may not meet the principles of the applicable financial reporting framework. For example, the entity may select service performance to report on the basis that the selected performance is readily measurable. However, it may not be the most relevant information to enable the user to understand or assess the service performance of the entity during the year.

Availability

~~A37.~~A39. Entity-developed ~~methods to measure, describe, aggregate, present or disclose~~ service performance criteria need to be made available to intended users to enable them to understand how the service performance has been measured or evaluated. The service performance criteria~~methods~~ may be made available in one or more of the following ways:[37]

(a) Publicly.

(b) Through inclusion in a clear manner in the presentation of the service performance information. Some performance measures may rely on complex methodologies. The auditor may consider whether complex service performance criteria ~~methods~~ are transparent, explained with sufficient detail and clarity so that they are considered to be available and enable the intended user to understand how the service performance has been assessed.

(c) Through inclusion in a clear manner in the assurance report.

(d) By general understanding, for example the method for measuring time in hours and minutes. The auditor may consider whether it is clear what the time is measuring. For example, an entity may measure its response time to an outage but will need to be clear as to whether the response time is measured from when a call is lodged, or measures the time taken to address a fault from when someone arrives to address the fault.

~~A38.~~A40. In determining whether the ~~methods used to measure, describe, aggregate, present and disclose the entity's~~ service performance criteria are available to intended users, the auditor may consider whether there will be enough context for the service performance information, including whether the rationale for determining:

(a) What service performance to report on; and

(b) Whether to include information about the role of other entities, collaborative relationships and the provision of resources to others

is transparent to users so that users can understand the judgements made in preparing the service performance information.

~~A39.~~A41. Disclosure of the judgements made by the entity ~~is important~~ may assist in making the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance

Commented [MP31]: Judgements cover the why not the how – recommend toning this down

[37] EG Au1 Framework for Assurance Engagements, paragraph 47

criteria available to intended users, where, for example, the ~~entity has more discretion in selecting what service performance to report on and what methods to use (i.e., the methods~~service performance criteria are internally generated~~)~~. Alternatively, the service performance criteria ~~methods~~ used may originate from an external performance framework supplemented by disclosures or cross references, in the general purpose financial report.

Commented [MP32]: Move from requirement to application material.

Communication

~~A40. In the early stages of reporting service performance information, the entity may not have developed an appropriate process, supported by internal controls, to identify what and how to report its service performance and may therefore be unable to include certain aspects of its service performance in its service performance information. The auditor exercises professional judgement to conclude on the impact of any such omissions (including those for which the entity has provided reasons or explanations). This is particularly relevant since entities may be at varying stages of maturity in respect of preparing service performance information.~~

~~A41. For example, in the early stages of an entity generating service performance information, an entity may focus its reporting on a particular area of service performance because reporting systems have not yet been established and implemented for other areas. The auditor may still be able to conclude that the selection of service performance and the methods used to measure, describe, aggregate, present or disclose service performance are suitable if there are:~~

~~(a) Clear disclosures in the service performance information of the facts and reasons surrounding the exclusion of some service performance. However, if the entity makes no progress in developing reporting systems over time or continues to exclude service performance once reporting systems are established and implemented, the auditor may no longer be satisfied that the selection of service performance and methods used to measure, describe, aggregate, present or disclose service performance are suitable; and~~

~~(b) The auditor concludes that the disclosures provided will assist intended users in their decision making.~~

~~A42. Service performance information reported because it is readily quantifiable may not be suitable and may not meet the principles of the applicable financial reporting framework. For example, the entity may select service performance to report on the basis that the selected performance is readily measurable. However, it may not be the most relevant information to enable the user to understand or assess the service performance of the entity during the year.~~

~~A43.~~A42. Communication with those charged with governance in a timely manner may enable improvements to be made to the service performance information.

~~A44.~~A43. Factors the auditor may consider in determining whether to perform further audit procedures include:

(a) The pervasiveness of the matter;

(b) The materiality of the matter;

(c) Whether the auditor's concern is with respect to the presentation of the information only;

(d) Whether further audit procedures will enable the auditor to express an opinion on some of the service performance information.

Obtaining an Understanding of the Entity's Internal Control (Ref: Para. 30)

~~A45.~~A44. Control activities that may be relevant to the audit of the service performance information include policies and procedures that pertain to internal management performance reviews,[38] including reviews and analyses of actual performance versus budgets and relating different sets of data – operating or financial – to one another. ~~An understanding of the control activities that pertain to performance reviews will be especially relevant to the audit of the general purpose financial report and may assist the auditor to audit the service performance information concurrently with the financial information.~~

Commented [MP33]: This builds on the ISA requirements for understanding internal controls. A36 acknowledges the need for internal controls to support the preparation of SPI, A57 captures need to test, And A58 -A59 expands where controls are weak.

Materiality in Planning and Performing the Engagement (Ref: Para. 31–32)

Consideration of what service performance is included in the report

~~A46.~~A45. The relevance of what service performance is selected to be included in the general purpose financial report is strongly linked with judgements made by the entity about the materiality of information. Service performance information is deemed to be material if it could reasonably be expected to influence the decisions of intended users taken on the basis of the general purpose financial report. The service performance information will not be considered to be complete if it does not contain all material service performance.

~~A47.~~A46. The applicable financial reporting framework may discuss the concept of materiality in the context of preparation and presentation of service performance information.[39] Such a discussion provides a frame of reference to the auditor in determining materiality. The auditor's consideration of the entity's process to select what and how to report its service performance provides context in determining materiality.

~~A48.~~A47. The evaluation required by paragraph 22 and factors considered by the auditor in paragraph A31 and A32, provides a frame of reference to the auditor in understanding what service performance information is of most significance to intended users, and may assist in identifying the risks of material misstatement in the service performance information.

~~A49.~~A48. When determining materiality, the auditor may:

- Discuss the entity's process for determining material service performance information with management and those charged with governance (and, if necessary and appropriate, external stakeholders). It may be appropriate to discuss matters with external stakeholders when the determination of the entity's material service performance information includes, for example, clearly contentious issues or performance measures for which there is no evidence to support the entity's role in the improvements reported.
- Consider whether the entity's determination of material service performance information is consistent with the auditor's knowledge of the entity and the

[38] ISA (NZ) 315 (Revised), Appendix 1, paragraph 9

[39] PBE IPSAS 1 *Presentation of Financial Statements, paragraphs 46A.1–2* and Explanatory Guide A7: *Materiality for Public Benefit Entities*

environment, including reporting by similar entities and previous reporting by the entity and information obtained from sources such as minutes of meetings, media reports and any stakeholder outreach activities, including satisfaction surveys, feedback and complaints received, ~~web and social media~~open source searches, targeted interviews or stakeholder workshops.

Commented [MP34]: Consistent with para A29 (i)

Materiality levels and factors

~~A50.~~A49. The materiality levels are expressed in terms of the appropriate unit of account for each element or performance measure reported. The materiality level determines what level of misstatement will be tolerated by the auditor. Using a percentage is another commonly used way to establish such a level. It may be possible to group similar service performance information and make materiality decisions on the same basis if they have the same unit of account. The basis and level may differ from the basis and level for determining materiality as required by ISA (NZ) 320.

~~A51.~~A50. There are multiple factors that may lead to a material misstatement:

(a) Omissions of fact – could omissions result in misleading the user?

(b) Misstatements of fact – could a misstatement result in misleading the user?

(c) Misrepresentation of trend – does the service performance information make claims that do not represent the facts available?

(d) Bias – does the service performance information focus unduly on positive aspects of performance, or omit negative aspects?

(e) Unsubstantiated claims.

~~A52.~~A51. The following factors may assist the auditor when exercising professional judgement in determining whether there are material misstatements in either the qualitative or quantitative service performance information:

(a) How the information is presented. For example, does the presentation draw attention to particular information? The auditor may be less tolerant of misstatement in information that is given the most prominence.

(b) The relative volatility of reported service performance information. For example, if service performance information varies significantly from period to period.

(c) The number of persons or entities affected.

(d) The importance of the activity to achieving the entity's service performance objectives. For example, whether the performance measures related to the primary purpose of the entity. The more important the activity, the less tolerance for misstatement.

(e) The extent of interest shown in particular aspects of service performance by, for example, the applicable legislation, funders, the media or the public and whether the service performance information is likely to cause funders to increase or decrease funding in the entity. The higher the level of interest shown, the lower the tolerance for misstatement. For matters where there is the most significant interest, the auditor may be less accepting of potentially misleading or inaccurate information.

(f) The type of performance measures and/or descriptions adopted, including the sensitivity of the information to error or the wording chosen to express a description. In some cases, there are particular types of disclosures for which misstatements of lesser or greater amounts are acceptable.

(g) The interaction between, and relative importance of, various components of the service performance information when it is made up of multiple components, such as information that includes numerous performance measures or relates to an activity that is financially significant. The auditor may be less tolerant of misstatement for information that is given the most prominence.

(h) The economic, social, political and environmental effect of a project or an entity's work, for example, there is a high level of wider societal interest in it, particularly high levels of public sensitivity, or relate to activity that could be a significant risk to the public.

(i) Whether there is information about achieving a target or threshold, and the relationship of the actual performance to the target. For example, if the entity compares actual performance to a previously reported target, the auditor may be particularly diligent where a target has only just been achieved.

(j) Whether a misstatement is the result of an intentional act or is unintentional. For example, intentional attempts to mislead users may result in the auditor performing more detailed work.

(k) Whether a misstatement is significant having regard to the auditor's understanding of known previous communications to users.

(l) Whether a particular aspect of the service performance information is significant with regard to the nature, visibility and sensitivity of the information. For example, there has been a large number of complaints relating to it, or relates to an activity that is strongly linked to management performance rewards.

~~A53.~~A52. The auditor is unlikely to be able to set an overall materiality level because there is unlikely to be a common unit of account. It is also unlikely that the auditor will be able to aggregate misstatements. However, this does not remove the need for the auditor to form a conclusion as to whether uncorrected misstatements are material individually or collectively as required by paragraph 45.

~~A54.~~A53. For historical financial information extracted from the audited financial statements, the auditor may determine that the materiality level used in the audit of the financial statements are acceptable for the purposes of the service performance information.

Identifying and Assessing Risks of Material Misstatement (Ref: Para. 34)

Assertions about service performance and related disclosures

~~A55.~~A54. The auditor may use the assertions as described in paragraph A56 or may express them differently provided all aspects described below have been covered. For example, the auditor may choose to combine the assertions about occurrence and attribution.

~~A56.~~A55. In the public sector, the entity may assert compliance with law or regulation, in addition to the assertions set out in paragraph A56.

~~A57.~~A56. Assertions used by the auditor in considering the different types of potential misstatements of service performance information that may occur may fall into the following categories:

(a) Occurrence – service performance that has been reported has occurred.

(b) Attributable to the entity – the service performance reported by the entity includes only service performance that the entity has evidence to support its involvement with.

(c) Completeness – all significant service performance that should have been reported has been included in the service performance information.

(d) Accuracy – service performance has been reported, measured and described appropriately and is not inconsistent with financial statement information.

(e) Cut-off – the service performance has been reported in the correct period.

(f) Presentation – service performance is appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable.

The Auditor's Responses to Assessed Risks (Ref: Para. 35–36)

~~A58.~~A57. Procedures that may be performed include:

(a) Testing and evaluating the systems, processes and controls that capture, record, analyse and monitor the service performance information;

(b) Performing analytical review procedures;

(c) Performing other substantive or re-performance tests.

~~A59.~~A58. The quality of the systems used to record and control results, and the nature and quality of evidence available, may have an effect on the mix of procedures used. For instance, a weak recording or control system may force the auditor to use primarily substantive procedures. In rare cases, the absence of controls may make it impossible to obtain sufficient appropriate audit evidence.

~~A60.~~A59. In some instances, there may not be control activities that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform audit procedures that are primarily substantive procedures. In rare cases, the absence of controls may make it impossible to obtain sufficient appropriate audit evidence.

Audit Evidence (Ref: Para. 37)

~~A61.~~A60. Making correlations with audit evidence obtained in the audit of the financial statements, as far as possible, maximises the effectiveness of the audit of the general purpose financial report.

~~A62.~~A61. The mix of procedures to be performed may vary compared with the mix used in regard to the financial information but does not alter the need to obtain sufficient appropriate audit evidence.

~~A63.~~A62. The auditor's procedures may include:

(a) Agreeing or reconciling amounts reported in the service performance information to

any underlying financial records;

(b) Agreeing cross references between the service performance information and the financial statements;

(c) Understanding any allocation methods adopted and assumptions made, and determining whether the methods adopted are suitable, have been applied consistently and are consistent with the applicable financial reporting framework; and

(d) Reconciling the aggregate amounts reported in the service performance information to the amounts reported in the financial statements.

Commented [MP35]: I think method is ok here.

Written Representations (Ref: Para. 41)

~~A64.~~A63. The representation letter for the audit of the general purpose financial report includes references to the service performance information. An example of an illustrative representation letter for the audit of the general purpose financial report that includes service performance information is set out in Appendix 5.

Using the Work of an Auditor's Expert (Ref: Para. 42)

~~A65.~~A64. Expertise in a field other than accounting or auditing may be necessary as a result of information included in the service performance information. Examples may include expertise in relation to such matters as:

- The measurement of complex performance measures, for example:
  - Climate change calculations;
  - Specific scientific measurements;
  - Social impact measurement
  - Human rights performance
  - People and diversity disclosure
- Assertions made about the entity's performance, for example, when reporting on the difference that the entity has made;
- Conformity assessments, ecolabelling and certification programmes.

Forming an Opinion and Reporting (Ref: Para. 43–44)

~~A66.~~A65. The auditor's conclusion on the service performance information covers both:

(a) Whether the ~~selected service performance and the methods used to measure, describe, aggregate, present or disclose~~ service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework; and

(b) Whether the service performance information represents the underlying service performance in accordance with the applicable financial reporting framework, including where relevant its fair presentation.

~~A67.~~A66. Those charged with governance will make a number of judgements about the selection, measurement, description, aggregation, presentation and disclosure of the service

Commented [MP36]: Think ok to spell it out here.

performance information reported. In considering the qualitative characteristics described in the applicable financial reporting framework, the auditor may become aware of management bias. The auditor may conclude that the collective effect of the lack of neutrality, together with the effect of uncorrected misstatements causes the service performance information to be materially misstated.

~~A68.~~A67. The disclosure of ~~the~~ significant judgements made in selecting, measuring, describing and aggregating service performance information is particularly important so that users can understand how particular service performance is reported in the service performance information.

Report Content (Ref: Para. 7(b), 47–50)

~~A69.~~A68. The auditor's report on the general purpose financial report includes references to the service performance information. An illustrative report that includes references to the service performance information is set out in Appendix 6.

~~A70.~~A69. This NZ AS requires the auditor's report to include at least all elements required by ISA (NZ) 700 (Revised). However, this NZ AS allows for flexibility and an auditor may include additional information, as described in paragraphs A70-A71, resulting in a long-form report.

~~A71.~~A70. The auditor's report identifies or refers to the ~~methods used to measure, describe, aggregate, disclose and present the~~ service performance ~~information~~ criteria so the intended users can understand the basis for the auditor's opinion. ~~The auditor's report may refer to the methods used to measure, describe, aggregate, present and disclose where the auditor has evaluated that the methods are available to intended users as part of the service performance information.~~

Commented [MP37]: Consider this sentence is unclear and does not help to explain why this is a requirement.

~~A72.~~A71. The auditor's report may describe additional details relevant to the audit of the service performance information that do not affect the auditor's opinion. This information may be required by legislation or agreed in the terms of the engagement to assist intended users in decision making based on the service performance information. A long-form report should not be worded in a manner that it may be regarded as a modification of the auditor's opinion. The auditor's report may describe, for example:

- The underlying facts and information about the entity's process to select what service performance to report on (e.g., the maturity of the entity's process compared to others in the industry).
- The source of the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance criteria, and whether they are externally established (e.g., established in section xxx of applicable legislation or externally established performance frameworks).
- Any significant interpretations made in selecting ~~what service performance to report on~~ or applying the entity's ~~methods to measure, describe, aggregate, present or disclose~~ service performance criteria in the circumstances.
- Whether there have been any changes in the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance criteria (e.g., changes in the performance measures used).

- Findings or recommendations for improvements to the service performance information.
- Any other matters the auditor considers necessary to assist intended users in making decisions based on the service performance information.

~~A73.~~A72. The auditor is encouraged to report their findings or recommendations where the auditor considers the information would enhance transparency and assist the user to understand the level of maturity that the entity has achieved in its reporting. Reporting of findings and recommendations may promote and also highlight to the user improvements in reporting over time.

Modifications to the Opinion in the Independent Auditor's Report (Ref: Para. 28, 52)

~~A74.~~A73. A misstatement of the service performance information may arise in relation to:

(a) The suitability of the ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria;

(b) The application of the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance criteria;

(c) Inadequate disclosure of judgements made, where applicable; or

(d) Incomplete disclosures that do not include all disclosures required by the applicable financial reporting framework or do not achieve fair presentation of the service performance information.

~~A75.~~A74. In relation to the suitability of the ~~selected service performance and methods used to measure, describe, aggregate, present or disclose~~ service performance criteria, material misstatements of the service performance information may arise, for example, when:

(a) The entity's ~~methods~~ service performance criteria are not consistent with the principles in the applicable financial reporting framework.

(b) The entity has not appropriately applied the qualitative characteristics, in accordance with the applicable financial reporting framework and therefore the service performance information does not enable a meaningful assessment of performance to be made by intended users.

Commented [MP38]: Consider deleting (a) as this is covered in (b)

Commented [SvD39R38]: Agree

~~A76.~~A75. The auditor may determine that a material misstatement exists in the service performance information:

(a) When, in the auditor's professional judgement, the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance criteria are likely to mislead the intended users. A qualified opinion or adverse opinion would be appropriate in the circumstances depending on how material and pervasive the matter is.

(b) In other cases, a qualified opinion or a disclaimer of opinion would be appropriate depending on, in the auditor's professional judgement, how material and pervasive the matter is.

~~A77.~~A76. In relation to the application of the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance criteria, material misstatements of the service

performance information may arise:

(a) Due to a misapplication of the ~~methods~~ criteria (e.g., an unintentional error in application of a formula developed to report a performance measure). A qualified opinion may be appropriate in the circumstances where there is a material misstatement that is not pervasive~~, depending on how material the matter is~~.

(b) When the ~~methods~~ criteria are not applied consistently to the service performance, or not applied consistently between periods.

~~A78.~~A77. In relation to the appropriateness or adequacy of disclosures in the service performance information, material misstatements may arise when:

(a) The service performance information does not provide all disclosures required by the applicable financial reporting framework.

(b) The service performance information does not provide all disclosures necessary to achieve fair presentation of the service performance information.

~~A79.~~A78. Appendix 4 includes illustrative auditor's reports with a qualified, adverse or disclaimer of opinion with respect to the service performance information.

~~A80.~~A79. In many instances, a modification with respect to the service performance information will have no impact on the opinion on the financial statements.

Other Information (Ref: Para. 59)

~~A81.~~A80. Appendix 1 illustrates what constitutes other information for the purposes of this NZ AS.

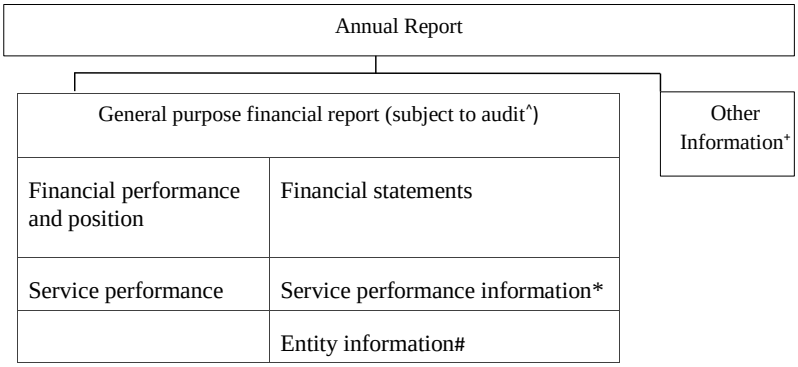
~~A82.~~A81. Other information, whether financial or non-financial information (other than the financial statement information and service performance information) may be included in an annual report. The auditor's opinion does not cover the other information. The auditor's responsibilities regarding other information within the annual report, but located outside of the general purpose financial report as defined in this NZ AS, is determined by ISA (NZ) 720 (Revised) and by this NZ AS.

Commented [SvD40]: What would an example of this be?

Appendix 1

(Ref: Para. 3,7, 8, A3, A80)

What Constitutes the General Purpose Financial Report



^ Some entities are required by law or regulation to have the general purpose financial report audited or reviewed. Other entities may elect to include service performance information within the scope of the audit. Where the service performance information is not included within the scope of the audit, this NZ AS does not apply.

* Service performance information may be included in the general purpose financial report by cross-reference where the applicable financial reporting framework permits disclosures to be cross referenced.

\# Where entity information is required to be included in the general purpose financial report by the applicable financial reporting framework.

\+ Other information may include forward looking information, other historical information and management discussion and analysis. ISA (NZ) 720 (Revised) addresses the auditor's responsibilities with respect to other information. ISA (NZ) 720 (Revised) applies to the service performance information when service performance information is not included within the scope of the audit.

Appendix 2

(Ref: Para. 22)

~~The Selected Service Performance and Methods Used to Measure, Describe, Aggregate, Present and Disclose the~~ Service Performance Criteria

	Financial reporting framework	Preparer	Auditor
Financial statements	Detailed recognition and measurement requirements established in PBE Standards	Apply the recognition and measurement requirements and disclose the accounting policies applied	The recognition and measurement requirements from PBE Standards are suitable
Service performance information	Principles in PBE Standards require the preparer to apply the qualitative characteristics and pervasive constraints	Apply the entity's process to select what service performance to report and ~~what methods to use to~~how to measure, describe, aggregate, present and disclose ~~the~~ its service performance	Auditor evaluates whether the ~~entity selected~~ service performance ~~and methods used~~criteria are suitable

Are~~Is~~ the ~~selected~~ service performance ~~and the methods used to measure, describe, aggregate, present and disclose the service performance~~criteria suitable? (Ref: Para 22) [40]	**These may be articulated differently in the applicable financial reporting framework (Ref: Para. A29)**[41]
Relevance	Relevance including timeliness
Reliability	Includes verifiability
Completeness Neutrality	Faithful representation including: Completeness Neutrality
Understandability	Understandability and comparability

[40] EG Au1A, *Framework for Assurance Engagements*, paragraph 44.

[41] The qualitative characteristics are described in PBE FRS 48 paragraph 9.

Appendix 3

Flowchart of the Audit of Service Performance Information (SPI) included in the General Purpose Financial Report (GPFR)

Acceptance

The auditor shall obtain agreement that those charged with governance (TCWG) accept responsibility for~~to select~~ service performance criteria~~and use methods to measure, describe, aggregate, present and disclose the service performance~~ that are suitable in order to prepare SPI in accordance with the AFRF (Ref: Para. 11)

Planning

The auditor shall develop the audit plan to concurrently cover financial statement information together with the SPI. (Ref: Para. 17)

The auditor shall obtain an understanding of:

- the applicable financial reporting framework (AFRF) and the legal framework applicable to the entity (Ref: Para. 14,18)
- the entity's service performance, the context in which it operates and its process to identify what and how to report (Ref: Para. 21)
- how much discretion the entity has ~~over what and how to report~~ and/or the extent of consultation with intended users to influence the ~~nature of the SPI and the methods~~ service performance criteria used to report (Ref: Para. 21)
- the internal controls operating over preparation of the SPI. (Ref: Para. 30)

The auditor shall identify and assess the risks of material misstatement at the SPI and at the assertion level. (Ref: Para. 34)

Performing

~~Is~~ Are the ~~selected~~ service performance ~~and the methods used to measure, describe, aggregate, present and disclose~~criteria suitable? (Ref: Para. 22)

No → Discuss with TCWG.

Can meaningful changes be made for the current year? (Ref: Para. 26)

Yes → The auditor shall:

No → Issue a modified opinion on the SPI.

Materiality considerations cover:

- ~~Selection and methods~~Service performance criteria are suitable (Ref: Para. 22)
- Individual and collective misstatements (Ref: Para 31)

The auditor shall evaluate whether the ~~methods used to report the entity's SPI~~service performance criteria are available to intended users ~~to enable intended users to understand the methods and assumptions underlying the SPI~~. (Ref: Para. 2~~43~~)

The auditor shall:

- determine and document materiality levels and/or materiality factors to be applied to the SPI. (Ref: Para. 32)
- design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to all material SPI. (Ref: Para. 35, 36)
- request written representations covering responsibility for the SPI. (Ref: Para. 41)

Reporting

The auditor shall form an opinion on whether the SPI is prepared in accordance with the entity's service performance criteria ~~selected methods~~ in accordance with the AFRF. (Ref: Para. 43)

Consider whether to prepare a long-form report. (Ref: Para. A68)

Are there serious concerns about the suitability of the ~~selected service performance or methods~~

No → Issue an unmodified opinion on the SPI. (Ref: Para. 49)

Yes → Issue a modified opinion on the SPI.

Appendix 4

(Ref: Para. A13)

Illustrative Engagement Letter Including Service Performance Information

The following is an example of an audit engagement letter for an audit of the general purpose financial report, including service performance information prepared in accordance with an applicable fair presentation financial reporting framework issued by the New Zealand Accounting Standards Board. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in the ISAs (NZ) including this NZ AS 1. It will need to be varied according to individual requirements and circumstances.

***

To the Chairperson:[42]

[*The objective and scope of the audit*]

You have requested that we audit the [*general purpose financial report/performance report*] of ABC [Entity], which comprise the financial statements, the *[service performance information/statement of service performance] [and the entity information]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity], the* statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the [*entity information,* financial statements as a whole*, and the service performance information/statement of service performance* are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and New Zealand Auditing Standard (NZ AS) 1 *The Audit of Service Performance Information* will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of this [*general purpose financial report/performance report*].

[*The responsibilities of the auditor*]

We will conduct our audit of the financial statements in accordance with ISAs (NZ) and the audit of the service performance information in accordance with the ISAs (NZ) and NZ AS 1. Those standards require that we comply with ethical requirements. As part of an audit in accordance with ISAs (NZ) and NZ AS 1, we exercise professional judgement and maintain professional

[42] The addressees and references in the letter would be those appropriate in the circumstances of the engagement. It is important to refer to the appropriate persons – refer to ISA (NZ) 210 paragraph A22.

scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the [*entity information, the financial statements and the service performance information*], whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of [*the entity information*], the financial statements and the service performance information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the [*general purpose financial report/performance report*] that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain an understanding of the process applied by the entity to select what and how to report its service performance.
- Evaluate whether the ~~selected service performance and the methods used to measure, describe, aggregate, present and disclose the~~ service performance criteria are suitable so as to result in service performance information that is in accordance with the [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*].
- Evaluate the overall presentation, structure and content of the [*general purpose financial report/performance report*] and whether the [*general purpose financial report/performance report*] represents the underlying transactions, events and service performance in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* [in a manner that achieves fair presentation].
- Conclude on the appropriateness of the use of the going concern basis of accounting by those charged with governance and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the [entity]'s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the [*general purpose financial report/performance report]* or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the [entity] to cease to continue as a going concern.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs (NZ).

[*The responsibilities of those charged with governance and identification of the applicable*

Commented [MP41]: Consistent with para 11(a)(i)

financial reporting framework]

Our audit will be conducted on the basis that [those charged with governance] acknowledge and understand that they have responsibility on behalf of the entity for:

(a) The preparation [and fair presentation] of the [*entity information*], financial statements and [*service performance information/statement of service performance*] in accordance with [*Public Benefit Entity Standards/ Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*;

(b) ~~The selected service performance and the methods used to measure, describe, aggregate, present and disclose the s~~Service performance criteria that are suitable in order to prepare service performance information in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*; and

(c) Such internal control as [they] determine is necessary to enable the preparation of the [financial statements and [*service performance information/statement of service performance*] that are free from material misstatement, whether due to fraud or error; and

(d) To provide us with:

(i) Access to all information of which [management and those charged with governance] are aware that is relevant to the preparation of the [*general purpose financial report/performance report*] such as records, documentation and other matters;

(ii) Additional information that we may request from [management or the directors] for the purpose of the audit; and

(iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.*]

[**Reporting**]

[*Insert appropriate reference to the expected form and content of the auditor's report*.]

The form and content of our report may need to be amended in the light of our audit findings [and may be in long-form, including findings or recommendations related to the entity's service performance information.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the [*general purpose financial report/performance report*] including our respective responsibilities.

[Governing body]

Acknowledged and agreed on behalf of the [Governing body] by

(signed)
.....

Name and Title

Date

Appendix 5

(Ref: Para. A61)

Illustrative Representation Letter Including Service Performance Information

The following illustrative letter includes written representations that are required by this standard and other ISAs (NZ). It is assumed in this illustration that the applicable financial reporting framework is a fair presentation framework, and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor) (Date)

This representation letter is provided in connection with your audit of the [*general purpose financial report/performance report*][43] of ABC Entity for the year ended December 31, 20XX which comprise the financial statements, the *[service performance information/statement of service performance] [and the entity information]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, and the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity], the* statement of cash flows and notes to the financial statements, including a summary of significant accounting policiesfor the purpose of expressing an opinion as to whether the [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*):

- [*the entity information as at December 31, 20XX*];
- the financial position of the [entity] as at December 31, 20XX, and (of) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20XX in accordance with ~~[~~the entity's service performance criteria~~]~~ ~~methods to measure, describe, aggregate, present and disclose its service performance~~

in accordance with [*Public Benefit Entity (PBE) Standards*/ *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*].

We confirm that (*to the best of our knowledge and belief, having made such enquiries as we considered necessary for the purpose of appropriately informing ourselves*):

[General Purpose Financial Report/Performance Report]

We have fulfilled our responsibilities on behalf of [the entity], as set out in the terms of the audit engagement dated [insert date]:

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[43] Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

- For the preparation, and fair presentation of the [*entity information*], financial statements and [*service performance information/statement of service performance*] in accordance with [*PBE Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*] issued by the New Zealand Accounting Standards Board.
- To select ~~of~~ service performance ~~and use of methods to measure, describe, aggregate, present and disclose the service performance~~criteria that are suitable in order to prepare service performance information in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* (NZ AS 1)
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (ISA (NZ) 540)
- Related party relationships and transactions have been appropriately accounted for and disclosed in the financial statements in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*. (ISA (NZ) 550)
- All events subsequent to the date of the financial statements which require adjustment or disclosure have been adjusted or disclosed. (ISA (NZ) 560)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate or collectively, to the [financial statements as a whole and [*service performance information/statement of service performance*]. A list of the uncorrected misstatements is attached to the representation letter. (ISA (NZ) 450)
- [Any other matters that the auditor may consider appropriate.]

Information Provided

- We have provided you with[44]:
  - Access to all information of which we are aware that is relevant to the preparation of the [*general purpose financial report/performance report*] such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the [financial statements and [*service performance information/statement of service performance*] may be materially misstated as a result of fraud. (ISA (NZ) 240)

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[44] If the auditor has included other matters relating to the responsibilities of those charged with governance in the audit engagement letter in accordance with ISA (NZ) 210, *Agreeing the Terms of Audit Engagements*, consideration may be given to including these matters in the written representations from those charged with governance.

- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the [*general purpose financial report/performance report*]. (ISA (NZ) 240)
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's [*general purpose financial report/performance report*] communicated by employees, former employees, analysts, regulators or others. (ISA (NZ) 240)
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing a [*general purpose financial report/performance report*]. (ISA (NZ) 250)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (ISA (NZ) 550)
- We will provide the final version of the documents determined to comprise the annual report to the auditor when available, and prior to its issuance by the entity.[45] (ISA (NZ) 720 (Revised))
- [Any other matters that the auditor may consider necessary.]

Governing body member | Governing body member

[45] This is only required when the other information is not available until after the date of the auditor's report.

Appendix 6

(Ref: Para. A66)

Illustrative Auditor's Report Including Service Performance Information

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- **Audit of a general purpose financial report/performance report of a public benefit entity that is not a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework[46]. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).**
- **The general purpose financial report/performance report is prepared by management of the entity in accordance with a general purpose framework.**
- **The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the general purpose financial report/performance report in ISA (NZ) 210.**
- **The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.**
- **Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* comprises all of the relevant ethical requirements that apply to the audit.**
- **Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).**
- **The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.**
- **The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.**
- **The auditor has no other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

To Appropriate Addressee

Opinion

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx*, the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the [*statement of financial performance/statement of comprehensive revenue and expense, statement of*

[46] The general purpose financial report may be referred to as a performance report and include entity information, according to the requirements of the applicable financial reporting framework.

changes in net assets/equity], statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*):

- [*the entity information as at December 31, 20X1*];
- the financial position of the [entity] as at December 31, 20X1, and (of) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20X1 in accordance with ~~[~~the entity's~~]~~ ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria

in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*] issued by the New Zealand Accounting Standards Board.

[For a long-form report, include a separate section, under an appropriate heading, for example:

- Underlying facts and information about the entity's process to select what service performance to report on (e.g., the maturity of the entity's process compared to others in the industry).
- The source of the ~~methods used to measure, describe, aggregate, present or disclose~~ service performance criteria, and whether ~~those methods~~they are externally established. (e.g., established in section xxx of applicable legislation or externally established performance frameworks).
- Any significant interpretations made in selecting ~~what service performance to report on~~ or applying the entity's ~~methods to measure, describe, aggregate, present or disclose~~ service performance criteria in the circumstances.
- Whether there have been any changes in the ~~entity's methods used to measure, describe, aggregate, present or disclose~~ service performance criteria (e.g., changes in the performance measures used).
- Findings or recommendations for improvements to the service performance information.
- Any other matters the auditor considers necessary to assist intended users in making decisions based on the service performance information.]

Basis for Opinion

We conducted our audit of the [*financial statements*] in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs and New Zealand Auditing Standard (NZ AS) 1 *The Audit of Service Performance Information* (NZ). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [*entity*] in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the general purpose financial report/performance report and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 1 in Appendix 2 of ISA (NZ) 720 (Revised).]

Responsibilities of Those Charged with Governance for the [*General Purpose Financial Report/Performance Report*]

Those charged with governance are responsible on behalf of the [entity] for:

(a) ~~for~~ the preparation and fair presentation of the [*entity information*], financial statements and [*service performance information/statement of service performance*] in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board;

(b) ~~to select~~ service performance criteria ~~and use methods to measure, describe, aggregate, present and disclose the service performance~~ that are suitable in order to prepare service performance information in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit]*; and

(c) ~~for~~ such internal control as those charged with governance determine is necessary to enable the preparation of the financial statements and [*service performance information/statement of service performance*] that are free from material misstatement, whether due to fraud or error.

In preparing the [*general purpose financial report/performance report*], those charged with governance are responsible for assessing the [entity's] ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless those charged with governance either intend to liquidate the [entity] or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the [*General Purpose Financial Report/Performance Report*]

Our objectives are to obtain reasonable assurance about whether the [*entity information,* financial statements as a whole*, and the service performance information/statement of service performance*] are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) and NZ AS 1 will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate or collectively, they could reasonably be expected to

influence the decisions of users taken on the basis of this [*general purpose financial report/performance report*].

A further description of the auditor's responsibilities for the audit of the [*general purpose financial report/performance report*] is located at the XRB's website at https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/.

Paragraph 41(b) of ISA (NZ) 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report.

Paragraph 41(c) explains that when law, regulation or ISAs (NZ) expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below. Paragraph NZ A57.1 states that when the auditor refers to a description of the auditor's responsibilities on a website, the appropriate authority is the External Reporting Board and the website address is https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/.

As part of an audit in accordance with ISAs (NZ) and NZ AS 1, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the [*entity information, the financial statements and the service performance information*], whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of [*the entity information*], the financial statements and the service performance information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the [Entity's] internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain an understanding of the process applied by the entity to select what and how to report its service performance.
- Evaluate whether the ~~selected~~ service performance criteria ~~and the methods used to measure, describe, aggregate, present and disclose the service performance~~ are suitable so as to result in service performance information that is in accordance with the [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*.
- Evaluate the overall presentation, structure and content of the [*general purpose financial report/performance report*] and whether the [*general purpose financial report/performance report*] represents the underlying transactions, events and service performance in accordance with [*Public Benefit Entity Standards/ Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* in a manner that achieves fair presentation.
- Conclude on the appropriateness of the use of the going concern basis of accounting by those charged with governance and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the

[entity]'s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the [*general purpose financial report/performance report*] or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the [entity] to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Appendix 7

(Ref: Para. A76)

Illustrations of Auditor's Reports with Modifications to the Opinion with Respect to the Service Performance Information

- Illustration 1: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to a material misstatement of the service performance information.
- Illustration 2: An auditor's report containing an unmodified opinion on the financial statements and an adverse opinion due to a material misstatement of the service performance information.
- Illustration 3: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the service performance information.
- Illustration 4: An auditor's report containing a qualified opinion on both the financial statements and the service performance information due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements.

Illustration 1: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to a material misstatement of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity]*, statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*) the [*entity information and the*] financial position of the [entity] as at December 31, 20X1, and (*of*) its, financial performance and its cash flows for the year then ended in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Qualified Opinion on the Service Performance Information

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion on the Service Performance Information* section of our report the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects (or *gives a true and fair view of*) the service performance of the [entity] for the year ended December 31, 20X1 in accordance with [the entity's] methods to measure, describe, aggregate, present and disclose its service performance criteria and with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion on the Service Performance Information

[As reported in the service performance information on page xx, the entity has identified its service performance as [*describe improvements reported or description of the difference that the entity has made]* and measured this performance by [list performance measures and/or descriptions reported] to report its service performance. The entity has not been able to provide evidence of its role in those particular improvements and therefore should not have reported this improvement.]

We conducted our audit of the [*financial statements*] in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [*entity*] in accordance with Professional and

Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report*] and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 6 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information].

Responsibilities of Those Charged with Governance for the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Illustration 2: An auditor's report containing an unmodified opinion on the financial statements and an adverse opinion due to a material misstatement of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity],* statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*) the [*entity information and the*] financial position of the [entity] as at December 31, 20X1, and (*of*) its financial performance and its cash flows for the year then ended in accordance with [*Public Benefit Entity Standards Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Adverse Opinion on the Service Performance Information

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion on the Service Performance Information* section of our report the accompanying [*general purpose financial report/ performance report]* does not present fairly (or *does not give a true and fair view of*) the service performance of the [entity] [*on pages x to xx]* for the year ended December 31, 20X1 in accordance with ~~[~~the entity's~~]~~ ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria and with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Adverse Opinion on the Service Performance Information

[As reported in the service performance information on pages …, the entity has identified its service performance to include [list appropriate goods and services] and measured and evaluated this performance with reference to [describe performance measures and/or descriptions reported] to report its service performance. We do not consider that these performance measures will enable a meaningful assessment of the service performance of the entity for the year ended December 31, 20X1 to be made. Had the entity identified more meaningful performance measures, the service performance information would have been materially affected, reporting performance measures including xxx and linking to its responsibility for yyyy.]

We conducted our audit of the [*financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report] section of our report. We are independent of the [*entity*] in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report*] and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 7 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 7 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information].

Responsibilities of Those Charged with Governance for the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Illustration 3: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity],* statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*) the [*entity information and the*] financial position of the [entity] as at December 31, 20X1, and (*of*) its financial performance and its cash flows for the year then ended in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Qualified Opinion on the Service Performance Information

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion on the Service Performance Information* section of our report the accompanying [*general purpose financial report/performance report]* presents fairly, in all material respects (or *gives a true and fair view of*) the service performance of the [entity] for the year ended December 31, 20X1 in accordance with ~~[~~the entity's~~]~~ ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria and with [Public Benefit Entity Standards/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion on the Service Performance Information

[Some significant performance measures of the entity, rely on information from third parties, such as (*give examples*). The entity's control over much of this information is limited, and there are no practical audit procedures to determine the effect of this limited control. For example, [*describe performance measure and explain where information comes from that we are unable to independently test.*]]

We conducted our audit of the [*financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance*

Report] section of our report. We are independent of the [*entity*] in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report]* and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 6 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information]

Responsibilities of Those Charged with Governance for the [General Purpose Financial Report/Performance Report*]*

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Illustration 4: Qualified opinion on both the financial statements and the service performance information due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Qualified Opinion on the [General Purpose Financial Report/Performance Report*]*

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity*], statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report the accompanying [*general purpose financial report/performance report]* presents fairly, in all material respects (or *gives a true and fair view of*):

- [*the entity information as at December 31, 20X1*];
- the financial position of the [entity] as at December 31, 20X1, and (*of*) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20X1 in accordance with ~~[~~the entity's~~]~~ ~~methods to measure, describe, aggregate, present and disclose its~~ service performance criteria

in accordance with [Public Benefit Entity Standards/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion

[As outlined on page xx of the [*general purpose financial report/ performance report]*, [entity] has not applied the requirements of the [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* to its grant expenditure. We have been unable to obtain sufficient audit evidence to quantify the effects of this limitation. As a result of this matter, we were unable to quantify the adjustments that are necessary in respect of grant expenditure in the [*statement of comprehensive revenue and expenses*]; assets, liabilities and equity in the statement of financial position, [*total comprehensive revenue and expense]* and opening and closing equity in the [*statement of changes in equity]* and grants expense reported in the [*service performance information/statement of service performance*].]

We conducted our audit of the [*financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [entity] in accordance with Professional and

Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report]* and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 6 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information].

Responsibilities of Those Charged with Governance for the [General Purpose Financial Report/Performance Report]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report /Performance Report]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Conforming Amendments to Other Pronouncements

New text is underlined.

Conforming amendments to XRB Au1 *Application of Auditing and Assurance Standards*

Appendix 2 lists the International Standards on Auditing (New Zealand) to be applied in conducting audits of historical financial information.

Appendix 2A will be added as follows:

Appendix 2A

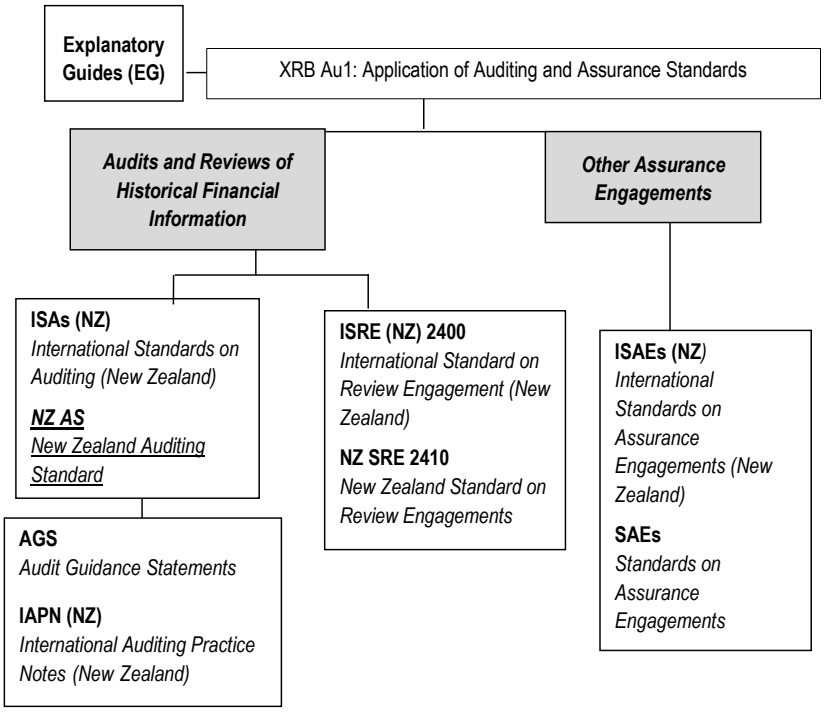
New Zealand Auditing Standards

This appendix is an integral part of the Standard

This appendix lists the New Zealand Auditing Standards to be applied in conjunction with the International Standards on Auditing (New Zealand) in conducting an audit of general purpose financial reports which comprise the financial statements and service performance information.

NZ AS 1 The Audit of Service Performance Information

Appendix 6 Overview of Auditing and Assurance Standards of the XRB is to be amended as follows:



ACCOMPANYING ATTACHMENT: CONFORMITY TO INTERNATIONAL AND AUSTRALIAN STANDARDS ON AUDITING

This conformity statement accompanies but is not part of NZ AS 1.

Conformity to International Standards on Auditing

There is no equivalent International Standard on Auditing (ISA), issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Comparison with Australian Auditing Standards

There is no equivalent Australian Auditing Standard, issued by the Australian Auditing and Assurance Standards Board (AUASB).

NZ AUDITING AND ASSURANCE STANDARDS BOARD

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NEW ZEALAND AUDITING STANDARD 1

The Audit of Service Performance Information

Issued [date]

This Standard was issued on [*date*] by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [*date*].

An auditor that is required to apply this Standard is required to apply it for audits of service performance information included in the general purpose financial report for periods beginning on or after 1 January 2021. However, early adoption is permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued as a result of the issue of financial reporting requirements in New Zealand that require the inclusion of service performance information within general purpose financial reports that are subject to audit.

DRAFT

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ISBN xxx

NEW ZEALAND AUDITING STANDARD 1

THE AUDIT OF SERVICE PERFORMANCE INFORMATION

Issued by the New Zealand Auditing and Assurance Standards Board

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Appendix 6: Illustrative Auditor's Report Including Service Performance Information

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Conforming Amendments to Other Pronouncements

Accompanying Attachment: Conformity to International and Australian Standards on Auditing

New Zealand Auditing Standard (NZ AS) 1, *The Audit of Service Performance Information*, should be read in conjunction with ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*.

History of Amendments

Table of pronouncements – NZ AS 1 *The Audit of Service Performance Information*

This table lists the pronouncements establishing and amending NZ AS 1.

Pronouncements	**Date approved**	**Effective date**
New Zealand Auditing Standard 1		This NZ AS is effective for audits of service performance information included in the general purpose financial report for periods beginning on or after 1 January 2021.

Introduction

Scope of this NZ AS

1. This New Zealand Auditing Standard (NZ AS) deals with the auditor's responsibilities with respect to service performance information when an auditor is engaged to audit the general purpose financial report. The auditor performs the audit of the service performance information concurrently with the audit of the financial statements. (Ref: Para. A1)

2. This NZ AS establishes requirements and provides guidance not addressed by other International Standards on Auditing (New Zealand) (ISAs (NZ)) with respect to service performance information. (Ref: Para. A2)

3. This NZ AS applies when the auditor is required by law or regulation or is otherwise engaged to audit the general purpose financial report, that is, engaged to audit both the financial statements and the service performance information. For purposes of this NZ AS, the financial statements and the service performance information are collectively referred to as the general purpose financial report. (Ref: Para. A3-A5, Appendix 1)

4. This NZ AS is not applicable when a review engagement is to be performed on the general purpose financial report.

Effective Date

5. This NZ AS is effective for audits of service performance information included in the general purpose financial report for periods beginning on or after 1 January 2021. Early adoption is permitted.

Objectives

6. The objectives of the auditor are:

   (a) To understand the process applied by the entity to select what and how to report on its service performance;

   (b) To evaluate whether the entity's service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework;

   (c) To obtain reasonable assurance about whether the service performance information included in the general purpose financial report is free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on the service performance information;

   (d) To report, in accordance with the auditor's findings, about whether the service performance information included in the general purpose financial report is prepared, in all material respects in accordance with the applicable financial reporting framework; and

   (e) To communicate further as required by the ISAs (NZ) and this NZ AS, in accordance with the auditor's findings.

Definitions

7. For the purposes of this NZ AS, the following terms have the meanings attributed below:

   (a) General purpose financial report – Comprise the financial statements and service performance information and, where applicable, entity information, prepared in accordance with the applicable financial reporting framework. The general purpose financial report may be referred to as a Performance Report. (Ref: Appendix 1)

   (b) Long-form report – Auditor's report including information and explanations that are intended to meet the information needs of intended users but not to affect the auditor's opinion. (Ref: Para. A69–A71)

   (c) Misstatement – A difference between the selection, measurement, description, aggregation, presentation, or disclosure of service performance information and the selection, measurement, description, aggregation, presentation or disclosure that is required for the information to be in accordance with the applicable financial reporting framework. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions. Misstatements can arise from error or fraud.

   (d) Other information – Financial or non-financial information (other than the financial statements, service performance information, entity information, if applicable and the auditor's report thereon) included in an entity's annual report. (Ref: Para. A5, Appendix 1)

   (e) Risk of material misstatement – The risk that the service performance information is materially misstated.

   (f) Service performance criteria – The selection of goods and/or services being reported on, and the performance measures and/or descriptions used to evaluate the entity's service performance for a particular engagement. (Ref: Para. A6–A8)

Requirements

Conduct of the Engagement in Accordance with ISAs (NZ)

8. The auditor shall apply the ISAs (NZ) and this NZ AS when auditing service performance information, as appropriate. Where an entity is required to include entity information within the general purpose financial report, and the auditor is engaged to audit the general purpose financial report, the auditor shall also apply the ISAs (NZ) and this NZ AS to the entity information, as appropriate. (Ref: Para. A9–A12, Appendix 1)

9. The auditor shall not represent compliance with this NZ AS unless the auditor has complied with the requirements of both this NZ AS and the ISAs (NZ).

General Principles of an Audit of the General Purpose Financial Report

10. The auditor shall plan and perform the audit by exercising professional judgement and with an attitude of professional scepticism, recognising that circumstances may exist that cause the service performance information to require a material adjustment for it to be prepared in all material respects, in accordance with the applicable financial reporting framework.

Agreement on Audit Engagement Terms

11. The terms of the audit engagement shall include: [1] (Ref: Para. A13)

    (a) The responsibilities of the auditor with respect to the service performance information:

        i. To obtain an understanding of the process applied by the entity to select what and how to report its service performance;

        ii. To evaluate whether the service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework;

        iii. To evaluate the overall presentation, structure and content of the general purpose financial report and whether the general purpose financial report represents the underlying transactions, events and service performance in accordance with the applicable financial reporting framework.

    (b) The responsibilities of those charged with governance, including that they acknowledge and understand their responsibility on behalf of the entity for:

        i. The preparation of service performance information in accordance with the applicable financial reporting framework;

        ii. Service performance criteria that are suitable in order to prepare service performance information in accordance with the applicable financial reporting framework;

        iii. Such internal control as those charged with governance determine is necessary to enable the preparation of the service performance information that is free from material misstatement, whether due to fraud or error;

    (c) Reference to the expected form and content of the auditor's report, including whether it will be a long-form report, including additional information about the service performance criteria, detailed findings or recommendations to meet the needs of the intended users.

Documentation

12. The auditor shall document the nature, timing and extent of the audit procedures performed to comply with this NZ AS.[2] (Ref: Para. A14)

13. The audit documentation shall, as far as possible, provide evidence of the correlation between the audit evidence obtained related to the financial statements and the service performance information.

Laws and Regulations

14. The auditor shall obtain an understanding of:

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[1] ISA (NZ) 210, paragraph 9-10

[2] ISA (NZ) 230, *Audit Documentation*, paragraphs 7-16

(a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and, in particular, laws and regulations that specify the form, content, preparation and audit of service performance information; and

(b) How the entity is complying with that framework.

15. The auditor shall obtain sufficient appropriate audit evidence that the entity has complied with laws and regulations that have a direct effect on the reporting of service performance information. [3]

Communication with Those Charged with Governance

16. The auditor shall communicate the following matters with those charged with governance:[4]

(a) The auditor's views about significant judgements made in reporting the entity's service performance information, including any significant deficiencies or areas for improvement; (Ref: Para. A15)

(b) Matters involving non-compliance with laws and regulations with respect to service performance reporting obligations; and

(c) Deficiencies in internal control with respect to the service performance information that, in the auditor's professional judgement, are of sufficient importance to merit attention.

Planning

17. The auditor shall develop the audit plan to concurrently cover the financial statements and the service performance information so that the audit is performed in the most effective manner and reflects the correlation between the service performance information and the financial statements. [5]

18. In establishing the overall audit strategy, the auditor shall:

(a) Obtain an understanding of the applicable financial reporting framework relevant to service performance information;

(b) Obtain an understanding of the entity's process for identifying the intended users, and the decisions that may be influenced by the service performance information;

(c) Consider the factors that, in the auditor's professional judgement, are significant in directing the engagement team's efforts in respect of the audit of service performance information.

19. The auditor shall discuss with those charged with governance where and how the entity intends to report its service performance information. (Ref: Para. A16)

20. When planning the audit of the service performance information, the auditor shall:

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[3] ISA (NZ) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

[4] ISA (NZ) 260 (Revised), *Communication with Those Charged with Governance*, paragraph 14-17

[5] ISA (NZ) 300, *Planning an Audit of Financial Statements*, paragraph 7

(a) Where a service organisation is used, obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit of the service performance information, sufficient to identify and assess the risks of material misstatement and design and perform audit procedures responsive to those risks in accordance with ISA (NZ) 402.[6] (Ref: Para. A17)

(b) Where the service performance information relates to a group, obtain sufficient appropriate audit evidence regarding the service performance information of the components and the consolidation process to express an opinion on whether the group's service performance information is prepared, in all material respects, in accordance with the applicable financial reporting framework.[7] (Ref: Para. A17)

(c) Where the service performance information includes information upon which another practitioner has expressed an opinion, communicate clearly with the other practitioner, when the auditor intends to use the work of another practitioner, about the scope and timing of the work and findings of the other practitioner and evaluate the sufficiency and appropriateness of evidence obtained and the process for including related information in the service performance information. (Ref: Para. A18)

Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing Risks of Material Misstatement

Obtaining an Understanding of the Entity and Its Environment

21. The auditor shall obtain an understanding of: (Ref: Para. A19–A24)

(a) The service performance of the entity and the context in which the entity operates;

(b) The entity's process for identifying what and how to report on its service performance, as well as what other options were considered;

(c) Whether the service performance criteria will generate service performance information that is consistent with and clearly linked to the entity's overall purpose and strategies;

(d) How much discretion the entity has in selecting the service performance criteria;

(e) The extent to which consultation with intended users influenced the service performance criteria; and (Ref: Para. A22–A24)

(f) The judgements made in deciding when to provide comparative narrative and descriptive information.

Suitability

22. The auditor shall evaluate whether the service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial

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6 ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

7 ISA (NZ) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

reporting framework, in that they exhibit the following characteristics: (Ref: Para. A25-A30)[8]

(a) Relevance (Ref: Para. A31)

(b) Completeness (Ref: Para. A32)

(c) Reliability (Ref: Para. A33)

(d) Neutrality (Ref: Para. A34)

(e) Understandability (Ref: Para. A35).

23. The auditor shall evaluate whether:

(a) In the auditor's judgement, significant aspects of service performance have been excluded, that have been, or could readily be, measured and/or described, and if such exclusions are reasonable in the circumstances; or (Ref: Para A36–A38)

(b) The service performance information inappropriately attributes service performance to the entity.

Availability

24. The auditor shall evaluate whether the service performance criteria are available to intended users so as to enable intended users to understand how the service performance information has been prepared, including any underlying assumptions. (Ref: Para. A39–A41)

25. If the entity has changed its service performance criteria from the prior period, the auditor shall evaluate whether the changes are suitable in the circumstances, have been approved appropriately, and are explained within the service performance information.

Communication

26. If the auditor considers that all or some of the entity's service performance information:

(a) Fails to comply with the applicable financial reporting framework;

(b) Is prepared using service performance criteria that are not suitable; or

(c) Otherwise fails to provide a reasonable basis for fairly reporting the service performance of the entity;

the auditor shall discuss the matter with those charged with governance as soon as practicable. (Ref: Para. A42)

27. The auditor shall determine:

(a) Whether the matter can be resolved to the auditor's satisfaction;

(b) Whether further audit procedures can be performed with respect to the service performance information; or (Ref: Para. A43)

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[8] The applicable financial reporting framework may describe different qualitative characteristics to these characteristics which align with the characteristics referred to in Appendix 2 of ISA (NZ) 210. The application material in paragraphs A39-A43 may need to be tailored to the applicable financial reporting framework. This is illustrated in Appendix 2.

(c) Whether, and if so, how to communicate the matter in the auditor's report where the matter is not resolved to the auditor's satisfaction.

28. In the circumstances described in paragraph 26, the auditor shall consider the implications for the audit, the auditor's report and the opinion and shall express a qualified, adverse, or a disclaimer of opinion, as appropriate in the circumstances, with respect to the service performance information. (Ref: Para. A73–A79)

29. In the circumstances described in paragraph 28, the auditor is not required to withdraw from the audit of the general purpose financial report but shall consider the impact of the modified opinion with respect to the service performance information on the opinion on the financial statements.

Obtaining an Understanding of the Entity's Internal Control

30. The auditor shall: [9]

(a) Obtain an understanding of internal control relevant to the audit over the preparation of the service performance information; and

(b) Evaluate the design of those controls and determine whether they have been implemented as designed. (Ref: Para. A44)

Materiality in Planning and Performing the Engagement

31. The auditor's consideration of materiality shall include both an evaluation of:

(a) Whether the service performance criteria are suitable as required by paragraph 22; and (Ref: Para. A31–A35, A45–A48,)

(b) Individual and collective misstatements in the reported service performance information, that based on the auditor's judgement, are likely to significantly influence the decisions of the intended users based on the information. (Ref: Para. A49–A53)

32. The auditor shall determine and document materiality levels and/or materiality factors to be applied to the service performance information for the purpose of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.[10] (Ref: Para. A48–A53)

33. The auditor shall revise the judgements made in determining materiality for the service performance information if matters come to the auditor's attention during the audit that would have caused the auditor to have determined different materiality levels or materiality factors initially.

Identifying and Assessing Risks of Material Misstatement

34. The auditor shall identify and assess the risks of material misstatement, whether due to fraud or error: [11]

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[9] ISA (NZ) 315 (Revised), paragraph 12

[10] ISA (NZ) 320, *Materiality in Planning and Performing an Audit*, paragraph 10 and 14

[11] ISA (NZ) 315 (Revised), paragraph 25

(a) At the service performance information level; and

(b) At the assertion level for performance measures, descriptions or disclosures where there is a reasonable possibility of material misstatement

through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement in accordance with ISA (NZ) 315 (Revised).[12] (Ref: Para. A51, A54–A56)

The Auditor's Responses to Assessed Risks

35. The auditor shall design and perform procedures whose nature, timing and extent[13]:

(a) Are responsive to assessed risks of material misstatement at the service performance information level and at the assertion level; and

(b) Allow the auditor to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement. The auditor's procedures shall include obtaining sufficient appropriate audit evidence as to the operating effectiveness of the relevant controls over the service performance information when:

(i) The auditor's assessment of the risk of material misstatement includes the expectation that controls are operating effectively, or

(ii) Where procedures other than tests of controls cannot provide sufficient appropriate audit evidence. (Ref: Para. A57–A59)

36. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for all material service performance information.[14]

Audit Evidence

37. The auditor shall obtain sufficient appropriate audit evidence to reduce the risk to an acceptably low level of expressing an inappropriate opinion when the service performance information is materially misstated, correlating, as far as possible, with the audit evidence obtained in the audit of the financial statements. [15] (Ref: Para. A60–A62)

38. The auditor shall consider the relevance and reliability of the information to be used as audit evidence. If:

(a) Evidence obtained from one source is inconsistent with that obtained from another; or

(b) The auditor has doubts about the reliability of information to be used as evidence,

the auditor shall determine whether additional procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

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[12] ISA (NZ) 315 (Revised), paragraph 5

[13] ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

[14] ISA (NZ) 330, paragraph 18

[15] ISA (NZ) 500, *Audit Evidence*, paragraph 6

39. The auditor shall obtain sufficient appropriate audit evidence about whether any disclosures of judgements related to service performance information are reasonable in the context of the requirements of the applicable financial reporting framework.

Analytical Procedures

40. When designing analytical procedures, the auditor shall evaluate the service performance information through analysis of plausible relationships among both financial and non-financial information, where relevant. [16]

Written Representations

41. The auditor shall request written representations from those charged with governance, with appropriate responsibilities for and knowledge of the service performance information, that they have fulfilled their responsibility:

    (a) For the preparation of service performance information in accordance with the applicable financial reporting framework.

    (b) To select service performance criteria that are suitable in order to prepare service performance information in accordance with the applicable financial reporting framework.[17] (Ref: Para. A63)

Using the Work of an Auditor's Expert

42. The auditor shall determine whether specialised skills or knowledge are required regarding the service performance information and whether to use the work of an auditor's expert. [18] (Ref: Para. A64)

Forming an Opinion and Reporting

43. The auditor shall form an opinion on whether the service performance information is prepared, in all material respects, in accordance with the entity's service performance criteria in accordance with the applicable financial reporting framework. [19] (Ref: Para. A65)

44. The auditor shall conclude whether, in view of the applicable financial reporting framework:

    (a) The service performance information will assist users in forming assessments about an entity's accountability for service performance, and in influencing decisions based on the service performance information.

    (b) The entity has selected service performance criteria that are suitable.

    (c) The service performance criteria are available to intended users. (Ref: Para. A66–A67)

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[16] ISA (NZ) 520, *Analytical Procedures*, paragraph 6

[17] ISA (NZ) 580, *Written Representations*, paragraph 9

[18] ISA (NZ) 620, *Using the Work of an Auditor's Expert*

[19] ISA (NZ) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 10

(d) When the general purpose financial report is prepared in accordance with a fair presentation framework[20], the service performance information achieves fair presentation, including whether:

(i) The overall presentation of the service performance information has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed;

(ii) The overall presentation, structure and content of the service performance information represents the service performance of the entity in a manner that achieves fair presentation; and

(iii) The disclosure of the judgements made in reporting the service performance information, if applicable, is reasonable.

45. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance. That conclusion shall take into account:

(a) Whether sufficient, appropriate audit evidence has been obtained;

(b) Whether uncorrected misstatements are material, individually or collectively;

(c) The auditor's evaluation of whether the service performance information is prepared, in all material respects, in accordance with the applicable financial reporting framework.

46. The auditor shall consider:

(a) Any matters arising during the course of the audit of the financial statements that may affect the auditor's evaluation of the service performance information.

(b) The impacts of any matters arising during the audit of the service performance information that may affect the auditor's evaluation of the financial statements.

Report Content

47. The auditor's report on the service performance information shall be included in a single report on the general purpose financial report and shall include the elements required by ISA (NZ) 700 (Revised) as applicable to the service performance information. (Ref: Para. A68–A69)

48. The opinion section of the auditor's report shall:

(a) Identify the service performance information;

(b) State that the service performance information has been audited;

(c) Identify or refer to the service performance criteria; and (Ref: Para. A70–A72)

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[20] Examples of a fair presentation framework include:

- Public Benefit Entity Standards (PBE Standards);
- Public Benefit Entity Standards Reduced Disclosure Regime (PBE Standards RDR);
- Public Benefit Entity Simple Format Reporting – Accrual (Public Sector) (PBE SFR – A (PS));
- Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit) (PBE SFR – A (NFP)).

49. When expressing an unmodified opinion on the service performance information prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

    (a) In our opinion the accompanying general purpose financial report presents fairly, in all material respects, the service performance for the year then ended in accordance with the entity's service performance criteria in accordance with [*the applicable financial reporting framework*]; or

    (b) In our opinion the accompanying general purpose financial report gives a true and fair view of the service performance for the year then ended in accordance with the entity's service performance criteria in accordance with [*the applicable financial reporting framework*].[21]

50. In addition to the requirements addressing financial statements in ISA (NZ) 700 (Revised), the auditor's report shall:

    (a) State, in the basis for opinion section, that the audit of the service performance information was conducted in accordance with International Standards on Auditing (New Zealand) and New Zealand Auditing Standard 1;

    (b) Describe, in the responsibilities for the general purpose financial report section, the responsibilities of those charged with governance:

        - For the preparation of service performance information in accordance with the applicable financial reporting framework;
        - To select service performance criteria that are suitable in order to prepare service performance information in accordance with the applicable financial reporting framework;
        - For such internal control as those charged with governance determine is necessary to enable the preparation of service performance information that is free from material misstatement, whether due to fraud or error.

    When the general purpose financial report is prepared in accordance with a fair presentation framework, the description of responsibilities for the general purpose financial report in the auditor's report shall refer to "the preparation and fair presentation of the service performance information" or the "preparation of service performance information that gives a true and fair view," as appropriate in the circumstances.

    (c) In the "Auditor's Responsibilities for the Audit of the General Purpose Financial Report" section:

        - Describe the audit of the service performance information by stating that, in accordance with the ISAs (NZ) and this New Zealand Auditing Standard, the auditor's responsibilities are to evaluate:

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[21] If the applicable financial reporting framework includes requirements for entity information, the opinion may be required by law, regulation or otherwise to cover the entity information.

i. Whether the selected service performance criteria are suitable so as to result in service performance information that is in accordance with the applicable financial reporting framework;

ii. The overall presentation, structure and content of the general purpose financial report, and whether the general purpose financial report represents the underlying transactions, events and service performance in accordance with the applicable financial reporting framework, including where relevant its fair presentation; and

Key Audit Matters

51. The auditor may be required, or may voluntarily report key audit matters in the auditor's report.[22] If reported, key audit matters shall include matters related to the audit of the service performance information where, in the auditor's judgement, such matters were of most significance to the audit of the general purpose financial report.

Modifications to the Opinion in the Independent Auditor's Report

52. The auditor shall modify the opinion, with respect to the service performance information, when: [23]

    (a) The auditor concludes that the selected service performance criteria are not suitable resulting in service performance information that is not in accordance with the applicable financial reporting framework; (Ref: Para A31–A35)

    (b) The auditor concludes, based on the audit evidence obtained, that the service performance information is not individually or collectively free from material misstatement; or (Ref: Para. A73–A78)

    (c) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the service performance information as a whole is free from material misstatement.

53. When the auditor modifies the opinion with respect to the service performance information, the auditor shall consider the effects of the modification on the opinion on the financial statements. (Ref: Para. A79)

54. When the auditor modifies the audit opinion with respect to the service performance information only, the audit opinion shall clearly indicate that the opinion on the financial statements is not modified. The auditor shall use the headings "Qualified Opinion on the Service Performance Information", "Adverse Opinion on the Service Performance Information" or "Disclaimer of Opinion on the Service Performance Information" as appropriate. The opinion with respect to the financial statements shall use the heading "Opinion on the Financial Statements".[24]

55. If the auditor modifies the opinion on the financial statements, the auditor shall consider the effect of the modification on the opinion on the service performance information.

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[22] ISA (NZ) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

[23] ISA (NZ) 705 (Revised), *Modifications to the Opinion in the Independent Auditors Report*

[24] Where appropriate, the heading may refer to the entity information.

Emphasis of Matter Paragraphs and Other Matter Paragraphs

56. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the service performance information, that in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the service performance information, the auditor shall include an Emphasis of Matter paragraph in the auditor's report. [25]

57. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the service performance information, that in the auditor's judgement, is relevant to users' understanding of the audit of the service performance information, the auditor shall include an Other Matter paragraph in the auditor's report.[26]

Comparative Information

58. Where the entity presents a comparison of published prospective service performance information with the service performance information, the auditor shall evaluate whether the prospective service performance information presented in the general purpose financial report agrees with the information presented in the published prospective service performance information.

Other Information

59. The auditor shall read the other information and consider whether there is a material inconsistency between: [27]

    (a) The other information and the service performance information; and

    (b) The other information and the auditor's knowledge obtained in the audit of the general purpose financial report. (Ref: Para. A80–A81)

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Application and Other Explanatory Material

Scope of this NZ AS (Ref: Para. 1–3, 7(d))

A1. Service performance information is information about what the entity has done during the reporting period in working towards its broader aims and objectives, together with supporting contextual information, prepared in accordance with the applicable financial reporting framework.

A2. Work performed in the audit of the financial statements can often be used for the purpose of the audit of the service performance information. By highlighting matters that are common to both the financial statements and the service performance information, this NZ AS assists the auditor to accept, plan, perform and report in an effective manner, as

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[25] ISA (NZ) 706 (Revised)

[26] ISA (NZ) 706 (Revised)

[27] ISA (NZ) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

well as highlighting areas where there are differences. This is to enable the auditor to perform the audit concurrently, effectively and in an all-encompassing manner.

A3. Some public benefit entities are required by the applicable financial reporting framework to prepare service performance information as part of the general purpose financial report. Appendix 1 illustrates what constitutes the general purpose financial report.

A4. Principles and requirements for the reporting of service performance information are specified within the applicable financial reporting framework as follows:

(a) For Tier 1 and Tier 2 public benefit entities, *PBE FRS 48 Service Performance Reporting*.

(b) For Tier 3 public benefit entities, PBE Simple Format Reporting – Accrual.

(c) For Tier 4 public benefit entities, PBE Simple Format Reporting – Cash.

The Tier 3 and Tier 4 requirements also require entity information to be reported as part of the general purpose financial report. These requirements refer to the general purpose financial report as a performance report.

A5. Some entities that are required by the applicable financial reporting framework to include service performance information in the general purpose financial report, may not be required by law or regulation to have the general purpose financial report audited or reviewed. For example, non-large and non-medium Tier 3 registered charities, and all Tier 4 registered charities may have no statutory assurance requirements. Where the service performance information is not within the scope of the audit engagement, the auditor's responsibility for the service performance information is limited to following the requirements in ISA (NZ) 720 (Revised).

Definitions (Ref: Para. 7(f))

A6. The applicable financial reporting framework includes principles to guide an entity through a process to select what service performance to report on and how to measure and/or describe its service performance and aggregate, present and disclose its service performance information to implement the applicable financial reporting framework. The entity will apply the process, as appropriate to the entity's circumstances, to select what service performance to report on, how to measure and/or describe that service performance, how to structure the information and how the information is related to each other and the entity's overall purpose and strategies. The entity's service performance criteria refers to how the entity applies the qualitative characteristics and pervasive constraints of information if required by the applicable financial reporting framework, applicable to its circumstances, with logical links to the entity's overall purpose and strategies.

A7. Even for the same underlying service performance there can be different service performance criteria which will yield a different measurement or description. For example, an entity might select, as one of its performance measures, the levels of satisfaction using a rating scale on a survey; another entity might select to report the number of complaints received. These are both examples of how the entity evaluates its service performance.

A8. The service performance criteria also address presentation and disclosure. Disclosures comprise explanatory notes or descriptive information, set out as required, expressly

permitted or otherwise allowed by the applicable financial reporting framework. Presentation refers to whether the service performance is appropriately aggregated or disaggregated and clearly described.

Conduct of the Engagement in Accordance with ISAs (NZ) (Ref: Para. 8)

A9. The ISAs (NZ), which are based on the International Standards on Auditing (ISAs), are written in the context of an audit of financial statements by an auditor. Although service performance information is considered to be an integral part of an entity's general purpose financial report, the nature of the underlying subject matter included in the service performance information includes non-financial information which is not part of the financial statements as defined in the ISAs (NZ). However, the requirements of the ISAs (NZ) apply equally to an audit of the entire general purpose financial report, prepared in accordance with the applicable financial reporting framework, where that financial reporting framework also incorporates requirements to prepare service performance information.

A10. The ISAs (NZ), together with this NZ AS, covers all aspects of the audit of the general purpose financial report and therefore there is no requirement for the auditor to apply ISAE (NZ) 3000 (Revised)[28] to the service performance information.

A11. This NZ AS supplements the ISAs (NZ). It expands on how the ISAs (NZ) are to be applied to the service performance information. This NZ AS includes specific requirements for the service performance information that are not dealt with by the ISAs (NZ) or where the application of the ISAs (NZ) differs as a result of the nature of the service performance information.

A12. The relevance of each of the ISAs (NZ) to the service performance information requires careful consideration. For example, ISA (NZ) 240,[29] ISA (NZ) 540,[30] ISA (NZ) 550[31] and ISA (NZ) 570 (Revised)[32] are, in principle, relevant. This is because the service performance information could be misstated as a result of fraud, misstated estimates as a result of measurement that is subject to estimation uncertainty, the effect of related party transactions, or the incorrect application of the going concern basis of accounting under the applicable financial reporting framework.

Agreement on Audit Engagement Terms (Ref: Para. 11)

A13. The terms of the audit engagement for the audit of the general purpose financial report include references to the service performance information. An example of an audit engagement letter for an audit of the general purpose financial report including service performance information is set out in Appendix 4.

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[28] ISAE (NZ) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

[29] ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

[30] ISA (NZ) 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

[31] ISA (NZ) 550, *Related Parties*

[32] ISA (NZ) 570 (Revised), *Going Concern*

Documentation (Ref: Para. 12)

A14. The following are examples of matters that the auditor may consider to be appropriate to include in the audit documentation:

- Planning: The overall engagement strategy, the engagement plan, capturing the nature of the plan, reflecting plans to make connections between the financial statements and service performance information, and any significant changes made during the engagement, and the reasons for such changes;
- Materiality: The materiality levels or materiality factors for the service performance information and matters considered in their determination;
- Risks of material misstatement: Key elements of the understanding obtained regarding the entity and its environment specified in paragraph 21, and the risks of material misstatement for which, in the auditor's professional judgement, further procedures were required;
- Procedures: The nature, timing and extent of the further audit procedures performed, the linkage of those further audit procedures with the risks of material misstatement, and the results of audit procedures;
- Evaluation of misstatements: Misstatements identified during the engagement and whether they have been corrected, the auditor's conclusion as to whether uncorrected misstatements are material, individually or collectively, and the basis for that conclusion.

Communication with Those Charged with Governance (Ref: Para. 16)

A15. The preparation of service performance information is highly judgemental. As a result, the auditor's views on the judgemental areas of reporting the entity's service performance may be particularly relevant to those charged with governance in discharging their responsibilities for the preparation of the service performance information. For example, why the auditor considers the service performance criteria are not suitable to the circumstances. Open and constructive communication including feedback on the maturity of the entity's process to prepare the service performance information, the suitability of its service performance criteria or how the information compares to other entities may drive improvements in reporting over time. This may include comments about, for example, judgemental aspects of what service performance to report on, concerns regarding management bias or the quality of the presentation of the information.

Planning (Ref: Para. 19–20)

A16. Information required to be included in the financial statements by the applicable financial reporting framework may be incorporated therein by cross-reference.[33] Such information is part of the financial statements. Service performance information that is incorporated into the general purpose financial report by cross-reference is part of the general purpose financial report and is subject to the audit in accordance with this NZ AS.

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[33] ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*, paragraph A2

A17. The applicable financial reporting framework may allow flexibility in where and how an entity reports its service performance information. It may be appropriate for an entity to report service performance information about service performance provided by other entities. ISA (NZ) 402[34] may be relevant to the audit of the service performance information, if the user entity makes use of a service organisation for the preparation of service performance reporting with another entity or where the entity outsources aspects of their business to organisations that provide services ranging from performing a specific task under the direction of the entity to replacing an entity's entire business units or functions that are significant to the service performance information. Alternatively, ISA (NZ) 600[35] may be relevant, adapted as necessary to the circumstances, when the auditor involves other auditors in the audit of the service performance information where the service performance information includes information about goods and services provided by other entities.

A18. The service performance information may include information upon which another practitioner may have expressed an opinion. The auditor may decide to use the evidence on which that other practitioner's opinion is based to provide evidence regarding the service performance information included in the general purpose financial report. The work of another practitioner may be used in relation to service performance information that falls outside the boundary of the reporting entity. Such practitioners are not part of the engagement team. Relevant considerations when the engagement team plans to use the work of another auditor may include:

(a) Whether the auditor understands and complies with the requirements of Professional and Ethical Standard 1.

(b) The other practitioner's professional competence.

(c) The extent of the engagement teams' involvement in the work of the other practitioner.

Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing Risks of Material Misstatement (Ref: Para. 21–29)

Obtaining an Understanding of the Entity and its Environment

A19. The entity may follow its own process to identify what and how to report its service performance to implement the applicable financial reporting framework applicable to its circumstances. Without suitable service performance criteria, the entity does not have an appropriate basis on which to prepare the service performance information and the auditor is unable to meet the objectives of the audit. Without the frame of reference provided by transparent assumptions and preparation protocols, any conclusion is open to individual interpretation and misunderstanding. The suitability of what and how to report service performance is context-sensitive, that is, it is determined in the context of the entity's circumstances.

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[34] ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

[35] ISA (NZ) 600, *Special* Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

A20. The selection of what service performance to report on and how to measure or describe that service performance, and then aggregate, disclose and present the information is more judgemental than reporting on financial information. An entity may have a wide variety of performance frameworks, guidance, or codes (or a combination thereof) to choose from in the preparation of this information.

A21. The entity will need to interpret the applicable financial reporting framework and either select pre-existing external service performance criteria, including pre-established performance measures and/or descriptions from guidance, standards, or laws or regulation, or it may need to apply judgement to develop its own internally developed service performance criteria for measuring or describing its service performance. The need for such judgement makes the preparation of the service performance information inherently more susceptible to the risk of management bias.

A22. The application of professional scepticism by the auditor is particularly important when assessing the neutrality and completeness of the service performance criteria due to the level of judgement to be exercised by the entity. This is particularly important if the entity's service performance criteria are not substantially based on established service performance criteria generally used in the entity's sector, or are inconsistent with such criteria. The auditor may need to apply significant professional judgement in the assessment of the suitability of the service performance criteria in situations where a well-designed due process is not followed or where the intended users were not involved in the selection of what service performance to report on and/or how to evaluate the underlying service performance.

A23. The process applied by the entity to determine what to report on and how to report its service performance may affect the work that the auditor carries out. The level of potential management bias in selecting what and how to report its service performance directly correlates with the amount of work that the auditor may need to perform when considering the design of the entity's service performance criteria. For example, use of performance measures specified by external benchmarks, industry guidance, or developed in consultation with intended users may require less work than internally generated performance measures as external guidance reduces the risk of management bias. Transparency about the entity's process to select what and how to report its service performance and the entity's consideration of materiality may also affect the work that the auditor carries out.

A24. Factors that the auditor may consider in obtaining an understanding of the entity's process for identifying what and how to report its service performance include:

- Whether there are factors that are outside the control of the entity or there are long time frames that are required to make assessments of the entity's service performance.
- Examples of the impact of the source of the service performance criteria:
    - The scope of what service performance to report on or how to evaluate such service performance may be embodied in law or regulation specific to the entity, industry or sector in which the entity operates and, in particular, with laws and regulations that specify the form and content of service performance information or which describe the entity's accountability. In the absence of indications to the contrary, such service performance criteria are presumed to be suitable and are publicly available.

- The entity may use a well-established performance framework, theory of change or intervention logic model to explain how its service performance during the reporting period relates to its broader aims and objectives or may have described predetermined objectives or specific performance goals or targets in agreements with key stakeholders, for example, a local authority's Long-Term Plan, statement of intent, charter, recent plans and strategies or in funding contracts or agreements with key funders. Service performance criteria that have been pre-agreed with key stakeholders may have a lower risk of management bias.
- Guidelines developed and issued collectively by a group or published in journals or results of benchmarking studies, for example, central agencies may provide guidance or establish requirements for the preparation of service performance information. The auditor may need to evaluate the suitability of these guidelines to the entity's circumstances and how these align to intended users' needs. More detailed service performance criteria may be more appropriate.

- Results of surveys, e.g., satisfaction surveys, or other evidence of stakeholder consultation, e.g., feedback, complaints, targeted interviews or stakeholder workshops, providing information about who the intended users are and what information they may find helpful to assess the performance of the entity. A well-designed process in developing service performance criteria with involvement of intended users lowers the risk of management bias.
- Other external requirements or agreements with external parties that influence the entity's service performance accountability.
- Other contextual information, including strategic and operational objectives. For example, an entity's constitution, trust deed, mission statement, recent plans and strategies.
- How the entity assesses its service performance for the purposes of internal decision making.
- Whether the entity's service performance criteria have been validated through research conducted to be well correlated with what they are intended to measure or describe.
- Changes from the prior period in the nature or extent of operations.
- Whether it is appropriate to report on information that falls outside of the boundary of the reporting entity.

Suitability

A25. When evaluating whether the service performance criteria are suitable, the auditor is evaluating the judgements made by the entity in applying the qualitative characteristics referred to in the applicable financial reporting framework. The qualitative characteristics described in some of the applicable financial reporting frameworks are similar to the characteristics of suitable criteria described in paragraph 22 but may differ in the words used. Appendix 2 illustrates the similarities. The characteristics in paragraph 22 are framework neutral.

A26. The characteristics are not mutually exclusive, and the relative importance of each characteristic varies according to the circumstances. The entity may exercise significant judgement to select what and how to report its service performance to meet the qualitative characteristics. The auditor applies professional scepticism recognising that circumstances may exist that cause the service performance criteria to be biased, incomplete or otherwise contrary to the qualitative characteristics required by the applicable financial reporting framework.

A27. The auditor's role is to evaluate whether the entity has appropriately applied the qualitative characteristics and pervasive constraints as required by the applicable financial reporting framework in preparing the service performance information. In doing so, the auditor evaluates whether the service performance criteria are suitable. This evaluation is based on a consideration of the process adopted, and choices and trade-offs made by the entity in determining the most appropriate manner to tell its service performance story.

A28. The service performance criteria are suitable when:

(a) The entity has appropriately applied the qualitative characteristics and pervasive constraints to enable users to make an informed assessment of the entity's service performance; and

(b) Include reasonable quantitative or qualitative measures or descriptions of service performance against which the entity's service performance may be assessed and are of particular value or importance for accountability and decision-making purposes.

A29. When evaluating the suitability of the service performance criteria as required by paragraph 22, the auditor may consider:

(a) The intended users of general purpose financial reports and the types of decisions that may be influenced on the basis of the service performance information,

(b) Whether users were involved in the selection of the service performance criteria and if not, reasons why not;

(c) How the qualitative characteristics applied by the entity have influenced the selection of what service performance to report on and how to measure or evaluate that performance (e.g., service performance information must be relevant, but the overall volume of information must also be accessible in order for it to be understandable);

(d) The various components of the entity's service performance and check for credible links, internal logic and consistency with the financial information;

(e) How the entity plans to present and disclose its financial statements and service performance information that is material;

(f) The complexity of the underlying service performance;

(g) Other potentially more suitable service performance criteria that could have been used and reasons why those were not considered;

(h) Potential misunderstanding of the resultant service performance information by intended users;

(i) Knowledge of other similar entities reporting format; and

(j) Open source searches.

A30. The evaluation required by paragraph 22 may be iterative and may require re-evaluation as the auditor's understanding of the entity or the types of decisions that may be influenced on the basis of the service performance information by intended users grows, if the entity makes changes to its service performance criteria or as the auditor gathers audit evidence.

A31. Factors that the auditor may consider when evaluating relevance include:

- The rationale for the selection of what service performance to report on, for example, whether the service performance relates to a significant risk to the public (e.g., the purity of water supply) or that could have a positive or negative effect on social, economic, or environmental wellbeing.
- Whether the service performance information is likely to meet the needs of intended users so as to be useful for decision making, for example, is of significant community interest or interest to the public.
- The extent to which consultation with users has influenced the selection of what service performance to report and how to evaluate the entity's service performance.
- Information that could significantly affect the reputation of the entity.
- Whether the service performance information shows clear and logical links between the service performance to be measured or evaluated and the entity's overall purpose and strategies so that the rationale for their selection is evident.
- Whether the service performance information is clearly linked with the financial information for example, relates to service performance that is financially material; or relates to a performance measure that may have a significant effect on management performance rewards.

A32. Factors that the auditor may consider when evaluating completeness include whether:

- All significant aspects of service performance that would enable the user to make an informed assessment are included;
- The service performance information includes negative aspects of performance or areas where there is a significant risk of performance failure by the entity.

Completeness relates more to a balanced reflection of service performance rather than an overly comprehensive and extensive set of performance measures which can result in too much information, reducing the relevance of the report.

A33. Factors that the auditor may consider when evaluating reliability include whether:

- The service performance is capable of measurement or description in a consistent manner from period to period;
- The process is well defined and there is likely to be evidence to support the information generated;
- The service performance information is capable of validation by the auditor and will not result in unsubstantiated claims, including whether there is a robust and reliable collection process;
- The service performance criteria are likely to result in service performance information that is free from material misstatements, including omission of fact, or

misrepresentation of trend;

- The service performance criteria are consistent with industry benchmarks, where these are available.

A34. Factors that the auditor may consider when evaluating neutrality include whether:

- The service performance criteria are balanced, and are likely to result in information that is aggregated, where appropriate, and covers all important aspects, with suitable emphasis, to fairly reflect the significance to the entity's service performance;
- The selected service performance criteria cover both favourable and unfavourable aspects of the entity's service performance in an unbiased manner;
- The selected service performance criteria are not changed arbitrarily to remove negative aspects of performance year on year.

Special care may be necessary to evaluate neutrality where, for example, there are no externally established service performance criteria, no predetermined performance measures established with key stakeholders or no guidelines developed by an external industry group.

A35. Factors that the auditor may consider when evaluating understandability include whether:

- The format adopted is clearly laid out and presented in a way that will enable the user to identify the main points of the entity's service performance in that year;
- The assessment of service performance is coherent, easy to follow, and will result in service performance information that is clear and logical;
- The service performance information is concise and aggregated where appropriate;
- The information is explained and presented in a way that makes its significance clear.

A36. In the early stages of reporting service performance information, the entity may not have developed an appropriate process, supported by internal controls, to identify what and how to report its service performance and may therefore be unable to include certain aspects of its service performance in its service performance information. The auditor exercises professional judgement to conclude on the impact of any such omissions (including those for which the entity has provided reasons or explanations). This is particularly relevant since entities may be at varying stages of maturity in respect of preparing service performance information.

A37. For example, in the early stages of an entity generating service performance information, an entity may focus its reporting on a particular area of service performance because reporting systems have not yet been established and implemented for other areas. The auditor may still be able to conclude that the service performance criteria are suitable if there are:

(a) Clear disclosures in the service performance information of the facts and reasons surrounding the exclusion of some service performance. However, if the entity makes no progress in developing reporting systems over time or continues to exclude service performance once reporting systems are established and implemented, the auditor may no longer be satisfied that the service performance criteria are suitable; and

(b) The auditor concludes that the disclosures provided will assist intended users in their

decision making.

A38. Service performance information reported because it is readily quantifiable may not be suitable and may not meet the principles of the applicable financial reporting framework. For example, the entity may select service performance to report on the basis that the selected performance is readily measurable. However, it may not be the most relevant information to enable the user to understand or assess the service performance of the entity during the year.

Availability

A39. Entity-developed service performance criteria need to be made available to intended users to enable them to understand how the service performance has been measured or evaluated. The service performance criteria may be made available in one or more of the following ways:[36]

(a) Publicly.

(b) Through inclusion in a clear manner in the presentation of the service performance information. Some performance measures may rely on complex methodologies. The auditor may consider whether complex service performance criteria are transparent, explained with sufficient detail and clarity so that they are considered to be available and enable the intended user to understand how the service performance has been assessed.

(c) Through inclusion in a clear manner in the assurance report.

(d) By general understanding, for example the method for measuring time in hours and minutes. The auditor may consider whether it is clear what the time is measuring. For example, an entity may measure its response time to an outage but will need to be clear as to whether the response time is measured from when a call is lodged, or measures the time taken to address a fault from when someone arrives to address the fault.

A40. In determining whether the service performance criteria are available to intended users, the auditor may consider whether there will be enough context for the service performance information, including whether the rationale for determining:

(a) What service performance to report on; and

(b) Whether to include information about the role of other entities, collaborative relationships and the provision of resources to others

is transparent to users so that users can understand the judgements made in preparing the service performance information.

A41. Disclosure of the judgements made by the entity may assist in making the service performance criteria available to intended users, where, for example, the service performance criteria are internally generated. Alternatively, the service performance criteria used may originate from an external performance framework supplemented by disclosures

[36] EG Au1 Framework for Assurance Engagements, paragraph 47

or cross references, in the general purpose financial report.

Communication

A42. Communication with those charged with governance in a timely manner may enable improvements to be made to the service performance information.

A43. Factors the auditor may consider in determining whether to perform further audit procedures include:

(a) The pervasiveness of the matter;

(b) The materiality of the matter;

(c) Whether the auditor's concern is with respect to the presentation of the information only;

(d) Whether further audit procedures will enable the auditor to express an opinion on some of the service performance information.

Obtaining an Understanding of the Entity's Internal Control (Ref: Para. 30)

A44. Control activities that may be relevant to the audit of the service performance information include policies and procedures that pertain to internal management performance reviews,[37] including reviews and analyses of actual performance versus budgets and relating different sets of data – operating or financial – to one another.

Materiality in Planning and Performing the Engagement (Ref: Para. 31–32)

Consideration of what service performance is included in the report

A45. The relevance of what service performance is selected to be included in the general purpose financial report is strongly linked with judgements made by the entity about the materiality of information. Service performance information is deemed to be material if it could reasonably be expected to influence the decisions of intended users taken on the basis of the general purpose financial report. The service performance information will not be considered to be complete if it does not contain all material service performance.

A46. The applicable financial reporting framework may discuss the concept of materiality in the context of preparation and presentation of service performance information.[38] Such a discussion provides a frame of reference to the auditor in determining materiality. The auditor's consideration of the entity's process to select what and how to report its service performance provides context in determining materiality.

A47. The evaluation required by paragraph 22 and factors considered by the auditor in paragraph A31 and A32, provides a frame of reference to the auditor in understanding what service performance information is of most significance to intended users, and may assist in identifying the risks of material misstatement in the service performance information.

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[37] ISA (NZ) 315 (Revised), Appendix 1, paragraph 9

[38] PBE IPSAS 1 *Presentation of Financial Statements, paragraphs 46A.1–2* and Explanatory Guide A7: *Materiality for Public Benefit Entities*

A48. When determining materiality, the auditor may:

- Discuss the entity's process for determining material service performance information with management and those charged with governance (and, if necessary and appropriate, external stakeholders). It may be appropriate to discuss matters with external stakeholders when the determination of the entity's material service performance information includes, for example, clearly contentious issues or performance measures for which there is no evidence to support the entity's role in the improvements reported.
- Consider whether the entity's determination of material service performance information is consistent with the auditor's knowledge of the entity and the environment, including reporting by similar entities and previous reporting by the entity and information obtained from sources such as minutes of meetings, media reports and any stakeholder outreach activities, including satisfaction surveys, feedback and complaints received, open source searches, targeted interviews or stakeholder workshops.

Materiality levels and factors

A49. The materiality levels are expressed in terms of the appropriate unit of account for each element or performance measure reported. The materiality level determines what level of misstatement will be tolerated by the auditor. Using a percentage is another commonly used way to establish such a level. It may be possible to group similar service performance information and make materiality decisions on the same basis if they have the same unit of account. The basis and level may differ from the basis and level for determining materiality as required by ISA (NZ) 320.

A50. There are multiple factors that may lead to a material misstatement:

(a) Omissions of fact – could omissions result in misleading the user?

(b) Misstatements of fact – could a misstatement result in misleading the user?

(c) Misrepresentation of trend – does the service performance information make claims that do not represent the facts available?

(d) Bias – does the service performance information focus unduly on positive aspects of performance, or omit negative aspects?

(e) Unsubstantiated claims.

A51. The following factors may assist the auditor when exercising professional judgement in determining whether there are material misstatements in either the qualitative or quantitative service performance information:

(a) How the information is presented. For example, does the presentation draw attention to particular information? The auditor may be less tolerant of misstatement in information that is given the most prominence.

(b) The relative volatility of reported service performance information. For example, if service performance information varies significantly from period to period.

(c) The number of persons or entities affected.

(d) The importance of the activity to achieving the entity's service performance objectives. For example, whether the performance measures related to the primary purpose of the entity. The more important the activity, the less tolerance for misstatement.

(e) The extent of interest shown in particular aspects of service performance by, for example, the applicable legislation, funders, the media or the public and whether the service performance information is likely to cause funders to increase or decrease funding in the entity. The higher the level of interest shown, the lower the tolerance for misstatement. For matters where there is the most significant interest, the auditor may be less accepting of potentially misleading or inaccurate information.

(f) The type of performance measures and/or descriptions adopted, including the sensitivity of the information to error or the wording chosen to express a description. In some cases, there are particular types of disclosures for which misstatements of lesser or greater amounts are acceptable.

(g) The interaction between, and relative importance of, various components of the service performance information when it is made up of multiple components, such as information that includes numerous performance measures or relates to an activity that is financially significant. The auditor may be less tolerant of misstatement for information that is given the most prominence.

(h) The economic, social, political and environmental effect of a project or an entity's work, for example, there is a high level of wider societal interest in it, particularly high levels of public sensitivity, or relate to activity that could be a significant risk to the public.

(i) Whether there is information about achieving a target or threshold, and the relationship of the actual performance to the target. For example, if the entity compares actual performance to a previously reported target, the auditor may be particularly diligent where a target has only just been achieved.

(j) Whether a misstatement is the result of an intentional act or is unintentional. For example, intentional attempts to mislead users may result in the auditor performing more detailed work.

(k) Whether a misstatement is significant having regard to the auditor's understanding of known previous communications to users.

(l) Whether a particular aspect of the service performance information is significant with regard to the nature, visibility and sensitivity of the information. For example, there has been a large number of complaints relating to it, or relates to an activity that is strongly linked to management performance rewards.

A52. The auditor is unlikely to be able to set an overall materiality level because there is unlikely to be a common unit of account. It is also unlikely that the auditor will be able to aggregate misstatements. However, this does not remove the need for the auditor to form a conclusion as to whether uncorrected misstatements are material individually or collectively as required by paragraph 45.

A53. For historical financial information extracted from the audited financial statements, the auditor may determine that the materiality level used in the audit of the financial statements

are acceptable for the purposes of the service performance information.

Identifying and Assessing Risks of Material Misstatement (Ref: Para. 34)

Assertions about service performance and related disclosures

A54. The auditor may use the assertions as described in paragraph A56 or may express them differently provided all aspects described below have been covered. For example, the auditor may choose to combine the assertions about occurrence and attribution.

A55. In the public sector, the entity may assert compliance with law or regulation, in addition to the assertions set out in paragraph A56.

A56. Assertions used by the auditor in considering the different types of potential misstatements of service performance information that may occur may fall into the following categories:

(a) Occurrence – service performance that has been reported has occurred.

(b) Attributable to the entity – the service performance reported by the entity includes only service performance that the entity has evidence to support its involvement with.

(c) Completeness – all significant service performance that should have been reported has been included in the service performance information.

(d) Accuracy – service performance has been reported, measured and described appropriately and is not inconsistent with financial statement information.

(e) Cut-off – the service performance has been reported in the correct period.

(f) Presentation – service performance is appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable.

The Auditor's Responses to Assessed Risks (Ref: Para. 35–36)

A57. Procedures that may be performed include:

(a) Testing and evaluating the systems, processes and controls that capture, record, analyse and monitor the service performance information;

(b) Performing analytical review procedures;

(c) Performing other substantive or re-performance tests.

A58. The quality of the systems used to record and control results, and the nature and quality of evidence available, may have an effect on the mix of procedures used. For instance, a weak recording or control system may force the auditor to use primarily substantive procedures. In rare cases, the absence of controls may make it impossible to obtain sufficient appropriate audit evidence.

A59. In some instances, there may not be control activities that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform audit procedures that are primarily substantive procedures. In rare cases, the absence of controls may make it impossible to obtain sufficient appropriate audit evidence.

Audit Evidence (Ref: Para. 37)

A60. Making correlations with audit evidence obtained in the audit of the financial statements, as far as possible, maximises the effectiveness of the audit of the general purpose financial report.

A61. The mix of procedures to be performed may vary compared with the mix used in regard to the financial information but does not alter the need to obtain sufficient appropriate audit evidence.

A62. The auditor's procedures may include:

(a) Agreeing or reconciling amounts reported in the service performance information to any underlying financial records;

(b) Agreeing cross references between the service performance information and the financial statements;

(c) Understanding any allocation methods adopted and assumptions made, and determining whether the methods adopted are suitable, have been applied consistently and are consistent with the applicable financial reporting framework; and

(d) Reconciling the aggregate amounts reported in the service performance information to the amounts reported in the financial statements.

Written Representations (Ref: Para. 41)

A63. The representation letter for the audit of the general purpose financial report includes references to the service performance information. An example of an illustrative representation letter for the audit of the general purpose financial report that includes service performance information is set out in Appendix 5.

Using the Work of an Auditor's Expert (Ref: Para. 42)

A64. Expertise in a field other than accounting or auditing may be necessary as a result of information included in the service performance information. Examples may include expertise in relation to such matters as:

- The measurement of complex performance measures, for example:
  - Climate change calculations;
  - Specific scientific measurements;
  - Social impact measurement
  - Human rights performance
  - People and diversity disclosure
- Assertions made about the entity's performance, for example, when reporting on the difference that the entity has made;
- Conformity assessments, ecolabelling and certification programmes.

Forming an Opinion and Reporting (Ref: Para. 43–44)

A65. The auditor's conclusion on the service performance information covers both:

(a) Whether the service performance criteria are suitable so as to result in service performance information in accordance with the applicable financial reporting framework; and

(b) Whether the service performance information represents the underlying service performance in accordance with the applicable financial reporting framework, including where relevant its fair presentation.

A66. Those charged with governance will make a number of judgements about the selection, measurement, description, aggregation, presentation and disclosure of the service performance information reported. In considering the qualitative characteristics described in the applicable financial reporting framework, the auditor may become aware of management bias. The auditor may conclude that the collective effect of the lack of neutrality, together with the effect of uncorrected misstatements causes the service performance information to be materially misstated.

A67. The disclosure of significant judgements made in selecting, measuring, describing and aggregating service performance information is particularly important so that users can understand how particular service performance is reported in the service performance information.

Report Content (Ref: Para. 7(b), 47–50)

A68. The auditor's report on the general purpose financial report includes references to the service performance information. An illustrative report that includes references to the service performance information is set out in Appendix 6.

A69. This NZ AS requires the auditor's report to include at least all elements required by ISA (NZ) 700 (Revised). However, this NZ AS allows for flexibility and an auditor may include additional information, as described in paragraphs A70-A71, resulting in a long-form report.

A70. The auditor's report identifies or refers to the service performance criteria so the intended users can understand the basis for the auditor's opinion.

A71. The auditor's report may describe additional details relevant to the audit of the service performance information that do not affect the auditor's opinion. This information may be required by legislation or agreed in the terms of the engagement to assist intended users in decision making based on the service performance information. A long-form report should not be worded in a manner that it may be regarded as a modification of the auditor's opinion. The auditor's report may describe, for example:

- The underlying facts and information about the entity's process to select what service performance to report on (e.g., the maturity of the entity's process compared to others in the industry).
- The source of the service performance criteria, and whether they are externally established (e.g., established in section xxx of applicable legislation or externally established performance frameworks).
- Any significant interpretations made in selecting or applying the entity's service performance criteria in the circumstances.

- Whether there have been any changes in the service performance criteria (e.g., changes in the performance measures used).
- Findings or recommendations for improvements to the service performance information.
- Any other matters the auditor considers necessary to assist intended users in making decisions based on the service performance information.

A72. The auditor is encouraged to report their findings or recommendations where the auditor considers the information would enhance transparency and assist the user to understand the level of maturity that the entity has achieved in its reporting. Reporting of findings and recommendations may promote and also highlight to the user improvements in reporting over time.

Modifications to the Opinion in the Independent Auditor's Report (Ref: Para. 28, 52)

A73. A misstatement of the service performance information may arise in relation to:

(a) The suitability of the service performance criteria;

(b) The application of the service performance criteria;

(c) Inadequate disclosure of judgements made, where applicable; or

(d) Incomplete disclosures that do not include all disclosures required by the applicable financial reporting framework or do not achieve fair presentation of the service performance information.

A74. In relation to the suitability of the service performance criteria, material misstatements of the service performance information may arise, for example, when:

(a) The entity's service performance criteria are not consistent with the principles in the applicable financial reporting framework.

(b) The entity has not appropriately applied the qualitative characteristics, in accordance with the applicable financial reporting framework and therefore the service performance information does not enable a meaningful assessment of performance to be made by intended users.

A75. The auditor may determine that a material misstatement exists in the service performance information:

(a) When, in the auditor's professional judgement, the service performance criteria are likely to mislead the intended users. A qualified opinion or adverse opinion would be appropriate in the circumstances depending on how material and pervasive the matter is.

(b) In other cases, a qualified opinion or a disclaimer of opinion would be appropriate depending on, in the auditor's professional judgement, how material and pervasive the matter is.

A76. In relation to the application of the service performance criteria, material misstatements of the service performance information may arise:

(a) Due to a misapplication of the criteria (e.g., an unintentional error in application of a

formula developed to report a performance measure). A qualified opinion may be appropriate in the circumstances where there is a material misstatement that is not pervasive.

(b) When the criteria are not applied consistently to the service performance, or not applied consistently between periods.

A77. In relation to the appropriateness or adequacy of disclosures in the service performance information, material misstatements may arise when:

(a) The service performance information does not provide all disclosures required by the applicable financial reporting framework.

(b) The service performance information does not provide all disclosures necessary to achieve fair presentation of the service performance information.

A78. Appendix 4 includes illustrative auditor's reports with a qualified, adverse or disclaimer of opinion with respect to the service performance information.

A79. In many instances, a modification with respect to the service performance information will have no impact on the opinion on the financial statements.

Other Information (Ref: Para. 59)

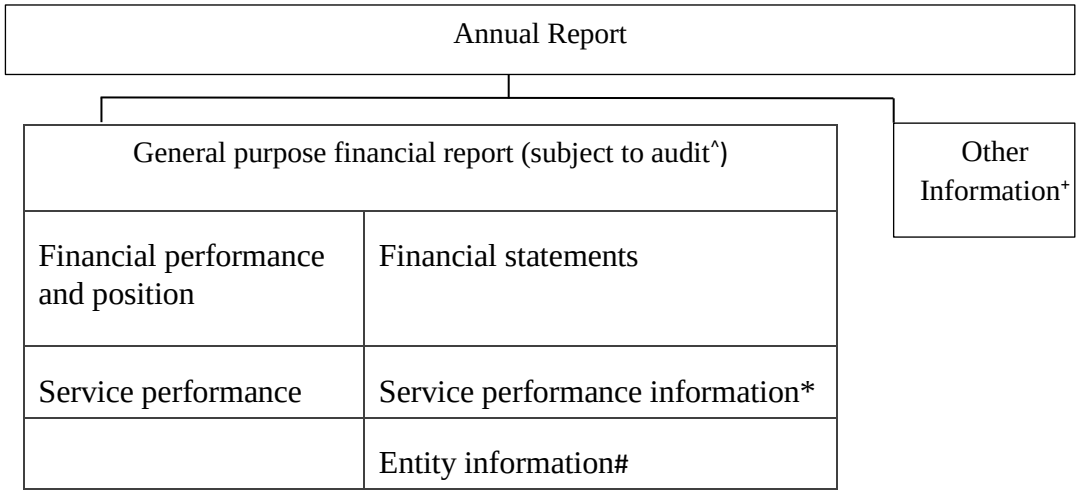
A80. Appendix 1 illustrates what constitutes other information for the purposes of this NZ AS.

A81. Other information, whether financial or non-financial information (other than the financial statement information and service performance information) may be included in an annual report. The auditor's opinion does not cover the other information. The auditor's responsibilities regarding other information within the annual report, but located outside of the general purpose financial report as defined in this NZ AS, is determined by ISA (NZ) 720 (Revised) and by this NZ AS.

Appendix 1

(Ref: Para. 3,7, 8, A3, A80)

What Constitutes the General Purpose Financial Report



^ Some entities are required by law or regulation to have the general purpose financial report audited or reviewed. Other entities may elect to include service performance information within the scope of the audit. Where the service performance information is not included within the scope of the audit, this NZ AS does not apply.

* Service performance information may be included in the general purpose financial report by cross-reference where the applicable financial reporting framework permits disclosures to be cross referenced.

\# Where entity information is required to be included in the general purpose financial report by the applicable financial reporting framework.

\+ Other information may include forward looking information, other historical information and management discussion and analysis. ISA (NZ) 720 (Revised) addresses the auditor's responsibilities with respect to other information. ISA (NZ) 720 (Revised) applies to the service performance information when service performance information is not included within the scope of the audit.

Appendix 2

(Ref: Para. 22)

Service Performance Criteria

	Financial reporting framework	Preparer	Auditor
Financial statements	Detailed recognition and measurement requirements established in PBE Standards	Apply the recognition and measurement requirements and disclose the accounting policies applied	The recognition and measurement requirements from PBE Standards are suitable
Service performance information	Principles in PBE Standards require the preparer to apply the qualitative characteristics and pervasive constraints	Apply the entity's process to select what service performance to report and how to measure, describe, aggregate, present and disclose its service performance	Auditor evaluates whether the service performance criteria are suitable

Are the service performance criteria suitable? (Ref: Para 22) [39]	**These may be articulated differently in the applicable financial reporting framework (Ref: Para. A29)**[40]
Relevance	Relevance including timeliness
Reliability	Includes verifiability
Completeness Neutrality	Faithful representation including: Completeness Neutrality
Understandability	Understandability and comparability

[39] EG Au1A, *Framework for Assurance Engagements*, paragraph 44.

[40] The qualitative characteristics are described in PBE FRS 48 paragraph 9.

Appendix 3

Flowchart of the Audit of Service Performance Information (SPI) included in the General Purpose Financial Report (GPFR)

Acceptance

The auditor shall obtain agreement that those charged with governance (TCWG) accept responsibility for service performance criteria that are suitable in order to prepare SPI in accordance with the AFRF (Ref: Para. 11)

Planning

The auditor shall develop the audit plan to concurrently cover financial statement information together with the SPI. (Ref: Para. 17)

The auditor shall obtain an understanding of:

- the applicable financial reporting framework (AFRF) and the legal framework applicable to the entity (Ref: Para. 14,18)
- the entity's service performance, the context in which it operates and its process to identify what and how to report (Ref: Para. 21)
- how much discretion the entity has and/or the extent of consultation with intended users to influence the service performance criteria used to report (Ref: Para. 21)
- the internal controls operating over preparation of the SPI. (Ref: Para. 30)

The auditor shall identify and assess the risks of material misstatement at the SPI and at the assertion level. (Ref: Para. 34)

Performing

Are the service performance criteria suitable? (Ref: Para. 22)

No

Discuss with TCWG.

Can meaningful changes be made for the current year? (Ref: Para. 26)

Yes

No

Materiality considerations cover:

- Service performance criteria are suitable (Ref: Para. 22)
- Individual and collective misstatements (Ref: Para 31)

The auditor shall evaluate whether the service performance criteria are available to intended users. (Ref: Para. 24)

The auditor shall:

- determine and document materiality levels and/or materiality factors to be applied to the SPI. (Ref: Para. 32)
- design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to all material SPI. (Ref: Para. 35, 36)
- request written representations covering responsibility for the SPI. (Ref: Para. 41)

Reporting

The auditor shall form an opinion on whether the SPI is prepared in accordance with the entity's service performance criteria in accordance with the AFRF. (Ref: Para. 43)
Consider whether to prepare a long-form report. (Ref: Para. A68)
Are there serious concerns about the suitability of the service performance criteria, the content of the SPI, and/or, the fair presentation of the SPI, if applicable?

No

Issue an unmodified opinion on the SPI. (Ref: Para. 49)

Yes

Issue a modified opinion on the SPI.

Appendix 4

(Ref: Para. A13)

Illustrative Engagement Letter Including Service Performance Information

The following is an example of an audit engagement letter for an audit of the general purpose financial report, including service performance information prepared in accordance with an applicable fair presentation financial reporting framework issued by the New Zealand Accounting Standards Board. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in the ISAs (NZ) including this NZ AS 1. It will need to be varied according to individual requirements and circumstances.

***

To the Chairperson:[41]

[*The objective and scope of the audit*]

You have requested that we audit the [*general purpose financial report/performance report*] of ABC [Entity], which comprise the financial statements, the *[service performance information/statement of service performance] [and the entity information]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity], the* statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the [*entity information,* financial statements as a whole*, and the service performance information/statement of service performance* are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and New Zealand Auditing Standard (NZ AS) 1 *The Audit of Service Performance Information* will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of this [*general purpose financial report/performance report*].

[*The responsibilities of the auditor*]

We will conduct our audit of the financial statements in accordance with ISAs (NZ) and the audit of the service performance information in accordance with the ISAs (NZ) and NZ AS 1. Those standards require that we comply with ethical requirements. As part of an audit in accordance with ISAs (NZ) and NZ AS 1, we exercise professional judgement and maintain professional

[41] The addressees and references in the letter would be those appropriate in the circumstances of the engagement. It is important to refer to the appropriate persons – refer to ISA (NZ) 210 paragraph A22.

scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the [*entity information, the financial statements and the service performance information*], whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of [*the entity information*], the financial statements and the service performance information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the [*general purpose financial report/performance report*] that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain an understanding of the process applied by the entity to select what and how to report its service performance.
- Evaluate whether the service performance criteria are suitable so as to result in service performance information that is in accordance with the [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*].
- Evaluate the overall presentation, structure and content of the [*general purpose financial report/performance report*] and whether the [*general purpose financial report/performance report*] represents the underlying transactions, events and service performance in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* [in a manner that achieves fair presentation].
- Conclude on the appropriateness of the use of the going concern basis of accounting by those charged with governance and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the [entity]'s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the [*general purpose financial report*/*performance report]* or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the [entity] to cease to continue as a going concern.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs (NZ).

[*The responsibilities of those charged with governance and identification of the applicable financial reporting framework*]

Our audit will be conducted on the basis that [those charged with governance] acknowledge and understand that they have responsibility on behalf of the entity for:

(a) The preparation [and fair presentation] of the [*entity information*], financial statements and [*service performance information/statement of service performance*] in accordance with [*Public Benefit Entity Standards/ Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*;

(b) Service performance criteria that are suitable in order to prepare service performance information in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*; and

(c) Such internal control as [they] determine is necessary to enable the preparation of the [financial statements and [*service performance information/statement of service performance*] that are free from material misstatement, whether due to fraud or error; and

(d) To provide us with:

(i) Access to all information of which [management and those charged with governance] are aware that is relevant to the preparation of the [*general purpose financial report/performance report*] such as records, documentation and other matters;

(ii) Additional information that we may request from [management or the directors] for the purpose of the audit; and

(iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.*]

[**Reporting**]

[*Insert appropriate reference to the expected form and content of the auditor's report*.]

The form and content of our report may need to be amended in the light of our audit findings [and may be in long-form, including findings or recommendations related to the entity's service performance information.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the [*general purpose financial report/performance report*] including our respective responsibilities.

[Governing body]

Acknowledged and agreed on behalf of the [Governing body] by

(signed)
.....

Name and Title

Date

Appendix 5

(Ref: Para. A61)

Illustrative Representation Letter Including Service Performance Information

The following illustrative letter includes written representations that are required by this standard and other ISAs (NZ). It is assumed in this illustration that the applicable financial reporting framework is a fair presentation framework, and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor) (Date)

This representation letter is provided in connection with your audit of the [*general purpose financial report/performance report*][42] of ABC Entity for the year ended December 31, 20XX which comprise the financial statements, the *[service performance information/statement of service performance] [and the entity information]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, and the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity], the* statement of cash flows and notes to the financial statements, including a summary of significant accounting policiesfor the purpose of expressing an opinion as to whether the [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*):

- [*the entity information as at December 31, 20XX*];
- the financial position of the [entity] as at December 31, 20XX, and (of) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20XX in accordance with the entity's service performance criteria

in accordance with [*Public Benefit Entity (PBE) Standards*/ *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*].

We confirm that (*to the best of our knowledge and belief, having made such enquiries as we considered necessary for the purpose of appropriately informing ourselves*):

[General Purpose Financial Report/Performance Report]

We have fulfilled our responsibilities on behalf of [the entity], as set out in the terms of the audit engagement dated [insert date]:

- For the preparation, and fair presentation of the [*entity information*], financial statements and [*service performance information/statement of service performance*] in accordance with

[42] Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

[*PBE Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*] issued by the New Zealand Accounting Standards Board.

- To select service performance criteria that are suitable in order to prepare service performance information in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* (NZ AS 1)
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (ISA (NZ) 540)
- Related party relationships and transactions have been appropriately accounted for and disclosed in the financial statements in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*. (ISA (NZ) 550)
- All events subsequent to the date of the financial statements which require adjustment or disclosure have been adjusted or disclosed. (ISA (NZ) 560)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate or collectively, to the [financial statements as a whole and [*service performance information/statement of service performance*]. A list of the uncorrected misstatements is attached to the representation letter. (ISA (NZ) 450)
- [Any other matters that the auditor may consider appropriate.]

Information Provided

- We have provided you with[43]:
  - Access to all information of which we are aware that is relevant to the preparation of the [*general purpose financial report/performance report*] such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the [financial statements and [*service performance information/statement of service performance*] may be materially misstated as a result of fraud. (ISA (NZ) 240)
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - Management;
  - Employees who have significant roles in internal control; or

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43 If the auditor has included other matters relating to the responsibilities of those charged with governance in the audit engagement letter in accordance with ISA (NZ) 210, *Agreeing the Terms of Audit Engagements,* consideration may be given to including these matters in the written representations from those charged with governance.

  - Others where the fraud could have a material effect on the [*general purpose financial report/performance report*]. (ISA (NZ) 240)
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's [*general purpose financial report/performance report*] communicated by employees, former employees, analysts, regulators or others. (ISA (NZ) 240)
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing a [*general purpose financial report/performance report*]. (ISA (NZ) 250)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (ISA (NZ) 550)
- We will provide the final version of the documents determined to comprise the annual report to the auditor when available, and prior to its issuance by the entity.[44] (ISA (NZ) 720 (Revised))
- [Any other matters that the auditor may consider necessary.]

Governing body member	Governing body member

[44] This is only required when the other information is not available until after the date of the auditor's report.

Appendix 6

(Ref: Para. A66)

Illustrative Auditor's Report Including Service Performance Information

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- **Audit of a general purpose financial report/performance report of a public benefit entity that is not a FMC reporting entity considered to have a higher level of public accountability using a fair presentation framework[45]. The audit is not a group audit (i.e., ISA (NZ) 600 does not apply).**
- **The general purpose financial report/performance report is prepared by management of the entity in accordance with a general purpose framework.**
- **The terms of the audit engagement reflect the description of the responsibilities of those charged with governance for the general purpose financial report/performance report in ISA (NZ) 210.**
- **The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.**
- **Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* comprises all of the relevant ethical requirements that apply to the audit.**
- **Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA (NZ) 570 (Revised).**
- **The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA (NZ) 701.**
- **The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.**
- **The auditor has no other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

To Appropriate Addressee

Opinion

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx*, the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the [*statement of financial performance/statement of comprehensive revenue and expense, statement of*

[45] The general purpose financial report may be referred to as a performance report and include entity information, according to the requirements of the applicable financial reporting framework.

changes in net assets/equity], statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*):

- [*the entity information as at December 31, 20X1*];
- the financial position of the [entity] as at December 31, 20X1, and (of) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20X1 in accordance with the entity's service performance criteria

in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)*] issued by the New Zealand Accounting Standards Board.

[For a long-form report, include a separate section, under an appropriate heading, for example:

- Underlying facts and information about the entity's process to select what service performance to report on (e.g., the maturity of the entity's process compared to others in the industry).
- The source of the service performance criteria, and whether they are externally established. (e.g., established in section xxx of applicable legislation or externally established performance frameworks).
- Any significant interpretations made in selecting or applying the entity's service performance criteria in the circumstances.
- Whether there have been any changes in the service performance criteria (e.g., changes in the performance measures used).
- Findings or recommendations for improvements to the service performance information.
- Any other matters the auditor considers necessary to assist intended users in making decisions based on the service performance information.]

Basis for Opinion

We conducted our audit of the [*financial statements*] in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs and New Zealand Auditing Standard (NZ AS) 1 *The Audit of Service Performance Information* (NZ). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [*entity*] in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the general purpose financial report/performance report and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 1 in Appendix 2 of ISA (NZ) 720 (Revised).]

Responsibilities of Those Charged with Governance for the [*General Purpose Financial Report/Performance Report*]

Those charged with governance are responsible on behalf of the [entity] for:

(a) the preparation and fair presentation of the [*entity information*], financial statements and [*service performance information/statement of service performance*] in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board;

(b) service performance criteria that are suitable in order to prepare service performance information in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit]*; and

(c) such internal control as those charged with governance determine is necessary to enable the preparation of the financial statements and [*service performance information/statement of service performance*] that are free from material misstatement, whether due to fraud or error.

In preparing the [*general purpose financial report/performance report*], those charged with governance are responsible for assessing the [entity's] ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless those charged with governance either intend to liquidate the [entity] or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the [*General Purpose Financial Report/Performance Report*]

Our objectives are to obtain reasonable assurance about whether the [*entity information,* financial statements as a whole*, and the service performance information/statement of service performance*] are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) and NZ AS 1 will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate or collectively, they could reasonably be expected to influence the decisions of users taken on the basis of this [*general purpose financial report/performance report*].

A further description of the auditor's responsibilities for the audit of the [*general purpose financial report/performance report*] is located at the XRB's website at https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/.

Paragraph 41(b) of ISA (NZ) 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report.

Paragraph 41(c) explains that when law, regulation or ISAs (NZ) expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below. Paragraph NZ A57.1 states that when the auditor refers to a description of the auditor's responsibilities on a website, the appropriate authority is the External Reporting Board and the website address is https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/.

As part of an audit in accordance with ISAs (NZ) and NZ AS 1, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the [*entity information, the financial statements and the service performance information*], whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of [*the entity information*], the financial statements and the service performance information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the [Entity's] internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain an understanding of the process applied by the entity to select what and how to report its service performance.
- Evaluate whether the service performance criteria are suitable so as to result in service performance information that is in accordance with the [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]*.
- Evaluate the overall presentation, structure and content of the [*general purpose financial report/performance report*] and whether the [*general purpose financial report/performance report*] represents the underlying transactions, events and service performance in accordance with [*Public Benefit Entity Standards/ Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* in a manner that achieves fair presentation.
- Conclude on the appropriateness of the use of the going concern basis of accounting by those charged with governance and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the [entity]'s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the [*general purpose financial report/performance report*] or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the [entity] to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Appendix 7

(Ref: Para. A76)

Illustrations of Auditor's Reports with Modifications to the Opinion with Respect to the Service Performance Information

- Illustration 1: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to a material misstatement of the service performance information.
- Illustration 2: An auditor's report containing an unmodified opinion on the financial statements and an adverse opinion due to a material misstatement of the service performance information.
- Illustration 3: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the service performance information.
- Illustration 4: An auditor's report containing a qualified opinion on both the financial statements and the service performance information due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements.

Illustration 1: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to a material misstatement of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity]*, statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*) the [*entity information and the*] financial position of the [entity] as at December 31, 20X1, and (*of*) its, financial performance and its cash flows for the year then ended in accordance with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Qualified Opinion on the Service Performance Information

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion on the Service Performance Information* section of our report the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects (or *gives a true and fair view of*) the service performance of the [entity] for the year ended December 31, 20X1 in accordance with the entity's service performance criteria and with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion on the Service Performance Information

[As reported in the service performance information on page xx, the entity has identified its service performance as [*describe improvements reported or description of the difference that the entity has made]* and measured this performance by [list performance measures and/or descriptions reported] to report its service performance. The entity has not been able to provide evidence of its role in those particular improvements and therefore should not have reported this improvement.]

We conducted our audit of the [*financial statements*] in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [*entity*] in accordance with Professional and

Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report*] and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 6 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information].

Responsibilities of Those Charged with Governance for the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Illustration 2: An auditor's report containing an unmodified opinion on the financial statements and an adverse opinion due to a material misstatement of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity],* statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*) the [*entity information and the*] financial position of the [entity] as at December 31, 20X1, and (*of*) its financial performance and its cash flows for the year then ended in accordance with [*Public Benefit Entity Standards Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Adverse Opinion on the Service Performance Information

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion on the Service Performance Information* section of our report the accompanying [*general purpose financial report/ performance report]* does not present fairly (or *does not give a true and fair view of*) the service performance of the [entity] [*on pages x to xx]* for the year ended December 31, 20X1 in accordance with the entity's service performance criteria and with [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Adverse Opinion on the Service Performance Information

[As reported in the service performance information on pages …, the entity has identified its service performance to include [list appropriate goods and services] and measured and evaluated this performance with reference to [describe performance measures and/or descriptions reported] to report its service performance. We do not consider that these performance measures will enable a meaningful assessment of the service performance of the entity for the year ended December 31, 20X1 to be made. Had the entity identified more meaningful performance measures, the service performance information would have been materially affected, reporting performance measures including xxx and linking to its responsibility for yyyy.]

We conducted our audit of the [*financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report] section of our report. We are independent of the [*entity*] in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report*] and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 7 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 7 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information].

Responsibilities of Those Charged with Governance for the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [*General Purpose Financial Report/Performance Report*]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Illustration 3: An auditor's report containing an unmodified opinion on the financial statements and a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the service performance information

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Opinions

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity],* statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion on the [Entity Information and] Financial Statements

In our opinion, the accompanying [*general purpose financial report/performance report*] presents fairly, in all material respects, (or *gives a true and fair view of*) the [*entity information and the*] financial position of the [entity] as at December 31, 20X1, and (*of*) its financial performance and its cash flows for the year then ended in accordance with [*Public Benefit Entity Standards*/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Qualified Opinion on the Service Performance Information

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion on the Service Performance Information* section of our report the accompanying [*general purpose financial report/performance report]* presents fairly, in all material respects (or *gives a true and fair view of*) the service performance of the [entity] for the year ended December 31, 20X1 in accordance with the entity's service performance criteria and with [Public Benefit Entity Standards/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion on the Service Performance Information

[Some significant performance measures of the entity, rely on information from third parties, such as (*give examples*). The entity's control over much of this information is limited, and there are no practical audit procedures to determine the effect of this limited control. For example, [*describe performance measure and explain where information comes from that we are unable to independently test.*]]

We conducted our audit of the [*financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance*

Report] section of our report. We are independent of the [*entity*] in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report]* and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 6 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information]

Responsibilities of Those Charged with Governance for the [General Purpose Financial Report/Performance Report*]*

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Illustration 4: Qualified opinion on both the financial statements and the service performance information due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements

INDEPENDENT AUDITOR'S REPORT

To [Appropriate Addressee]

Qualified Opinion on the [General Purpose Financial Report/Performance Report*]*

We have audited the *[general purpose financial report/performance report*] of ABC [entity], which comprise the financial statements on pages *x to xx,* the *[service performance information/statement of service performance]* on pages *x to xx [and the entity information on page x]*. The complete set of financial statements comprise the statement of financial position as at December 31, 20X1, the *[statement of financial performance/statement of comprehensive revenue and expense, statement of changes in net assets/equity*], statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report the accompanying [*general purpose financial report/performance report]* presents fairly, in all material respects (or *gives a true and fair view of*):

- [*the entity information as at December 31, 20X1*];
- the financial position of the [entity] as at December 31, 20X1, and (*of*) its financial performance, and its cash flows for the year then ended; and
- the service performance for the year ended December 31, 20X1 in accordance with the entity's service performance criteria

in accordance with [Public Benefit Entity Standards/*Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* issued by the New Zealand Accounting Standards Board.

Basis for Qualified Opinion

[As outlined on page xx of the [*general purpose financial report/ performance report]*, [entity] has not applied the requirements of the [*Public Benefit Entity Standards/Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)]* to its grant expenditure. We have been unable to obtain sufficient audit evidence to quantify the effects of this limitation. As a result of this matter, we were unable to quantify the adjustments that are necessary in respect of grant expenditure in the [*statement of comprehensive revenue and expenses*]; assets, liabilities and equity in the statement of financial position, [*total comprehensive revenue and expense]* and opening and closing equity in the [*statement of changes in equity]* and grants expense reported in the [*service performance information/statement of service performance*].]

We conducted our audit of the [*financial statements]* in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and the audit of the service performance information in accordance with the ISAs (NZ) and New Zealand Auditing Standard 1 *The Audit of Service Performance Information*. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the [General Purpose Financial Report/Performance Report]* section of our report. We are independent of the [entity] in accordance with Professional and

Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other than in our capacity as auditor we have no relationship with, or interests in, the [entity].

Other Information [or another title if appropriate such as "Information other than the [*general purpose financial report/performance report]* and auditor's report thereon"]

[Reporting in accordance with the reporting requirements in ISA (NZ) 720 (Revised) – see Illustration 6 in Appendix 2 of ISA (NZ) 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customised to describe the specific matter giving rise to the qualified opinion that also affects the other information].

Responsibilities of Those Charged with Governance for the [General Purpose Financial Report/Performance Report]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

Auditor's Responsibilities for the Audit of the [General Purpose Financial Report /Performance Report]

[*Reporting in accordance with ISA (NZ) 700 (Revised) – see Illustration 3A in ISA (NZ) 700 (Revised)*].

[*Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate*]

[*Auditor Address*]

[*Date*]

Conforming Amendments to Other Pronouncements

New text is underlined.

Conforming amendments to XRB Au1 *Application of Auditing and Assurance Standards*

Appendix 2 lists the International Standards on Auditing (New Zealand) to be applied in conducting audits of historical financial information.

Appendix 2A will be added as follows:

Appendix 2A

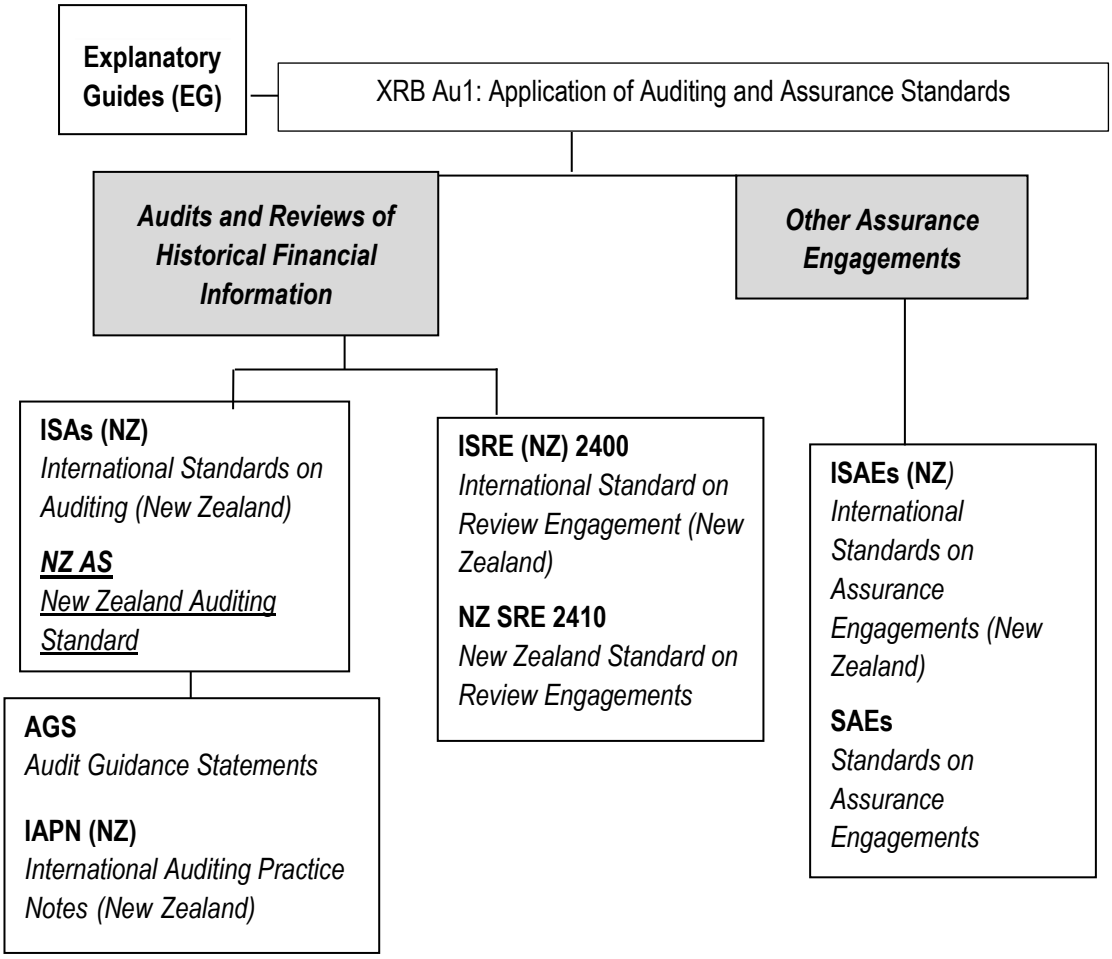
New Zealand Auditing Standards

This appendix is an integral part of the Standard

This appendix lists the New Zealand Auditing Standards to be applied in conjunction with the International Standards on Auditing (New Zealand) in conducting an audit of general purpose financial reports which comprise the financial statements and service performance information.

NZ AS 1 The Audit of Service Performance Information

Appendix 6 Overview of Auditing and Assurance Standards of the XRB is to be amended as follows:



ACCOMPANYING ATTACHMENT: CONFORMITY TO INTERNATIONAL AND AUSTRALIAN STANDARDS ON AUDITING

This conformity statement accompanies but is not part of NZ AS 1.

Conformity to International Standards on Auditing

There is no equivalent International Standard on Auditing (ISA), issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Comparison with Australian Auditing Standards

There is no equivalent Australian Auditing Standard, issued by the Australian Auditing and Assurance Standards Board (AUASB).

Memorandum

Date:	13 February 2019
To:	Graeme Mitchell, Chairman XRB Board
From:	Robert Buchanan, Chairman NZAuASB
Subject:	Certificate Signing Memo: New Zealand Auditing Standard 1, *The Audit of Service Performance Information*

Introduction

1. In accordance with the protocols established by the XRB Board, the NZAuASB seeks your approval to issue New Zealand Auditing Standard 1, *The Audit of Service Performance Information* in New Zealand.

Background

International process

2. There is no international equivalent auditing or assurance standard that deals specifically with the audit of service performance information directly. The NZAuASB therefore identified the need to develop a domestic standard.

3. The International Auditing and Assurance Standards Board (IAASB) has an active project to develop guidance to assist assurance practitioners to apply ISAE 3000 (Revised)[1] to extended forms of external reporting. The developing guidance deals with many of the same issues that the NZAuASB has considered in developing the New Zealand Auditing Standard 1 (NZ AS 1).

4. The NZAuASB has been mindful of the need to, and importance of, remaining consistent with the principles of the International Assurance Framework, the International Standards on Auditing (ISAs) and the developing international guidance.

5. The NZAuASB developed NZ AS 1 as an auditing standard, rather than a domestic standard that would fall under the ISAE 3000 (Revised) umbrella. Whilst internationally

[1] ISAE 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*

this type of information would fall under ISAE 3000 (Revised), the NZAuASB considered it important to emphasize the integrated nature of the engagement, given that by law, both the financial information and service performance information is part of the same general purpose financial report. While the majority of stakeholders supported this approach, two New Zealand stakeholders felt strongly that ISAE 3000 (Revised) was not relevant to the audit of service performance information.

6. The NZAuASB has incorporated the relevant requirements from ISAE 3000 (Revised), which are principles for any assurance engagement as described in EG Au1A Framework for Assurance Engagements. In this way, NZ AS1 1remains consistent with the international standards.

Domestic process

7. The NZAuASB followed the development of the financial reporting requirements for reporting service performance information. The NZAuASB provided feedback to the NZASB on assurance matters that could bear upon the developing financial reporting requirements by way of joint sub-committee meetings.

8. In December 2015, the NZAuASB issued EG Au9, *Guidance on the Audit or Review of the Performance Report of Tier 3 Not-For Profit Public Benefit Entities.* This guidance was a temporary measure to assist practitioners who may be engaged to audit the performance report of tier 3 entities that included service performance information. It is intended that this guidance will be withdrawn when the NZAuASB has developed a review engagement standard, which is on the NZAuASB's action plan to develop upon the issue of NZ AS 1.

9. In September 2017, after the NZASB issued PBE FRS 48[2], the NZAuASB issued an exposure draft ED NZAuASB 2017-2 (the ED) with a comment deadline of 20 December 2017. The NZAuASB received nine comment letters, and obtained additional feedback through two roundtable discussions and received feedback from the NZASB sub-committee.

10. There was general support for the development of the domestic standard. There was overall support for the two-step process described in the invitation to comment and the

[2] PBE FRS 48, *Service Performance Reporting*

need to emphasize the concurrent nature of the audit of the financial statement information and the service performance information.

11. However there was a wide range of opposing views on a number of topics. The Office of the Auditor General (OAG) raised the most significant concerns. In summary these related to:

    - Alignment (or the perceived lack thereof) to PBE FRS 48
    - Service performance criteria
    - Materiality
    - The opinion

12. The NZAuASB met separately with the OAG to better understand their concerns and made changes to the exposure draft to enhance the understandability and address the perceived complexity of the standard. In recognition of the OAG's concerns, the NZAuASB developed an alternative approach to describing the entity's service performance criteria.

13. The NZAuASB issued a limited scope review draft of the standard on 3 August 2018, seeking fatal flaw comments from all of those who had commented on the exposure draft. The comment period closed on 1 October 2018. The request for fatal flaw feedback acknowledged that the developing standard had proposed to adopt new terminology in an attempt to bridge the perceived gap between the accounting and auditing standard, largely in response to concerns raised by the OAG.

14. The NZAuASB received five submissions to the limited scope review draft. The majority of feedback received was editorial in nature, however the OAG continued to raise concerns, remaining of the view that the draft standard may be unworkable, or have unintended consequences, in the public sector. The OAG remained opposed to the new way in which the limited scope review draft had described the "criteria" for the engagement (i.e. the methods to measure, describe, aggregate, present and disclose the entity's service performance).

15. The NZAuASB again met with the OAG to better understand these concerns.

16. The NZAuASB agreed to revert back to the term "service performance criteria" which better aligns with the international assurance framework and the developing guidance being prepared by the IAASB. The majority of stakeholders were largely comfortable

with the term, although many had provided editorial suggestions for clarity. Auditors of tier 3 charities are already applying the concept of service performance criteria in the audits of tier 3 entities and no concerns have been raised that this concept is unworkable or is having unintended consequences. This approach was discussed with the OAG.

17. The revised definition of service performance criteria includes a link to the qualitative characteristics in the applicable financial reporting framework (noting that the tier 4 requirements have no such requirements).

18. The rationale for the decisions taken in responding to stakeholders concerns are outlined in the Explanations for Decisions made.

19. Thereafter the OAG provided more detailed editorial comments for consideration by the NZAuASB. The largest remaining concern of the OAG relates to requirements to make the criteria available and include a reference to the criteria in the opinion.

20. The NZAuASB acknowledges that the OAG is able to issue their own standard for adoption in the public sector, as they see fit. The standard developed by the NZAuASB is intentionally developed to be framework neutral (i.e., applicable to tier 3 and tier 4 financial reporting requirements in the charity sector, not linked only to PBE FRS 48).

21. The NZAuASB is committed to performing a post implementation review of the standard after a short period (within 2 to 3 years) in order to ascertain how the new standard is being applied.

Australian process

22. There is no Australian equivalent auditing or assurance standard that deals specifically with the audit of service performance information directly. The AUASB technical reference group has however followed the New Zealand process closely and responded to both consultation documents, expressing support for the approach adopted.

Due process

23. The due process followed by the NZAuASB complied with the due process requirements established by the XRB Board and in the NZAuASB's view meets the requirements of section 12(b) of the Financial Reporting Act 2013.

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Consistency with XRB Financial Reporting Strategy

24. The adoption of New Zealand Auditing Standard 1, *The Audit of Service Performance Information* is unique to New Zealand given the unique financial reporting requirements issued by the NZASB. There is no international or Australian equivalent. NZ AS 1 therefore does not harmonise or converge in line with the strategic objectives of the XRB Board. However the NZAuASB has been mindful to remain consistent with the principles established in the International Assurance Framework and has been informed through submissions received by the AUASB's technical reference group.

Other matters

25. The NZAuASB considers that the issue of this domestic standard has highlighted a need for better collaboration between the NZASB and NZAuASB, both early on, and throughout, joint projects. The NZAuASB is supportive of a review of the processes going forward on joint projects that impact on both accounting and assurance standards to ensure that there is cross pollination of ideas and thinking throughout the projects.

Recommendation

26. The NZAuASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

New Zealand Auditing Standard 1, *The Audit of Service Performance Information.*

Robert Buchanan

Chair NZAuASB

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NZ AUDITING AND ASSURANCE STANDARDS BOARD

NEW ZEALAND AUDITING STANDARD 1

THE AUDIT OF SERVICE PERFORMANCE INFORMATION

Explanation of Decisions made

Issued [DATE]

This document relates to, but does not form part of NZ AS 1, *The Audit of Service Performance Information* which was approved by the NZAuASB in [February 2019]. It summarises the major issues raised by respondents in response to Exposure draft NZAuASB 2017-2 and the subsequent limited scope review draft and how the NZAuASB has addressed them.

This document is an explanatory document and has no legal status.

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NEW ZEALAND AUDITING STANDARD 1

THE AUDIT OF SERVICE PERFORMANCE INFORMATION

Explanation of Decisions made by the NZAuASB in Finalising NZ AS 1

Issued by the New Zealand Auditing and Assurance Standards Board

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BACKGROUND

1. This Explanation of Decisions Made summarises the NZAuASB's considerations in developing NZ AS 1 *The Audit of Service Performance Information.*

2. There is no international equivalent auditing or assurance standard that addresses the audit of service performance information directly and the NZAuASB therefore identified the need to develop a domestic standard. The NZAuASB was mindful of the need to, and importance of, remaining consistent with the principles in EG Au1A[1] and the requirements of the International Standards on Auditing (ISAs), issuing a standard that is framework neutral, applicable to the audit of service performance information prepared by Tier 1 to Tier 4 entities, and to develop a standard that is workable and understandable for New Zealand.

3. The NZAuASB issued an exposure draft ED NZAuASB 2017-2 (the ED) in September 2017 with a comment deadline of 20 December 2017. The NZAuASB received 9 comment letters, obtained additional feedback through 2 roundtable discussions on the ED and received feedback from the NZASB.

4. The NZAuASB revised the proposals to address concerns raised on exposure and sought fatal flaw feedback on revised limited scope review draft in August 2018. It did so by notifying the respondents to the 2017 ED of the revised proposals and making the limited scope review draft of the proposed standard available on the XRB website for two months.

5. There was general support for the development of a domestic standard. There was support for the two-step approach described in the invitation to comment (ITC) and the need to emphasize the concurrent nature of the audit of the financial statement information and the service performance information. However, there was a wide range of opposing views on a number of topics explored in the ITC in response to the specific proposals.

MAJOR ISSUES RAISED BY RESPONDENTS

6. The NZAuASB analysed all comments received. The most substantive issues that involved meetings with stakeholders and further deliberations by the Board included:

   - Alignment with PBE FRS 48[2] as opposed to alignment with language used in the ISAs.
   - The use of the term "criteria" and the definition of "service performance criteria".
   - Reference to the qualitative characteristics described in PBE FRS 48.
   - Materiality considerations.

7. Other key issues raised in the submissions received included:

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1 EG Au1A Framework for Assurance Engagements
2 PBE FRS 48 *Service Performance Reporting*

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- Concern at the perceived level of prescription in the ED and the cost/benefit ratio.
- Criticism of the length and readability of the ED but some submitters seeking additional application guidance.
- Mixed views on proposed assertions.
- Lack of support for opining on the suitability of the service performance criteria.
- Some concern at allowing a long-form auditor's report.
- Confusion as to the need for reference to both the ISAs (NZ) and the domestic standard in the auditor's report.

HOW THE NZAuASB RESPONDED

Substantive Matters

Alignment with PBE FRS 48

8. One respondent, and feedback from the NZASB, raised concern at a perceived disconnect between the auditing standard and the requirements of PBE FRS 48. The ED made use of assurance terminology, including terms like criteria and characteristics of suitable criteria. These terms are not used in PBE FRS 48.

Response by the NZAuASB

9. Whilst mindful of the need to link to the financial reporting requirements as much as possible, the NZAuASB considers that it is necessary, for both conceptual and practical reasons, for the auditing standard to be based on established assurance requirements and to meet the preconditions for an assurance engagement described in EG Au1A and the International Framework for Assurance Engagements. The preferred approach is to use assurance terminology but link to the financial reporting requirements where appropriate. This approach was explicitly supported by other stakeholders in response to the ED.

10. The ISAs are developed to be framework neutral, applicable to the audit of financial statements regardless of the applicable financial reporting framework. The NZAuASB considers that the advantages of remaining framework neutral to develop NZ AS 1 outweigh any perceived risks. In New Zealand, NZ AS 1 will be applied to audit service performance information prepared by Tier 3 and even Tier 4 entities, and therefore should not be a response only to PBE FRS 48.

Service Performance Criteria

11. Mixed views were received on the use of and/or the proposed definition of "service performance criteria". Some were supportive of the proposals, others suggested enhancements to the definition, whilst others were very strongly opposed to including the term "criteria". Those who were strongly opposed expressed confusion as to why PBE FRS 48 alone was not the criteria for the engagement.

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12. The NZAuASB met with stakeholders who were most strongly opposed to the proposed approach to better understand the concerns. The NZAuASB weighed up those concerns against the support expressed by other stakeholders, as well as considering current developments internationally[3] to develop guidance on assurance of non-financial information dealing with similar issues.

Response by the NZAuASB

13. While the NZAuASB considers that the overarching "criteria" for the engagement, in the case of a Tier 1 and Tier 2 entity, is PBE FRS 48, each entity will identify its own service performance to report on and appropriate ways to measure or evaluate that performance. The manner in which an entity measures or evaluates its service performance is an integral part of the criteria for the purposes of an assurance engagement as described in EG Au1A[4].

14. Financial reporting standards include detailed recognition and measurement criteria for the elements included in financial statements. These are required to be described in the accounting policies in the financial statements. ISA (NZ) 700[5] requires the auditor to evaluate whether the financial statements appropriately disclose the significant accounting policies selected and applied, including whether the information disclosed is relevant and reflects how the recognition, measurement and presentation criteria in the applicable financial reporting framework have been applied in the circumstances.

15. The NZASB noted in finalising PBE FRS 48, that revisions were made so that the standard could be more readily applied by entities using a range of performance frameworks. The service performance standard is purposefully not prescriptive in establishing recognition and measurement criteria, rather encouraging the entity to tell its own story, while outlining the objective of such reporting. However, the way in which an entity measures or evaluates its performance is what the criteria refer to for the purpose of the audit of the service performance information. There was much support for a two step process, and evaluating the suitability of the criteria is the first step in this two step process. It is a precondition for any assurance engagement that the criteria (with reference to both PBE FRS 48 and the way in which the entity measures or evaluates its service performance) are suitable and are available to users of the auditor's report.

16. Given the concerns expressed, the NZAuASB proposed describing criteria in a different way in the limited scope review draft:

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3 IAASB project to develop guidance related to Emerging Forms of External Reporting (EER) Assurance

4 EG Au1A *Framework for Assurance Engagements*

5 ISA (NZ) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements* paragraph 13 and A4

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a. To continue to use the language in EG Au1A as the underlying basis of NZ AS 1, given that this is an auditing standard that will be a part of the ISAs (NZ) suite of standards.

b. To remove the term "service performance criteria" as there is misunderstanding as to what was meant.

c. To remove references to ISAE (NZ) 3000 (Revised), except to make it explicit that the auditor need not apply ISAE (NZ) 3000 (Revised) to the service performance information.

17. The NZAuASB explored many alternative ways to describe "service performance criteria", rejecting options such as "reporting policies and procedures" or "the reporting process" or "compilation methods" based on discussions with those stakeholders who originated the concerns.

18. The limited scope review draft standard replaced the term "service performance criteria" with reference to the "selected service performance and methods used to measure, describe, aggregate, present and disclose". These methods used were defined with reference to the "applicable criteria" to link to assurance terminology.

19. Feedback in response to the limited scope review draft from the key respondent opposed to "service performance criteria" remained opposed to describing "criteria" in this alternative way.

20. Taking into account all of the feedback received on the exposure draft and the limited scope review draft, the NZAuASB determined to revert back to "service performance criteria", to align with established assurance terminology.

Qualitative Characteristics

21. There were mixed views about the proposed application material to assist the auditor in evaluating the suitability of the criteria,. Some feedback was supportive of the application material provided, others sought more practical application material and another noted that evaluation of completeness will be challenging regardless of the amount of application material included.

22. One stakeholder noted that the words used to describe suitable characteristics in the ED[6] differed from the qualitative characteristics in PBE FRS 48[7] and considered that there may be a risk in using different words, e.g., causing the auditor to look for or require different things of the preparer than are required by PBE FRS 48.

Response by the NZAuASB

23. The NZAuASB acknowledges the risk raised that these characteristics are not identical to the qualitative characteristics in PBE FRS 48 but considers the risks to be

6 ED NZAuASB 2017-2, paragraph A17
7 PBE FRS 48, paragraph 9

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low. In fact, the NZAuASB considers that this risk already exists for all audits of financial statements but has never been advised that this is creating any difficulties for the audit of financial statements. For example, ISA (NZ) 210[8] and ISA (NZ) 700 (Revised)[9] both refer to relevant, reliable, comparable, understandable and neutral rather than the qualitative characteristics as described in the PBE FRS 48 or the PBE Conceptual Framework. The NZAuASB has raised this matter with the IAASB.

24. The characteristics under EG Au1A[10] already differ from the qualitative characteristics in the PBE Conceptual Framework. Although the words differ, there is significant overlap. The NZAuASB are of the view that if the qualitative characteristics are met then the methods used will also be considered to be suitable.

25. The NZAuASB agreed to retain the words used in EG Au1A to describe suitable criteria. The advantages of doing so include remaining framework neutral, aligning with established assurance terminology and the ISAs (NZ), and avoiding the need to amend the auditing standard each time the accounting standards are updated. These words highlight the role of the auditor in a framework neutral manner and are equally applicable to the audit of service performance information prepared using the Tier 4 requirements which do not include reference to any qualitative characteristics.

26. Although NZ AS 1 continues to refer to the characteristics described in EG Au1A, additional application material has been added to bridge the gap to PBE FRS 48 in response to the concerns raised.

27. An amended appendix 2 has been included to emphasize the similarities between the qualitative characteristics in PBE FRS 48 and the characteristics of suitable criteria. The application material emphasises that where the auditor evaluates that the qualitative characteristics have been appropriately applied, the methods used by the preparer will be considered to be suitable. For this reason, the NZAuASB does not consider that the standard will have unintended consequences.

28. Additional application material has also been added to assist the auditor when evaluating the suitability of methods used where an entity's process is still developing. This highlights that the auditor may still be able to conclude, in early stages of reporting, that the selected service performance and the methods used are suitable, even where the preparer does not report on a particular measure because of a lack of process or systems to support such reporting. This can be done where there are clear disclosures in the service performance information of the reasons for exclusions. Over time, it is expected that the entity will develop such systems.

29. Additional application material has been added to emphasize that the work effort to evaluate the suitability of the methods used may correlate with the potential for management bias. If the methods are sourced from externally established

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8 ISA (NZ) 210, Agreeing the Terms of Audit Engagements, Appendix 2

9 ISA (NZ) 700 (Revised), paragraph 13, A2

10 EG Au1A, paragraph 44

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performance frameworks, or developed in conjunction with the intended users, the auditor's work effort may be reduced, given a lower risk of management bias.

Materiality

30. One submission highlighted the challenge of determining materiality when auditing service performance information, queried the materiality requirements and sought additional practical application material. This stakeholder also queried the requirement to identify and assess the risk of material misstatement at the general purpose financial report level.

31. Given the challenges of and difference in establishing materiality for the service performance information from the financial statement information, it is not practical for the auditor to assess the risk of misstatement at the general purpose financial report level. It was noted that in the public sector, the approach has been to provide a separate opinion on the service performance information, illustrating how the audit is performed concurrently over two related but different types of information. This does not require assessment of the risk of material misstatement at the general purpose financial report level.

Response by the NZAuASB

32. The NZAuASB has elevated a paragraph from the application material to a requirement, to highlight that when considering materiality, the auditor is evaluating both:

    a. The judgements made by the preparer in selecting what to report on and how to report; and

    b. Individual and collective misstatements in the reported information that are likely to significantly influence decisions of intended users.

33. The evaluation of the suitability of the service performance information is therefore part of the auditor's determination of materiality.

34. Further changes made to the materiality requirements and application material include:

    a. Removing the arbitrary distinction made in the ED between materiality levels and materiality factors, as these considerations impact on both quantitative and qualitative information. This has resulted in some re-ordering of the application material.

    b. Removing references to performance materiality because the auditor is dealing with multiple units of account in the context of service performance information.

    c. Adding additional emphasis on tolerance for error and examples of things to think about in establishing materiality to address calls for more practical guidance.

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35. The NZAuASB removed the requirement to identify and assess the risk of material misstatement at the general purpose financial level.

Other Matters

Perceived Level of Prescription and the Cost/Benefit Ratio

36. Concern was raised, in one submission, that many smaller PBE entities have limited financial resource and capability and they are likely to find the preparation of service performance information challenging, given the level of judgement involved and customised nature of the information. The cost of designing and implementing relevant performance measures, including relevant controls around those performance measures, and capturing and monitoring the relevant data may be prohibitive. This may result in the cost of an audit being disproportionately high and may be inhibited by the lack of verifiable information. This may result in a significant number of qualified auditor reports.

37. Additional guidance was sought to facilitate comparability across sectors to reduce the cost of preparing and auditing the service performance information.

38. Submitters suggested some alternatives for the XRB to consider, for example raising the minimum threshold for entities requiring an audit of the service performance information, enabling an opt out of the audit of the service performance information or treating the service performance information as other information.

Response by the NZAuASB

39. The XRB is not responsible for determining when the general purpose financial report is required to be audited. This is established in legislation (for example the Charities Act 2005) or by an entity itself. It is therefore not within the mandate of the NZAuASB to provide for an opt out or to establish a higher audit threshold. Rather the NZAuASB is tasked with developing an auditing standard that promotes consistency amongst auditors, when the service performance information is audited.

40. The NZAuASB was mindful of the risk of undermining the confidence of the audit of the financial statement information and therefore determined to remain compliant with the requirements of the international assurance standards when performing a reasonable assurance engagement.

Length and Understanding

41. Conflicting views were expressed related to the length of the ED, and the amount of application material included. Some submitters were critical of the length of the ED, suggesting that the standard should only include a minimum number of requirements, specific to service performance information. Some submissions identified specific requirements that they considered could be removed. Some feedback supported the

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level of application material provided, whilst others sought additional application material.

Response by the NZAuASB

42. The NZAuASB is committed to developing a domestic auditing standard that will form a part of the ISAs (NZ) in New Zealand. The domestic auditing standard will require the auditor to apply all the ISAs (NZ) to the service performance information. This does require a level of prescription, consistent with the requirements for any audit engagement. The domestic auditing standard will however focus on the specific aspects of auditing service performance information that differs from the audit of the historical financial information.

43. To address the concerns around length and understanding, the NZAuASB shortened and streamlined the ED by:

    a. Avoiding repeating the requirements of the ISAs (NZ).

    b. Moved and merged the section on "Preconditions for the Audit of General Purpose Financial Report" with the section on "Understanding the Entity". Given that the auditor is engaged to audit the general purpose financial report, even where the auditor has concerns over what and how the entity has selected to report its service performance, the auditor will continue to audit the financial statements. This emphasizes that the timing of the evaluation of what and how the entity selects to report its service performance, does not only occur on acceptance of the engagement, rather is an iterative process. Additional application material has been added to make the iterative process explicit.

    c. Removed the section "Evaluation of Misstatements Identified During the Audit" as feedback highlighted that this is not sufficiently different in application to service performance information, and the differences are covered in the application material on establishing materiality.

    d. Merging the requirements on:

        - Audit Considerations Relating to an Entity Using a Service Organisation;
        - Special Considerations – Audit of Groups; and
        - Using the Work of Another Practitioner

        into one requirement for the auditor to consider the relevant ISAs (NZ).

44. One submitter sought additional guidance where the auditor needs to obtain evidence about services delivered by third parties (e.g. contractors or service organisations) especially when those third parties are directly responsible for collecting the service performance information that is reported by the reporting entity. The NZAuASB

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considers that ISA (NZ) 402[11] should be applied to the service performance information in these circumstances. It would be up to the auditor to consider how that standard should be applied to the service performance information.

Assertions

45. The majority of submissions were supportive of the assertions identified in the ED, however some concern was raised about adding new assertions (notably the assertion of "attribution" and "consistency") and confusion over how "completeness" as an assertion differs from "completeness" as a qualitative characteristic.

Response by the NZAuASB

46. The NZAuASB agreed to add application material from ISA (NZ) 315 (Revised)[12] to emphasize that the assertions included in the standard may be used by the auditor but the auditor may wish to express them differently.

47. The NZAuASB agreed to retain the assertion "Attributable to the entity", and considers that in some instances, this may require additional work effort by the auditor, however acknowledges that it may not always apply. The new application material highlights that this is not a requirement, and allows flexibility to combine attribution and occurrence. However, the NZAuASB still considers that the assertion of attribution may be an important consideration in the context of service performance information.

48. In response to queries related to the need for an assertion related to classification, the NZAuASB again considered that the application material is flexible and may be reworded by the auditor. The NZAuASB continues to be of the view that the way in which a matter is described (e.g. described as high/medium/low) is covered by accuracy, however an auditor may wish to describe this as classification. The NZAuASB was reluctant to introduce the term "classification" as the different categories of service performance information (i.e. outputs, outcomes and impacts) was removed when PBE FRS 48 was finalised.

49. The NZAuASB agreed to remove the assertion related to consistency, noting that there is already a requirement in the standard for the auditor to evaluate any changes, where an entity changes the way in which it reports its service performance.

Opining on the Suitability of the Service Performance Criteria

50. The invitation to comment sought views as to whether it was preferable for the auditor's opinion to be explicit on the auditor's evaluation of the suitability of the entity's service performance criteria. Only one submission preferred the alternative

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11 ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

12 ISA (NZ) 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, paragraph A128.

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opinion and there was strong support for the opinion to remain implicit on the suitability.

Response by the NZAuASB

51. The NZAuASB agreed to maintain the approach as proposed, and there is no requirement for the auditor to opine on the suitability of the methods used. This is consistent with the reporting requirements of any assurance engagement, where there is no requirement to opine on the suitability of the criteria.

52. It is however a precondition of an assurance engagement for the "criteria" to be available to the intended users.

53. The entity's service performance criteria may be made available as part of the service performance information. The auditor is required to evaluate whether those methods are transparent and clear so that the user understands how the service performance has been measured or evaluated. Where the methods used are complex, the explanation of the methods used needs to be made clear, and may not be apparent from the performance measure. Additional application material has been added to explain various ways in which the methods used may be made available to the user.

54. It is also a requirement of an assurance engagement that the opinion identify the "criteria" used to measure or evaluate the underlying subject matter. For this reason, the standard requires that the opinion refer to the service performance criteria, in recognition that there is a sub-layer of applicable criteria below FRS 48 which is used for each individual engagement.

55. For financial statement information, the financial reporting standards establish detailed recognition and measurement criteria and the preparer must disclose these accounting policies as part of the financial statements. ISA (NZ) 700 (Revised)[13] requires the auditor to evaluate whether the financial statements appropriately disclose the significant accounting policies in an understandable manner.

56. For the service performance information, the accounting standard is encouraging the entity to tell its own story and therefore does not establish detailed recognition and measurement criteria, leaving it up to the entity to determine while requiring the preparer to meet the objectives of the qualitative characteristics in accordance with the applicable financial reporting framework. It is still necessary however that the user understand how the entity has measured and described its service performance and that the auditor refer to these criteria in the opinion.

57. One submitter remains opposed to the inclusion of the requirements to make the criteria available and for the opinion to identify the criteria, considering that these requirements may have unintended consequences.

[13] ISA (NZ) 700 (Revised), paragraph 13

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Allowing a Long-Form Auditor's Report

58. There were mixed views as to whether the standard should refer to a long-form report. Whilst some submitters were supportive of allowing flexibility, others were concerned that this may give undue prominence to the service performance information.

Response by the NZAuASB

59. The NZAuASB determined it appropriate to permit flexibility where such information better meets the needs of intended users, noting that this is not mandatory. A definition of long-form report has been added to the amended standard as suggested by one respondent.

Reference to the ISAs (NZ) and NZ AS 1

60. Feedback from one submission and from roundtable participants raised concern at requiring references to both the ISAs (NZ) and NZ AS 1 in the engagement letter and auditor's report. This is an area identified as confusing for both the auditor and the user and most likely to give rise to inadvertent non-compliance with the standard.

Response by the NZAuASB

61. When developing the ED, the NZAuASB was mindful of the prescriptive requirements in the ISAs (refer paragraph 43 of ISA 700 (Revised)), and was mindful to ensure that the requirements of NZ AS 1 adhere to the ISAs. It was for this reason that the proposal to refer to both the ISAs (NZ) and NZ AS 1 was developed.

62. The NZAuASB determined that the auditor's report should reflect the fact that while the auditor is engaged to audit the general purpose financial report, there are "two legs" to that report. For this reason, the opinion should reflect two bullets to distinguish the service performance information leg from the financial statement leg. While the two are related, the subject matter differs, the materiality considerations differ and the auditor is therefore opining separately on the service performance information, as noted in the materiality section above.

63. The NZAuASB heard support for emphasising the need for a concurrent audit of these two legs. In order to emphasize this in the auditor's report, reference has been added to the consistency between the financial statement information and the service performance information.

64. As there is a need to distinguish between the financial statement information and the service performance information in the report, the NZAuASB agreed to retain the reference to both the ISAs (NZ) and NZ AS 1 as proposed in the ED. This enables compliance with both the ISAs and the ISAs (NZ).

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NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	4.1
Meeting date:	13 February 2019
Subject:	NZ SRE 2410
Date:	30 January 2019
Prepared by:	Misha Pieters

X	**Action Required**		**For Information Purposes Only**

Agenda Item Objectives

To:

- Approve an exposure draft to update NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* as a result of changes to the auditors' report and updates to the standards for non-compliance with laws and regulations (NOCLAR).

Background

1. In October 2018 the NZAuASB considered a project to amend NZ SRE 2410.

2. Extracts from the minutes are as follows:

"The Board AGREED:

- That the scope of the project should be limited to the auditor reporting changes and amendments to incorporate the non-compliance with laws and regulations;

- To refer to ethical requirements in New Zealand in the report;

- To include the description of the responsibility related to going concern in the report with reference to "enquiry" to describe the auditors' responsibility.

- That inclusion of the section on Other Information should not be mandated at this stage given the level of confusion that the requirements are creating for annual reporting. This may be considered after a post implementation review of the reporting requirements has been completed by the IAASB. In addition, there is much less "other information" reported at the interim stage and therefore there is no need to place additional reporting requirements on the auditor at the interim stage.

The Board AGREED to work closely with the AUASB and will consider any feedback from the AUASB at the February 2019 meeting in order to approve an exposure draft."

3. The AUASB discussed an issues paper at its December 2018 and agreed in principle with the key decisions reflected above. The AUASB are yet to consider a detailed invitation to comment and exposure draft. This is scheduled for the March meeting.

4. Historically there have been differences between the New Zealand and Australian standards, for example, a requirement in NZ SRE 2410 to apply ISA (NZ) 220 *Quality Control for an Audit of Financial Statements* and NZ SRE 2410 covers both fair presentation and compliance frameworks. These differences are beyond the scope of the current project.

Key matters arising

5. The Board is asked to approve a draft invitation to comment and exposure draft subject to any matters arising from the AUASB meeting in March. The draft exposure draft shows the mark ups to the existing New Zealand standard.

Material Presented

Agenda item 4.1	Board Meeting Summary Paper
Agenda item 4.2	Draft invitation to comment
Agenda item 4.3	Draft Exposure draft

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ AUDITING AND ASSURANCE STANDARDS BOARD

EXPOSURE DRAFT NZAUASB 2019-1

AMENDMENTS TO NEW ZEALAND STANDARD ON REVIEW ENGAGEMENTS 2410 *REVIEW OF FINANCIAL STATEMENTS PERFORMED BY THE INDEPENDENT AUDITOR OF THE ENTITY*

(ED NZAUASB 2019-1)

Invitation to Comment

[Date]

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External Reporting Board
PO Box 11250
Manners St Central, Wellington 6142
New Zealand
http://www.xrb.govt.nz

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Information for respondents

Invitation to comment

The New Zealand Auditing and Assurance Standards Board (NZAuASB)[1] is seeking comments on the specific matters raised in this Invitation to Comment. Responses to this Invitation to Comment will be considered by the NZAuASB which will then make final decisions about New Zealand Standard on Review Engagements 2410.

Respondents are encouraged to supplement their opinions by detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Respondents should feel free to provide comments only for those questions that are relevant to their perspective if they so wish.

Submissions should be sent to:

Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142
New Zealand

Email: submissions@xrb.govt.nz
(please include the title of the Exposure Draft in the subject line)

We would appreciate receiving a copy of your submission in electronic form (preferably Microsoft Word format) as that helps us to efficiently collate and analyse comments.

Please note in your submission on whose behalf the submission is being made (for example, own behalf, a group of people, or an entity).

The closing date for submission is xxx 2019.

[1] The NZAuASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting auditing and assurance standards.

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part of in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the ground under the Official Information Act 1982 for doing so (e.g., that it would be likely to unfairly prejudice the commercial position of the person providing the information).

List of Abbreviations

The following abbreviations are used in this Invitation to Comment.

NZAuASB	New Zealand Auditing and Assurance Standards Board
ED	Exposure Draft
IAASB	International Auditing and Assurance Standards Board
IESBA	International Ethics Standards Board for Accountants
ITC	Invitation to Comment
AUASB	Australian Auditing and Assurance Standards Board
ISA	International Standard on Auditing
ISRE	International Standard on Review Engagements
PES	Professional and Ethical Standard

Summary of questions for respondents

1. Do you agree with the proposals to incorporate the reporting amendments made to the annual audit report consistently into the interim review report?
2. More specifically, do you agree with the proposals to require the auditor to:
    a. Move the review conclusion to the top of the interim review report?
    b. Include the independence statement in the interim review report?
    c. To include the engagement partners name?
    d. To include a description of the responsibilities related to going concern?
    e. To refer to a "Material Uncertainty Related to Going Concern" rather than an Emphasis of Matter paragraph, when appropriate?
3. Do you agree that it is not appropriate to include a section on Other Information in the interim review report? If you disagree, please explain why?
4. Do you agree that it is unnecessary to refer to a website when describing the auditor's responsibilities given that this description is more condensed for a review?
5. Do you agree that reporting of Key Review Matters at the interim stage is not appropriate?
6. Do you agree with the proposed amendments to align with the new ethical framework when encountering non-compliance with laws and regulations, including a reference to guidance in ISA (NZ) 250 rather than including detailed requirements and application material within NZ SRE 2410?
7. Do you consider that there are any further amendments required to be made to NZ SRE 2410? If so, please expand on what changes and why such changes are considered necessary?
8. Do you agree with the proposed effective date? If not, please explain why not.

1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this Invitation to Comment is to seek feedback on the proposed amendments to NZ SRE 2410.

1.2 Background

2. The XRB has delegated authority to the NZAuASB to issue auditing and assurance standards to govern the professional conduct of assurance practitioners. In doing so, the XRB requires the NZAuASB to adopt international auditing and assurance standards, unless there is a compelling reason not to do so. A second key strategic objective of the XRB is harmonisation with Australia.

3. The IAASB has issued ISRE 2410 but has not amended it since 2006 (i.e. it is not in the clarified format). It was for this reason that the NZAuASB agreed to issue a domestic standard to address interim reviews conducted by the auditor of the entity. The NZAuASB based NZ SRE 2410 on an equivalent Australian standard, which is in the clarified format, rather than the older version issued by the IAASB. Further explanations for the decision to issue a domestic standard are outlined in the Explanations for Decisions made by the NZAuASB in Finalising NZ SRE 2410.

4. Given that the IAASB has not prioritised the maintenance of the international standard, the NZAuASB and the AUASB have agreed to work together to maintain the domestic standard that deals with a review engagement performed by the auditor.

1.3 Reasons for issuing this Exposure Draft

5. From December 2016, the auditor's report was changed as a result of the IAASB's project to enhance the auditor's report from the user's perspective. These changes were limited to the ISAs.

6. Subsequently, questions have arisen, both in New Zealand and Australia, as to whether and how the new auditor reporting requirements impact the format and content of the interim review report in accordance with NZ SRE 2410, or the Australian equivalent.

7. Currently, while NZ SRE 2410 has not been updated, auditors can, but are not required to, use the new reporting format and new features when issuing a review report provided any reporting is not inconsistent with NZ SRE 2410. There was a view expressed by the Board that it would be preferable to promote consistency in practice. Based on indicative and early feedback from informal discussions with targeted stakeholders the NZAuASB agreed to develop an exposure draft to incorporate these updates into NZ SRE 2410 to promote consistency in reporting.

8. In addition, the NZAuASB identified a need to include conforming amendments as a result of the new ethical framework related to non-compliance with laws and regulations (NOCLAR).

9. The NZAuASB is not proposing to reopen or fundamentally revise NZ SRE 2410, rather to make conforming amendments to the standard as a result of recent changes to the ISAs (NZ) and PES 1 (Revised).

1.4 Timeline and next steps

10. Submissions on ED 2019-1 are due by xxx 2019. Information on how to make submissions is provided on page 4 of this Invitation to Comment.

11. The NZAuASB will consider the submissions received immediately after the consultation period ends. Subject to the content of feedback, the NZAuASB hopes to finalise any amendments to NZ SRE 2410 in the xxx of 2019.

2. Overview of ED NZ 2019-1

2.1 Key Differences Between the Exposure Draft and Extant NZ SRE 2410

2.1.1 Reporting Requirements

12. Key changes made to the auditor's report include, but were not limited to, the reporting of key audit matters (KAMs). Other changes made included:

- Re-ordering the report so that the opinion comes first, followed by a "Basis for Opinion" section;
- Naming the engagement partner in the interim review report;
- An affirmative statement about the auditor's independence and fulfilment of relevant ethical requirements;
- A description of the respective responsibilities of those charged with governance and the auditor for going concern;
- Referring to a material uncertainty related to going concern as an "emphasis of matter" or under the heading "Material uncertainty related to going concern";
- An "Other Information" section to clarify that the auditor's opinion does not cover the other information included in an annual report;
- An enhanced and expanded auditor's responsibility section describing the key features of an audit. There is also an option to refer to the XRB website instead of repeating these responsibilities in all reports;

A key reason for making these changes to the auditor's report was to enhance the value of the auditor's report to better meet user needs.

13. The exposure draft is proposing to include the enhanced features that are deemed relevant for an interim review report, into NZ SRE 2410. However, not all of the revised auditor reporting requirements have been determined to be appropriate for a review engagement.

Interim Review Reporting requirements to align with the auditor's report

14. The NZAuASB is proposing to include the following requirements in NZ SRE 2410:

- Re-ordering the report so that the conclusion comes first, followed by a "Basis for Conclusion" section;
- Naming the engagement partner in the interim review report;
- An affirmative statement about the auditor's independence and fulfilment of relevant ethical requirements;
- A description of the respective responsibilities of those charged with governance and the auditor for going concern;
- Referring to a material uncertainty related to going concern as an "emphasis of matter" or under the heading "Material uncertainty related to going concern";

15. The NZAuASB has heard favourable feedback from users, that including the Opinion first is an improvement to the auditor's report. Given that this is also the most useful information to the user of the interim review report, it would enhance the value of, and consistency of the user experience, if the review conclusion (and the structure of the report) followed the same basic order. For this reason, the ED proposes to mandate the order of the review report, so that the conclusion comes first, followed by the "Basis for Conclusion".

16. In Australia, it is required by law for the engagement partner to include their name on both the auditor's report and the interim review report (this was required before the auditor reporting changes), i.e. it is consistent practice for the engagement partner's name to appear in both the year end and interim review reports. This is not required in New Zealand.

17. Naming the engagement partner was identified as useful for the user. Reporting the engagement partner name at year end, but not including the name at the interim period may be misleading. If the engagement partner has changed since the year end audit, it could mislead the user to believe that the same engagement partner has performed the interim review. As noted above this is inconsistent with practice in Australia. For this reason, the ED proposes to require the name of the engagement partner to be included in the interim review report. This is common practice in the public sector in New Zealand.

18. The auditor is subject to the same independence and ethical requirements when performing the interim review. Independence is most likely just as

important to the user at the interim review stage. The ED therefore proposes to make this explicit statement in the review report.

19. The requirements in NZ IAS 1[2] related to making an assessment of the ability of an entity to continue as a going concern apply when preparing interim financial statements. Similarly, the auditor is required by extant NZ SRE 2410[3] to make enquiries as to whether those charged with governance have changed their assessment of the entity's ability to continue as a going concern. Highlighting these responsibilities in a similar way in the interim report, will promote consistency and for this reason the ED proposes to require these descriptions in an interim review report.

20. Changes to ISA (NZ) 570 (Revised)[4] require a new heading to be used when the auditor concludes that there is a material uncertainty and adequate disclosures have been made about a material uncertainty in the financial statements. Historically this was reported under the heading "Emphasis of Matter". NZ SRE 2410[5] refers to an emphasis of matter paragraph in these circumstances. The NZAuASB considered that there is a need to promote consistency in this reporting. Not to do so may result in inadvertent non-compliance with extant NZ SRE 2410.

21. The NZAuASB has not identified that any of these proposals will be overly onerous to apply in the New Zealand context.

22. The NZAuASB is <u>not</u> proposing to incorporate the following features:

- Reporting of key audit matters or key review matters;
- An "Other Information" section to clarify that the auditor's opinion does not cover the other information included in an annual report;
- An enhanced and expanded auditor's responsibility section describing the key features of a review. There is also an option to refer to the XRB website instead of repeating these responsibilities in all reports.

23. The reporting of key audit matters at the interim audit stage was not considered to be appropriate in the context of the work that is performed in a review engagement.

24. The NZAuASB is not proposing to include a section on "Other Information" for interim review engagements. There is less "other information" reported at the interim stage and therefore there is no need to place additional reporting requirements on the auditor at the interim stage. This may be re-considered

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[2] NZ IAS 1, *Presentation of Financial Statements*, paragraph 4 and 25

[3] NZ SRE 2410, paragraph 20

[4] ISA (NZ) 570 (Revised), Going Concern, paragraph 22

[5] NZ SRE 2410, paragraph 41

after a post implementation review of the reporting requirements has been completed by the IAASB.

25. The description of the auditor's responsibilities when performing the review is more condensed than for an audit, given that the procedures performed are substantially less than for a review. Given the condensed nature of the description, it is not necessary to provide the option to refer to a website.

Question for respondents

1. Do you agree with the proposals to incorporate the reporting amendments made to the annual audit report consistently into the interim review report?

2. More specifically, do you agree with the proposals to require the auditor to:

   a. Move the review conclusion to the top of the interim review report?

   b. Include the independence statement in the interim review report?

   c. To include the engagement partners name?

   d. To include a description of responsibilities related to going concern?

   e. To refer to a "Material Uncertainty Related to Going Concern" rather than an Emphasis of Matter paragraph, when appropriate?

3. Do you agree that it is not appropriate to include a section on Other Information in the interim review report? If you disagree, please explain why?

4. Do you agree that it is unnecessary to refer to a website when describing the auditor's responsibilities given that this description is more condensed for a review?

5. Do you agree that reporting of Key Review Matters at the interim stage is not appropriate?

2.1.2 Non-Compliance with Laws and Regulations (NOCLAR)

26. Amendments to PES 1 (Revised) *Non-compliance with Laws and Regulations* was issued in August 2016 to align with changes made by IESBA to the *Code of Ethics for Professional Accountants*. The IAASB revised ISA 250[6] and issued conforming amendments to a number of other pronouncements, including ISRE 2400 (Revised)[7]. However, no changes were made to ISRE 2410. The amendments made by the IAASB, responded to new requirements

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[6] ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

[7] ISRE 2400 (Revised), *Review of Historical Financial Statements Performed by an Assurance Practitioner*

in the IESBA Code of Ethics to enable the IAASB's standards to be effectively applied alongside the IESBA Code.

27. This ED is proposing to make limited amendments to NZ SRE 2410 to align with the new terminology of identified and suspected NOCLAR, and amend the communication requirements to prompt the auditor to think about whether to report identified or suspected NOCLAR to an appropriate authority outside the entity, taking into consideration the provisions of laws, regulations or relevant ethical requirements. Limited changes are proposed to the application material, which refers the auditor to the ISA (NZ) 250 (Revised).

Question for respondents

6. Do you agree with the proposed amendments to align with the new ethical framework when encountering non-compliance with laws and regulations, including a reference to guidance in ISA (NZ) 250 rather than including detailed requirements and application material within NZ SRE 2410?

2.1.3 Other changes

28. The extent of the proposed amendments are limited in nature, restricted to changes to the auditor reporting requirements and conforming amendments to NOCLAR.

29. Minor changes are proposed to revise the title of the standards, to reflect changes to the restructured Code and other recent developments in the ISAs.

Question for respondents

7. Do you consider that there are any further amendments required to be made to NZ SRE 2410? If so, please expand on what changes and why such changes are considered necessary?

2.2 Effective Date

30. The NZAuASB proposes that the effective date of the proposals should be effective for reviews of financial statements for periods beginning on or after xxx 2019. The NZAuASB does not consider that a lengthy transition period is required, given that the extent of change is limited in nature.

Question for respondents

8. Do you agree with the proposed effective date? If not, please explain why not.

EXPOSURE DRAFT NZAUASB 2018-2

PROPOSED AMENDMENTS TO NZ SRE 2410

This exposure draft uses underlines and strike through to indicate proposed changes to NZ SRE 2410

Commented [MP1]: Consider whether to include entire standard or only paragraphs that are revised? To update contents and cross references once agreed changes

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Accompanying Attachment: Conformity to International and Australian Standards on Review Engagements

Amendments to Other Pronouncements

Operative Date

1. This New Zealand Standard on Review Engagements (NZ SRE) 2410 is effective for reviews of financial statements for periods ending on or after December 31, 2014.
2. This NZ SRE 2410 supersedes Review Standard 1 issued by the External Reporting Board in July 2011.

Introduction

Scope of this NZ SRE 2410

3. This NZ SRE 2410 deals with the auditor's responsibilities when an auditor undertakes an engagement to review the financial statements of an audit client, and on the form and content of the auditor's review report. The term "auditor" is used throughout this NZ SRE 2410, not because the auditor is performing an audit function but because the scope of this NZ SRE 2410 is limited to a review performed by the independent auditor of the financial statements of the entity.
4. This NZ SRE 2410 is directed towards a review of financial statements by an entity's auditor. This NZ SRE 2410 is to be applied, adapted as necessary, when an entity's auditor undertakes an engagement to review historical financial information other than financial statements of an audit client.

Objective

5. The objective of the auditor is to plan and perform the review to enable the auditor to express a conclusion whether, on the basis of the review, anything has come to the auditor's attention that causes the auditor to believe that the financial statement, or complete set of financial statements, is (are) not prepared, in all material respects, in accordance with the applicable financial reporting framework. (Ref: Para. A1-A3)

Definitions

6. For the purposes of this NZ SRE 2410, the following terms have the meanings attributed below:

   (a) Interim financial statements means financial statements that are prepared in accordance with an applicable financial reporting framework for a period that is shorter than the entity's financial year.

   (b) Financial statements means a structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of the financial statement, or in the notes, or incorporated therein by cross-reference.

   (c) An applicable financial reporting framework means the financial reporting framework adopted by management and, where appropriate, those charged with

governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(a) acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(b) acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above.

Requirements

Performing a Review

7. The auditor who is engaged to perform a review of financial statements shall perform the review in accordance with this NZ SRE 2410. (Ref: Para. A4)

General Principles of a Review of Financial Statements

8. The auditor shall comply with relevant ethical requirements relating to the audit of the annual financial statements of the entity. (Ref: Para. A5)

9. The auditor shall implement quality control procedures that are applicable to the individual engagement. (Ref: Para. A6)

10. The auditor shall comply with the engagement quality control requirements of ISA (NZ) 220[1] when performing a review engagement in accordance with this NZ SRE 2410.

11. The auditor shall plan and perform the review by exercising professional judgement and with an attitude of professional scepticism, recognising that circumstances may exist that cause the financial statements to require a material adjustment for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework. (Ref: Para. A7)

Agreeing the Terms of the Engagement (Ref: Para. A8, A55 and A57)

Preconditions for a Review

12. The auditor shall, prior to agreeing the terms of the engagement, determine whether the financial reporting framework is acceptable and obtain agreement from those charged with governance, that they acknowledge and understand their responsibility:

    (a) For the preparation and fair presentation of the financial statements;

[1] ISA (NZ) 220, Quality Control for an Audit of Financial Statements.

(b) For such internal controls as management and those charged with governance deem necessary to enable the preparation of the financial statements that are free from material misstatement; and

(c) To provide the auditor with:

- access to information relevant to the preparation of the financial statements;
- additional information that the auditor may request for the purposes of the review engagement; and
- unrestricted access to persons from whom the auditor determines it necessary to obtain evidence.

Agreement on Review Engagement Terms

13. The auditor shall agree the terms of the engagement with those charged with governance, which shall be recorded in writing by the auditor and forwarded to the entity. When the review engagement is undertaken pursuant to legislation, the minimum applicable terms are those contained in the legislation.

Procedures for a Review of Financial Statements

Understanding the Entity and its Environment, Including its Internal Control

14. The auditor shall obtain an understanding of the entity and its environment, including its internal control, as it relates to the preparation of both the annual and interim or other financial statements, sufficient to plan and conduct the engagement so as to be able to:

    (a) Identify the types of potential material misstatements and consider the likelihood of their occurrence; and

    (b) Select the enquiries, analytical and other review procedures that will provide the auditor with a basis for reporting whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework. (Ref: Para. A9-A12)

15. In order to plan and conduct a review of financial statements, a recently appointed auditor, who has not yet performed an audit of the annual financial statements in accordance with International Standards on Auditing (New Zealand), shall obtain an understanding of the entity and its environment, including its internal control, as it relates to the preparation of both the annual and interim or other financial statements. (Ref: Para. A13)

Materiality (Ref: Para. A14-A18)

16. The auditor shall consider materiality, using professional judgement, when:

    (a) Determining the nature, timing and extent of review procedures; and

    (b) Evaluating the effect of misstatements.

Enquiries, Analytical and Other Review Procedures

17. The auditor shall make enquiries, primarily of persons responsible for financial and accounting matters, and perform analytical and other review procedures to enable the auditor to conclude whether, on the basis of the procedures performed, anything has come to the auditor's attention that causes the auditor to believe that the financial

statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework. (Ref: Para. A19-A23)

18. The auditor shall obtain evidence that the financial statements agree or reconcile with the underlying accounting records. (Ref: Para. A24)

19. The auditor shall enquire whether management has identified all events up to the date of the review report that may require adjustment to or disclosure in the financial statements. (Ref: Para. A25)

20. The auditor shall enquire whether those charged with governance have changed their assessment of the entity's ability to continue as a going concern. When, as the result of this enquiry or other review procedures, the auditor becomes aware of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall:

    (a) Enquire of those charged with governance as to their plans for future actions based on their going concern assessment, the feasibility of these plans, and whether they believe that the outcome of these plans will improve the situation; and

    (b) Consider the adequacy of the disclosure about such matters in the financial statements. (Ref: Para. A26)

21. When a matter comes to the auditor's attention that leads the auditor to question whether a material adjustment should be made for the financial statements to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor shall make additional enquiries or perform other procedures to enable the auditor to express a conclusion in the review report. (Ref: Para. A27)

Comparatives – First Financial Statements (Ref: Para. A28-A31)

22. When comparative information is included for the first time in the financial statements, an auditor shall perform similar procedures on the comparative information as applied to the current period financial statements.

Evaluation of Misstatements (Ref: Para. A32-A34)

23. The auditor shall evaluate, individually and in the aggregate, whether uncorrected misstatements that have come to the auditor's attention are material to the financial statements.

Written Representations

24. The auditor shall endeavour to obtain written representations from those charged with governance, that:

    (a) They acknowledge their responsibility for the design and implementation of internal control to prevent and detect fraud and error;

    (b) The financial statements are prepared and presented in accordance with the applicable financial reporting framework;

    (c) They believe the effect of those uncorrected misstatements aggregated by the auditor during the review are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items is included in or attached to the written representations;

(d) They have disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to them that may have affected the entity;

(e) They have disclosed to the auditor the results of their assessment of the risk that the financial statements may be materially misstated as a result of fraud;

(f) They have disclosed to the auditor all ~~known actual~~identified or ~~possible~~ suspected non-compliance with laws and regulations, the effects of which are to be considered when preparing the financial statements; and

(g) They have disclosed to the auditor all significant events that have occurred subsequent to the balance sheet date and through to the date of the review report that may require adjustment to or disclosure in the financial statements. (Ref: Para. A35)

(h) They have disclosed to the auditor all information relevant to the use of the going concern ~~assumption~~ basis of accounting~~in the financial statements~~.

25. If those charged with governance refuse to provide a written representation that the auditor considers necessary, this constitutes a limitation on the scope of the auditor's work and the auditor shall express a qualified conclusion or a disclaimer of conclusion, as appropriate.

Auditor's Responsibility for ~~Accompanying~~ Other Information

26. The auditor shall read the other information that accompanies the financial statements to consider whether there is ~~any~~ material inconsistencies ~~such information is materially inconsistent~~ with the financial statements. (Ref: Para. A36)

27. If a matter comes to the auditor's attention that causes the auditor to believe that the other information appears to include a material misstatement of fact, the auditor shall discuss the matter with the entity's management, and where appropriate, those charged with governance. (Ref: Para. A37)

Commented [MP2]: This is the defined term in ISA 720 (Revised)

Commented [MP3]: An audit requires the auditor to identify, "consider" still appropriate for a review?

Commented [MP4R3]: Shall we list procedures like in ISA (NZ) 720 or is this level of detail enough for a review engagement?

Commented [MP5]: ISA (NZ) 720 goes into much more detail but gets complex. Do you consider we should add this level of detail, or refer to ISA (NZ) 720. We suggest adding a reference to ISA (NZ) 720 in the application material. This gets complicated by the fact that 2410 does not require an "other information" section in the report.

Communication

28. When, as a result of performing a review of the financial statements, a matter comes to the auditor's attention that causes the auditor to believe that it is necessary to make a material adjustment to the financial statements for them to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor shall communicate this matter as soon as practicable to the appropriate level of management.

29. When, in the auditor's judgement, management does not respond appropriately within a reasonable period of time, the auditor shall inform those charged with governance. (Ref: Para. A38)

30. When, in the auditor's judgement, those charged with governance do not respond appropriately within a reasonable period of time, the auditor shall consider:

(a) Whether to modify the review report; or

(b) The possibility of withdrawing from the engagement; and

(c) The possibility of resigning from the appointment to audit the annual financial statements. (Ref: Para. A36 and A58)

31. When, as a result of performing the review of the financial statements, a matter comes to the auditor's attention that ~~causes~~ indicates ~~the auditor to believe in~~ the existence of fraud or non-compliance ~~by the entity~~ with laws and regulations or suspected fraud or non-compliance with laws and regulations, has occurred in the entity, the auditor shall:

(a) ~~C~~communicate the matter, unless prohibited by law or regulation, as soon as practicable with ~~to~~ those charged with governance; (Ref: Para. A39)

(b) Request management's assessment of the effect(s), if any, on the financial statements;

(c) ~~and shall~~ Consider the ~~implications~~ effect on~~for~~ the auditor's conclusion and the review report; and~~.~~

(d) Determine whether law, regulation or relevant ethical requirements:

(i) Require the auditor to report to an appropriate authority outside the entity.

~~(i)~~(ii) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances. ~~(Ref: Para. A39)~~

~~31.~~32. The auditor shall communicate relevant matters of governance interest arising from the review of the financial statements to those charged with governance. (Ref: Para. A40 and A59)

Reporting the Nature, Extent and Results of the Review of Financial Statements

~~32.~~33. The auditor shall issue a written report that contains the following:

(a) An appropriate title clearly identifying it as a review report of the independent auditor of the entity.

(b) An addressee, as required by the circumstances of the engagement.

34. The first section of the report shall include the auditor's conclusion, and shall have the heading "Conclusion". The Conclusion section of the report shall:

(a) Identify~~ication of~~ the entity whose financial statements have been reviewed;~~,~~

(b) State that the financial statements have been reviewed;

(c) ~~including i~~Identify~~ication of~~ the title of each ~~of the~~ statement~~s contained~~ comprising ~~in~~ the financial statements;

(d) Refer to the notes, including the summary of significant accounting policies; and

~~(b)~~(e) Specify the date of, ~~and~~or period covered by, each ~~the~~ financial statement comprising the financial statements.

35. If the financial statements comprises a complete set of general purpose financial statements prepared in accordance with a ~~financial reporting~~ fair presentation framework ~~designed to achieve fair presentation~~, the report shall include a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements do not present fairly, or if applicable, are not true and fair, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the jurisdiction or country of origin of the financial reporting framework when New Zealand is not the origin of the financial reporting framework used).

Commented [MP6]: Aligns with conforming amendments to ISRE 2400 (Revised)

Commented [MP7]: ISRE 2400 refers to management or those charged with governance but leave as was in NZ SRE?

Commented [MP8]: Not really communication from here on. Are you happy to keep under this heading as one requirement dealing with NOCLAR or do you prefer to split out into a separate section on NOCLAR?

Commented [MP9]: ISA (NZ) 700 is prescriptive as to the phrases to be used in the opinion. I have not amended to reflect the same level of prescription but amended the existing requirement to make it a stand alone requirement.

36. In other circumstances, the report shall include a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the jurisdiction or country of origin of the financial reporting framework when New Zealand is not the origin of the financial reporting framework used).

37. The report shall include a section, directly following the Conclusion section, with the heading "Basis for Conclusion", that:

(a) ~~A s~~State~~s~~~~ment~~ that the review of the financial statements was conducted in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*; ~~and~~

(b) Refers to the section of the auditor's review report that describes the auditor's responsibilities under NZ SRE 2410;

(c) Includes a statement that ~~NZ SRE 2410 requires~~ the auditor is independent of the entity in accordance with the relevant ethical requirements in New Zealand relating to the audit of the annual financial statements, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. ~~to comply with ethical requirements relevant to the audit of the annual financial statements.~~

(d) Includes ~~A~~a statement as to the existence of any relationship (other than that of ~~assurance practitioner~~auditor) which the ~~assurance practitioner~~auditor has with, or any interests which the ~~assurance practitioner~~auditor has in, the entity or any of its subsidiaries.

38. The report shall include a section with a heading "Responsibilities of Those Charged with Governance for the Financial Statements." This section of the report shall describe the responsibilities of those charged with governance for:

(a) ~~If the financial statements comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, a statement that those charged with governance are responsible for the P~~preparing~~ation~~ ~~and fair presentation of~~ the financial statements in accordance with the applicable financial reporting framework, and for such internal control as those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

~~(c)~~(b) ~~.~~Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.

39. When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to the "preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view" as appropriate.~~In other circumstances, a statement that those charged with governance are responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.~~

Commented [MP10]: From ISA (NZ) 700

Commented [MP11]: Or review? .

Commented [MP12]: Is it not auditor in this case? As this standard is dealing with the review performed by the auditor? Correction from extant.

Commented [MP13]: 700 requirements include a statement that the auditor believes that the audit evidence obtained is sufficient and appropriate to identify the relationships with, or interest in, the entity.

Commented [MP14]: Was previously in the illustration but not in the requirements so add in here consistent with illustration and ISA 700

Commented [MP15]: Introduce new mandatory statement on GC as done in ISA (NZ) 700?

~~33.~~40. The report shall include a section with the heading "Auditor's Responsibilities for the Review of the Financial Statements." This section of the report shall:

(a) ~~A statement~~State that the auditor is responsible for expressing a conclusion on the financial statements based on the review.

(b) ~~A statement~~State that a review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

~~(b)~~(c) State that the auditor makes enquiries about the appropriateness of the use of the going concern basis of accounting. If the auditor considers that a material uncertainty exists, the auditor is required to draw attention in the review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the conclusion. The auditor's conclusions are based on the evidence obtained up to the date of the auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.

~~(c)~~(d) ~~A statement~~State that a review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable the auditor to obtain assurance that the auditor would become aware of all significant matters that might be identified in an audit, and that accordingly no audit opinion is expressed.

~~(d)(a) If the financial statements comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements do not present fairly, or if applicable, are not true and fair, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the jurisdiction or country of origin of the financial reporting framework when New Zealand is not the origin of the financial reporting framework used).~~

~~(e)~~(a)~~In other circumstances, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the jurisdiction or country of origin of the financial reporting framework when New Zealand is not the origin of the financial reporting framework used).~~

41. The name of the engagement partner shall be included in the review report on financial statements of FMC reporting entities considered to have a higher level of public accountability unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.

42. The review report shall include:

~~(f)~~(a) The date ~~of~~ the auditor signs the ~~auditor's review~~ report.

~~(g)~~(b) ~~The review report shall name t~~The location in the country or jurisdiction where the auditor practices.

~~(h)~~(c) The auditor's signature. (Ref: Para. A41)

Commented [MP16]: No option to refer to the website to be included in NZ SRE 2410. The responsibility section is condensed therefore no real need to do so?

~~(i)(a) A statement as to the existence of any relationship (other than that of assurance practitioner) which the assurance practitioner has with, or any interests which the assurance practitioner has in, the entity or any of its subsidiaries.~~

Departure from the Applicable Financial Reporting Framework

~~34.~~43. The auditor shall express a qualified or adverse conclusion when a matter has come to the auditor's attention that causes the auditor to believe that a material adjustment should be made to the financial statements for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework. The auditor shall amend the heading "Basis for Conclusion" to "Basis for Qualified Conclusion" or "Basis for Adverse Conclusion" ~~include a basis for modification paragraph~~ in the report, that describes the nature of the departure and, if practicable, states the effects on the financial statements. If the effects or possible effects are incapable of being measured reliably, a statement to that effect and the reasons therefore shall be included in the ~~basis for modification paragraph~~Basis for Conclusion section. The conclusion paragraph shall be headed "Qualified Conclusion" or "Adverse Conclusion", whichever is relevant. (Ref: Para. A42)

~~35.~~44. When the effect of the departure is so material and pervasive to the financial statements that the auditor concludes a qualified conclusion is not adequate to disclose the misleading or incomplete nature of the financial statements, the auditor shall express an adverse conclusion. (Ref: Para. A43)

Limitation on Scope (Ref: Para. A44)

~~36.~~45. When the auditor is unable to complete the review, the auditor shall communicate, in writing, to the appropriate level of management and to those charged with governance the reason why the review cannot be completed, and consider whether it is appropriate to issue a review report.

Limitation on Scope Imposed by Management

~~37.~~46. Unless required by law or regulation, an auditor shall not accept an engagement to review the financial statements when management has imposed a limitation on the scope of the auditor's review. (Ref: Para. A45 and A58)

~~38.~~47. If, after accepting the engagement, management imposes a limitation on the scope of the review, the auditor shall request management to remove the limitation. If management refuses the auditor's request to remove the limitation, the auditor shall communicate, in writing, to the appropriate level of management and those charged with governance, the reason(s) why the review cannot be completed. (Ref: Para. A46)

48. If management and, where appropriate, those charged with governance, refuses the auditor's request to remove a limitation that has been imposed on the scope of the review, but there is a legal or regulatory requirement for the auditor to issue a report, the auditor shall issue a disclaimer of conclusion or qualified conclusion report, as appropriate, containing the reason(s) why the review cannot be completed. (Ref: Para. A47)

49. When the auditor disclaims a conclusion on the financial statements, the auditor shall amend the description of the auditor's responsibilities required by paragraph 40 to include only:

Commented [MP17]: Position? Do you consider this is better after paragraph 45?

(a) A statement that the auditor's responsibility is to conduct the review of the entity's financial statements in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity;*

~~(a)~~(b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Conclusion section, the auditor was not able to obtain sufficient evidence to provide a basis for a review conclusion on the financial statements; and

Other Limitations on Scope Not Imposed by Management (Ref: Para. A48-A49)

~~39.~~50. The auditor shall express a qualified conclusion when, in rare circumstances, there is a limitation on the scope of the auditor's work that is confined to one or more specific matters, which while material, is not in the auditor's judgement pervasive to the financial statements, and when the auditor concludes that an unqualified ~~opinion~~ conclusion cannot be expressed. A qualified conclusion shall be expressed as being "except for" the effects of the matter to which the qualification relates. The conclusion paragraph shall be headed "Qualified Conclusion".

Commented [MP18]: Seems consistent with the changes introduced. Any further change identified?

Going Concern and ~~Significant~~ a Material Uncertainty~~ies~~ Exists (Ref: Para. A51~~0~~-A53~~4~~)

51. If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified conclusion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern"~~add an emphasis of matter paragraph~~ to ~~the review report to highlight a material uncertainty relating to an event or condition that casts significant doubt on the entity's ability to continue as a going concern~~:

(a) Draw attention to the note in the financial statements that discloses the matter; and

~~(a)~~(b) State that the events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and ~~and~~ that the auditor's conclusion is not modified in respect of the matter.

52. If a material uncertainty that casts significant doubt on the entity's ability to continue as a going concern is not adequately disclosed in the financial statements, the auditor shall:

(a) E~~e~~xpress a qualified or adverse conclusion, as appropriate; and

(b) In the Basis for Qualified (Adverse) Conclusion section of the review report, state ~~. The report shall include specific reference to the fact~~ that ~~there is such~~ a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter ~~in the Basis for Qualified (Adverse) Conclusion section of the review report~~.

Emphasis of Matter Paragraphs (Ref: Para. A54)

53. ~~In circumstances other than a going concern problem, t~~The auditor shall consider adding an emphasis of matter paragraph to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements

~~highlight a significant uncertainty that is adequately disclosed in the financial statements, that came to the auditor's attention, the resolution of which is dependent upon future events and which may materially affect the financial statements~~.

54. When the auditor includes an Emphasis of Matter paragraph in the review report, the auditor shall:

(a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";

(b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and

~~(b)~~(c) Indicate that the auditor's conclusion is not modified in respect of the matter emphasized.

~~40. If a significant uncertainty (other than a going concern problem) is not adequately disclosed in the financial statements, the auditor shall express a qualified or adverse conclusion, as appropriate. The report shall include specific reference to the fact that there is such a significant uncertainty.~~

Commented [MP19]: This does not align with the way in which an emphasis of matter paragraph is described in ISA (NZ) 706

Commented [MP20]: From ISA (NZ) 706 para 9

Commented [MP21]: No longer makes sense given the change above.

Documentation (Ref: Para. A60)

~~41.~~55. The auditor shall prepare review documentation that is sufficient and appropriate to provide a basis for the auditor's conclusion, and to provide evidence that the review was performed in accordance with this NZ SRE 2410 and applicable legal and regulatory requirements.

* * *

Application and Other Explanatory Material

Objective (Ref: Para. 5)

A1. Under paragraph 14, the auditor needs to make enquiries, and perform analytical and other review procedures in order to reduce to a limited level the risk of expressing an inappropriate conclusion when the financial statements are materially misstated.

A2. The objective of a review of the financial statements differs significantly from that of an audit conducted in accordance with International Standards on Auditing (New Zealand). A review of the financial statements does not provide a basis for expressing an opinion whether the financial statements give a true and fair view, or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

A3. A review, in contrast to an audit, is not designed to obtain reasonable assurance that the financial statements are free from material misstatement. A review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review may bring significant matters affecting the financial statements to the auditor's attention, but it does not provide all of the evidence that would be required in an audit.

Performing a Review (Ref: Para 7)

A4. Through performing the audit of the annual financial statements, the auditor obtains an understanding of the entity and its environment, including its internal control. When the auditor is engaged to review the financial statements, under paragraph 13, the auditor needs to update this understanding through enquiries made in the course of the review, to assist the auditor in focusing the enquiries to be made and the analytical and other review procedures to be applied. An assurance practitioner who is engaged to perform a review of the financial statements, and who is not the auditor of the entity, does not perform the review in accordance with NZ SRE 2410*, as the assurance practitioner ordinarily does not have the same understanding of the entity and its environment, including its internal control, as the auditor of the entity.

Although other International Standards on Auditing (New Zealand) do not apply to review engagements, they include guidance which may be helpful to auditors performing reviews covered by this NZ SRE 2410.

General Principles of a Review of Financial Statements

A5. Relevant ethical requirements[2] govern the auditor's professional responsibilities in the following areas: independence, integrity, objectivity, professional competence and due care, confidentiality, professional behaviour, and technical standards. (Ref: Para. 8)

Commented [MP22]: What does this mean? This is not a fundamental principle and seems out of place here – can I delete?

A6. The elements of quality control that are relevant to an individual engagement include leadership responsibilities for quality on the engagement, ethical requirements, acceptance and continuance of client relationships and specific engagements, assignment of engagement teams, engagement performance, and monitoring. (Ref: Para. 9)

A7. An attitude of professional scepticism denotes that the auditor makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations by those charged with governance of the entity. ISA (NZ) 200 includes guidance which may be helpful.* (Ref: Para. 11)

Agreeing the Terms of the Engagement

A8. Written agreement of the terms of the engagement helps to avoid misunderstandings regarding the nature of the engagement and, in particular, the objective and scope of the review, the responsibilities of those charged with governance, the extent of the auditor's responsibilities, the assurance obtained, and the nature and form of the report. The communication ordinarily covers the following matters:

(a) the objective of a review of the financial statements;

(b) the scope of the review;

(c) the responsibilities of those charged with governance for:

(i) the financial statements;

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* See ISRE (NZ) 2400 *Engagements to Review Historical Financial Statements*.

[2] Professional and Ethical Standard 1 (Revised), *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*.

* ISA (NZ) 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*.

(ii) establishing and maintaining effective internal control relevant to the preparation of the financial statements; and

(iii) making all financial records and related information available to the auditor;

(d) agreement from those charged with governance:

(i) to provide written representations to the auditor to confirm representations made orally during the review, as well as representations that are implicit in the entity's records; and

(ii) that where any document containing the financial statements indicates that the financial statements has been reviewed by the entity's auditor, the review report also will be included in the document; and

(e) the anticipated form and content of the report to be issued, including the identity of the addressee of the report.

An illustrative engagement letter is set out in Appendix 1. The terms of engagement to review the financial statements can also be combined with the terms of engagement to audit the annual financial statements. ISA (NZ) 210 includes guidance which may be helpful.* (Ref: Para. 12)

Procedures for a Review of the Financial Statements

Understanding the Entity and its Environment, Including its Internal Control

A9. Under ISA (NZ) 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, the auditor who has audited the entity's financial statements for one or more annual periods has obtained an understanding of the entity and its environment, including its internal control, as it relates to the preparation of the annual financial statements, that was sufficient to conduct the audit. In planning a review of the financial statements, the auditor needs to update this understanding. The auditor also needs to obtain a sufficient understanding of internal control as it relates to the preparation of the financial statements subject to review, as it may differ from internal control as it relates to the preparation of the annual financial statements. (Ref: Para. 14)

A10. The auditor needs to use the understanding of the entity and its environment, including its internal control, to determine the enquiries to be made and the analytical and other review procedures to be applied, and to identify the particular events, transactions or assertions to which enquiries may be directed or analytical or other review procedures applied. (Ref: Para. 14)

A11. The procedures performed by the auditor to update the understanding of the entity and its environment, including its internal control, ordinarily include the following:

(a) reading the documentation, to the extent necessary, of the preceding year's audit, reviews of prior period(s) of the current year, and corresponding period(s) of the prior year, to enable the auditor to identify matters that may affect the current-period financial statements;

(b) considering any significant risks, including the risk of management override of controls, that were identified in the audit of the prior year's financial statements;

* ISA (NZ) 210 *Agreeing the Terms of Audit Engagements*.

(c) reading the most recent annual and comparable prior period financial statements;

(d) considering materiality with reference to the applicable financial reporting framework as it relates to the financial statements, to assist in determining the nature and extent of the procedures to be performed and evaluating the effect of misstatements;

(e) considering the nature of any corrected material misstatements and any identified uncorrected immaterial misstatements in the prior year's financial statements;

(f) considering significant financial accounting and reporting matters that may be of continuing significance, such as material weaknesses in internal control;

(g) considering the results of any audit procedures performed with respect to the current year's financial statements;

(h) considering the results of any internal audit performed and the subsequent actions taken by management;

(i) enquiring of management about the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud;

(j) enquiring of management about the effect of changes in the entity's business activities;

(k) enquiring of management about any significant changes in internal control and the potential effect of any such changes on the preparation of the financial statements; and

(l) enquiring of management of the process by which the financial statements have been prepared and the reliability of the underlying accounting records to which the financial statements are agreed or reconciled. (Ref: Para. 14)

A12. The auditor needs to determine the nature of the review procedures, if any, to be performed for components and, where applicable, communicate these matters to other auditors involved in the review. Factors considered ordinarily include the materiality of, and risk of misstatement in, the financial statement components, and the auditor's understanding of the extent to which internal control over the preparation of such financial statements is centralised or decentralised. (Ref: Para. 14)

A13. Obtaining an understanding of the entity and its environment enables the auditor to focus the enquiries made, and the analytical and other review procedures applied in performing a review of the financial statements in accordance with this NZ SRE 2410. As part of obtaining this understanding, ordinarily the auditor makes enquiries of the predecessor auditor and, where practicable, reviews the predecessor auditor's documentation for the preceding annual audit and for any prior periods in the current year that have been reviewed by the predecessor auditor. In doing so, ordinarily the auditor considers the nature of any corrected misstatements, and any uncorrected misstatements aggregated by the auditor, any significant risks, including the risk of management override of controls, and significant accounting and any reporting matters that may be of continuing significance, such as material weaknesses in internal control. (Ref: Para. 15)

Materiality (Ref: Para. 16)

A14. The auditor needs to use professional judgement and consider qualitative and quantitative factors in determining materiality.

A15. Ordinarily, the auditor's consideration of materiality for a review of the financial statements is based on the period financial data and accordingly, materiality based on interim period financial data may be less than materiality for annual financial data. If the entity's business is subject to cyclical variations or if the financial results for the current period show an exceptional decrease or increase compared to prior periods and expected results for the current year, the auditor may, for example, conclude that materiality is more appropriately determined using a normalised figure for the period.

A16. The auditor's consideration of materiality, in evaluating the effects of misstatements, is a matter of professional judgement and is affected by the auditor's perception of the financial information needs of users of the financial statements.

A17. If the applicable financial reporting framework contains a definition of materiality, it will ordinarily provide a frame of reference to the auditor when determining materiality for planning and performing the review.

A18. The auditor needs, when relevant, to consider materiality from the perspective of both the entity and the consolidated entity.

Enquiries, Analytical and Other Review Procedures

A19. A review ordinarily does not require tests of the accounting records through inspection, observation or confirmation. Procedures for performing a review of the financial statements ordinarily are limited to making enquiries, primarily of persons responsible for financial and accounting matters and applying analytical and other review procedures, rather than corroborating information obtained concerning matters relating to the financial statements. The auditor's understanding of the entity and its environment, including its internal control, the results of the risk assessments relating to the preceding audit and the auditor's consideration of materiality as it relates to the financial statements, affects the nature and extent of the enquiries made, and analytical and other review procedures applied. (Ref: Para. 17)

A20. The auditor ordinarily performs the following procedures:

(a) Reading the minutes of the meetings of shareholders, those charged with governance and other appropriate committees to identify matters that may affect the financial statements, and enquiring about matters dealt with at meetings for which minutes are not available that may affect the financial statements.

(b) Considering the effect, if any, of matters giving rise to a modification of the audit or review report, accounting adjustments or unadjusted misstatements, at the time of the previous audit or reviews.

(c) Communicating, where appropriate, with other auditors who are performing a review of the financial statements of the entity's significant components.

(d) Enquiring of members of management responsible for financial and accounting matters, and others as appropriate, about the following:

(i) whether the financial statements have been prepared and presented in accordance with the applicable financial reporting framework;

(ii) whether there have been any changes in accounting principles or in the methods of applying them;

(iii) whether any new transactions have necessitated the application of a new accounting principle;

(iv) whether the financial statements contain any known uncorrected misstatements;

(v) unusual or complex situations that may have affected the financial statements, such as a business combination or disposal of a segment of the business;

(vi) significant assumptions that are relevant to the fair value measurement or disclosures and management's intention and ability to carry out specific courses of action on behalf of the entity;

(vii) whether related party transactions have been appropriately accounted for and disclosed in the financial statements;

(viii) significant changes in commitments and contractual obligations;

(ix) significant changes in contingent assets and contingent liabilities including litigation or claims;

(x) compliance with debt covenants;

(xi) matters about which questions have arisen in the course of applying the review procedures;

(xii) significant transactions occurring in the last several days of the period or the first several days of the next period;

(xiii) knowledge of any fraud or suspected fraud affecting the entity involving:

- management;
- employees who have significant roles in internal control; or
- others where the fraud could have a material effect on the financial statements; and

(xiv) knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial information communicated by employees, former employees, analysts, regulators or others; and

(xv) knowledge of any actual or ~~possible~~ suspected non-compliance with laws and regulations that could have a material effect on the financial statements.

(e) Applying analytical procedures to the financial statements designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement in the financial statements. Analytical procedures may include ratio analysis and statistical techniques such as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted auditing techniques. Appendix 2 to this NZ SRE 2410 contains examples of analytical procedures the auditor may consider when performing a review of the financial statements.

(f) Reading the financial statements and considering whether anything has come to the auditor's attention that causes the auditor to believe that the financial

statements are not in accordance with the applicable financial reporting framework. (Ref: Para. 16)

A21. The auditor may perform many of the review procedures before or simultaneously with the entity's preparation of the financial statements. For example, it may be practicable to update the understanding of the entity and its environment, including its internal control, and begin reading applicable minutes before the end of the period. Performing some of the review procedures earlier in the period also permits early identification and consideration of significant accounting matters affecting the financial statements. (Ref: Para. 17)

A22. The auditor performing a review of the financial statements is also the auditor of the annual financial statements of the entity. For convenience and efficiency, the auditor may decide to perform certain audit procedures concurrently with the review of the financial statements. For example, information gained from reading the minutes of meetings of the board of directors in connection with the review of the financial statements may also be used for the annual audit. The auditor may decide also to perform, at the time of the review, auditing procedures that would need to be performed for the purpose of the audit of the annual financial statements, for example, performing auditing procedures on:

(a) significant or unusual transactions that occurred during the period, such as business combinations, restructurings, or significant revenue transactions, or

(b) opening balances (when applicable). (Ref: Para. 17)

A23. A review of financial statements ordinarily does not require corroborating the enquiries about litigation or claims. It is, therefore, ordinarily not necessary to send an enquiry letter to the entity's lawyer. Direct communication with the entity's lawyer with respect to litigation or claims, or alternative procedures, may, however, be appropriate if a matter comes to the auditor's attention that causes the auditor to question whether the financial statements are in accordance with the applicable financial reporting framework. (Ref: Para. 17)

A24. The auditor may obtain evidence that the financial statements agree or reconcile with the underlying accounting records by tracing the financial statements to:

(a) the accounting records, such as the general ledger, or a consolidating schedule that agrees or reconciles with the accounting records; and

(b) other supporting data in the entity's records as necessary. (Ref: Para. 18)

A25. The auditor need not perform procedures to identify events occurring after the date of the review report. (Ref: Para. 19)

A26. Events or conditions which may cast significant doubt on the entity's ability to continue as a going concern may have existed at the date of the annual financial statements, or may be identified as a result of enquiries of management or in the course of performing other review procedures. When such events or conditions come to the auditor's attention, the auditor needs to enquire of those charged with governance as to their plans for future action, such as their plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital. The auditor needs to enquire also as to the feasibility of the plans of those charged with governance and whether they believe that the outcome of these plans will improve the situation. Ordinarily, the auditor considers, based on procedures performed, whether it is

necessary to corroborate the feasibility of the plans of those charged with governance and whether the outcome of these plans will improve the situation. (Ref: Para. 20)

A27. For example, if the auditor's review procedures lead the auditor to question whether a significant sales transaction is recorded in accordance with the applicable financial reporting framework, the auditor performs additional procedures sufficient to resolve the auditor's questions, such as discussing the terms of the transaction with senior marketing and accounting personnel or reading the sales contract. (Ref: Para. 21)

Comparatives – First Financial Statements (Ref: Para. 22)

A28. When comparative information is included in the first financial statements and the auditor is unable to obtain sufficient appropriate review evidence to achieve the review objective, a limitation on the scope of the review exists and the auditor needs to modify the review report. Ordinarily, a restriction on the scope of the auditor's work will result in a qualified ("except for") conclusion. In such cases, ordinarily an auditor encourages clear disclosure in the financial statements, that the auditor has been unable to review the comparatives. An example of a modified review report is included in Appendix 3.

A29. When comparative information is included in the first financial statements and the auditor believes a material adjustment should be made to the financial statements, under paragraph 34, the auditor needs to modify the review report.

A30. When an entity has come into existence only within the first financial reporting period, comparative information will not be provided in the first financial statements and no modified review report is required.

A31. New Zealand Equivalent to International Accounting Standard 1 *Presentation of Financial Statements* provides requirements and explanatory guidance relating to comparative information included in financial statements prepared in accordance with New Zealand Accounting Standards. New Zealand Equivalent to International Financial Reporting Standards 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* provides requirements and guidance relating to comparative information when an entity adopts New Zealand Equivalents to International Financial Reporting Standards for the first time.

Evaluation of Misstatements (Ref: Para. 23)

A32. A review of the financial statements, in contrast to an audit engagement, is not designed to obtain reasonable assurance that the financial statements are free from material misstatement. However, misstatements which come to the auditor's attention, including inadequate disclosures, need to be evaluated individually and in the aggregate to determine whether a material adjustment is required to be made to the financial statements for them to be prepared, in all material respects, in accordance with the applicable financial reporting framework.

A33. The auditor needs to exercise professional judgement in evaluating the materiality of any misstatements that the entity has not corrected. Ordinarily, the auditor considers matters such as the nature, cause and amount of the misstatements, whether the misstatements originated in the preceding year or current year, and the potential effect of the misstatements on future interim or annual periods.

A34. The auditor may designate an amount below which misstatements need not be aggregated, because the auditor expects that the aggregation of such amounts clearly

would not have a material effect on the financial statements. In so doing, under paragraph 16, the auditor needs to consider the fact that the determination of materiality involves quantitative as well as qualitative considerations and that misstatements of a relatively small amount could nevertheless have a material effect on the financial statements.

Written Representations

A35. The auditor needs to endeavour to obtain additional representations as are appropriate to matters specific to the entity's business or industry. An illustrative representation letter is set out in Appendix 1. (Ref: Para. 24)

Auditor's Responsibility for ~~Accompanying~~ Other Information

A36. If the auditor identifies a material inconsistency, the auditor needs to consider whether the financial statements or the other information needs to be amended. If an amendment is necessary in the financial statements and those charged with governance refuse to make the amendment, under paragraph 30, the auditor needs to consider the implications for the review report. If an amendment is necessary in the other information and those charged with governance refuse to make the amendment, the auditor may, for example, consider including in the review report an Other Matter Paragraph describing the material inconsistency ~~(ISA (NZ) 720 (Revised) and ISA (NZ) 706 (Revised) include guidance which may be helpful[3])~~ or taking other actions, such as withholding the issuance of the review report or withdrawing from the engagement. For example, those charged with governance may present alternative measures of earnings that more positively portray financial performance than the financial statements, and such alternative measures are given excessive prominence, or are not clearly defined, or not clearly reconciled to the financial statements such that they are confusing and potentially misleading. (Ref: Para. 26)

Commented [MP23]: ISA (NZ) 720 no longer helpful as would be covered by separate section under the revised standard. Should we identify including an Other Information Section and following ISA (NZ) 720 in this instance?

A37. While reading the other information for the purpose of identifying material inconsistencies, an apparent material misstatement of fact may come to the auditor's attention (that is, information, not related to matters appearing in the financial statements, that is incorrectly stated or presented). When discussing the matter with the entity's management, ordinarily the auditor considers the validity of the other information and management's responses to the auditor's enquiries, whether valid differences of judgement or opinion exist and whether to request management to consult with a qualified third party to resolve the apparent misstatement of fact. If an amendment is necessary to correct a material misstatement of fact and management refuses to make the amendment, ordinarily the auditor considers taking further action as appropriate, such as notifying those charged with governance and, if necessary, considering the implications for the review report~~obtaining legal advice~~. ISA (NZ) 720 (Revised) includes guidance which may be helpful. (Ref: Para. 27)

Commented [MP24]: Consistent with ISA 720 (Revised) para 18?

Communication

A38. Communications with management and/or those charged with governance are made as soon as practicable, either orally or in writing. The auditor's decision whether to

[3] ~~ISA (NZ) 720 (Revised) *The Auditor's Responsibilityies Relating to Other Information in Documents Containing Audited Financial Statements*; and ISA (NZ) 706 (Revised) *Emphasis of Matter Paragraphs or and Other Matter Paragraphs in the Independent Auditor's Report*.~~

communicate orally or in writing ordinarily is affected by factors such as the nature, sensitivity and significance of the matter to be communicated and the timing of the communications. If the information is communicated orally, under paragraph 45, the auditor needs to document the communication. (Ref: Para. 29)

A39. The determination of which level of management may also be informed is affected by the likelihood of collusion or the involvement of a member of management. (Ref: Para. 31)

A40. Law or regulation may restrict the auditor's communication of certain matters with management or those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report identified or suspected non-compliance with laws and regulation to an appropriate authority pursuant to anti-money laundering legislation. In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice. ISA (NZ) 250 (Revised) includes guidance which may be helpful.[4] (Ref. Para 31)

~~A39.~~A41. As a result of performing a review of financial statements, the auditor may become aware of matters that in the opinion of the auditor are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. (Ref: Para. 32)

Reporting the Nature, Extent and Results of the Review of Financial Statements (Ref: Para. 33)

~~A40.~~A42. ~~A41.~~ In some cases, law or regulation governing the review of financial statements may prescribe wording for the auditor's conclusion that is different from the wording described in paragraph 33(j). Although the auditor may be obliged to use the prescribed wording, the auditor's responsibilities as described in this NZ SRE 2410 for coming to the conclusion remain the same. ISA (NZ) 700 (Revised) includes guidance which may be helpful.[5] Illustrative review reports are set out in Appendix 3.

Departure from the Applicable Financial Reporting Framework (Ref: Para. 34–35)

~~A41.~~A43. ~~A42.~~ If matters have come to the auditor's attention that cause the auditor to believe that the financial statements are or may be materially affected by a departure from the applicable financial reporting framework, and those charged with governance do not correct the financial statements, the auditor needs to modify the review report. If the information that the auditor believes is necessary for adequate disclosure is not included in the financial statements, the auditor needs to modify the review report and, if practicable, include the necessary information in the review report. Illustrative review reports with a qualified conclusion are set out in Appendix 3.

~~A42.~~A44. ~~A43.~~ Departures from the applicable financial reporting framework, may result in an adverse conclusion. An illustrative review report with an adverse conclusion is set out in Appendix 3.

Commented [MP25]: From NOCLAR conforming amendments to ISRE (NZ) 2400 (Revised). Do we need to follow this in such detail or can we refer to ISA 250?

This para is also included in ISA (NZ) 260 (Revised). Consider whether just this is sufficient and then reference to ISA (NZ) 250, rather than include the lengthy application material from ISRE 2400 (Revised) which follows?

Commented [MP26]: Board agreed to include a simple sentence to refer the auditor to guidance in ISA (NZ) 250 (Revised) rather than expanding on the application material as added in ISRE (NZ) 2400 (Revised).

[4] ISA (NZ) 250 (Revised) *Consideration of Laws and Regulations in an Audit of Financial Statements*.

[5] ISA (NZ) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*.

Limitation on Scope (Ref: Para. 36)

~~A43.~~A45. ~~A44.~~ Ordinarily, a limitation on scope prevents the auditor from completing the review.

Limitation on Scope Imposed by Management

~~A44.~~A46. ~~A45.~~ The auditor needs to refuse to accept an engagement to review financial statements if the auditor's preliminary knowledge of the engagement circumstances indicates that the auditor would be unable to complete the review because there will be a limitation on the scope of the auditor's review imposed by management of the entity. (Ref: Para. 37)

~~A45.~~A47. ~~A46.~~ If, after accepting the engagement, management imposes a limitation on the scope of the review, the auditor needs to request the removal of that limitation. If management refuses to do so, the auditor is unable to complete the review and express a conclusion. In such cases, the auditor needs to communicate, in writing, to the appropriate level of management and those charged with governance, the reason(s) why the review cannot be completed. Nevertheless, if a matter comes to the auditor's attention that causes the auditor to believe that a material adjustment to the financial statements is necessary for the financial statements to be prepared, in all material respects, in accordance with the applicable financial reporting framework, under paragraphs 28, 29 and 31, the auditor needs to communicate such matters to the appropriate level of management and, where appropriate, those charged with governance. (Ref: Para. 38)

~~A46.~~A48. ~~A47.~~ The auditor needs to consider the legal and regulatory requirements, including whether there is a legal requirement for the auditor to issue a report. If there is such a requirement, the auditor needs to disclaim a conclusion and provide in the review report the reason why the review cannot be completed. However, if a matter comes to the auditor's attention that causes the auditor to believe that a material adjustment to the financial statements is necessary for the financial statements to be prepared, in all material respects, in accordance with the applicable financial reporting framework the auditor needs to communicate such a matter in the report. (Ref: Para. 39)

Other Limitations on Scope Not Imposed by Management (Ref: Para. 40)

~~A47.~~A49. ~~A48.~~ A limitation on scope may occur due to circumstances other than a limitation on scope imposed by management or those charged with governance. In such circumstances, the auditor is ordinarily unable to complete the review and express a conclusion, and is guided by paragraphs 39 and 40. There may be, however, some rare circumstances where the limitation on the scope of the auditor's work is clearly confined to one or more specific matters that, while material, are not in the auditor's judgement pervasive to the financial statements. In such circumstances, the auditor needs to modify the review report by indicating that, except for the matter which is described in an explanatory paragraph to the review report, the review was conducted in accordance with this NZ SRE 2410, and by qualifying the conclusion. Illustrative review reports with a qualified conclusion are set out in Appendix 3.

~~A48.~~A50. ~~A49.~~ The auditor may have expressed a qualified opinion on the audit of the latest annual financial statements because of a limitation on the scope of that audit. The

auditor needs to consider whether that limitation on scope still exists and, if so, the implications for the review report.

Going Concern and ~~Significant~~ a Material Uncertainty~~ies~~ Exists (Ref: Para. 5~~4~~1-52~~44~~)

~~A50. In certain circumstances, an emphasis of matter paragraph may be added to a review report, without affecting the auditor's conclusion, to highlight a matter that is included in a note to the financial statements that more extensively discusses the matter. The paragraph would preferably be included after the conclusion paragraph and ordinarily refers to the fact that the conclusion is not qualified in this respect.~~

~~A49.~~A51. ~~A51.~~ The auditor may have ~~modified~~ alerted users to the existence of a material uncertainty relating to an event or condition that casts significant doubt on the entity's ability to continue as a going concern by adding an emphasis of matter paragraph to a prior audit or review report ~~by adding an emphasis of matter paragraph to highlight a material uncertainty relating to an event or condition that casts significant doubt on the entity's ability to continue as a going concern~~. If the material uncertainty still exists and adequate disclosure is made in the financial statements, the auditor needs to ~~modify the review report on the current financial statements~~continue to alert users by adding a "Material Uncertainty Related to Going Concern" paragraph to highlight the continued material uncertainty.

~~A50. A52.~~ If, as a result of enquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that casts significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made in the financial statements, the auditor ~~needs to modify the review report by adding an emphasis of matter paragraph~~alerts users to the existence of a material uncertainty related to going concern in a separate section .

A52.

~~A51. A53.~~ ISA (NZ) 570 (Revised) *Going Concern* provides information that the auditor may find helpful in considering going concern in the context of the review engagement.

~~A52.~~A53. ~~A54. Ordinarily, a significant uncertainty in relation to any other matter, the resolution of which may materially affect the financial statements, would warrant an emphasis of matter paragraph in the auditor's review report.~~

Emphasis of Matter Paragraphs

A54. Ordinarily, a significant uncertainty in relation to any other matter, the resolution of which may materially affect the financial statements, would warrant an emphasis of matter paragraph in the auditor's review report.

Other Considerations

~~A53.~~A55. ~~A55.~~ The terms of the engagement include agreement by those charged with governance that, where any document containing the financial statements indicates that the financial statements have been reviewed by the entity's auditor, the review report will be also included in the document. If those charged with governance have not included the review report in the document, ordinarily the auditor considers seeking legal advice to assist in determining the appropriate course of action in the circumstances. (Ref: Para. 12)

Commented [MP27]: Added new requirement under separate heading dealing with emphasis of matter separately. ISA 706 is more prescriptive than this application material so elevate to requirement and align with 706.

Commented [MP28]: Consider deleting this all together – not sure it adds anything? Requirement in 53 probably enough?

~~A54.~~A56. ~~A56.~~ If the auditor has issued a modified review report and those charged with governance issue the financial statements without including the modified review report in the document containing the financial statements, ordinarily the auditor considers seeking legal advice to assist in determining the appropriate course of action in the circumstances, and the possibility of resigning from the appointment to audit the annual financial statements.

Considerations Specific to Public Sector Entities

~~A55.~~A57. ~~A57.~~ The auditor needs to communicate the terms of engagement to the entity subject to the review. When communicating the terms of engagement, an engagement letter helps to avoid misunderstandings regarding the nature of the engagement and, in particular, the objective and scope of the review, the responsibilities of those charged with governance, the extent of the auditor's responsibilities, the assurance obtained, and the nature and form of the report. Law or regulation governing review engagements in the public sector ordinarily mandates the appointment of the auditor. Nevertheless, an engagement letter setting out the matters referred to in paragraph A8 may be useful to both the public sector auditor and the entity subject to the review. Public sector auditors, therefore, consider communicating the terms of a review engagement by way of an engagement letter[6]. (Ref: Para. 12)

~~A56.~~A58. ~~A58.~~ In the public sector, the auditor's statutory audit obligation may extend to other work, such as a review of interim financial information. Where this is the case, the public sector auditor cannot avoid such an obligation and, consequently, may not be in a position not to accept, or to withdraw from a review engagement. The public sector auditor also may not be in the position to resign from the appointment to audit the annual financial statements. (Ref: Para. 30(b)-30(c) and 37)

~~A57.~~A59. ~~A59.~~ The auditor needs to communicate to those charged with governance and consider the implications for the review when a matter comes to the auditor's attention that causes the auditor to believe in the existence of fraud or non-compliance by the entity with laws and regulations. In the public sector, the auditor may be subject to statutory or other regulatory requirements to report such a matter to regulatory or other public authorities. (Ref: Para. 32)

Documentation (Ref: Para. 45)

~~A58.~~A60. ~~A60.~~ The auditor needs to prepare documentation that enables an experienced auditor having no previous connection with the engagement to understand the nature, timing and extent of the enquiries made and analytical and other review procedures applied, information obtained, and any significant matters considered during the performance of the review, including the disposition of such matters.

[6] Paragraphs A57-A59 are a reproduction of the AUASB's standard. The External Reporting Board does not have the statutory mandate to formulate auditing and assurance standards for public sector entities, and does not intend this guidance to have mandatory effect. New Zealand amendments have been made to align the text with the New Zealand legal position.

Appendix 1

(Ref: Para. A8)

Example of an Engagement Letter For A Review of Financial Statements

The following letter is to be used as a guide in conjunction with the requirements outlined in paragraph 12-13 of this NZ SRE 2410 and will need to be adapted according to individual requirements and circumstances.

To [those charged with governance:[7]]

You have requested that we review the interim financial statements of [name of entity], which comprises the statement of financial position as at 31 December 20XX, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the six-month period ended on that date, and notes comprising a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of the terms and objectives of our engagement by means of this letter.

Our review will be conducted in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*, issued by the New Zealand Auditing and Assurance Standards Board, with the objective of providing us with a basis for reporting whether anything has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with the [indicate applicable financial reporting framework, including a reference to the jurisdiction or country of origin of the financial reporting when New Zealand is not the origin of the financial reporting framework]. Such a review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures and does not, ordinarily, require corroboration of the information obtained. The scope of a review of the financial statements is substantially less than the scope of an audit conducted in accordance with International Standards on Auditing (New Zealand) whose objective is the expression of an opinion regarding the financial statements and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly, we shall express no such opinion. NZ SRE 2410 requires us to also comply with the ethical requirements relevant to the audit of the annual financial statements of the entity.

Commented [MP29]: Does this need expansion for going concern or leave as is? ISA 210 illustrative report is structured similar to new auditor's report but this has not been re-ordered here?

Commented [MP30]: To match changes to report – see comment below.

Commented [MP31]: Does this need expansion at this stage – or independence statement only for report?

We expect to report on the interim financial statements as follows:

[Include text of sample review report - see Appendix 3 as appropriate.]

The directors [those charged with governance[8]] of the [type of entity] are responsible for the preparation of the interim financial statements in accordance with generally accepted accounting practice in New Zealand and that gives a true and fair view of the matters to which they relate and for such internal control as the directors [those charged with governance] determine is necessary to enable the preparation of the interim financial statements that are free from material misstatement, whether due to fraud or error. As part of our review, we shall request written representations from those charged with governance concerning assertions made in connection with the review. We shall also request that where any document containing the interim financial statements indicates that the interim financial statements have been reviewed, our review report will also be included in the document.

Commented [MP32]: No reference to going concern responsibilities of TCWG is ISA (NZ) 210

[7] Insert the appropriate term, such as "Directors' or 'Board of Management".

[8] Insert the appropriate term, such as "Directors or Board of Management".

The directors [those charged with governance] of the [entity] acknowledge and understand they have responsibility to provide us with:

i. access to information relevant to the preparation of the financial statements;
ii. additional information that we may request for the purposes of the review engagement; and
iii. unrestricted access to persons from whom we determine it is necessary to obtain evidence.

A review of the interim financial statements does not provide assurance that we shall become aware of all significant matters that might be identified in an audit. Further, our engagement cannot be relied upon to disclose whether fraud or errors, or illegal acts exist. However, we shall inform you of any material matters that come to our attention.

Fees

[Insert additional information here regarding fee arrangements and billings, as appropriate.]

We look forward to full co-operation with your staff and we trust that they will make available to us whatever records, documentation and other information are requested in connection with our review.

[This letter will be effective for future years unless it is terminated, amended or superseded.[9]]

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our review of the interim financial statements.

Yours faithfully,

(signed)

…….

Name and Title

Date

Acknowledged on behalf of [entity] by

(signed)

…….

Name and Title

Date

[9] Use if applicable.

Example of a Representation Letter

The following letter is not intended to be a standard letter. It is to be used as a guide only and will need to be adapted according to individual requirements and circumstances.

Representations by those charged with governance will vary from one entity to another and from one period to the next. Representation letters are ordinarily useful where evidence, other than that obtained by enquiry, may not be reasonably expected to be available or when those charged with governance have made oral representations which the auditor wishes to confirm in writing.

[Entity Letterhead]

[Addressee – Auditor]

[Date]

This representation letter is provided in connection with your review of the financial statements of [name of entity] for the [period] ended [date], for the purpose of you expressing a conclusion as to whether anything has come to your attention that causes you to believe that the financial statements are not, in all material respects, presented fairly in accordance with [applicable financial reporting framework[10]].

We acknowledge our responsibility for ensuring that the financial statements are in accordance with [applicable financial reporting framework].

We confirm that the financial statements are prepared and presented fairly in accordance with [applicable financial reporting framework] and are free of material misstatements, including omissions].

We confirm, to the best of our knowledge and belief, the following representations made to you during your review.

[Include representations required by this NZ SRE 2410 (paragraph 24) and those relevant to the entity. Such representations may include the following examples.]

1. We have made available to you:
   (a) all financial records and related data, other information, explanations and assistance necessary for the conduct of the review; and
   (b) minutes of all meetings of [shareholders, directors, committees of directors, Boards of Management].
2. We have disclosed to you the results of our assessment of the risk that the [financial statements] may be materially misstated as a result of fraud.
3. There:
   (a) has been no fraud or suspected fraud, error or non-compliance with laws and regulations involving management or employees who have a significant role in the internal control structure;
   (b) has been no fraud or suspected fraud, error or non-compliance with laws and regulations that could have a material effect on the financial statements; and

Commented [MP33]: Is it alright to have suspected here?

[10] Specify the applicable financial reporting framework requirements.

(c) have been no communications from regulatory agencies concerning non-compliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial statements.

4. We are responsible for an adequate internal control structure to prevent and detect fraud and error and to facilitate the preparation of reliable financial statements. We confirm that adequate accounting records have been maintained and that all material transactions have been recorded properly in the accounting records underlying the financial statements.

5. We have no plans or intentions that may affect materially the carrying values, or classification, of assets and liabilities.

6. We have considered the requirements of New Zealand Equivalents to International Accounting Standard 36 Impairment of Assets, when assessing the impairment of assets and in ensuring that no assets are stated in excess of their recoverable amount.

7. We believe the effects of uncorrected misstatements summarised in the accompanying schedule are immaterial, both individually and in the aggregate, to the [interim] financial statements taken as a whole.

8. The following have been recorded and/or disclosed properly in the [interim] financial statements:

   (a) related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements and guarantees (written or oral);

   (b) share options, warrants, conversions or other requirements;

   (c) arrangements involving restrictions on cash balances, compensating balances and line-of-credit or similar arrangements;

   (d) agreements to repurchase assets previously sold;

   (e) material liabilities or contingent liabilities or assets including those arising under derivative financial instruments;

   (f) all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements in accordance with the applicable financial reporting framework.

9. There are no ~~violations or possible violations~~known or suspected non-compliance with ~~of~~ laws or regulations the effects of which should be considered for disclosure in the financial statements or as a basis for recording an expense.

10. The entity has satisfactory title to all assets, and there are no liens or encumbrances on such assets that have not been disclosed nor has any asset been pledged as collateral. Allowances for depreciation have been adjusted for all important items of property, plant and equipment that have been abandoned or are otherwise unusable.

11. The entity has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of non-compliance.

12. There were no material commitments for construction or acquisition of property, plant and equipment or to acquire other non-current assets, such as investments or intangibles, other than those disclosed in the financial statements.

13. We have no plans to abandon lines of product or other plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of net realisable value.

14. No events have occurred subsequent to the balance sheet date through to the date of this letter that would require adjustment to, or disclosure in, the [financial statements].

We understand that your examination was made in accordance with NZ SRE 2410 and was, therefore, designed primarily for the purpose of expressing a conclusion on the financial statements of [the entity], and that your procedures were limited to those which you considered necessary for that purpose.

Yours faithfully

[Name of signing officer and title]

Notes:

[*The above example representation letter may need to be amended in certain circumstances. The following illustrate some of those situations.*]

(a) Exceptions

Where matters are disclosed in the financial statements, the associated representation needs to be amended, for example:

- If a subsequent event has been disclosed, Item 14 (above) could be modified to read:

  "Except as discussed in Note X to the financial report, no events have occurred ….."

- If the entity has plans that impact the carrying values of assets and liabilities, Item 5 (above) could be modified to read:

  "The entity has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plan to dispose of segment X, as disclosed in note Y in the financial statements, which is discussed in the minutes of the meeting of the governing body[11] held on [date]".

(b) Other Required Information

Certain entities may be required to include other information in the financial statements, for example, performance indicators for government entities. In addition to identifying this information and the applicable financial reporting framework in paragraphs 1 and 2 of the example representation letter, an additional paragraph similar to the following may be appropriate:

"The disclosures of key performance indicators have been prepared and presented in conformity with [relevant statutory requirements] and we consider the indicators reported to be relevant to the stated objectives of the [entity]".

Commented [MP34]: Impact for SPI standard and review standard.

(c) Opinions and Representation in the Notes to the Financial Statements

Where the notes to the financial statements include opinions and representations by those charged with governance, such matters may be addressed in the representation letter. For example, notes relating to the anticipated outcome of litigation, the intent

[11] Insert the appropriate term, such as "Directors or Board of Management".

and ability to hold long-term securities to maturity and plans necessary to support the going concern basis.

(d) Environmental Matters

In situations where there are environmental matters that may, but probably will not, require an outflow of resources, this may be reflected in an addition to Item 9 (above), for example:

"However, the [entity] has received a notice from the Environmental Protection Agency that it may be required to share in the cost of cleanup of the [name] waste disposal site. This matter has been disclosed in Note A in the financial statements and we believe that the disclosure and estimated contingent loss is reasonable based on available information."

(e) Compliance

If, as part of the review, the auditor is required also to report on the entity's compliance with laws and regulations, a representation may be appropriate acknowledging that those charged with governance are responsible for the entity's compliance with applicable laws and regulations and that the requirements have been met. For example, the following paragraph may be added:

"The financial records of the [company, registered scheme or disclosing entity] have been kept so as to be sufficient to enable financial statements to be prepared and reviewed, and other records and registers required by the [applicable legislation] have been kept properly and are up-to-date."

(f) Other Matters

Additional representations that may be appropriate in specific situations may include the following:

- Justification for a change in accounting policy.
- The work of a management expert has been used.
- Arrangements for controlling the dissemination of the financial statements and review report on the Internet.

Appendix 2

(Ref: Para. A20)

Analytical Procedures the Auditor May Consider When Performing a Review of Financial Statements

The analytical procedures carried out in a review of the financial statements are determined by the auditor's judgement. The procedures listed below are for illustrative purposes only. It is not intended that all the procedures suggested apply to every review engagement. This Appendix is not intended to serve as a programme or checklist in the conduct of a review.

Examples of analytical procedures the auditor may consider when performing a review of the financial statements include the following:

- Comparing the financial statements with the financial statements of the immediately preceding period, with the financial statements of the corresponding period of the preceding financial year, with the financial statements that was expected by management for the current period, and with the most recent audited annual financial statements.
- Comparing the current financial statements with anticipated results, such as budgets or forecasts. For example, comparing sources of revenue and the cost of sales in the current financial statements with corresponding information in:
  - (a) budgets, including expected gross margin(s); and
  - (b) financial information for prior periods.
- Comparing the current financial statements with relevant non-financial information.
- Comparing the recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and applying relationships that reasonably are expected to exist based on the auditor's understanding of the entity and of the industry in which the entity operates.
- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial statements with corresponding relationships in the financial statements of prior periods, for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables.
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
  - (a) by period, for example, revenue or expense items disaggregated into quarterly, monthly, or weekly amounts;
  - (b) by product line or source of revenue;
  - (c) by location, for example by component;
  - (d) by attributes of the transaction, for example, revenue generated by designers, architects, or craftsmen; and
  - (e) by several attributes of the transaction, for example, sales by product and month.

Appendix 3

(Ref: Para. A41)

Illustrations of Review Reports—Unmodified and Modified Conclusions

Example of an Unmodified -Review Report on Financial Statements

Example of a Review Report with a Qualified Conclusion (Except For) for a Departure from the Applicable Financial Reporting Framework

Example of a Review Report with a Qualified Conclusion for a Limitation On Scope Not Imposed by Management

Example of a Review Report with an Adverse Conclusion for a Departure from the Applicable Financial Reporting Framework

Example of a Review Report with a Qualified Conclusion (Except for) on the Basis that Comparatives have not been Reviewed or Audited

Example of an Unmodified Review Report on Financial Statements

For purposes of this illustrative report, it is assumed that the auditor has reviewed the interim financial statements of a FMC reporting entity considered to have higher level of public accountability.

INDEPENDENT AUDITOR'S REVIEW REPORT

To [Appropriate Addressee]

Report on the [appropriate title for the financial statements] Financial Statements

Conclusion

We have reviewed the accompanying [period] financial statements of [name of entity], which comprise the statement of financial position as at [date], and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the [period] ended on that date, -and a summary of significant accounting policies and other explanatory information.

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of[12]"] the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] ended on that date, in accordance with [applicable financial reporting framework][13].

or

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework][14].

Basis for Conclusion

We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*. Our responsibilities are further described in the *Auditor's Responsibilities for the Review of the Financial Statements* section of our report. We are independent of the [entity] in accordance with the relevant ethical requirements in New Zealand~~As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements~~, and we have fulfilled our other ethical responsibilities in accordance with the ethical requirements relevant to the audit of the annual financial statements. Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].

[*Title of those charged with governance*] *Responsibility for the* [*period*] *Financial Statements*

The [title of those charged with governance] of the [type of entity] are responsible, on behalf of the [entity], for the preparation *[and fair presentation]* of the [period] financial statements in accordance with the [applicable financial reporting framework] and for such internal control as the directors [those charged with governance] determine is necessary to enable the preparation *[and fair presentation]* of the [period] financial statements that are free from material misstatement, whether due to fraud or error.

Commented [MP35]: Re-ordered – Conclusion first in para 35.

Commented [MP36]: Para 36

Commented [MP37]: Mandatory order of report – paragraph 39

Commented [MP38]: ISA 700 refers to these requirements – but amended to clarify that under 2410 have to comply with ethical requirements that apply to the annual financial statements. (I think that they would do so anyway under PES 1 as we have aligned the requirements for audits and reviews throughout).

Commented [MP39]: Do you still need this? I don't think so as integrated into the sentence from 700

Commented [MP40]: To match changes previously made to the ISAs (NZ) – made in illustration not in requirements consistent with approach in ISAs (NZ).

Commented [MP41]: Now added into requirement in 40(a)

[12] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statement*, contains information on the wording of reports that may be helpful.

[13] This conclusion is appropriate where a fair presentation framework has been used.

[14] This conclusion is appropriate where a compliance framework has been used.

In preparing the financial statements, [those charged with governance] are responsible on behalf of the entity for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless [those charged with governance] either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so.

~~*Our*~~ *Auditor's* *Responsibilities for the Review of the Financial Statements*~~*y*~~

Our responsibility is to express a conclusion on the [period] financial statements based on our review. ~~*We conducted our review in accordance with NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity.*~~ NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects, in accordance with the [applicable financial reporting framework]. ~~As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.~~

A review of [period] financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The auditor makes enquiries about the appropriateness of the use of the going concern basis of accounting. If we conclude that a material uncertainty exists, we are required to draw attention in our review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our conclusion. Our conclusions are based on the evidence obtained up to the date of our review report. However, future events or conditions may cause the entity to cease to continue as a going concern.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly we do not express an audit opinion on those financial statements.

~~Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].~~

~~*Conclusion*~~

~~Based on our review, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of[15]"] the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] ended on that date, in accordance with [applicable financial reporting framework][16].~~

~~*or*~~

~~*Based on our review, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*[17].~~

Commented [MP42]: New in para 40(b)

Commented [MP43]: Para 42

Commented [MP44]: Para 42(b)

Commented [MP45]: New in para 42(c)

Commented [MP46]: ISA 700 - to conclude on the appropriateness of the use of the going concern basis of accounting and based on the audit evidence obtained whether a material uncertainty exists

Commented [MP47]: Is this the right word for a review?

Commented [MP48]: Para 42(d)

Commented [MP49]: To match requirement wording previously in the standard.

Commented [MP50]: No need to include communication with TCWG as done in the auditor's responsibility section – this section is condensed therefore would not fit there?

[15] ~~ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statement*, contains information on the wording of reports that may be helpful.~~

[16] ~~This conclusion is appropriate where a fair presentation framework has been used.~~

[17] ~~This conclusion is appropriate where a compliance framework has been used.~~

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the review report will vary depending on the nature of the auditor's other reporting responsibilities.]

The engagement partner on the review resulting in this independent auditor's review report is [name].

Commented [MP51]: New in para 43

[Auditor's signature][18]

[Date of the review report][19]

[Auditor's address]

[18] The review report is required to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor, as appropriate.

[19] The date of the review report is the date the auditor signs the report.

Example of a~~n~~ Review Report with a Qualified Conclusion (Except For) For a Departure From the Applicable Financial Reporting Framework

INDEPENDENT AUDITOR'S REVIEW REPORT

[Appropriate Addressee]

Report on the [appropriate title for the financial statements] Financial Statements

Qualified Conclusion

We have reviewed the accompanying [period] financial statements of [name of entity], which comprise the statement of financial position as at [date], and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the [period] ended on that date, and a summary of significant accounting policies and other explanatory information.

Based on our review, which is not an audit, with the exception of the matter described in the ~~preceding~~*Basis for Qualified Conclusion* section of our report ~~paragraph~~, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of"[20]] the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework].[21]

or

Based on our review, which is not an audit, *with the exception of the matter described in the Basis for Qualified Conclusion* section of our report*~~preceding paragraph~~, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*[22].

Basis for Qualified Conclusion

Based on information provided to us by management, [name of entity] has excluded *from* property and long-term debt certain lease obligations that we believe should be capitalised to conform with [indicate applicable financial reporting framework]. This information indicates that if these lease obligations were capitalised at 31 December 20XX, property would be increased by $_____, long-term debt by $_____, and net income and earnings per share would be increased (decreased) by $_____ and $_____ respectively for the [period] ended on that date.

We conducted our review in accordance with NZ SRE 2410 *Review of ~~-~~Financial Statements Performed by the Independent Auditor of the Entity.* Our responsibilities are further described in the *Auditor's Responsibilities for the Review of the Financial Statements* section of our report. We are independent of the Company in accordance with the relevant ethical requirements in New Zealand. As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

[20] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.

[21] This conclusion is appropriate where a fair presentation framework has been used.

[22] This conclusion is appropriate where a compliance framework has been used.

Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].

[Title of those charged with governance] Responsibility for the [period] Financial Statements

The [title of those charged with governance] of the [type of entity] are responsible, on behalf of the entity, for the preparation *[and fair presentation]* of the [period] financial statements in accordance with the [applicable financial reporting framework] and for such internal control as the directors [those charged with governance] determine is necessary to enable the preparation *[and fair presentation]* of the [period] financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, [those charged with governance] are responsible on behalf of the entity for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless [those charged with governance] either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so.

~~*Our*~~ *Auditor's* *Responsibilit~~y~~ies for the Review of the Financial Statements*

Our responsibility is to express a conclusion on the [period] financial statements based on our review. ~~We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*.~~ NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the [applicable financial reporting framework]. ~~As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.~~

A review of [period] financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The auditor makes enquiries about the appropriateness of the use of the going concern basis of accounting. If we conclude that a material uncertainty exists, we are required to draw attention in our review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our conclusion. Our conclusions are based on the evidence obtained up to the date of our review report. However, future events or conditions may cause the entity to cease to continue as a going concern.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly we do not express an audit opinion on those financial statements.

Commented [MP52]: To match requirement wording previously in the standard.

~~Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].~~

~~*Basis for Qualified Conclusion*~~

~~Based on information provided to us by management, [name of entity] has excluded *from* property and long-term debt certain lease obligations that we believe should be capitalised to conform with [indicate applicable financial reporting framework]. This information indicates that if these lease obligations were capitalised at 31 December 20XX, property would be increased by $_____, long-term debt by $_____, and net income and earnings per share~~

~~would be increased (decreased) by $_____ and $_____ respectively for the [period] ended on that date.~~

~~*Qualified Conclusion*~~

~~Based on our review, with the exception of the matter described in the preceding paragraph, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of"[23]] the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework].[24]~~

~~*or*~~

~~*Based on our review, with the exception of the matter described in the preceding paragraph, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*[25]~~.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the review report will vary depending on the nature of the auditor's other reporting responsibilities].

The engagement partner on the review resulting in this independent auditor's review report is [name].

[Auditor's signature][26]

[Date of the review report][27]

[Auditor's address]

~~[23] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.~~

~~[24] This conclusion is appropriate where a fair presentation framework has been used.~~

~~[25] This conclusion is appropriate where a compliance framework has been used.~~

[26] The review report is required to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor, as appropriate.

[27] The date of the review report is the date the auditor signs the report.

Example of a~~n~~ Review Report with a Qualified Conclusion For a Limitation on Scope Not Imposed by Management or Those Charged with Governance

INDEPENDENT AUDITOR'S REVIEW REPORT

To [Appropriate Addressee]

Report on the [appropriate title for the financial statements] Financial Statements

Qualified Conclusion

We have reviewed the accompanying [period] financial statements of [name of entity], which comprises the statement of financial position as at [date], and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the [period] ended on that date, and a summary of significant accounting policies and other explanatory information.

Except for the adjustments to the [period] financial statements that we might have become aware of had it not been for the situation described above, based on our review nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] does not present fairly, in all material respects, [or "give a true and fair view of[28]]" the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework].[29]

or

Except for the adjustments to the [period] financial statements that we might have become aware of had it not been for the situation described above, based on our review, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework][30].

Basis for Qualified Conclusion

As a result of a fire in a branch office on [date] that destroyed its accounts receivable records, we were unable to complete our review of accounts receivable totalling $_____ included in the [period] financial statements. The [entity] is in the process of reconstructing these records and is uncertain as to whether these records will support the amount shown above and the related allowance for uncollectible accounts. Had we been able to complete our review of accounts receivable, matters might have come to our attention indicating that adjustments might be necessary to the [period] financial statements.

We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity.* Our responsibilities are further described in the *Auditor's Responsibilities for the Review of the Financial Statements* section of our report. We are independent of the Company in accordance with the relevant ethical requirements in New Zealand. As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

[28] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.

[29] This conclusion is appropriate where a fair presentation framework has been used.

[30] This conclusion is appropriate where a compliance framework has been used.

Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].

[*Title of those charged with governance*] *Responsibility for the* [*period*] *Financial Statements*

The [title of those charged with governance] of the [type of entity] are responsible, on behalf of the entity, for the preparation *[and fair presentation]* of the [period] financial statements in accordance with the [applicable financial reporting framework] and for such internal control as the directors [those charged with governance] determine is necessary to enable the preparation *[and fair presentation]* of the [period] financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, [those charged with governance] are responsible on behalf of the entity for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless [those charged with governance] either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so.

~~Our~~ Auditor's Responsibility~~y~~ies for the Review of the Financial Statements

Our responsibility is to express a conclusion on the [period] financial statements based on our review. ~~We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*.~~ NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared, in all material respects, in accordance with the [applicable financial reporting framework]. ~~As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.~~

A review of [period] financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The auditor makes enquiries about the appropriateness of the use of the going concern basis of accounting. If we conclude that a material uncertainty exists, we are required to draw attention in our review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our conclusion. Our conclusions are based on the evidence obtained up to the date of our review report. However, future events or conditions may cause the entity to cease to continue as a going concern.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly, we do not express an audit opinion on those financial statements.

Commented [MP53]: To match requirement wording previously in the standard.

~~Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].~~

~~*Basis for Qualified Conclusion*~~

~~As a result of a fire in a branch office on [date] that destroyed its accounts receivable records, we were unable to complete our review of accounts receivable totalling $_____ included in the [period] financial statements. The [entity] is in the process of reconstructing these records and is uncertain as to whether these records will support the amount shown above and the related allowance for uncollectible accounts. Had we been able to complete our review of~~

~~accounts receivable, matters might have come to our attention indicating that adjustments might be necessary to the [period] financial statements.~~

~~*Qualified Conclusion*~~

~~Except for the adjustments to the [period] financial statements that we might have become aware of had it not been for the situation described above, based on our review nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] does not present fairly, in all material respects, [or "give a true and fair view of[31]]" the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework].[32]~~

~~or~~

~~*Except for the adjustments to the [period] financial statements that we might have become aware of had it not been for the situation described above, based on our review, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*[33].~~

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the review report will vary depending on the nature of the auditor's other reporting responsibilities.]

The engagement partner on the review resulting in this independent auditor's review report is [name].

[Auditor's signature[34]]

[Date of the review report][35]

[Auditor's address]

~~[31] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.~~

~~[32] This conclusion is appropriate where a fair presentation framework has been used.~~

~~[33] This conclusion is appropriate where a compliance framework has been used.~~

[34] The review report is required to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor, as appropriate.

[35] The date of the review report is the date the auditor signs the report.

Example of a Review Report With an Adverse Conclusion For a Departure From the Applicable Financial Reporting Framework

INDEPENDENT AUDITOR'S REVIEW REPORT

To [Appropriate Addressee]

Report on the [appropriate title for the financial statements] Financial Statements

Adverse Conclusion

We have reviewed the accompanying [period] financial statements of [name of entity], which comprise statement of financial position as at [date], and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the [period] ended on that date, and summary of significant accounting policies and other explanatory information.

Our review indicates, because the [entity's] investment in subsidiary companies is not accounted for on a consolidation basis, as described in the previous paragraph, the [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of[36]]" the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework].[37]

or

Our review indicates, because the [entity's] investment in subsidiary companies is not accounted for on a consolidation basis, as described in the previous paragraph, the [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework][38].

Basis for Adverse Conclusion

Commencing this period, [title of those charged with governance] of the [entity] ceased to consolidate the financial statements of its subsidiary companies since [title of those charged with governance] considers consolidation to be inappropriate because of the existence of new substantial non-controlling interests. This is not in accordance with [applicable financial reporting framework]. Had consolidated financial statements been prepared, virtually every account in the financial statements would have been materially different.

We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity.* Our responsibilities are further described in the *Auditor's Responsibilities for the Review of the Financial Statements* section of our report. We are independent of the Company in accordance with the relevant ethical requirements in New Zealand. As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].

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36 ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.

37 This conclusion is appropriate where a fair presentation framework has been used.

38 This conclusion is appropriate where a compliance framework has been used.

[*Title of those charged with governance*] *Responsibility for the* [*period*] *Financial Statements*

The [title of those charged with governance] of the [type of entity] are responsible, on behalf of the entity, for the preparation *[and fair presentation]* of the [period] financial statements in accordance with the [applicable financial reporting framework] and for such internal control as the directors [those charged with governance] determine is necessary to enable the preparation *[and fair presentation]* of the [period] financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, [those charged with governance] are responsible on behalf of the entity for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless [those charged with governance] either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so.

~~Our~~ Auditor's Responsibility~~y~~ies for the Review of the Financial Statements

Our responsibility is to express a conclusion on the [period] financial statements based on our review. ~~We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*.~~ NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the [applicable financial reporting framework]. ~~As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.~~

A review of [period] financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The auditor makes enquiries about the appropriateness of the use of the going concern basis of accounting. If we conclude that a material uncertainty exists, we are required to draw attention in our review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our conclusion. Our conclusions are based on the evidence obtained up to the date of our review report. However, future events or conditions may cause the entity to cease to continue as a going concern.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly, we do not express an audit opinion on those financial statements.

~~Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].~~

~~*Basis for Adverse Conclusion*~~

~~Commencing this period, [title of those charged with governance] of the [entity] ceased to consolidate the financial statements of its subsidiary companies since [title of those charged with governance] considers consolidation to be inappropriate because of the existence of new substantial non-controlling interests. This is not in accordance with [applicable financial reporting framework]. Had consolidated financial statements been prepared, virtually every account in the financial statements would have been materially different.~~

~~*Adverse Conclusion*~~

~~Our review indicates, because the [entity's] investment in subsidiary companies is not accounted for on a consolidation basis, as described in the previous paragraph, the [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of[39]]" the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework].[40]~~

~~or~~

~~*Our review indicates, because the [entity's] investment in subsidiary companies is not accounted for on a consolidation basis, as described in the previous paragraph, the [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*[41].~~

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the review report will vary depending on the nature of the auditor's other reporting responsibilities.]

The engagement partner on the review resulting in this independent auditor's review report is [name].

[Auditor's signature[42]]

[Date of the review report][43]

[Auditor's address]

~~[39] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.~~

~~[40] This conclusion is appropriate where a fair presentation framework has been used.~~

~~[41] This conclusion is appropriate where a compliance framework has been used.~~

[42] The review report is required to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor, as appropriate.

[43] The date of the review report is the date the auditor signs the report.

Example of a Review Report With a Qualified Conclusion (Except For) on the Basis That Comparatives Have Not Been Reviewed or Audited

INDEPENDENT AUDITOR'S REVIEW REPORT

To [Appropriate Addressee]

Report on the [appropriate title for the financial statements] Financial Statements

Qualified Conclusion

We have reviewed the accompanying [period] financial statements of [name of entity], which comprise the statement of financial position as at [date], and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the [period] ended on that date, and a summary of significant accounting policies and other explanatory information.

Except for the effect, if any, on the comparatives for the preceding corresponding [period] that may result from the qualification in the *Basis for Qualified Conclusion* section of our report~~preceding paragraph~~, based on our review nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of[44]]" the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework][45].

or

Except for the effect, if any, on the comparatives for the preceding corresponding [period] that may result from the qualification Basis for Qualified Conclusion section of our report~~*in the preceding paragraph*~~*, based on our review, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*[46].

Basis for Qualified Conclusion

As this is the first year that [name of entity] is required to prepare [period] financial statements and have it reviewed, the statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flows-, and summary of significant accounting policies and other explanatory information for the preceding corresponding [period] have not been reviewed or audited. Accordingly, we are not in a position to and do not express any assurance in respect of the comparative information for the [period] ended [date of preceding corresponding period]. We have, however, audited the financial statements for the preceding financial year ended [date of preceding financial year] and therefore our review statement is not qualified in respect of the comparative information for the year ended [date of preceding financial year] included in the statement of financial position.

We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*. Our responsibilities are further described in the *Auditor's Responsibilities for the Review of the Financial Statements* section of our report. We are independent of the Company in accordance with the relevant ethical

Commented [MP54]: ?

[44] ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.

[45] This conclusion is appropriate where a fair presentation framework has been used.

[46] This conclusion is appropriate where a compliance framework has been used.

requirements in New Zealand. As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].

[*Title of those charged with governance*] *Responsibility for the* [*period*] *Financial Statements*

The [title of those charged with governance] of the [type of entity] are responsible, on behalf of the entity, for the preparation *[and fair presentation]* of the [period] financial statements in accordance with the [applicable financial reporting framework]and for such internal control as the directors [those charged with governance] determine is necessary to enable the preparation *[and fair presentation]* of the [period] financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, [those charged with governance] are responsible on behalf of the entity for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless [those charged with governance] either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so.

~~*Our*~~ *Auditor's Responsibilities for the Review of the Financial Statements* ~~*y*~~

Our responsibility is to express a conclusion on the [period] financial statements based on our review. ~~*We conducted our review in accordance with NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity.*~~ NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the [applicable financial reporting framework]. ~~As the auditor of [name of entity], NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.~~

A review of a [period] financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The auditor makes enquiries about the appropriateness of the use of the going concern basis of accounting. If we conclude that a material uncertainty exists, we are required to draw attention in our review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our conclusion. Our conclusions are based on the evidence obtained up to the date of our review report. However, future events or conditions may cause the entity to cease to continue as a going concern.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly, we do not express an audit opinion on those financial statements.

~~Other than in our capacity as assurance practitioner we have no relationship with, or interests in, [name of entity].~~

~~*Basis for Qualified Conclusion*~~

~~As this is the first year that [name of entity] is required to prepare [period] financial statements and have it reviewed, the statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flows , and summary of significant accounting~~

~~policies and other explanatory information for the preceding corresponding [period] have not been reviewed or audited. Accordingly, we are not in a position to and do not express any assurance in respect of the comparative information for the [period] ended [date of preceding corresponding period]. We have, however, audited the financial statements for the preceding financial year ended [date of preceding financial year] and therefore our review statement is not qualified in respect of the comparative information for the year ended [date of preceding financial year] included in the statement of financial position.~~

~~*Qualified Conclusion*~~

~~Except for the effect, if any, on the comparatives for the preceding corresponding [period] that may result from the qualification in the preceding paragraph, based on our review nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] do not present fairly, in all material respects, [or "give a true and fair view of[47]"] the financial position of the [entity] as at [date], and of its financial performance and its cash flows for the [period] period ended on that date, in accordance with [applicable financial reporting framework]~~[48]~~.~~

~~or~~

~~*Except for the effect, if any, on the comparatives for the preceding corresponding [period] that may result from the qualification in the preceding paragraph, based on our review, nothing has come to our attention that causes us to believe that these [period] financial statements of [name of entity] are not prepared, in all material respects, in accordance with [applicable financial reporting framework]*~~[49]~~.~~

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the review report will vary depending on the nature of the auditor's other reporting responsibilities.]

The engagement partner on the review resulting in this independent auditor's review report is [name].

[Auditor's signature[50]]

[Date of the review report][51]

[Auditor's address]

~~47 ISA (NZ) 700 *Forming an Opinion and Reporting on Financial Statements*, contains information on the wording of reports that may be helpful.~~

~~48 This conclusion is appropriate where a fair presentation framework has been used.~~

~~49 This conclusion is appropriate where a compliance framework has been used.~~

50 The review report is required to be signed in one or more of the name of the audit firm, the name of the audit company or the personal name of the auditor, as appropriate.

51 The date of the review report is the date the auditor signs the report.

Accompanying Attachment: Conformity to International and Australian Standards on Review Engagements

Commented [MP55]: To be updated.

This conformity statement accompanies but is not part of NZ SRE 2410.

Conformity with International Standards on Review Engagements and comparison to the Australian Auditing Standard on Review Engagements 2410

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC), has issued International Standard on Review Engagements (ISRE) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*.

ISRE 2410 has not been drafted in "clarity" format by the IAASB.

In Australia, the Australian Auditing and Assurance Standards Board (AUASB) has issued Auditing Standard on Review Engagements (ASRE) 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity.

ASRE 2410 is in the "clarity" format. ASRE 2410 conforms with ISRE 2410.

This NZ SRE 2410 is based on ASRE 2410, but has been amended with the addition of requirements and application material.

This NZ SRE 2410 is effective for reviews of financial statements for periods ending on or after December 31, 2014. The effective date differs from the international and Australian standards' effective dates.

The comparison that follows indicates the differences between this NZ SRE 2410 and both ISRE 2410 and ASRE 2410.

NZ SRE 2410 contains the following requirements that are not contained in ISRE 2410 or ASRE 2410:

- The auditor shall comply with the engagement quality control requirements of ISA (NZ) 220[52] when performing a review in accordance with this NZ SRE 2410. (Paragraph 10)
- The auditor shall endeavor to obtain written representations from those charged with governance that they have disclosed to the auditor all information relevant to the use of the going concern assumption in the financial statements. (paragraph 24(h))
- A statement as to the existence of any relationship (other than that of assurance practitioner) which the assurance practitioner has with, or any interests which the assurance practitioner has in, the entity or any of its subsidiaries. (Paragraph 33(o)).

NZ SRE 2410 contains the following requirements that have been amended from ASRE 2410 and that are not contained in ISRE 2410:

Those charged with governance are responsible for the financial statements. It is therefore appropriate to agree the terms of the engagement and obtain written representation from those charged with governance. The following requirements have been amended from ASRE 2410 by removing or replacing references to management with references to those charged with governance:

[52] ISA (NZ) 220, Quality Control for an Audit of Financial Statements.

- The auditor shall, prior to agreeing the terms of the engagement, determine whether the financial reporting framework is acceptable and obtain agreement from those charged with governance, that they acknowledge and understand their responsibility:
  - for the preparation and fair presentation of the financial statements;
  - for such internal controls as management and those charged with governance, deem necessary to enable the preparation of the financial statements that are free from material misstatement; and
  - to provide the auditor with:
    - access to information relevant to the preparation of the financial statements;
    - additional information that the auditor may request for the purposes of the review engagement; and
    - unrestricted access to persons from whom the auditor determines it necessary to obtain evidence (Ref: Para. 12).
- The auditor shall agree the terms of the engagement with those charged with governance, which shall be recorded in writing by the auditor and forwarded to the entity. When the review engagement is undertaken pursuant to legislation, the minimum applicable terms are those contained in the legislation (Ref: Para. 13).
- If those charged with governance refuse to provide a written representation that the auditor considers necessary, this constitutes a limitation of the scope of the auditor's work and the auditor shall express a qualified conclusion or a disclaimer of conclusion, as appropriate (Ref: Para. 25).

<u>NZ SRE 2410 and ASRE 2410 contain the following requirements that are not contained in ISRE 2410:</u>

- The auditor shall consider materiality, using professional judgement, when:
  - determining the nature, timing and extent of review procedures; and
  - evaluating the effect of misstatements (Ref: Para. 16).
- When comparative information is included for the first time in the financial statements, an auditor shall perform similar procedures on the comparative information as applied to the current period financial statements (Ref: Para. 22).
- When, as a result of performing the review of the financial statements, a matter comes to the auditor's attention that causes the auditor to believe in the existence of fraud or non-compliance by the entity with laws and regulations, the auditor shall communicate the matter as soon as practicable to those charged with governance and shall consider the implications for the review (Ref: Para. 31).
- The auditor shall express a qualified or adverse conclusion when a matter has come to the auditor's attention that causes the auditor to believe a material adjustment should be made to the financial statements for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework. The auditor shall include a basis for modification paragraph in the report, that describes the nature of the departure and, if practicable, states the effects on the financial statements. If the effects or possible effects are incapable of being measured reliably, a statement to that effect and the reasons therefor shall be included in the basis for modification paragraph. The conclusion

paragraph shall be headed "Qualified Conclusion" or "Adverse Conclusion", whichever is relevant (Ref: Para. 34).

- Unless required by law or regulation, an auditor shall not accept an engagement to review the financial statements when management or those charged with governance has imposed a limitation on the scope of the review (Ref: Para. 37).
- If management and, where appropriate, those charged with governance, refuses the auditor's request to remove a limitation that has been imposed on the scope of the review, but there is a legal or regulatory requirement for the auditor to issue a report, the auditor shall issue a disclaimer of conclusion or qualified conclusion report, as appropriate, containing the reason(s) why the review cannot be completed (Ref: Para. 39).
- This NZ SRE 2410 includes explanatory guidance not contained within ISRE 2410 on:
  - Materiality (Ref: Para.A14 to A18); and
  - Comparatives (Ref: Para.A28 to A31).

<u>NZ SRE 2410 and ISRE 2410 contain the following requirements that are not contained in ASRE 2410:</u>

- This NZ SRE 2410 is directed towards a review of financial statements by an entity's auditor. This NZ SRE 2410 is to be applied, adapted as necessary, when an entity's auditor undertakes an engagement to review historical financial information other than financial statements of an audit client. (Paragraph 4)
- The auditor shall issue a written report that contains the following:

  (d) If the financial statements comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, a statement that those charged with governance are responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.

  (e) In other circumstances, a statement that those charged with governance are responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.

  (j) If the financial statements comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements do not present fairly, or if applicable, are not true and fair, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the jurisdiction or country of origin of the financial reporting framework when New Zealand is not the origin of the financial reporting framework used).

  (k) In other circumstances, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the jurisdiction or country of origin of the financial reporting framework when New Zealand is not the origin of the financial reporting framework used). (Paragraph 33)

ASRE 2410 contains the following requirements that are not contained in ISRE 2410 or NZ SRE 2410:

The AUASB has decided that:

- due to the nature of reviews of other historical financial information, a separate Standard is more appropriate than ASRE 2410 being adapted by the auditor for this purpose; and
- ASRE 2405 *Review of Historical Financial Information Other than a Financial Report*, developed by the AUASB, deals with reviews of other historical financial information.

There is no equivalent to ASRE 2405 in New Zealand or internationally. NZ SRE 2410 is to be applied, adapted as necessary, when an entity's auditor undertakes an engagement to review historical financial information other than financial statements of an audit client.

- This Auditing Standard applies to:
  (a) a review, by the independent auditor of the entity, of a financial report for a half-year in accordance with the *Corporations Act 2001*; and
  (b) a review, by the independent auditor of the entity, of a financial report, or a complete set of financial statements, comprising historical financial information, for any other purpose (Ref: Para. 1(a) and (b)).
- Where in rare and exceptional circumstances, factors outside the auditor's control prevent the auditor from complying with an essential procedure contained within a relevant requirement, the auditor shall:
  - if possible, perform appropriate alternative procedures; and
  - document in the working papers:
    - the circumstances surrounding the inability to comply;
    - the reasons for the inability to comply; and
    - justification of how alternative procedures achieve the objectives of the requirement.

  When the auditor is unable to perform appropriate alternative procedures, the auditor shall consider the implications for the review report.

Other amendments

New Zealand terminology has been adopted throughout the standard. NZ SRE 2410 has defined financial statements and applicable financial reporting framework consistently with the definitions in the International Standards on Auditing (New Zealand). These definitions are not included in ISRE 2410 and differ in the Australian ASRE 2410.

This NZ SRE 2410 provides illustrative examples that differ in form and content from those contained in ISRE 2410 and ASRE 2410, namely:

- An engagement letter (Appendix 1).
- A written representation letter (Appendix 1).
- Illustrative review reports (Appendices 3).

Amendments to Other Pronouncements

This appendix sets out amendments to other pronouncements issued by the XRB or the NZAuASB that are as a consequence of the issuance of ISRE (NZ) 2400. Amended paragraphs are shown with the new text underlined and deleted text struck through.

XRB Au1 Application of Auditing and Assurance Standards

In Appendix 3, Review Engagement Standards

~~RS-1~~	~~Statement of Review Engagement Standards~~
NZ SRE 2410	Review of Financial Statements Performed by the Independent Auditor of the Entity.

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	5.1
Meeting date:	13 February 2019
Subject:	Meeting with the Auditor-General
Date:	30 January 2019
Prepared By:	Sylvia van Dyk

[x] **Action Required** [ ] **For Information Purposes Only**

Agenda Item Objectives

To meet John Ryan, the new Auditor-General, to receive an overview of the Auditor-General's vision for the OAG, and to discuss how the NZAuASB can continue to collaborate with the OAG in future.

Background

1. We have asked John to share some of his visions for the OAG, to be followed by a general discussion on how we can continue (and better) collaborate with the OAG.
2. John will be joining the Board for lunch after the discussion, together with Tim Ng from the Treasury (see agenda 6).

About John Ryan

1. John 's appointment as Controller and Auditor-General was confirmed by Parliament in April 2018, and he officially started as Auditor-General on 2 July 2018.
2. An accountant and member of Chartered Accountants Australia and New Zealand, John has had a long and successful career in New Zealand's public sector. He has held senior executive positions in a range of government organisations, including district health boards, as well as in the private sector. His experience spans corporate functions, regulatory and operational management, and assurance.
3. During his career of more than 30 years, John has led some of the largest programmes of capital works in the public sector. He also has a background in change management and developing new and improved ways of working in large service delivery organisations.
4. As well as extensive experience as a leader of people and programmes, John has also contributed widely to his community and the arts sector in particular. Before his appointment, he was a board member of the Royal New Zealand Ballet, the New Zealand Festival, and the Wellington Jazz Festival.

Material Presented

Agenda item 5.1 Board meeting summary paper

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	6.1
Meeting date:	13 February 2019
Subject:	Update on Living Standards Framework
Date:	30 January 2019
Prepared By:	Sylvia van Dyk

☐	**Action Required**	x	**For Information Purposes Only**

Agenda Item Objectives

To receive a presentation from Tim Ng, Deputy Secretary, Chief Economic Advisor, Treasury, on the Treasury's Living Standards Framework.

Background

1. Tim Ng will be joining the Board for lunch at 12.45, together with the Auditor-General, and then present on the Treasury's Living Standards Framework thereafter.

About Tim Ng

2. Tim is responsible for ensuring that the Treasury's policy advice on raising New Zealand living standards is supported and strengthened by sound economic theory and evidence.
3. Tim is a macroeconomist by training, with extensive international experience in monetary, fiscal and financial system policy. His work is published in a range of professional and academic journals.
4. Prior to joining the Treasury, Tim managed various functions at the Reserve Bank of New Zealand, including domestic and international economic monitoring and forecasting, analysis of monetary policy conduct, banking regulation and payments system policy.
5. Tim has also worked as an economist at the Bank for International Settlements in Basel, Switzerland and at the Federal Reserve Bank of New York.
6. Tim was born and raised in Auckland. He has postgraduate degrees in economics from Victoria University of Wellington and in biochemistry from the University of Auckland.

The Treasury's Living Standards Framework.

7. The Treasury wants higher living standards for all New Zealanders. However, well-established economic and financial measures miss some important aspects of what matters to New Zealanders when they think about what makes their life worthwhile.

8. The Treasury has therefore developed a Living Standards Framework (LSF) to help it advise successive governments about the likely effects of their policy choices on New Zealanders' living standards over time. By adopting the LSF, it is aligning its stewardship of the public finance system with an intergenerational wellbeing approach.
9. The LSF looks across the human, social, natural and financial/physical aspects of those things that affect our wellbeing – the 'four capitals'. It is a tool that emphasises the diversity of outcomes meaningful for New Zealanders, and helps the Treasury to analyse, measure and compare those outcomes through a wide and evolving set of indicators.
10. For those Board members who would like more background information and to prepare for any questions you may want to ask, you can read more about the Treasury's approach to living standards here: The Treasury Approach to the Living Standards Framework.

Material Presented

Agenda item 6.1	Board Meeting Summary Paper

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	7.1
Meeting date:	13 February 2019
Subject:	Alternative engagement for small entities project
Date:	1 February 2019[1]
Prepared By:	Peyman Momenan

☐ **Action Required** ☒ **For Information Purposes Only**

Agenda Item Objectives

1. To CONSIDER and PROVIDE feedback on the recommendation of the working group on a possible approach for an alternative engagement for small not-for-profits.

Background

2. In its September 2018 meeting the Board agreed that there is a need for a product for small entities that find an audit/review engagement unaffordable and not value for money.

3. The Board agreed to establish a working group consisting of nominated Board members and staff to explore this further, potentially as an alternative engagement to an audit or review of financial statements for small not-for-profit entities. The working group consisted of Craig Fisher, Karen Shires, Rowena Sinclair, Roger Simnett, Peyman Momenan, Misha Pieters and Sylvia van Dyk. Tim Austin of the AUASB also participated in the discussion.

4. The Board further agreed that the working group will report its recommendations to the Board at its December meeting. An important consideration for the working group was to decide whether an alternative engagement can be of an assurance nature and hence within the existing mandate of the Board.

5. The Board expressed tentative support for the recommended approach at the December 2018 meeting but due to time constraints deferred consideration of the recommended approach to the February 2019 meeting. An extract from draft December meeting minutes are as follows:

   "The Board expressed tentative support for the recommended approach and made the following observations on the agenda materials presented:

[1] This summary paper is carried forward from the NZAuASB's meeting in December 2018.

- It is not clear whether the alternative engagement will address service performance information.
- It needs to be very clear that the alternative engagement is not an audit or a review and to be very specific on independence.
- This engagement is expected to be volunteer based.
- There needs to be engagement with the expected users of this service to ensure that the proposed service will meet their needs."

Matters to Consider

6. The working group held its first meeting on 23 November 2018. A summary of the discussion and the working group's recommendations are included in Agenda item 7.2

Recommendations

We recommend that the Board note the summary of discussions and provide feedback on the working group's recommendations on a possible approach for an alternative engagement for small not-for-profits.

Material Presented

Agenda item 7.1	Board Meeting Summary Paper
Agenda item 7.2	Summary of working group's discussions and recommendations.
Agenda item 7.3	A comparison between review and IE engagements.

Issue Paper Agenda Item 7.2[1]

During the first meeting of the project on an alternative engagement for small not-for-profit (NFP) entities, the working group considered. what type of engagement was appropriate.

Assurance vs. Non-assurance engagements: The working group agreed that an assurance engagement was an appropriate instrument as it provided stakeholders [e.g. NFP's Boards and Funders] with a conclusion, as opposed to a non-assurance engagement [e.g. agreed upon procedures].

The working group concluded that an assurance engagement specifically designed to address assurance needs of smaller not for profit organisations is the most appropriate course of action. This conclusion is supported by the outcome of the NZAuASB research on assurance needs of small registered charities in New Zealand. In that research those charged with governance of small registered charities indicated their need for some form of scrutiny over their annual reports.

NZAuASB Mandate
The working group felt that as assurance engagements are within the NZAuASB's mandate we could coordinate the development of an appropriate assurance engagement amongst relevant stakeholders e.g. Charities Services.

Where to start?

The working group discussed if there is already an example of an assurance engagement that is likely to provide an appropriate source of inspiration for this project. The working group agreed that the **Independent Examination** (**IE**) regime[2] in the UK could provide a suitable assurance engagement for small NFPs for advancing the project. The working group felt there were several advantages and potential issues that were worth exploring further:

ADVANTAGES:

- The IE regime is the only known example of an assurance engagement for smaller entities that is in use. Proposals in other countries for an alternative to an audit or a review engagement are yet to gain serious traction.
- The UK's IE regime addresses the assurance needs of specific user groups (i.e. users of financial information of small not for profit entities). That user group is also a major intended user of the NZAuASB project.
- The adopted approach to specify the IE engagement allows flexibility in specifying the objective(s) of the engagement and the required procedures. Also, by incorporating set procedures with a conclusion; it accommodates the possibility to addressing core assurance needs of stakeholders with specified procedures.
- Could tailor England's IE regime for the New Zealand market e.g. focus on money in the bank account(s);
- Unlike a review where an audit level of background knowledge was expected IE could be performed by an individual without any formal accreditations, as opposed to

[1] This issue paper is carried forward from the NZAuASB previous meeting in December 2018.
[2] Appendix 1 to this agenda includes a summary overview of the IE engagements.

a accredited professional accountant or a firm, depending on the level of complexity in the NFP.

POTENTIAL ISSUES

a) Expectation gap: bringing a new assurance engagement to the market there was a need to ensure that the expectation gap was addressed e.g.
    i. Biggest challenge would be communicating with all relevant stakeholders.
    ii. Review vs. Independent examination: needs to be clear articulation of the differences.
b) Independence: limited independence meaning a potential lack of credibility. Would need to ensure independence was clearly articulated to add value to the engagement without limiting the usability of the engagement.
c) Credibility: the UK's IE regime has no checking regime to determine the quality of the IE engagements being undertaken.

The working group also considered how an IE is different from a review engagement (Agenda item 7.3 also includes a comparison between these two engagements). During that discussion the following differentiation points were identified:

- A review engagement is required to be undertaken by a professional assurance practitioner, while an IE engagement can be undertaken by a layman with adequate accounting knowledge (please refer to item 2 in Agenda item 7.3 for details).
- An examination involves checking the accounting records kept by the charity and a comparison of the accounts presented with those records. It also involves an assessment of the accounts and the consideration of any unusual items or disclosures identified. It is important to note that verification and vouching procedures, where an item in the accounts is checked against an original document such as an invoice or a receipt, only becomes necessary where significant concerns are identified from the work of the examiner, or where satisfactory explanations cannot be obtained from the trustees.
- The professional ethical requirements that apply to a review engagement are comprehensive and closely align with such requirements for an audit engagement. While an independent examiner is also required to comply with certain independence and ethical considerations, those requirements are much simpler and less detailed compared to a review engagement.
- For a review engagement to be successfully designed and implemented, the assurance practitioner would require a high (audit) level of expertise and industry knowledge. In contrast the limited scope of an IE does not require a similar level of competency and knowledge.
- In contrast to a review engagement, there are no quality control requirements for an IE.

- A review engagement provides a conclusion on whether the financial statements are fairly presented. An IE does not require a conclusion on fair representation of the financial statements.

Independent examiner's statement [3]
I have completed my examination. I confirm that no material matters have come to my attention in connection with the examination giving me cause to believe that in any material respect: 1. accounting records were not kept in respect of the Trust as required by section 130 of the Act; or 2. the accounts do not accord with those records. I have no concerns and have come across no other matters in connection with the examination to which attention should be drawn in this report in order to enable a proper understanding of the accounts to be reached.

Consequently, the working group considered an IE engagement to be an engagement that provides less assurance than a review engagement. The working group acknowledges that the user expectation gap may be increased by introducing another level of assurance, and that awareness raising would be a critical component of the development and implementation of a new assurance product.

Recommendation

The working group recommends that the Board:

Investigates using a similar approach /model as that of the IE regime to develop the engagement, by engaging with relevant stakeholders and considering the results of the NZAuASB previous research on user needs of small NZ charities.

Bring together a group of stakeholders to better inform the development of the project, and to ensure user needs are met. The following organisations/groups were mentioned as potential candidates to be represented in the panel.

- Charities services
- Professional bodies such as CAANZ, CPA Australia and NZ Bookkeepers.
- Assurance practitioners
- Members of governing bodies of small not for profit organisations
- Philanthropic funding organisations.

Does the Board agree with the working group's recommendations?

If not, are there other alternatives/approaches that should be considered?

[3] Charity Commission () CC32 Independence examination of charity accounts: Directions and guidance for examiners (CC32), Example 4.2, page 54.

Independent Examination:

The Independent Examination (IE) regime was initially introduced in the UK in 1996. On introduction, the regime had the following three tiers:

- for charities up to £10,000 income no external scrutiny was needed
- from £10,000 to £250,000 income, the charity must at least have it accounts scrutinised by an independent examiner
- above £250,000 income a professional audit was needed.

Overtime, the audit threshold moved higher and higher and currently all registered charities with an annual income between £25,000 and £1,000,000 must at least have their annual accounts examined.

Another change in the regime is creating a new category of accredited assurance practitioners. While originally, any person who was deemed adequately competent could undertake an IE (layperson IE), from 2011 only members of certain accredited bodies are allowed to undertake an IE for charities with annual income more than £250,000.

There is little publicly available research about the effectiveness of this regime, however lifting the IE threshold up indicates that the UK regulators and legislators consider the regime a success.

Morgan[4] found that the IE framework provides "a very comprehensive scrutiny, that meets the International Framework for Assurance Engagements (IFAC, 2015) definition of a "limited assurance engagement" and, being charity specific, potentially exceeds the "conventional duties of an auditor reporting on the accounts of a small business". Substantial issues of concern raised by the independent examiner to the trustees as part of the external scrutiny process encourages self-reporting of charities to the regulator (Breen, 2013)[5].

Furthermore, the statutory duty for independent examiners to inform the regulator if they become aware of a matter of "material significance" in the course of their examination, as defined by the specified list of circumstances specified by the regulator, motivates charities to ensure appropriate use of funds (Morgan, 2011). Morgan[6] suggests the IE regime is critical in maintaining accounting standards and argues, "Where charity accounts have been properly scrutinised by a competent auditor or independent examiner who has given an unqualified report on the accounts, a higher level of confidence can be attached to their content".

Morgan also reports that uptake of IE by registered charities have been very high (in contrast to the use of review engagements). He estimates that using IE instead of audit engagements have saved the small UK charities about £37m over a five years period.

The reporting duties of an Independent Examiner

What an Independent Examiner must do is set out in the Directions made by the Charities Commission for England and Wales (the Commission). The content of the examiner's report is set out in the Charities (Accounts and Reports) Regulations 2008 (The 2008 Regulations).

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[4] Morgan, G. G. (2011). The role of independent examiners in the accountability of UK charities. Public Money and Management, 31(3), 183–192.

[5] Breen, O. B. (2013). The disclosure panacea: A comparative perspective on charity financial reporting. Voluntas: International Journal of Voluntary and Nonprofit Organizations, 24(3), 852–880.

[6] Morgan, G. G. (2011). The use of UK charity accounts data for researching the performance of voluntary organisations. Voluntary Sector Review, 2(2), 213–230.

The 2008 Regulations and Directions are mandatory and apply to examinations of both registered charities and those charities currently exempt from registration.

An examination involves a review of the accounting records kept by the charity and a comparison of the accounts presented with those records. It also involves a review of the accounts and the consideration of any unusual items and/or disclosures provided. The examiner must also consider whether any matters of concern have come to the examiner's attention as a result of the independent examination that should be included in their report to enable a proper understanding of the accounts to be reached.

The examiner confirms whether or not anything has come to their attention that suggests:

- Sufficient accounting records have not been kept
- The accounts do not agree with the records
- For accrual accounting, whether they fail to comply with relevant accounting requirements under the 2008 Regulations (for charitable companies, with section 396 of the Companies Act 2006), or are not consistent with the applicable SORP
- Any matter which the examiner believes should be drawn to the attention of the reader to gain a proper understanding of the accounts

Matters that the examiner must report include:

- Material expenditure or action contrary to the charities' purpose
- Failure by trustees to provide information and explanations reasonable required by the examiner
- Evidence that accounts prepared on an accrual basis are materially inconsistent with the Trustees Annual Report (Directors' Report for charitable companies).

The required procedures in an IE:

All examiners must follow the Directions listed under the following heading. The Directions have legal force as they are made by the Commission under section 145(5) (b) of the 2011 Act which places three specific duties on the examiner:

- Firstly, they must carry out the independent examination in accordance with the Commission's Directions
- Secondly, they must make their independent examiner's report to the charity's trustees
- Thirdly, they must consider if matters of material significance have come to their attention during the independent examination which give rise to a legal duty to report direct to the Commission.

The examiner must follow all the Directions that apply. The Directions provide the procedural basis for an independent examination. 'Independent examination of charity accounts checklist' issued by the Commission includes the independent examination of charity accounts checklist which summarise the directions and the expected work effort.

The potential reasons why the IE regime has been successful:

- Flexibility about who can be appointed as the charity's IE. This allows smaller charities (with annual income less than £250K) to engage volunteers (e.g. their own members) to undertake the IE. Larger charities (with annual income between £250k and £1m) can also engage a professional IE instead of an accredited auditor. The professional qualification threshold for an IE is considerably lower than that of an auditor. Thus, an IE engagement is likely to be cheaper than an audit.

- Including specific procedures over certain matters that users would like to gain confidence over (e.g. checking bank reconciliations) in a checklist simplifies the engagement and increases its relevance for the intended users.
- The expected level of documentation to support the engagement's conclusion is much lower in an IE compared to an audit.
- The expected level of independence is much lower in an IE compared to an audit or a review. Also there are no quality control requirements for an IE.
- Relaxed supervisory framework to oversee the quality of IEs work compared to an audit. In fact, layperson IEs (i.e. those not accredited) are not subject to any supervisory arrangements.
- The reporting language of an IE report is easier to understand by users in comparison to an audit report.

		Review Engagement	Independent Examination
Accepting the engagement	1.	The assurance practitioner shall comply with relevant ethical requirements, including those pertaining to independence (compliance with PES1)	The examiner must be independent of the charity which they are examining. Independence means that the examiner is not influenced, or perceived to be influenced, by either close personal relationships with the trustees of the charity or by a day to day involvement in the administration of the charity being examined. Whether a connection with the charity amounts to a close personal relationship with the trustees of the charity that affects the examiner's independence will depend upon the particular circumstances. An examiner: A) Can be a member of the charity B) Can assist in preparing the accounts C) Must not be involved in the day to day administration of the charity D) Must not have any conflict of interest E) any close relationship with the trustees
	2.	The engagement partner shall possess competence in assurance skills and techniques, and competence in financial reporting, appropriate to the engagement circumstances.	A person with financial awareness and numeracy skills should have the requisite ability to act as an independent examiner for receipts and payments accounts. For accruals accounts the examiner should have a good understanding of accountancy principles, accounting standards and knowledge of the applicable Statement of Recommended Practice (SORP) issued by the UK Charities Commission.
	3.	The review engagement must be undertaken in accordance with relevant Engagement Level Quality Control requirements.	The IE does not have any engagement level quality control requirement.
	4.	An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate and operate effectively. The engagement partner shall consider the results of the firm's	The IE is not subject to any form of monitoring process.

		Review Engagement	Independent Examination
		monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the review engagement.	
	5.	The review engagement must be undertaken with professional scepticism and professional judgement	Not applicable
	6.	Requirements for accepting/continuing an engagement (other than independence) apply	No similar requirement
Determining materiality	7.	The assurance practitioner shall determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures.	There is no specific requirement for determining materiality or how materiality should be determined. But an independent examiner is expected to focus on material items. Definition of materiality is similar to a review engagement.
Understanding the entity and its environment and identifying areas of importance	8.	The assurance practitioner shall obtain an understanding of the entity and its environment, and the applicable financial reporting framework, to identify areas in the financial statements where material misstatements are likely to arise and thereby provide a basis for designing procedures to address those areas. The assurance practitioner's understanding shall include the following: a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework; b) The nature of the entity, including: (i) Its operations; (ii) Its ownership and governance structure; (iii) The types of investments that the entity is making and plans to make; (iv) The way that the entity is structured and how it is financed; and	An examiner is required to obtain an understanding of the charity's constitution, objectives, organisational structure, the funds managed, its activities and accounting records and systems. Where accruals accounts are prepared, the examiner must check that the accounting policies adopted are consistent with the SORP and are appropriate to the activities of the charity. The examiner is recommended (but not required to) obtain details of the internal financial controls that the trustees have put in place.

		Review Engagement	Independent Examination
		(v) The entity's objectives and strategies; c) The entity's accounting systems and accounting records; d) The entity's selection and application of accounting policies; and e) Internal control, as it relates to the preparation of the financial statements	
Required procedures and enquiries	9.	In obtaining sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole, the assurance practitioner shall design and perform enquiry and analytical procedures: a) To address all material items in the financial statements, including disclosures; and b) To focus on addressing areas in the financial statements where material misstatements are likely to arise. If the assurance practitioner becomes aware of a matter(s) that causes the assurance practitioner to believe the financial statements may be materially misstated, the assurance practitioner shall design and perform additional procedures sufficient to enable the assurance practitioner to: a) Conclude that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated; or b) Determine that the matter(s) causes the financial statements as a whole to be materially misstated.	The examiner must undertake an analytical review of the accounts to identify any material changes between the reported and previous reporting period that require explanation. The analytical review should be documented in the examiner's working papers. In undertaking the analytical review the examiner may decide they have all the necessary explanations or confirmations that they need and so no further action is needed. For those items identified for which the examiner does not have the necessary explanation or confirmation the examiner must undertake further work to obtain the required explanation or confirmation or to identify that such information cannot be obtained The examiner should consider which material items, if any, may require some form of vouching or evidence to check that those items are not misstated in the accounts.
	10.	The assurance practitioner's enquiries of management and others within the entity, as appropriate, shall include the following:	An examiner is expected to:

		Review Engagement	Independent Examination
		a) How management makes the significant accounting estimates required under the applicable financial reporting framework; b) The identification of related parties and related party transactions, including the purpose of those transactions; c) Whether there are significant, unusual or complex transactions, events or matters that have affected or may affect the entity's financial statements, including: (i) Significant changes in the entity's business activities or operations; (ii) Significant changes to the terms of contracts that materially affect the entity's financial statements, including terms of finance and debt contracts or covenants; (iii) Significant journal entries or other adjustments to the financial statements; (iv) Significant transactions occurring or recognised near the end of the reporting period; (v) The status of any uncorrected misstatements identified during previous engagements; and (vi) Effects or possible implications for the entity of transactions or relationships with related parties; d) The existence of any actual, suspected or alleged: (i) Fraud or illegal acts affecting the entity; and (ii) Non-compliance with provisions of laws and regulations that are generally recognised to have a direct effect on the determination of	a) Check the reasonableness of any significant estimates or judgments that have been made in preparing the accounts b) Where accruals accounts are prepared, check that the accounting policies adopted are consistent with the SORP and are appropriate to the activities of the charity c) If the accounts are prepared on an accruals basis and one or more related party transactions took place the examiner must check if these were properly disclosed in the notes to the accounts d) check whether the trustees have considered the financial circumstances of the charity at the end of the reporting period and, if the accounts are prepared on an accruals basis, check whether the trustees have made an assessment of the charity's position as a going concern when approving the accounts No requirements for considering fraud or non-compliance with laws and regulations. Nevertheless, the examiner is required to inform the appropriate authority if they become aware of instances of fraud or non-compliance. There is no requirement for considering subsequent event or material commitments and obligations.

		Review Engagement	Independent Examination
		material amounts and disclosures in the financial statements, such as tax and pension laws and regulations; e) Whether management has identified and addressed events occurring between the date of the financial statements and the date of the assurance practitioner's report that require adjustment of, or disclosure in, the financial statements; f) The basis for management's assessment of the entity's ability to continue as a going concern; g) Whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern; h) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and i) Material non-monetary transactions or transactions for no consideration in the financial reporting period under consideration.	
	11.	In designing analytical procedures, the assurance practitioner shall consider whether the data from the entity's accounting system and accounting records are adequate for the purpose of performing the analytical procedures.	The examiner is not required to consider the adequacy of data from the entity's accounting system.
	12.	The assurance practitioner shall obtain evidence that the financial statements agree with, or reconcile to, the entity's underlying accounting records (e.g. agree the FSs with the trial balance)	The examiner must compare the accounts of the charity with the charity's accounting records in sufficient detail to reasonably conclude that the accounts are not materially inconsistent with the accounting records.

		Review Engagement	Independent Examination
			The examiner should check that the accounting records kept include source documents (eg invoices, supplier statements, purchase orders, Gift Aid records etc). The examiner is expected to check some entries from the listing of transactions of income and expenditure to vouchers such as invoices, bank statements, and receipts. The examiner should have identified material items in the accounts from their analytical review and identified the transactions that make up those material items. The examiner should seek an explanation from the trustees for items identified in their analytical review and consider if they need to vouch one or more of the material items that they have identified to the accounting records kept.
	13.	The assurance practitioner shall request management to provide a written representation that management has fulfilled its responsibilities described in the agreed terms of engagement	No requirement for a representation letter.
	14.	Not explicitly required.	An examiner is required to check that accounting records are kept to the required standard The examiner should check whether records including vouchers (invoices, receipts, claims and similar paperwork) have been kept to support the accounts. The examiner should ask the trustees to explain how they have ensured that the accounting records kept are a complete record. Smaller charities may not have very detailed records but trustees must keep a record of transactions in the reporting period and a record of any unpaid invoices and amounts due but not yet received.

Agenda item 7.3 A comparison between a Review engagement and an Independent Examination

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	8.1
Meeting date:	13 February 2019
Subject:	IAASB's EDs for Quality Management
Date:	28 January 2019
Prepared By:	Sylvia van Dyk

[x] **Action Required**	[ ] **For Information Purposes Only**

Agenda Item Objectives

To provide the Board with:

- an overview of the IAASB's exposure drafts for Quality management at the Firm and Engagement Level, including engagement quality reviews;
- an outline of the proposed plan for outreach; and

To receive comments from the Board on the proposed plan for outreach.

Background

IAASB exposure drafts

1. The IAASB approved in December 2018 the three Exposure Drafts for quality management at the firm and engagement levels:

   (a) Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1[1]), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance Engagements or Related Services Engagements* (ED-ISQM 1).

   (b) Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED-ISQM 2).

   (c) Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220).

[1] ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

2. The final explanatory memorandums for each of the three standards, together with an overall explanatory memorandum, will be issued in early February, for a 150-day period until the end of June.

3. The overall explanatory memorandum includes background to the IAASB's three quality management exposure drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

4. As the IAASB has not yet released the final documents to date, we have included copies of the explanatory memorandums that the IAASB approved at a teleconference on 22 January, subject to some editorial comments from members, with no fatal flaw comments raised. We do not expect the final documents to be substantially different from the ones included. If the IAASB issues the EDs prior to the February meeting, we will inform the Board of any major differences. We will provide the NZAuASB with the issued final documents at the April meeting, together with potential issues to consider for the submission to the IAASB.

5. We will present a high-level overview of the Exposure drafts at the meeting.

6. We have not identified any compelling reason amendments at this date. We will be liaising with the AUASB staff about whether they have identified any.

Outreach Plan

7. We have prepared an outreach plan to ensure relevant stakeholders are aware of the due process documents and to encourage them to make submissions either directly to the IAASB or to the NZAuASB. The proposed standards are substantially different from the extant standards with the introduction of a quality management approach and with ISQM 2 being a new standard.

8. A key question we (and the IAASB) specifically want to explore is on the scalability of each of the standards. A key focus of our proposed outreach is therefore aimed at raising awareness with SMPs and obtaining feedback about whether they see any foreseeable difficulties in implementing the standards in New Zealand. In doing so, we are planning to hold workshops to field test some of the requirements in ISQM 1, specifically targeting SMPs.

9. Summary and timing of proposed outreach plan:

Action	**Audience**	**Timing**
Issue IAASB EDs in New Zealand via newsletter, inviting comments	All stakeholders	As soon as issued by the IAASB, expect early Feb.
1.5 hour Webinar providing an overview of the standards and ITC	All stakeholders	Monday 1 April

Workshops in various centres[2] on ISQC 1 to obtain feedback on scalability and implementation issues • Auckland • Tauranga • Wellington • Hastings/Napier • Christchurch	Targeting SMPs	3 April – 17 April, 9am -1 pm
Video/teleconference	Bigger firms and OAG	29 April 9am -12 pm
Video/teleconference on issues in the explanatory memorandums	SMPs	30 April 9am -11 am

10. We are in the process of developing some preliminary ideas on how we can set up the workshops, in collaboration with staff from the Canadian Auditing and Assurance Standards Board. We intend to liaise with the AUASB staff and CA ANZ as well on their outreach plan. The proposed outreach plan, which will include more detail about the proposed workshops, will be issued as a late paper, as agenda item 8.6.

Recommendations

We recommend that the Board:

- note the explanatory memorandums of the IAASB quality standards, and
- provide us with comments on the NZAuASB proposed outreach plan.

Material Presented

Agenda item 8.1	Board Meeting Summary Paper
Agenda item 8.2	Proposed Covering Explanatory Memorandum
Agenda item 8.3	Proposed ISQM1 Explanatory memorandum
Agenda item 8.4	Proposed ISQM 2 Explanatory memorandum
Agenda item 8.5	Proposed ISA 220 (Revised) Explanatory memorandum
Agenda item 8.6	Proposed NZAuASB outreach plan (Late paper)

[2] These may change, depending on the number of participants interested in attending.

Exposure Drafts
February 2019
Comments due: July 1, 2019

The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews

IAASB
International Auditing and Assurance Standards Board

About the IAASB

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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ISA.

IAASB International Auditing and Assurance Standards Board.

THE IAASB'S EXPOSURE DRAFTS FOR QUALITY MANAGEMENT AT THE FIRM AND ENGAGEMENT LEVEL, INCLUDING ENGAGEMENT QUALITY REVIEWS

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Section 1 Introduction

1. This memorandum provides background to the IAASB's three Exposure Drafts for quality management at the firm and engagement levels:

   (a) Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1[1]), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance Engagements or Related Services Engagements* (ED-ISQM 1).

   (b) Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED-ISQM 2).

   (c) Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220).

   The three proposed standards were approved for exposure by the IAASB in December 2018. The IAASB is of the view that the three standards will, individually and collectively, improve the quality of engagements through addressing key public interest issues related to the management of quality at a firm and engagement level and the performance on engagement quality reviews.

2. This memorandum also provides an explanation of the significant issues pervasive to the three exposure drafts, including a discussion of scalability and the interrelationship of the three proposed standards. It also sets out the IAASB's proposals regarding the effective date and the related implementation period for the three proposed standards, as well as the IAASB's planned implementation support activities.

3. This memorandum should be read in conjunction with the explanatory memorandums for each of the three proposed standards, which provide background to each of the exposure drafts, and the key issues considered by the IAASB in developing the exposure drafts. The explanatory memorandums for each of the standards are available at www.iaasb.org.

Section 1-A – Background

4. In March 2009, the IAASB completed its Clarity Project, designed to improve the clarity and understandability of the International Standards on Auditing (ISAs) and ISQC 1. Firms were required to establish a system of quality control in compliance with extant ISQC 1 by December 15, 2009. At the engagement level, extant ISA 220[2] was effective for audits of financial statements for periods beginning on or after December 15, 2009. Requirements and guidance material on engagement quality reviews were included in both ISQC 1 and ISA 220. One of the initiatives in the IAASB's Strategy and Work Program 2009–2011 was the development of a process for assessing the effectiveness of the implementation of the clarified ISAs, including ISQC 1 and ISA 220.

5. The post-implementation review of the clarified ISAs was completed in 2013, and the findings from this review formed the basis for the IAASB's Strategy for 2015–2019 and the IAASB Work Plan for 2015–2016:Enhancing Audit Quality and Preparing for the Future. Findings with regard to ISQC 1 and ISA 220 suggested that additional guidance was needed to demonstrate how ISQC 1 could be

[1] ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

[2] ISA 220, *Quality Control for an Audit of Financial Statements*

applied proportionately by small- and medium-sized practitioners (SMPs) and that there were calls to make various aspects of the standards more robust . Accordingly, the Board included planned work on its quality control standards in its Strategy for 2015–2019 and its Work Plan for 2015–2016.

6. As work commenced on the IAASB's quality control standards, the working groups reflected on the issues identified through the post-implementation review of the clarified ISAs, inspection findings and ongoing outreach. The IAASB released the Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*, in December 2015 to obtain stakeholder views on key issues regarding quality control, group audits, and professional skepticism. Respondents generally agreed that the IAASB should take action to address the issues presented in the ITC.

7. Recognizing the importance of taking action to respond to the issues identified, in December 2016 the IAASB approved the project to revise ISQC 1 and ISA 220 and develop other outputs, as necessary. The project proposal included engagement quality reviews as one of the issues to be addressed.

Section 1-B – Key Public Interest Issues

8. The proposed revisions in ED-ISQM 1, ED-ISQM 2 and ED-220 have been made with the public interest in the forefront. The proposed revisions address the most relevant public interest issues related to quality control, including the following public interest issues that were identified in the ITC:

   (a) Fostering an appropriately independent and challenging skeptical mindset of the auditor.

   (b) Encouraging proactive quality management at the firm and engagement level.

   (c) Exploring transparency and its role in audit quality.

   (d) Focusing more on firms' (including network's) structures and communication processes and their internal and external monitoring and remediation activities.

   (e) Reinforcing the need for robust communication and interactions during the audit engagement.

9. The explanatory memorandums for each of the standards further explain how the above public interest issues have been addressed.

Section 2 Significant Matters

Section 2-A – Scalability of the Standards and a New Approach to Quality Management

10. The business environment is becoming increasingly complex; expectations of firms' stakeholders are escalating and there is growing pressure for the IAASB's standards to keep pace with these changes to enhance engagement quality. These factors have given rise to challenges in developing international standards that enhance engagement quality and address complex issues. Developing standards in this environment may lead to more detailed and longer standards, but at the same time the IAASB is conscious that the standards need to be able to be effectively applied to a wide range of circumstances, particularly smaller firms and engagements of less complex entities. Addressing the scalability and proportionality of the IAASB's International Standards is a key focus area for the IAASB to make sure that the standards are scalable to all types of engagements. The IAASB is also aware of the need for its standards to be fit-for-purpose for all firms, regardless of their size or complexity.

11. In order to improve the robustness of firms' systems of quality control and address the scalability of extant ISQC 1, the ITC proposed a new approach to managing quality that encourages proactive management of quality. This approach is intended to be adaptable to the size and nature of a firm~~s~~ or the services it provides. Taking into account the ITC respondents' views on the proposed new approach, the IAASB concluded that ED-ISQM 1 should adopt the new approach, termed quality management, that is focused on how each firm manages its risks to quality. The explanatory memorandum for ED-ISQM 1 provides further explanation of this approach and the IAASB's key considerations in incorporating it in ED-ISQM 1. ED-220 takes this further by embedding the principles of quality management into the engagement level requirements. The explanatory memorandum for ED-ISQM 1 explains that, given the new quality management approach, the references to "quality control" have been changed to "quality management." The terms have also been adjusted in ED-ISQM 2 and ED-220.

12. In addition to the new quality management approach, the IAASB has taken various other steps to address scalability across the standards, which have been further discussed in the explanatory memorandums for each of the standards. In particular, ED-ISQM 1 emphasizes the need for the firm to consider the nature and circumstances of the firm and the engagements it performs in designing, implementing and operating its system of quality management, and the standard is focused on achieving quality objectives that are outcomes-based. Similarly, ED-220 has increased the focus on taking into account the nature and circumstances of the audit engagement in managing quality at the engagement level.

13. Given the importance of the scalability of the IAASB's International Standards, the IAASB is seeking input from respondents, in particular SMPs, on the scalability of each of the standards. Relevant discussion of scalability have been included in the explanatory memorandums for each of the three proposed standards.

Section 2-B – Interrelationship between the Standards

Relationship Between Quality Management at the Firm and the Engagement Level

14. Although a new quality management approach has been introduced in ED-ISQM 1, the nature and spirit of the relationship between ED-220 and ED-ISQM 1 has not changed. The firm is responsible for establishing its system of quality management, which provides the foundation for managing quality at the engagement level, and the engagement partner is responsible for managing and achieving quality at the engagement level.

15. Although the firm is responsible for establishing its system of quality management, aspects of the system of quality management may be implemented at the engagement level, as illustrated in paragraph A62 of ED-ISQM 1. The extent to which aspects of the firm's system of quality management are implemented at the engagement level will depend on the nature and circumstances of the firm and the engagements it performs. For example, in the case of a sole practitioner, it is possible that much of the firm's system of quality management will operate at the engagement level.

16. Various enhancements have been made to ED-ISQM 1 and ED-220 to clarify the respective responsibilities of the firm and the engagement partner. These include:

    (a) A new requirement in paragraph 41(b) of ED-ISQM 1 for the firm to communicate the responsibility for implementing the firm's responses to relevant personnel, including engagement teams.

(b) An explicit statement in paragraph 4 of ED-220 regarding the responsibility of the engagement team, led by the engagement partner, for implementing the firm's responses to quality risks that are applicable to the audit engagement. This paragraph also explains the engagement partner's further responsibilities for determining whether to design and implement responses beyond those required by the firm, given the nature and circumstances of the engagement. This is intended to recognize that the firm cannot identify and design and implement responses to address all quality risks that are relevant to the engagement.

Two-Way Communication

17. As highlighted in Section 1–B, one of the most significant public interest issues highlighted in the ITC was reinforcing the need for robust communication and interactions during the audit. Ongoing communication between the firm, engagement quality reviewers and engagement teams is necessary for the firm's system of quality management to operate effectively and to support the performance of engagements. The IAASB is of the view that emphasis is needed of the importance of this communication and therefore ED-ISQM 1, ED-ISQM 2 and ED-220 now include various requirements and application material that address the required communications between the various parties.

A New Standard for Engagement Quality Reviews

18. Given the importance and value placed on the role of the engagement quality review by stakeholders, particularly investors and regulators, it was proposed in the ITC that a separate standard be developed for engagement quality reviews. The ITC further explained that doing so may help to address scalability and may provide a simpler mechanism for elaborating the requirements and application material for engagement quality reviews. Respondents to the ITC had mixed views about whether a separate standard for engagement quality reviews would be appropriate.

19. As the IAASB's thinking about the new quality management approach evolved and the revisions to ED-ISQ 1 progressed and as the work advanced on addressing issues relating to engagement quality reviews, the IAASB noted that the requirements and application material addressing engagement quality reviews were more specific than other aspects of ED-ISQM 1 which were being developed in a more principles-based manner. Accordingly, the IAASB concluded that it would be better to place the requirements and related application material for engagement quality reviews in a separate standard, ED-ISQM 2. The explanatory memorandum for ED-ISQM 2 provides further information regarding the IAASB's key considerations in determining that a separate standard should be developed for engagement quality reviews and in developing the new standard, including how the requirements between ED-ISQM 1 and ED-ISQM 2 have been linked.

20. The IAASB is of the view that having proposed ISQM 2 as a separate standard for engagement quality reviews provides many benefits, including:

    (a) Increasing the scalability of ED-ISQM 1 because there may be circumstances when a firm determines that there are no engagements for which an engagement quality review should be performed (e.g., a firm that performs only compilation engagements).

    (b) Placing emphasis on the importance of the engagement quality review.

    (c) More clearly differentiating the responsibilities of the firm and the engagement quality reviewer.

21. As a result of the development of a separate standard for engagement quality reviews, the requirements in extant ISA 220 for the engagement quality control reviewer have been removed from ED-220, and revised and relocated to ED-ISQM 2. The IAASB noted that this approach reinforces the function of the engagement quality review as a firm-level activity that is undertaken by an individual who is acting on behalf of the firm, and clarifies the responsibility of the engagement partner for managing quality at the engagement level.

Section 3 Effective Date

22. In finalizing the three standards, the IAASB considered the possible effective dates for each of the standards, recognizing that the effective dates would need to be aligned because of the interrelationships of the standards described previously in this memorandum. The IAASB also considered the appropriate wording of the effective dates of the standards, in particular ED-ISQM 2 given that the standard addresses all types of engagements and some engagements do not relate to a particular period. The proposed wording of the effective date paragraphs are included in each of the standards (see paragraph 17 of ED-ISQM 1, paragraph 9 of ED-ISQM 2 and paragraph 8 of ED-220).

23. The IAASB is proposing that an implementation period of approximately 18 months following the approval of the standards by the Public Interest Oversight Board,[3] would be appropriate for all three proposed standards.

24. In proposing these effective dates, the IAASB noted the concerns of stakeholders that firms' systems of quality control and the management of engagement quality is an area of urgent improvement. For example, the International Forum of Independent Audit Regulators' *2017 Inspection Findings Survey* highlights that findings related to firms' systems of quality control continue to occur and that improvements are needed. The IAASB is of the view that the three standards will, individually and collectively, improve the quality of engagements through addressing the key public interest issues mentioned previously in this document. Accordingly, facilitating timely and effective implementation of the three standards such that the intended benefits are realized, is a priority of the IAASB and in the public interest.

25. Establishing an implementation period that allows enough time to effectively implement the standards, including the translation of the standards and the development of implementation guidance and support materials, is important. The new quality management approach in ED-ISQM 1 represents a substantial revision to the extant standard and there are various other new requirements across the three standards that enhance the rigor of the standards. Accordingly, there will be a need for focused and likely substantial effort by firms and engagement teams to implement the new standards. For example, unlike extant ISQC 1 that sets forth the requirements for the firm's policies and procedures, the new quality management approach requires firms to (1) identify and assess their quality risks, (2) design and implement responses to meet the objective of the standard, and (3) design processes related to monitoring and remediation. Designing and implementing the new system of quality management will take time and effort and increased levels of coordination and cooperation within the firm, and may also require internal organizational changes and the acquisition

[3] When the final standards are approved by the IAASB, their approval is subject to the approval of the Public Interest Oversight Board that an appropriate due process was followed. Typically, the Public Interest Oversight Board approves the standards one quarter after the approval of the standards by the IAASB. For example, if the standards are approved by the IAASB in March 2020, the approval of the Public Interest Oversight Board is likely to be sought in June 2020.

and development of resources. For firms that belong to a network, there will be a direct impact on the network given the need for increased cooperation between the firm and the network and a likely desire by some networks for centralized implementation efforts to support the implementation at member firm level and in order to improve the consistency and quality of the implementation. Furthermore, some firms or networks may need time to test aspects of the system to determine that they are appropriate for use across the firm or the network before implementing them. There may also be firms, including SMPs, who are dependent on guidance and support materials developed by national standard setters or professional accounting organizations to implement the standards.

26. Based on its outreach to date, the IAASB has heard concerns that an 18 month implementation period may not be adequate for firms to effectively implement the standard. It has also been noted that a rushed implementation may exacerbate risks to quality and lead to increased inspection findings. Bearing in mind the competing priorities outlined in paragraphs 24–25 above, the IAASB concluded that an 18 month implementation period, supported by appropriate implementation support materials, is both practical and in the public interest.

27. The IAASB proposes to allow early adoption; however, all three standards would need to be early adopted as a package due to the linkages between them and the incompatibility of a mix of the extant and new standards.

Section 4 Conforming Amendments

28. As a result of the proposals in the three EDs, the IAASB is also proposing conforming amendments to the following IAASB pronouncements: the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*; ISA 200;[4] ISA 210;[5] ISA 230;[6] ISA 250 (Revised);[7] ISA 260 (Revised);[8] ISA 300;[9] ISA 500;[10] ISA 540 (Revised);[11] ISA 610 (Revised 2013);[12] ISA 620;[13] ISA 700 (Revised);[14] ISA 701;[15] ISA 720 (Revised);[16] and IAPN 1000.[17]

29. These conforming amendments are included in the Appendix. The IAASB will consider the nature and scope of conforming and consequential amendments to the assurance and related services standards in due course. The conforming amendments do not include changes for the revised and

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[4] ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*

[5] ISA 210, *Agreeing the Terms of Audit Engagements;*

[6] ISA 230, *Audit Documentation*

[7] ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

[8] ISA 260 (Revised), *Communication with Those Charged with Governance*

[9] ISA 300, *Planning an Audit of Financial Statements*

[10] ISA 500, *Audit Evidence*

[11] ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

[12] ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

[13] ISA 620, *Using the Work of an Auditor's Expert*

[14] ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

[15] ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

[16] ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

[17] IAPN 1000, *Special Considerations in Auditing Financial Instruments*

restructured International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)* as any necessary changes will be addressed in a separate project.

Section 5 Perspectives on Practical Implementation

30. For most firms, the proposals would result in a significant change in practice, in particular the proposals in ED-ISQM 1. The nature and extent of change would depend on many factors, such as the nature and circumstances of the firm and the engagements the firm performs, and the extent to which the firm already uses a risk-based approach in managing quality. The IAASB is aware that some firms have already evolved their processes to incorporate a risk-based approach to quality management, while others have commenced activities to plan for the implementation of the standards when they are eventually issued. The IAASB is interested in learning about practical challenges and experiences in implementing the proposals and the possible effects of the proposals. This includes the perspectives of SMPs regarding any practical challenges that can be foreseen in implementing the standards.

Section 6 Implementation Support

31. The IAASB is currently in the process of developing its strategy for 2020–2023, with an increased focus on other mechanisms for addressing issues and challenges on a more timely basis, including implementation support that is of particular importance to SMPs. Recognizing the increasing demand for implementation support, the IAASB plans to develop materials to accompany the standards, in particular ED-ISQM 1, to facilitate an improved understanding of the standards. The IAASB has developed illustrations of the accompanying materials to facilitate input from respondents on the nature of implementation support that is most useful. The illustrative materials include:

    (a) Practical examples that demonstrate how the requirements of ED-ISQM 1 may be scaled according to the nature and circumstances of the firm and its engagements.

    (b) Frequently asked questions that provide additional explanations and examples of more complex aspects of ED-ISQM 1.

32. In addition, during the exposure period, the IAASB plans to undertake various outreach activities, such as videos and webcasts, that will also provide a mechanism for respondents to further understand the standards, in particular their application to SMPs.

Section 7 Request for Comments

The explanatory memorandums for each of the standards include questions about the key issues considered by the IAASB in developing the exposure drafts, and are available at www.iaasb.org. The questions below address key issues pervasive to the three standards. Comments will be most helpful if they include the reasons for any concern about the matters covered in the questions below.

Overall Questions

1) Do you support the approach and rationale for the proposed implementation period of approximately 18 months after the approval of the three standards by the Public Interest Oversight Board? If not, what do you believe ~~is~~ an appropriate implementation period would be?

2) In order to support implementation of the standards in accordance with the IAASB's proposed effective date, what implementation materials would be most helpful, in particular for SMPs?

General Questions

In addition, the IAASB is also seeking comments on the general matters set out below for all three EDs:

(a) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposals, in particular, on any foreseeable difficulties in applying it in a developing nation environment.

(b) *Public Sector*—The IAASB welcomes input from public sector auditors on how the proposed standards affect engagements in the public sector, particularly regarding whether there are potential concerns about the applicability of the proposals to the structure and governance arrangements of public sector auditors.

(c) *Translations*—Recognizing that many respondents may intend to translate the final ISQMs and ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed ISA.

PROPOSED CONFORMING AMENDMENTS TO THE INTERNATIONAL STANDARDS ON AUDITING ARISING FROM PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 1 AND INTERNATIONAL STANDARD ON AUDITING 220 (REVISED)

Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements

Introduction

1. This preface to the *International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* is issued to facilitate understanding of the scope and authority of the pronouncements the International Auditing and Assurance Standards Board (IAASB) issues, as set forth in the IAASB's Terms of Reference.

…

The Authority Attaching to International Standards Issued by the International Auditing and Assurance Standards Board

…

9. International Standards on Quality Management (ISQMs) are to be applied for all services falling under the IAASB's Engagement Standards.

…

International Standards on Quality Management

11. ISQMs are written to apply to firms in respect of all their services falling under the IAASB's Engagement Standards. The authority of ISQMs is set out in the introduction to each ISQM.[18]

…

Applicability of the International Standards

…

18. International Standards are relevant to engagements in the public sector. When appropriate, additional considerations specific to public sector entities are included:

    (a) Within the body of an International Standard in the case of ISAs and ISQMs; or

    (b) In a Public Sector Perspective (PSP) appearing at the end of other International Standards. …

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[18] Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* paragraph 16

ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*

…

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

14. The auditor shall comply with relevant ethical requirements, including those related to independence, relating to financial statement audit engagements. (Ref: Para. A16–A19)

…

Application and Other Explanatory Material

…

Definitions

…

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 14)

…

A19. International Standard on Quality Management (ISQM) 1, or national requirements that are at least as demanding,[19] deal with the firm's responsibilities to design, implement and operate a system of quality management that provides the firm with reasonable assurance that the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements. As part of its system of quality management, ISQM 1 requires the firm to address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence.[20] ISA 220 (Revised) sets out the engagement partner's responsibilities with respect to relevant ethical requirements, including those related to independence.[21].

…

Professional Judgment (Ref: Para. 16)

…

A27. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as that required by ISA 220 (Revised),[22] assist the auditor in making informed and reasonable judgments.

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[19] ISA 220 (Revised), *Quality Control for an Audit of Financial Statements*, paragraph 3

[20] ISQM 1, paragraphs 32–33

[21] ISA 220 (Revised), paragraph 14-19

[22] ISA 220 (Revised), paragraph 32

…

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 5 and 17)

Sufficiency and Appropriateness of Audit Evidence

A30. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[23]) or through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

…

Conduct of an Audit in Accordance with ISAs

…

Contents of the ISAs (Ref: Para. 19)

…

A64. An ISA may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms relating to International Standards issued by the International Auditing and Assurance Standards Board in the *Handbook of International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC contains a complete listing of terms defined in the ISAs. It also includes descriptions of other terms found in ISAs to assist in common and consistent interpretation and translation.

…

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[23] ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 9

ISA 210, *Agreeing the Terms of Audit Engagements*

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present. ISA 220 (Revised) deals with those aspects of engagement acceptance that are within the control of the auditor. (Ref: Para. A1)

…

Application and Other Explanatory Material

Scope of this ISA (Ref: Para. 1)

A1. ISQM 1 deals with the firm's responsibilities regarding the acceptance and continuance of client relationships and specific engagements. The auditor's responsibilities in respect of relevant ethical requirements, including those related to independence, in the context of the acceptance of an audit engagement and in so far as they are within the control of the auditor are dealt with in ISA 220 (Revised).[24] This ISA deals with those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

…

***

ISA 230, *Audit Documentation*

Introduction

…

Nature and Purposes of Audit Documentation

…

3. Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with ISA 220 (Revised).[25]
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.

[24] ISA 220 (Revised), paragraphs 14–19

[25] ISA 220 (Revised), paragraphs 27–31

- Enabling the conduct of engagement quality reviews,[26] other engagement reviews and monitoring activities under the firm's system of quality management.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

…

Application and Other Explanatory Material

…

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

…

Form, Content and Extent of Audit Documentation (Ref: Para. 8)

…

A7. Audit documentation provides evidence that the audit complies with the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management or, where appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the ISAs.
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
    - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with the ISAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
    - Similarly, that the engagement partner has taken responsibility for the nature, timing and extent of direction and supervision of the engagement team and the review of the work performed may be evidenced in a number of ways within the audit documentation. This may include documentation that evidences the engagement partner's sufficient and

[26] International Standard on Quality Management 2, *Engagement Quality Reviews*

appropriate involvement in the audit, such as participation in engagement team discussions.

…

Identification of Specific Items or Matters Tested, and of the Preparer and Reviewer (Ref: Para. 9)

…

A13. ISA 220 (Revised) contains requirements and guidance on the review of audit documentation.[27] The requirement to document who reviewed the audit work performed does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

…

Matters Arising after the Date of the Auditor's Report (Ref: Para. 13)

A20. Examples of exceptional circumstances include facts which become known to the auditor after the date of the auditor's report but which existed at that date and which, if known at that date, might have caused the financial statements to be amended or the auditor to modify the opinion in the auditor's report.[28] The resulting changes to the audit documentation are reviewed in accordance with the review responsibilities set out in ISA 220 (Revised).[29]

Assembly of the Final Audit File (Ref: Para. 14–16)

A21. ISQM 1 (or national requirements that are at least as demanding) requires firms to establish policies or procedures that require the engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized.[30] An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.[31]

…

A23. ISQM 1 (or national requirements that are at least as demanding) requires firms to establish policies or procedures that require the engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards.[32] The retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor's report, or, if later, the date of the auditor's report on the group financial statements, when applicable.[33]

A24. An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need

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[27] ISA 220 (Revised), paragraph 28–29

[28] ISA 560, *Subsequent Events*, paragraph 14

[29] ISA 220 (Revised), paragraph 27

[30] ISQM 1, paragraph 37(f)(i)

[31] ISQM 1, paragraph A110

[32] ISQM 1, paragraph 37(f)(ii)

[33] ISQM 1, paragraph A111

to clarify existing audit documentation arising from comments received during monitoring activities or external inspections.

Appendix

(Ref: Para. 1)

Specific Audit Documentation Requirements in Other ISAs

This appendix identifies paragraphs in other ISAs that contain specific documentation requirements. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISA 210, *Agreeing the Terms of Audit Engagements* – paragraphs 10–12
- ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* – paragraph 38
- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraphs 44–47
- ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraph 29
- ISA 260 (Revised), Communication with Those Charged with Governance – paragraph 23
- ISA 300, Planning an Audit of Financial Statements – paragraph 12
- ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment – paragraph 32
- ISA 320, Materiality in Planning and Performing an Audit – paragraph 14
- ISA 330, The Auditor's Responses to Assessed Risks – paragraphs 28–30
- ISA 450, Evaluation of Misstatements Identified during the Audit – paragraph 15
- ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures – paragraph 37
- ISA 550, Related Parties – paragraph 28
- ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors) – paragraph 50
- ISA 610 (Revised 2013), Using the Work of Internal Auditors – paragraph 36–37
- ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information – paragraph 25

***

ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

…

Application and Other Explanatory Material

…

Audit Procedures When Non-Compliance Is Identified or Suspected

…

Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)

…

A25. In certain circumstances, the auditor may consider withdrawing from the engagement, where permitted by law or regulation, for example when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances or the identified or suspected non-compliance raises questions regarding the integrity of management or those charged with governance, even when the non-compliance is not material to the financial statements. The auditor may consider it appropriate to obtain legal advice to determine whether withdrawal from the engagement is appropriate. When the auditor determines that withdrawing from the engagement would be appropriate, doing so would not be a substitute for complying with other responsibilities under law, regulation or relevant ethical requirements to respond to identified or suspected non-compliance. Furthermore, paragraph A49 of ISA 220 (Revised) indicates that some ethical requirements may require the predecessor auditor, upon request by the proposed successor auditor, to provide information regarding non-compliance with laws and regulations to the successor auditor.

***

ISA 260 (Revised), *Communication with Those Charged with Governance*

…

Application and Other Explanatory Material

Matters to Be Communicated

…

Significant Findings from the Audit (Ref: Para. 16)

…

Other Significant Matters Relevant to the Financial Reporting Process (Ref: Para. 16(e))

…

A28. To the extent not already addressed by the requirements in paragraphs 16(a)–(d) and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality reviewer, if one has been appointed.

…

Appendix 1

Specific Requirements in ISQM 1 and Other ISAs that Refer to Communications with Those Charged With Governance

This appendix identifies paragraphs in ISQM 1[34] and other ISAs that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* – paragraph 41(c)

…

***

ISA 300, *Planning an Audit of Financial Statements*

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to plan an audit of financial statements. This ISA is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified.

2. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Quality management at the engagement level in accordance with ISA 220 (Revised), in conjunction with adequate planning in accordance with this ISA, benefits the audit of financial statements in several ways, including the following: (Ref: Para. A0-A3)

   - Helping the auditor to devote appropriate attention to important areas of the audit.
   - Helping the auditor identify and resolve potential problems on a timely basis.
   - Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
   - Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
   - Facilitating the direction and supervision of engagement team members and the review of their work.
   - Assisting, where applicable, in coordination of work done by auditors of components and experts.

…

[34] ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

Requirements

…

Preliminary Engagement Activities

6. The auditor shall undertake the following activities at the beginning of the current audit engagement:

   (a) Performing procedures required by ISA 220 (Revised) regarding the acceptance and continuance of the client relationship and audit engagement;[35]

   (b) Evaluating compliance with relevant ethical requirements, including those related to independence, in accordance with ISA 220 (Revised);[36] and

   (c) Establishing an understanding of the terms of the engagement, as required by ISA 210.37 (Ref: Para. A5-A7)

…

Planning Activities

…

8. In establishing the overall audit strategy, the auditor shall consider the information obtained from complying with the requirements of ISA 220 (Revised) and:

   (a) Identify the characteristics of the engagement that define its scope;

   (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;

   (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;

   (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and

   (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement. (Ref: Para. A8-A11)

…

11. The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work as required by ISA 220 (Revised). (Ref: Para. A16)

…

Additional Considerations in Initial Audit Engagements

13. The auditor shall undertake the following activities prior to starting an initial audit:

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[35] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraphs 20–22

[36] ISA 220 (Revised), paragraphs 14–19

[37] ISA 210, *Agreeing the Terms of Audit Engagements*, paragraphs 9–13

(a) Performing procedures required by ISA 220 (Revised) regarding the acceptance of client relationships and audit engagements;[38] and

(b) Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements. (Ref: Para. A22)

…

Application and Other Explanatory Material

A0. ISA 220 (Revised) establishes requirements and provides guidance on the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner. Information obtained from complying with the requirements of ISA 220 (Revised) is relevant to this ISA. For example, in accordance with ISA 220 (Revised), the engagement partner is required to determine that sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, given the nature and circumstances of the audit engagement. Such a determination is directly relevant when describing the nature, timing and extent of resources necessary to perform the engagement in the overall strategy, as required by paragraph 8 of this ISA.

The Role and Timing of Planning (Ref: Para. 2)

A1. The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement. In planning the audit, the auditor may use project management techniques and tools. ISA 220 (Revised)[39] describes how such techniques and tools may support the engagement partner and the other members of the engagement team in managing the quality of the engagement.

…

A3. The auditor may decide to discuss elements of planning with the entity's management to inform quality management at the engagement level (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

…

Preliminary Engagement Activities (Ref: Para. 6)

A5. Performing the preliminary engagement activities specified in paragraph 6 at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances

[38] ISA 220 (Revised), paragraphs 20–22

[39] ISA 220 (Revised), A63–A64

that may adversely affect the auditor's ability to manage quality at the engagement level in accordance with ISA 220 (Revised).

A6. Performing preliminary engagement activities enables the auditor to plan an audit engagement in order to, for example:

- Maintain the necessary independence and ability to perform the engagement.
- Determine that there are no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- Determine that there is no misunderstanding with the client as to the terms of the engagement.

A7. Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often occur shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: Para. 7- 8)

A8. The process of establishing the overall audit strategy, subject to the completion of the auditor's risk assessment procedures, may include such matters as:

- The nature of resources (human, technological or intellectual) to be deployed for specific audit areas. For example, the deployment of experienced team members for high risk areas, or the assignment of experts to address complex matters;
- The amount of resources to be allocated to specific audit areas. For example, the number of team members assigned to attend the physical inventory count at multiple locations; the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
- When these resources are to be deployed, such as whether at an interim audit stage or at key cutoff dates; and
- How such resources are directed, supervised or used. For example, when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site).

A8A. ISA 220 (Revised) contains requirements and guidance on engagement resources and engagement performance (including direction and supervision of the members of the engagement team and the review of the work performed).

…

Direction, Supervision and Review (Ref: Para. 11)

A16. ISA 220 (Revised)40 establishes requirements and provides guidance on the engagement partner's responsibility for the nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed.

Documentation (Ref: Para. 12)

A18. The documentation of the overall audit strategy is a record of the key decisions in managing quality at the engagement level and a means to communicate significant matters to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

…

Additional Considerations in Initial Audit Engagements (Ref: Para. 13)

A22. The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Unless prohibited by law or regulation, arrangements to be made with the predecessor auditor, for example, to review the predecessor auditor's working papers.
- Any major issues (including the application of accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances.[41]
- Other responses designed and implemented by the firm for initial audit engagements (e.g., the firm's system of quality management may include responses that require another partner or individual with appropriate authority to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

Appendix

(Ref: Para. 7–8, A8–A11)

Considerations in Establishing the Overall Audit Strategy

This appendix provides examples of matters the auditor may consider in managing quality at the engagement level. Many of these matters will influence the auditor's overall audit strategy and detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. While

[40] ISA 220 (Revised), paragraphs 27-29

[41] ISA 510, *Initial Audit Engagements—Opening Balances*

some of the matters referred to below may be required by other ISAs, not all matters are relevant to every audit engagement and the list is not necessarily complete.

…

Nature, Timing and Extent of Resources

- The human, technological and intellectual resources assigned or made available to the engagement (e.g., assignment of the engagement team and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement).
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement

***

ISA 500, *Audit Evidence*

…

Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

A1. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[42]) or through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

…

Information to Be Used as Audit Evidence

Relevance and Reliability (Ref: Para. 7)

A26. As noted in paragraph A1, while audit evidence is primarily obtained from audit procedures performed during the course of the audit, it may also include information obtained from other sources, for example, previous audits, through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement and in complying with certain additional responsibilities under law, regulation or relevant ethical requirements (e.g., regarding an entity's non-

[42] ISA 315 (Revised), paragraph 9

compliance with laws and regulations). The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.

…

***

ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

…

Application and Other Explanatory Material

Risk Assessment Procedures and Related Activities

…

Specialized Skills or Knowledge (Ref: Para. 15)

A61. Matters that may affect the auditor's determination of whether the engagement team requires specialized skills or knowledge, include, for example:[43]

- The nature of the accounting estimates for a particular business or industry (for example, mineral deposits, agricultural assets, complex financial instruments, insurance contract liabilities).

…

***

ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Introduction

Scope of this ISA

…

4. In accordance with ISA 220 (Revised),[44] the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities, including sufficient time. The group engagement partner is also responsible for the direction, supervision and performance of the group audit engagement.

5. The group engagement partner applies the requirements of ISA 220 (Revised) regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This ISA assists the group engagement partner to meet the requirements of ISA 220 (Revised) where component auditors perform work on the financial information of components.

…

[43] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 23–24 and ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

[44] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraphs 14–15

Requirements

…

Acceptance and Continuance

12. In applying ISA 220 (Revised), the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. (Ref: Para. A10–A12)

…

***

ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

Introduction

…

Requirements

…

Using Internal Auditors to Provide Direct Assistance

…

34. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220 (Revised).[45] In so doing:

    (a) The nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29 of this ISA; and

    (b) The review procedures shall include the external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors.

    The direction, supervision and review by the external auditor of the work performed by the internal auditors shall be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work. (Ref: Para. A40–A41)

…

[45] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

Application and Other Explanatory Material

…

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used

Evaluating the Internal Audit Function

…

Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

…

A11. Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

- The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
- Whether the internal audit function has appropriate quality control policies and procedures, for example, policies and procedures that would be applicable to an internal audit function (such as those relating to leadership, human resources and engagement performance) or quality control requirements in standards set by the relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements such as conducting periodic external quality assessments.

…

***

ISA 620, *Using the Work of an Auditor's Expert*

Introduction

Scope of this ISA

…

2. ISA does not deal with:

   (a) Situations where the engagement team includes a member, or consults an individual or organization, with expertise in a specialized area of accounting or auditing, which are dealt with in ISA 220 (Revised);[46] or

   (b) The auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's expert), which is dealt with in ISA 500.[47]

---

[46] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraphs A56

[47] ISA 500, *Audit Evidence*, paragraphs A34–A48

…

Requirements

…

Nature, Timing and Extent of Audit Procedures

8. The nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 9–13 of this ISA will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including: (Ref: Para. A10)

   (a) The nature of the matter to which that expert's work relates;

   (b) The risks of material misstatement in the matter to which that expert's work relates;

   (c) The significance of that expert's work in the context of the audit;

   (d) The auditor's knowledge of and experience with previous work performed by that expert; and

   (e) Whether that expert is subject to the auditor's firm's system of quality management. (Ref: Para. A11–A13)

Application and Other Explanatory Material

…

Determining the Need for an Auditor's Expert (Ref: Para. 7)

…

A6. If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement.[48] Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement.[49] The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert.

…

Nature, Timing and Extent of Audit Procedures (Ref: Para. 8)

A10. The nature, timing and extent of audit procedures with respect to the requirements in paragraphs 9–13 of this ISA will vary depending on the circumstances. For example, the following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

---

[48] ISA 220 (Revised), paragraph 24

[49] ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

- The work of the auditor's expert relates to a significant matter that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's expert, and has no prior knowledge of that expert's competence, capabilities and objectivity.
- The auditor's expert is performing procedures that are integral to the audit, rather than being consulted to provide advice on an individual matter.
- The expert is an auditor's external expert and is not, therefore, subject to the firm's system of quality management.

The Auditor's Firm's System of Quality Management (Ref: Para. 8(e))

A11. An auditor's internal expert may be a partner or staff, including temporary staff, of the auditor's firm, and therefore subject to the system of quality management of that firm in accordance with ISQM 1[50] or national requirements that are at least as demanding.[51] An auditor's internal expert may also be a partner or staff, including temporary staff, of a network firm, which may share common quality management policies or procedures with the auditor's firm.

A12. An auditor's external expert is not a member of the engagement team and is not subject to the firm's system of quality management in accordance with ISQM 1.[52] However, ISQM 1 includes requirements for the firm when the firm intends to obtain or use resources provided by a service provider in performing engagements, which includes the use of an external expert.[53] Relevant ethical requirements or law or regulation may require that an auditor's external expert be treated as a member of the engagement team, and the external expert may therefore be subject to relevant ethical requirements, including those related to independence, and other professional requirements, as determined by the relevant ethical requirements or law or regulation.

A13. As described in ISA 220 (Revised),[54] quality management at the engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. The auditor may be able to depend on the firm's related policies or procedures in respect of:

- Competence and capabilities, through recruitment and training programs.
- Objectivity. Auditor's internal experts are subject to relevant ethical requirements, including those relating to independence.
- The auditor's evaluation of the adequacy of the auditor's expert's work. For example, the firm's training programs may provide auditor's internal experts with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm experts, may affect the nature, timing and extent of the auditor's procedures to evaluate the adequacy of the auditor's expert's work.

---

[50] ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 19(f)

[51] ISA 220 (Revised), paragraph 3

[52] ISQM 1, paragraph 19(f)

[53] ISQM 1, paragraphs 64–65

[54] ISA 220 (Revised), paragraph A5

- Adherence to regulatory and legal requirements, through monitoring processes.
- Agreement with the auditor's expert.

Matters that the auditor may take into account when determining whether, and if so, the degree to which, the auditor may depend on the firm's policies or procedures are described in ISA 220 (Revised). Dependence on the firm's policies or procedures does not reduce the auditor's responsibility to meet the requirements of this ISA.

The Competence, Capabilities and Objectivity of the Auditor's Expert (Ref: Para. 9)

…

A15. Information regarding the competence, capabilities and objectivity of an auditor's expert may come from a variety of sources, such as:

…

- Personal experience with previous work of that expert.
- Discussions with that expert.
- Discussions with other auditors or others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.
- The auditor's firm's system of quality management (see paragraphs A11–A13).

A18. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may eliminate or reduce such threats, and may be created by external structures (e.g., the auditor's expert's profession, legislation or regulation), or by the auditor's expert's work environment (e.g., the firm's policies or procedures or the external expert's organization's policies or procedures). There may also be safeguards specific to the audit engagement.

…

Agreement with the Auditor's Expert (Ref: Para. 11)

…

A26. When there is no written agreement between the auditor and the auditor's expert, evidence of the agreement may be included in, for example:

- Planning memoranda, or related working papers such as the audit program.
- The policies or procedures of the auditor's firm's system of quality management. In the case of an auditor's internal expert, the requirements to which that expert is subject under the firm's system of quality management may include, for example, particular policies or procedures in relation to that expert's work. The extent of documentation in the auditor's working papers depends on the nature of such policies or procedures. For example, no documentation may be

required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an expert is used.

…

***

ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

…

Application and Other Explanatory Material

Auditor's Report (Ref: Para. 20)

…

Auditor's Report for Audits Conducted in Accordance with International Standards on Auditing

…

Name of the Engagement Partner (Ref: Para. 46)

A61. The objective of the firm in ISQM 1[55] is to design, implement and operate a system of quality management that provides the firm with reasonable assurance that:

- The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
- Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Notwithstanding the objective of ISQM 1, naming the engagement partner in the auditor's report is intended to provide further transparency to the users of the auditor's report on financial statements of a listed entity.

…

***

[55] ISQM 1, *Quality Control for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* paragraph 18

ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

…

Application and Other Explanatory Material

…

Determining Key Audit Matters

…

Matters that Required Significant Auditor Attention (Ref: Para. 9)

…

A15 Various ISAs require specific communications with those charged with governance and others that may relate to areas of significant auditor attention. For example:

- ISA 260 (Revised) requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.[56] The ISAs acknowledge potential difficulties in relation to, for example:
  - Related party transactions,[57] in particular limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's length transaction.
  - Limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.[58]
- ISA 220 (Revised) establishes requirements for the engagement partner in relation to undertaking appropriate consultation on matters where the firm's policies or procedures require consultation, difficult or contentious matters,[59] and other matters that in the engagement partner's professional judgment, require consultation. For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality reviewer.[60]

…

[56] ISA 260 (Revised), paragraphs 16(b) and A21

[57] ISA 550, *Related Parties*, paragraph A42

[58] ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 49(d)

[59] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 32

[60] ISA 220 (Revised), paragraph 33

Communication with Those Charged with Governance (Ref: Para. 17)

…

A63. The requirement in paragraph 17(b) to communicate with those charged with governance when the auditor has determined there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality reviewer, where one has been appointed). These discussions may cause the auditor to re-evaluate the auditor's determination that there are no key audit matters.

…

***

ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

…

Application and Other Explanatory Material

…

Reading and Considering the Other Information (Ref: Para. 14–15)

…

A24. In accordance with ISA 220 (Revised),[61] the engagement partner is required to take responsibility for the nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed, and be satisfied that such direction, supervision and review is in compliance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements. In the context of this ISA, factors that may be taken into account when determining the appropriate engagement team members to address the requirements of paragraphs 14–15, include:

- The relative experience of engagement team members.
- Whether the engagement team members to be assigned the tasks have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge.
- The degree of judgment involved in addressing the requirements of paragraph 14–15. For example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members.
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component.

…

***

[61] ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 27(a)

IAPN 1000, *Special Considerations in Auditing Financial Instruments*

Contents

International Auditing Practice Note (IAPN) 1000, *Special Considerations in Auditing Financial Instruments*, should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*. IAPNs do not impose additional requirements on auditors beyond those included in the International Standards on Auditing (ISAs), nor do they change the auditor's responsibility to comply with all ISAs relevant to the audit. IAPNs provide practical assistance to auditors. They are intended to be disseminated by those responsible for national standards, or used in developing corresponding national material. They also provide material that firms can use in developing their training programs and internal guidance.

…

Section II—Audit Considerations Relating to Financial Instruments

…

Planning Considerations

…

Using Those with Specialized Skills and Knowledge in the Audit[62]

78. A key consideration in audits involving financial instruments, particularly complex financial instruments, is the competence of the auditor. ISA 220 (Revised)[63] requires the engagement partner to be satisfied that members of the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the competence and capabilities, including sufficient time, to perform the audit engagement. Further, relevant ethical requirements require the auditor to determine whether acceptance of the engagement would create any threats to compliance with the fundamental principles, including the professional competence and due care. Paragraph 79 below provides examples of the types of matters that may be relevant to the auditor's considerations in the context of financial instruments.

…

[62] When such a person's expertise is in auditing and accounting, regardless of whether the person is from within or external to the firm, this person is considered to be part of the engagement team and is subject to the requirements of ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*. When such a person's expertise is in a field other than accounting or auditing, such person is considered to be an auditor's expert, and the provisions of ISA 620, *Using the Work of an Auditor's Expert*, apply. ISA 620 explains that distinguishing between specialized areas of accounting or auditing, and expertise in another field, will be a matter of professional judgment, but notes the distinction may be made between expertise in methods of accounting for financial instruments (accounting and auditing expertise) and expertise in complex valuation techniques for financial instruments (expertise in a field other than accounting or auditing).

[63] ISA 220 (Revised), paragraph 24

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International Standard on Quality Management

Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control 1)

Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

IAASB International Auditing and Assurance Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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ISA.

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REQUEST FOR COMMENTS

This Exposure Draft, proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

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Section 1 Introduction

1. This memorandum provides background to, and an explanation of, the exposure draft of proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1[1]), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1), which was approved for exposure by the IAASB in December 2018. The sections that follow describe the key issues considered by the IAASB in developing ED-ISQM 1. The proposed revisions in ED-ISQM 1 have been made with public interest considerations at the forefront. The proposed revisions address the most relevant public interest issues related to firms' systems of quality control, including those highlighted in the Invitation to Comment (ITC) released in December 2015, *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*.

2. ED-ISQM 1 is part of a package of proposed quality management standards in respect of which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level*, which is available at www.iaasb.org. The overall explanatory memorandum includes background to the IAASB's three quality management exposure drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

Section 2 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-ISQM 1, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are free to address only questions relevant to them. When a respondent agrees with the proposals in ED-ISQM 1, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

Section 3 Significant Matters

Section 3A – A New Approach Focused on Quality Management

3. An effective system of quality control provides the foundation for the approach to achieving consistent engagement quality as it sets out what is needed in a firm's system of quality control to manage the quality of engagements performed by the firm. Extant ISQC 1 requires firms to establish and maintain a system of quality control and specifies the policies and procedures that firms are required to establish as part of the system of quality control.

4. In the wake of the financial crisis, many companies responded to the changing environment and emerging corporate governance risks by revisiting their business practices and relevant activities. Questions have arisen about whether extant ISQC 1 remains fit for purpose, given the evolving

[1] ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

environment in which firms operate, the intensifying focus on quality and the increasing expectations of firms' stakeholders. Furthermore, the findings from the post-implementation review of the clarified ISAs, inspection findings and ongoing outreach have suggested that several aspects of extant ISQC 1 could be more robust and additional action is needed to address the proportional application of the standard by small- and medium-sized practitioners (SMPs).

5. Recognizing these issues, the ITC highlighted several public interest issues, which included the need for proactive management of quality and keeping the standard fit for purpose. The ITC suggested that a new approach to quality control at the firm level is needed that emphasizes the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size and nature of firms or the services they provide. As a result, the ITC proposed a new approach for ISQC 1, the quality management approach.

6. Respondents to the ITC supported the quality management approach because it is more risk-based and proactive, and agreed that the approach could provide benefits for firms' systems of quality control, including that it would likely enhance the ability for firms to proportionately apply the standard. However, some respondents noted that only limited information had been provided in the ITC about the new approach and cautioned that the new approach should not simply result in add-ons to the existing requirements that may result in compliance with the standard becoming unneccesarily onerous, particularly for SMPs. On the other hand, other respondents were concerned that a new approach could diminish the robustness of ISQC 1, especially if the requirements of the extant standard were not carried over appropriately.

7. The IAASB concluded that in order to substantively enhance firms' management of engagement quality and at the same time improve the scalability of the standard, ED-ISQM 1 should incoporate the new quality management approach that would be focused on proactively identifying and responding to risks to quality. This approach would include other enhancements to address key issues highlighted in the ITC and considered necessary to improve the robustness of firms' systems of quality management (e.g., enhanced requirements and focus on governance and leadership, monitoring and remediation and circumstances when a firm belongs to a network).

8. The essence of the new approach is to focus firms' attention on risks that may have an impact on engagement quality. Unlike extant ISQC 1, the new approach requires a firm to customize the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs. The new approach also requires the firm to transition from policies and procedures that address standalone elements, as required by extant ISQC 1, to an integrated approach that reflects upon the system as a whole.

9. The new approach, termed quality management, is expected to generate multiple benefits for firms' systems of quality control that support the consistent performance of quality engagements, including:

   (a) A system of quality management tailored for the nature and circumstances of the firm and the engagements it performs, thereby improving the robustness and effectiveness of activities undertaken by the firm to address engagement quality. A tailored system of quality management may also result in improved utilization of firm resources.

   (b) Facilitating a proactive response by the firm to changing circumstances and proactively managing or mitigating risks, and promoting continual improvement and responsiveness. This new approach will also aid in keeping the standard fit for purpose and adaptable to a changing environment.

(c) Increased emphasis on monitoring the system as a whole and timely and effective remediation, to promote ongoing improvement and consideration of the appropriateness of the system, including whether it is effective in supporting engagement quality.

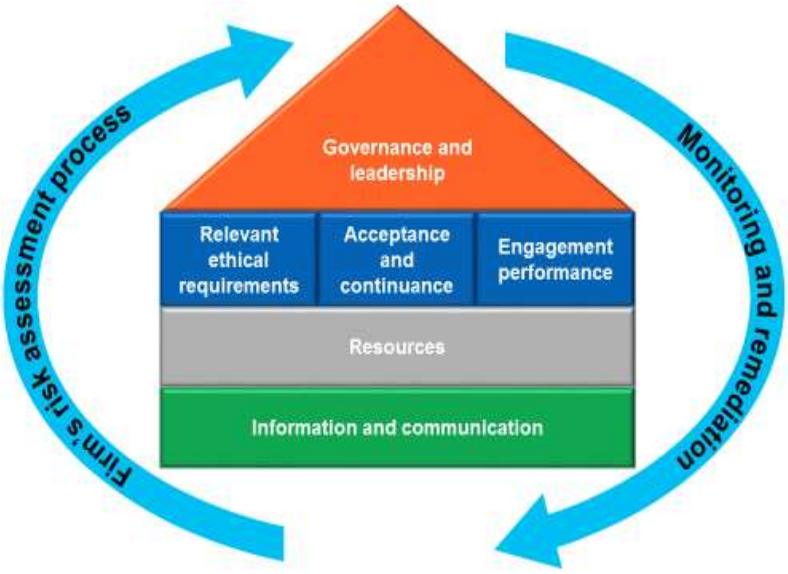
(d) Improved integration of the components of the system, thereby promoting an ongoing process of improvement, and consideration of the effect of decisions across the system.

10. In incorporating the new approach into the standard, the IAASB considered many other risk management and governance frameworks, such as the COSO Integrated Framework – 2013.[2] ED-ISQM 1 has many similarities to these frameworks, where the aim is to achieve objectives or principles through managing risks to achieving those objectives. The IAASB also undertook outreach with firms that have begun to adopt risk-based approaches in their systems of quality control.

11. Given the new references to quality management, the title of the standard and other references to quality control in the requirements and application material have been changed to refer to quality management. The IAASB recognizes that many jurisdictions have law or regulation that requires firms to adopt ISQC 1 or otherwise refer to ISQC 1 in jurisdictional professional standards, and changing the title may create the need for law or regulation or jurisdictional standards to be amended. However, the IAASB notes the introduction of ED-ISQM 2, which may create the need for amendments to law or regulation or jurisdictional standards. The IAASB is seeking views of respondents as to whether the change in title will create significant difficulties in adopting the standard at a jurisdictional level (see question 15).

The Components of a System of Quality Management

12. In determining the key components of the system of quality management that need to be addressed in ED-ISQM 1, the IAASB considered the organization of the other risk management and governance frameworks highlighted previously and how the elements in extant ISQC 1 should be retained. The IAASB agreed that retaining the elements of extant ISQC 1 is important as they reflect topics that continue to be relevant to a firm's system of quality management and provide a necessary link to the management of quality at the engagement level (i.e., ED-220). The eight components of the proposed system of quality management, which are depicted in the diagram, are as follows:



[2] Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework (2013)*

(a) Governance and leadership (adapted from “leadership responsibilities for quality within the firm” in extant ISQC 1);

(b) The firm’s risk assessment process (new);

(c) Relevent ethical requirements (same as extant ISQC 1);

(d) Acceptance and continuance of client relationships and specific engagements (same as extant ISQC 1);

(e) Engagement performance (same as extant ISQC 1);

(f) Resources (adapted from “human resources” in extant ISQC 1);

(g) Information and communication (new); and

(h) Monitoring and remediation (adapted from “monitoring” in extant ISQC 1).

13. While ED-ISQM 1 is organized according to the eight components, firms are not required to organize their systems according to these discrete components (see paragraph A5 of ED-ISQM 1). ED-ISQM 1 only requires that a firm meet all of the requirements of the standard in designing, implementing and operating its system of quality management. For example, provided that all of the requirements of the standard are still met, a firm may have different names for the components, may combine the components or may have additional components.

14. Unlike the elements of extant ISQC 1 that appear disconnected from one another, the eight components in ED-ISQM 1 are specifically designed and described as highly integrated. For example, resources and information and communication are essential aspects that enable the operation of each of the other components of the system of quality management. The integration of the components means that the system of quality management does not operate in a linear manner. As a result, many aspects of ED-ISQM 1 would be designed, implemented and operated by the firm in an iterative manner.

15. In order to provide an overall understanding of the integrated nature of the system, the introductory paragraphs of the standard provide a summary explanation of the components (see paragraphs 8–13 of ED-ISQM 1). Additionally, the interrelationships between the components have been emphasized and explained throughout ED-ISQM 1. However, the IAASB agreed that matters that relate to more than one component should not be repeated in each component because that would result in a voluminous standard and be perceived as more prescriptive. For example, communication of independence matters is not specifically required in the relevant ethical requirements component because it is addressed by the broader requirements in the information and communication component.

Section 3B – General Considerations

Objective of the Standard

16. The *objective of the firm* in the context of the standard is to design, implement and operate a system of quality management.

17. The system of quality management is designed to achieve the following two objectives, which are similar to the objectives in extant ISQC 1:

    (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

    (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

18. An effective system of quality management provides the firm with reasonable assurance regarding the achievement of the two objectives (see paragraph A3 of ED-ISQM 1). A system of quality management cannot be designed to provide absolute assurance because of the inherent limitations of a system, for example, human error or uncertainty in judgments. The term "reasonable assurance" rather than "absolute assurance" acknowledges that limitations exist in all systems of quality management, and that uncertainties and risks may exist that cannot be predicted. Accordingly, the *objective of the system of quality management* is to provide the firm with reasonable assurance regarding the achievement of the objectives. In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (i.e., in the case of an assurance engagement). Instead, reasonable assurance is obtained through the operation of the system as a whole. This approach is similar to other risk management and governance frameworks.

Public Interest

19. In the ITC, one of the actions proposed to address the culture of the firm and responsibility and accountability of leadership for quality was to emphasize in the introduction or application material the importance of relevant public interest considerations in relation to the design of the firm's system of quality control. Respondents to the ITC had mixed views about this proposal and indicated that there is no common interpretation or understanding of the term "public interest."

20. The International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (Including International Independence Standards)* (the Code) indicates that professional accountants have a responsibility to act in the public interest. The IAASB is of the view that although public interest considerations vary across engagement types, the consistent performance of quality engagements is integral to a firm's responsibility to act in the public interest.

As a result, paragraph 23(c) of ED-ISQM 1 describes the firm's role in serving the public interest, and paragraphs 7 and A2 of the standard explain the meaning of this term and its relationship to the Code.

21. Paragraph 7 of ED-ISQM 1 also explains the connection between the public interest and the objective of the standard. However, some Board members were of the view that the firm's role to act in the public interest should be explicitly referred to in the objective of the standard. Others were of the view that without explicit criteria, a reference to acting in the public interest in the objective would result in an objective that is not capable of being consistently measured, observed or attained. The IAASB is seeking the views of respondents on whether is it clear how achieving the objective of the standard relates to the firm's public interest role (see question 5).

Professional Judgment and Professional Skepticism

Professional Skepticism at the Engagement Level

22. One of the most significant public interest issues highlighted in the ITC is fostering an appropriately independent and challenging skeptical mindset of the auditor. The IAASB recognizes that many aspects of the firm's system of quality management support the exercise of professional skepticism at the engagement level. For example:

    (a) The firm's culture and the tone set by leadership should promote the importance of quality, and the need to exercise professional skepticism when performing audit, review or other assurance engagements.

    (b) Allocating appropriate resources to perform engagements may prevent impediments to professional skepticism, such as limited time, knowledge or experience.

    Given the pervasive effect of the system of quality management on supporting professional skepticism at the engagement level, ED-ISQM 1 does not specifically highlight which aspects of the system support professional skepticism. However, an emphasis on professional skepticism at the engagement level has been made in the introductory section and the engagement performance component (see paragraphs 7 and 36(b) of ED-ISQM 1). Furthermore, ED-220 addresses professional skepticism in the context of managing quality at the engagement level through explaining the impediments to the exercise of professional skepticism and actions that the engagement partner may take to deal with such impediments.

Professional Judgment and Professional Skepticism at the Firm Level

23. Unlike extant ISQC 1, ED-ISQM 1 explicitly requires the firm to exercise professional judgment in applying the requirements of the standard. Doing so is necessary so that a firm's system of quality management is appropriately tailored to the nature and circumstances of the firm and the engagements it performs. The need to exercise professional judgment is reinforced throughout the standard and a definition of professional judgment has been introduced (see, for example, paragraphs 7,8, 19(n) and 22 of ED-ISQM 1).

24. The IAASB considered whether the concept of professional skepticism is relevant to professional judgments made about the system and agreed that professional skepticism is a concept that is relevant to judgments made in performing engagements. Nevertheless, the IESBA's project addressing the role, mindset and behavioral characteristics expected of all professional accountants when performing their professional activities may be relevant to professional judgments made about the system of quality management, and the IAASB will continue to coordinate with IESBA in considering the impact of that project on ED-ISQM 1.

Section 3C – The Firm's Risk Assessment Process

25. As explained in Section 3A, ED-ISQM 1 includes a new approach that focuses firms' attention on risks that may have an impact on engagement quality. ED-ISQM 1 includes a component, the firm's risk assessment process, that comprises the process the firm is required to follow in implementing the risk-based approach to quality management. The firm's risk assessment process is applied to the other seven components of the system of quality management, i.e., the firm is required to use this process in establishing quality objectives, identifying and assessing quality risks and designing and implementing responses for the other seven components.

26. As explained previously in this explanatory memorandum, ED-ISQM 1 does not require that firms organize their systems according to the components. Accordingly, firms may perform the firm's risk assessment process in a variety of ways, for example, the process may be applied to the firm as a whole for all components together, the process may be applied individually to each component, or the process may be applied to individual business units or service lines (see paragraph A48 of ED-ISQM 1).

Establish Quality Objectives

27. The quality objectives established by the firm consist of 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 (see paragraph 19(p) of ED-ISQM 1). The relationship between the quality objectives, the objective of the system of quality management and the objective of the standard is as follows:

28. ED-ISQM 1 includes quality objectives that all firms are required to establish (see paragraphs 23, 32, 34, 36, 38, 40 and 42 of ED-ISQM 1). The quality objectives are outcome-based and how they are achieved is determined by the firm, thereby improving the scalability of the standard. The quality objectives required by the standard comprise important aspects of extant ISQC 1 that have been retained[3] as well as objectives that have been introduced to address key issues highlighted in the ITC or elements the IAASB considers necessary for a system of quality management.

[3] In developing the quality objectives, the IAASB identified that there was an inconsistent level of granularity across the requirements in extant ISQC 1. As a result, some of the requirements transposed from extant ISQC 1 are less specific in ED-ISQM 1 to ensure a consistent level of granularity across the quality objectives.

29. The IAASB is of the view that the quality objectives in ED-ISQM 1 are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved. However, the IAASB recognizes that the nature and circumstances of firms and the engagements they perform will vary, which may give rise to the need for the firm to establish additional quality objectives beyond those set out in the standard in order to achieve the objective of the standard. Accordingly, the firm is required to establish additional quality objectives beyond those required by the standard, when those objectives are necessary to achieve the objective of the standard (see paragraph 26 of ED-ISQM 1). This requirement will also aid in keeping the standard fit for purpose and adaptable to a changing environment. A description of the purpose of each component has been included in each lead-in to the requirement to establish quality objectives.[4]

30. The IAASB debated whether there should also be a requirement for firms to establish more granular quality objectives than those required by the standard in order to facilitate the identification and assessment of quality risks, i.e., a requirement for the firm to break down the quality objectives required by the standard into more specific quality objectives. The IAASB agreed that such a requirement would not be necessary, as some firms may identify high-level objectives that may be as effective in providing a basis for the identification and assessment of quality risks as firms that choose to establish more granular quality objectives. Accordingly, establishing more granular quality objectives is not required (see paragraph A49 of ED-ISQM 1).

Identify and Assess Quality Risks

31. A risk-based approach supports the firm in focusing its efforts and resources on areas where they are needed the most. ED-ISQM 1 recognizes that it is not reasonable or practicable for firms to identify and assess every possible risk, and to design and implement responses for every risk (see paragraph A54 of ED-ISQM 1). Accordingly, ED-ISQM 1 includes a process for identifying and assessing quality risks that is intended to filter risks and assess them, such that the nature, timing and extent of the responses designed and implemented by the firm are appropriately focused on what is important for the system of quality management.

[4] For example, paragraph 38 of ED-ISQM 1 describes the resources component as "appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management."

32. The IAASB is of the view that a consistent approach to identifying and assessing risks across the IAASB's standards helps to reinforce key concepts of a risk-based approach. Accordingly, the approach for identifying and assessing quality risks in ED-ISQM 1 echoes the principles in the IAASB's recently published Exposure Draft, ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* (ED-ISA 315 (Revised)).[5]

33. The process in ED-ISQM 1 consists of two steps:

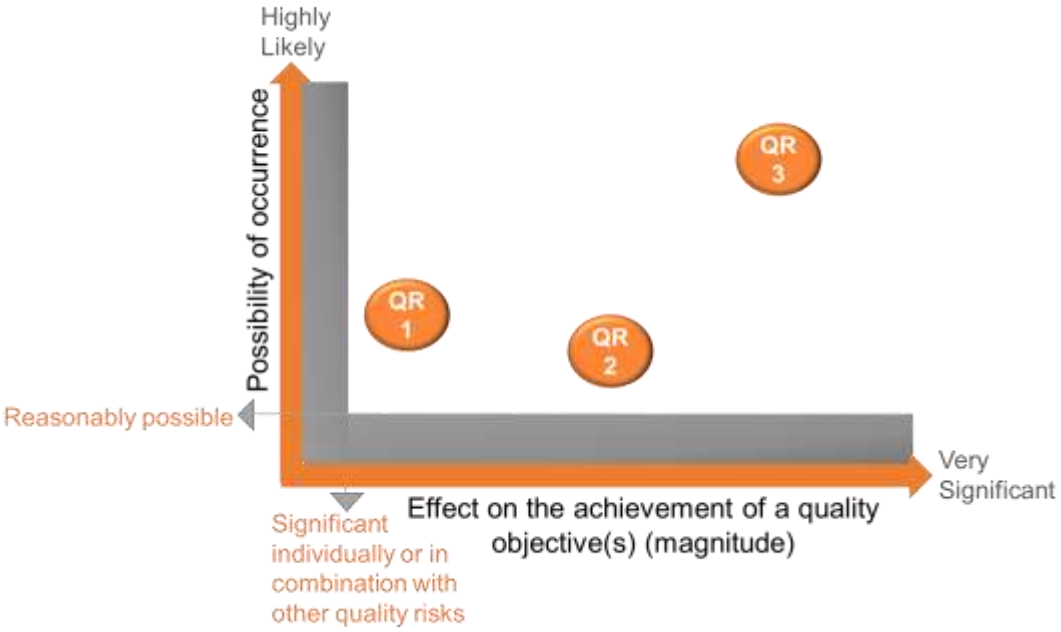
    (a) Identifying the quality risks based on a *preliminary consideration* of the possibility of the quality risks occurring and their effect on the achievement of the quality objectives (see paragraph 28 of ED-ISQM 1); and

    (b) Assessing the identified quality risks, which involves a *more detailed consideration* of the degree of the likelihood of the quality risks occurring and the significance of the effect of the identified quality risks on the achievement of the quality objectives (see paragraph 29 of ED-ISQM 1). The purpose of assessing the quality risks is to assist the firm in designing and implementing responses, because the reasons for the assessment of the quality risks affect the nature, timing and extent of the responses.

    The IAASB acknowledges that in some instances, the two steps may be undertaken concurrently by the firm. However, the firm is not expected to assess every quality risk; the firm is only expected to assess those risks that reach the threshold criteria (i.e., 1. There is a reasonable possibility of the risk occurring; and 2. If the risk were to occur, it may individually or in combination with other quality risks, have a significant effect on the achievement of a quality objective(s)).The process for identifying quality risks and the further assessment is depicted as follows:

[5] The IAASB plans to consider the feedback from respondents on ED-ISA 315 (Revised) as it relates to the concepts incorporated in ED-ISQM 1, including whether the threshold of "a reasonable possibility of occurring" is appropriate.

34. As explained above, the assessment of the identified quality risks involves a more detailed consideration of the possibility of occurrence and effect on the achievement of a quality objective(s), and may entail an analysis such as the following:



35. Unlike the quality objectives, ED-ISQM 1 does not identify quality risks that are applicable for all firms. The firm is expected to identify and assess its own quality risks for the quality objectives set forth in the standard and any additional quality objectives that the firm has established, taking into account the nature and circumstances of the firm and the engagements it performs. As a result, the quality risks identified and assessed by the firm are customized and tailored for the firm. The IAASB is of the view that specifying quality risks in the standard would result in less tailored quality risks and would likely drive a checklist-based approach to implementing the standard, contrary to the new quality management approach.

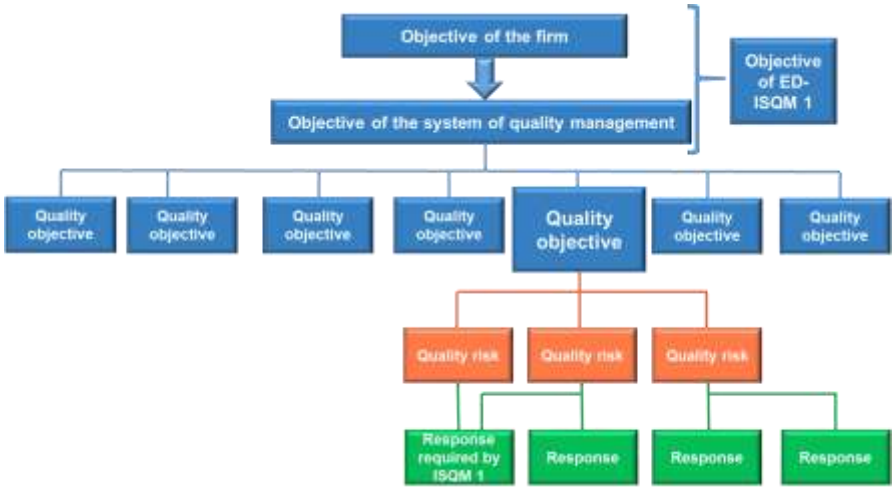
Design and Implement Responses

Definition of Responses

36. The definition of controls in ED-ISA 315 (Revised) refers to policies or procedures, consistent with the COSO Integrated Framework – 2013.[6] The IAASB is of the view that responses to quality risks are analagous to controls, and therefore the definition of responses in ED-ISQM 1 has been aligned to the definition of controls in ED-ISA 315 (Revised) (see paragraph 19(t) of ED-ISQM 1). This definition recognizes that policies or procedures may include aspects of governance, for example, tone at the top and other aspects of the firm's system which are established but are not formally documented policies or procedures. The IAASB used the term responses instead of controls or policies or procedures because it emphasizes the importance of responding to the quality risks and the proactive nature of the new quality management approach.

[6] The COSO Integrated Framework – 2013 describes control activities as the actions established by policies and procedures to help ensure management directives to mitigate risks to the achievement of objectives are carried out.

The Requirement to Design and Implement Responses



37. ED-ISQM 1 requires the firm to design and implement responses to address the quality risks, in order that the quality objectives are achieved (see paragraph 30 of ED-ISQM 1). As explained previously, the standard includes quality objectives that are comprehensive and, if properly addressed by a firm, will result in the system providing reasonable assurance that its objectives have been achieved. ED-ISQM 1 includes some responses that all firms are required to design and implement, however these responses are not comprehensive (see paragraphs 24, 25, 33, 35, 37, 41 and 43 of ED-ISQM 1). For example, the resources component does not include any required responses. As a result, the standard is explicit that the firm is required to design and implement responses to address the assessed quality risks, in addition to the responses required by the standard (see paragraphs 10(c) and A59 of ED-ISQM 1). In the view of the IAASB, this approach promotes a tailored and scalable approach to managing quality.

38. The responses in ED-ISQM 1 that all firms are required to design and implement include:

    (a) Important aspects of extant ISQC 1 that need to be retained in order to preserve the robustness of the extant standard;

    (b) New matters that have been introduced to address key issues, for example, issues highlighted in the ITC (e.g., undertaking periodic performance evaluations of firm leadership); or

    (c) Responses needed for consistency with, or linkage to, other professional standards, including relevant ethical requirements and ED-220.

    Although these responses are required by the standard, the firm would tailor them taking into account the assessed quality risks that the responses address, as well as the nature and circumstances of the firm and the engagements it performs. For example, paragraph 33(d) of ED-ISQM 1 requires the firm to obtain, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent. The firm may tailor this response by adapting its frequency (e.g., obtaining the confirmation twice a year), or by adding specificity as to how the firm's personnel will evidence the confirmation (e.g., a manual signature on a hard copy or a digital signature through an IT application).

39. The IAASB explored including more prescriptive reponses in the standard, however agreed that doing so would deter firms from identifying and assessing the quality risks in a proper manner and result in firms only implementing the responses required by the standard, contrary to the new quality management approach. Furthermore, the IAASB noted that it would not be possible to comprehensively address all of the responses needed by firms in the standard, given the varying nature and circumstances of firms and the engagements they perform.

Changes in the Nature and Circumstances of the Firm or its Engagements

40. A key aspect of the quality management approach is continuous improvement. ED-ISQM 1 sets forth two instances when the quality objectives, quality risks or responses may need to be revised to improve the system:

    (a) As a result of information arising from the firm's monitoring activities. The revisions to the monitoring and remediation component in ED-ISQM 1 have improved the focus on ongoing, or more real-time, monitoring. In responding to identified deficiencies, which may be identified through the firm's own monitoring activities, external inspections or other information sources, paragraph 49 of ED-ISQM 1 requires the firm to determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate and modify them, as appropriate.

    (b) As a result of changes in the nature and circumstances of the firm or its engagements. Paragraph 31 of ED-ISQM 1 requires the firm to take actions to identify these changes and modify the quality objectives, quality risks or responses, as appropriate, in response to such changes.

Section 3D – Governance and Leadership

41. The ITC noted that extant ISQC 1 does not specifically address firm governance, nor contain much detail as to what is expected from firm leadership in relation to firm governance, and therefore included various suggestions to address firm governance and enhance the role of firm leadership in sustaining and continually improving audit quality. Respondents to the ITC overall supported the various suggestions to strengthen firm governance and leadership, although emphasized that any actions would need to be flexible to accommodate different jurisdictions and firm structures.

42. The IAASB is of the view that a firm's governance and leadership is of paramount importance to engagement quality, as it is the way in which the firm embeds its culture and ethics and self-regulates, and serves as the framework for how the firm's decisions are made. Accordingly, the governance and leadership component has been placed first in ED-ISQM 1. A firm's governance also affects the public's perception of the firm; a firm without effective governance may be regarded as one that does not operate in the public interest.

43. In developing the various quality objectives and responses for this component, the IAASB considered numerous global resources addressing governance and leadership in general for all entities, and those more specific to the governance of audit firms. ED-ISQM 1 has been substantially enhanced to improve the robustness of firms' governance and leadership. In particular, it addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership and holding leadership accountable through performance evaluations. The standard also now addresses the effect of the firm's strategic actions, including financial and operational decisions,[7] on engagement quality and the firm's public interest role, as well as firm leadership's ability to influence decisions about the firm's resources.

44. In developing the requirements, the IAASB considered who in the firm should be ultimately responsible for the system of quality management, and whether that responsibility should be extended to quality more broadly. The IAASB resolved to retain the requirement of extant ISQC 1, which assigns this role to the firm's chief executive officer (or equivalent) or, if appropriate, the firm's

[7] The IAASB is of the view that commercial considerations are the same as financial and operational decisions, and preferred the latter term as it provides a more accurate description of what is meant.

managing board of partners (or equivalent) (see paragraph 24(a) of ED-ISQM 1). However, recognizing that SMPs may not have these types of roles in their leadership structures, outreach feedback suggested an additional option be added to acknowledge SMPs (i.e., the firm's managing partner). The IAASB further agreed that leadership cannot be responsible and accountable for quality broadly, but is responsible and accountable for the system of quality management that supports the consistent performance of quality engagements.The accountability of leadership is reinforced by the new requirement for the firm to undertake performance evaluations of those assigned leadership roles.

45. In developing ED-ISQM 1, the IAASB undertook various outreach activities across many stakeholder groups. The IAASB heard concerns that SMPs may experience practical challenges in implementing certain proposals related to governance and leadership. The IAASB is of the view that the requirements in this component are universally applicable to firms of all sizes, in particular since the quality objectives have been established as outcomes. The nature and extent of the actions taken in achieving those objectives may be more simple for an SMP. For example, paragraph A28 of ED-ISQM 1 explains that a smaller firm may be able to establish the desired culture of the firm through the direct interaction of firm leadership with other personnel, which is not always possible in the case of a larger firm. Furthermore, paragraph 21 of the standard recognizes that not all requirements are relevant in all circumstances, and paragraph A20 of ED-ISQM 1 provides examples of when the requirements might not be relevant, which includes aspects of governance and leadership in certain circumstances.

Operational Responsibility for Compliance with Independence Requirements

46. In the ITC the IAASB had included a proposal to specifically require a firm to identify appropriate personnel within the firm's leadership to be responsible and accountable for independence matters. This proposal was included in response to calls from certain regulatory stakeholders to the IESBA to more clearly and robustly address the issue of responsibility for independence within a firm. Although respondents to the ITC expressed mixed views about this proposal, the IAASB is of the view that independence is critical to the performance of engagements for which independence is required. Accordingly, requiring firms to assign responsibility for independence emphasizes that independence is an important consideration in a firm's system of quality management (see paragraph 24(a)(iii) of ED-ISQM 1). This new requirement operates in conjunction with many other enhanced requirements of the standard, for example, the firm may need resources to support its activities to determine compliance with independence requirements.

47. In developing ED-ISQM 1, the IAASB coordinated with the IESBA on many matters of mutual interest, including responsibility for independence. Through this engagement, the IESBA suggested that the requirement in ED-ISQM 1 should more broadly capture responsibility for relevant ethical requirements. In general, the IAASB is of the view that doing so would reduce the focus on the importance of independence. However, the IAASB is interested in respondents' views as to whether there should be an individual assigned responsiblitiy for relevant ethical requirements, and if so, whether this should be in addition to assigning responsibility for compliance with independence requirements (see question 8(a)). The IAASB recognizes that an individual within the firm could fulfill both roles, particularly in the case of an SMP.

Responsibility for Understanding ED-ISQM 1

48. In order to improve leadership's responsibility for the system of quality management, paragraph 20 of ED-ISQM 1 is more explicit about who is responsible for understanding ED-ISQM 1. However, through its outreach in developing the standard, the IAASB heard that while these individuals may have ultimate responsibility for the system, responsibilities for aspects of the system are delegated to other individuals within the firm who support leadership (this is particularly the case in large firms). As a result, the IAASB heard concerns that requiring those with ultimate or operational responsibility for the system to have an in-depth understanding of the standard would be impractical. Accordingly, paragraph 20 of ED-ISQM 1 has been adjusted from extant ISQC 1 and requires these individuals to have an understanding of ED-ISQM 1 that is relevant to their responsibilities.

Section 3E – Resources

Technological Resources

49. The IAASB recognizes that firms are increasingly using technology in performing engagements, which may be developed by the firm or obtained from the firm's network or an external service provider. Firms are also increasing their use of technology in facilitating the operation of their systems of quality management, for example, technology may be used to continually monitor the permissibility of financial investments recorded by personnel as part of the firm's independence responses.

50. As part of the modernization of the standard, the IAASB has introduced a new requirement addressing the use of technological resources, both in the performance of engagements and the operation of the system of quality management (see paragraph 38(e) of ED-ISQM 1). The requirement is principles-based because the IAASB is mindful that the types of technologies, and the extent to which they are being used, are continually evolving. It is noted that the application material includes IT-related concepts that have been explained in a consistent manner to ED-ISA 315 (Revised).[8]

Intellectual Resources

51. The IAASB noted that intellectual resources are essential to enabling the performance of quality engagements, and are not currently addressed in extant ISQC 1. For example, in performing an audit of financial statements, engagement teams ordinarily depend on the firm's methodology to perform their work, which is based on professional standards and addresses applicable law or regulation. Accordingly, a new principles-based requirement has been introduced in ED-ISQM 1 addressing intellectual resources that has been designed to be adaptable to the variety of intellectual resources that may be utilized within the firm (see paragraph 38(f) of ED-ISQM 1).

Section 3F – Information and Communication

52. Extant ISQC 1 does not address the broader need for information and communication across the system and the communication of information with engagement teams, which is essential for the effective operation of the system of quality management and the performance of engagements. It

[8] ED-ISA 315 (Revised) includes new material to address how automated tools and techniques are being used in performing audits. ED-ISA 315 (Revised) also includes significant clarifications and enhancements to address the auditor's understanding of an entity's IT environment, and provides greater clarity on IT-related concepts. The IAASB is mindful that the explanations and descriptions in ED-ISA 315 (Revised) need to be principles-based, given that rapid changes in IT and the terms in which it is described could outdate the standard within a short period of time.

also does not acknowledge the two-way nature of communication. As a result, ED-ISQM 1 includes a new component, information and communication, that includes requirements for the firm to establish an information system[9] and emphasizes the need for effective two-way communication within the firm, as well as the responsibility of all personnel for communication (see paragraphs 40 and 41 of ED-ISQM 1). The new component also supports the firm in addressing the need for robust communication and interactions during the performance of engagements, a key public interest issue highlighted in the ITC.

53. The IAASB considered whether the requirements in the information and communication component should further specify with whom communication should take place and the type of information that should be obtained, generated and communicated. The IAASB is of the view that specifying the information and communication needs for each component would result in lengthy requirements and could inadvertently omit information or communication needs. Furthermore, such an approach would be prescriptive and contrary to the principles-based nature of the standard. Accordingly, the requirements do not include this specificity and in designing the system of quality management, the firm would need to understand the integration of the components and the information that needs to be obtained, generated or communicated to support the firm in achieving the requirements of each of the components.

Communication with External Parties

54. The ITC recognized that some firms are increasingly issuing publicly available reports that provide transparency regarding certain elements of the firm and its operations, commonly referred to as transparency reports. Accordingly, the ITC explored various actions for the IAASB to take. Respondents to the ITC were generally supportive of further actions but cautioned that any actions should not stifle developments or innovation related to transparency reporting at a jurisdictional level. However, certain respondents, mostly investors, called for the IAASB to more specifically address transparency reports in the IAASB's standards.

55. Transparency reports are required in many jurisdictions, largely for firms that perform audits of public interest entities or certain listed entities, and are commonly prepared by firms in certain other jurisdictions on a voluntary basis. However, the IAASB observed that there are still many jurisdictions where transparency reporting is not required or common practice, largely because there is a lack of demand from stakeholders in those regions for such information. Furthermore, firms that tend to prepare transparency reports perform audit engagements of public interest entities or listed entities; there is low demand for transparency reporting for smaller firms that do not perform these types of engagements.

56. The IAASB recognizes that firms communicate with external parties in a variety of ways and the communication is continually evolving. For example, firms may provide information on their website or through a publication other than a transparency report or may have a mechanism to engage directly with external parties. The IAASB is of the view that specifically requiring firms to prepare transparency reports may discourage the exchange of valuable and insightful information with external parties through alternative means that may be more appropriate or effective than a transparency report given the circumstances of the firm. The IAASB further noted that other means of communication with external parties are just as relevant and important as transparency reports.

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[9] Paragraphs A137 and A138 of ED-ISQM 1 explain that the information system may include the use of manual or IT elements and in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

57. Accordingly, the requirements in ED-ISQM 1 for communication with external parties address all forms of communication with external parties and have been developed in a manner that is adaptable to the circumstances of the firm (see paragraph 41(c) of ED-ISQM 1). The requirements aim to promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders without stifling innovation or other developments at the jurisdictional level. Although the requirements explicitly recognize transparency reports so that firms are encouraged to consider whether a transparency report is appropriate, the preparation of a transparency report is not required. However, if jurisdictional law, regulation or professional standards require the firm to prepare a transparency report, this is addressed by the requirement in paragraph 41(c)(i) of ED-ISQM 1.

Section 3G – Engagement Quality Reviews

58. An engagement quality review is a firm-level response to an assessed quality risk(s) that is implemented by the engagement quality reviewer on behalf of the firm. As explained in the explanatory memorandum for ED-ISQM 2, the IAASB agreed that since the engagement quality review is a response to an assessed quality risk(s), ED-ISQM 1 should address the engagements for which an engagement quality review is to be performed. The specific criteria for an individual to be eligible to perform the engagement quality review and requirements for the performance and documentation of the review are located in ED-ISQM 2.

59. The ITC proposed several enhancements to address engagement quality reviews, given the need to keep the standard fit for purpose and enhance support for exercising professional skepticism at the engagement level. Among the proposals, the IAASB explored whether the requirements for engagements that should be subject to an engagement quality review should be strengthened by requiring an engagement quality review for audits of entities other than listed entities. The ITC considered whether it would be appropriate to require an engagement quality review to be performed for audits of public interest entities (PIE), as this term is used in the Code. However, the IAASB recognized in the ITC the difficulty of defining the term on a global basis, given the various definitions and interpretations across different jurisdictions.

60. Respondents to the ITC supported strengthening the requirement; however, there was not extensive support for requiring the performance of an engagement quality review for audits of PIEs. Respondents who did not support this proposal noted that the lack of a universal definition of PIEs could lead to inconsistent application in practice. Further, they noted that in many jurisdictions PIEs could include very small or non-complex entities (such as small charities) and performing an engagement quality review for audits of such entities would be overly burdensome.

61. However, the IAASB recognizes the need to enhance the scope of engagements subject to an engagement quality review because there are audits of certain entities for which engagement quality reviews would be appropriate. These entities may include, for example, some entities operating in the public sector and financial institutions such as certain banks, insurance companies and pension funds. Accordingly, paragraph 37(e)(ii) of ED-ISQM 1 includes a new requirement for the firm's policies or procedures to require an engagement quality review for audits of financial statements of entities that the firm determines are of significant public interest. ED-ISQM 1 also provides application material that describes the characteristics of such entities to support firms in fulfilling this requirement. "Entities that are of significant public interest" is a term that is used elsewhere in the IAASB's

standards, such as ISA 700 (Revised)[10] and ISA 260 (Revised),[11] to describe those entities that may have characteristics that give rise to similar public interest issues as listed entities.

62. The IAASB is of the view that in addition to audits of listed entities or entities that the firm determines are of significant public interest, an engagement quality review may be an appropriate response to an assessed quality risk(s) for other engagements. Accordingly, paragraph 37(e)(iii)(b) of ED-ISQM 1 requires the firm to establish policies or procedures to require an engagement quality review for engagements for which the firm determines that an engagement quality review is an appropriate response, based on the reasons for the assessments given to the assessed quality risk(s). However, the IAASB recognizes that an engagement quality review is not always an appropriate response to an assessed quality risk(s) and paragraph A95 of ED-ISQM 1 explains that other types of responses may be more appropriate or effective to address the assessed quality risk(s).

Section 3H – Monitoring and Remediation

63. The ITC highlighted the need for greater focus on internal and external monitoring and remediation activities as one of the key public interest issues, and an area where the extant standard is in need of modernization. The improvements proposed in the ITC for monitoring and remediation were in general supported by respondents. As a result, ED-ISQM 1 has various new and improved requirements for monitoring and remediation, in particular:

    (a) The requirements promote more proactive and effective monitoring activities and have increased the emphasis on tailoring the monitoring activities to provide a sufficient basis for the firm to evaluate the system. The IAASB is of the view that this approach may further encourage firms to develop innovative monitoring techniques to further enhance quality management.

    (b) The requirements focus on monitoring all aspects of the system. Extant ISQC 1 is largely focused on inspections of completed engagements, which only address monitoring responses that are implemented at the engagement level.

    (c) The requirements acknowledge that there may be a variety of information sources that provide the firm with information about the operation of the system of quality management, including external inspection findings.

    (d) The requirements have been clarified to differentiate between findings and deficiencies, so that it is clear that not all findings are deficiencies for which further action is needed.

    (e) The firm is now required to investigate the root causes of deficiencies so that appropriate action can be taken to remediate the deficiencies effectively.

    (f) The responsibilities of firm leadership have been enhanced, and include a requirement to determine the effectiveness of remedial actions, and an evaluation, at least annually, of whether there is reasonable assurance that the objective of the system has been achieved.

64. While the monitoring and remediation process has been set up in ED-ISQM 1 in a logical order, the IAASB is of the view that the monitoring and remediation process is iterative, as opposed to being purely linear. For example, the firm may adjust the nature, timing or extent of the monitoring activities based on the severity and pervasiveness of the deficiencies identified.

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[10] International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

[11] International Standard on Auditing (ISA) 260 (Revised), *Communication with Those Charged with Governance*

Monitoring Activities, Including Inspection of Engagements

65. The IAASB recognizes that the nature, timing and extent of the firm's monitoring activities should vary from firm to firm. Accordingly, the new requirements have been designed to emphasize factors that the firm would consider in designing its monitoring activities, rather than prescribing all of the monitoring activities that need to be performed (see paragraph 44 of ED-ISQM 1).

66. The IAASB debated the retention of the requirement in extant ISQC 1 for the firm to inspect at least one completed engagement for each engagement partner on a cyclical basis. The IAASB noted the need to retain the robustness of the extant standard in this regard but at the same time address concerns that the extant requirement is inflexible and consumes resources that could be used to perform more effective monitoring activities. The IAASB resolved to retain the requirement (see paragraph 45 of ED-ISQM 1), but has taken the following steps to improve its scalability and place emphasis on other types of monitoring activities that may be more effective:

    (a) The requirement explicitly recognizes inspections of in-progress engagements (these may also be referred to as in-process reviews). It is noted that in some cases, in-process reviews may be a monitoring activity, but in other cases they may be a response to a quality risk in another component (e.g., a quality risk related to judgments made in the performance of engagements). Whether an in-process review is a monitoring activity depends on how the firm has designed the review, including how the results of the review are considered and addressed by the firm.

    (b) The requirement emphasizes that in determining the nature, timing and extent of the inspection of engagements, the firm takes into account various factors set out in the standard, such as changes in the system.

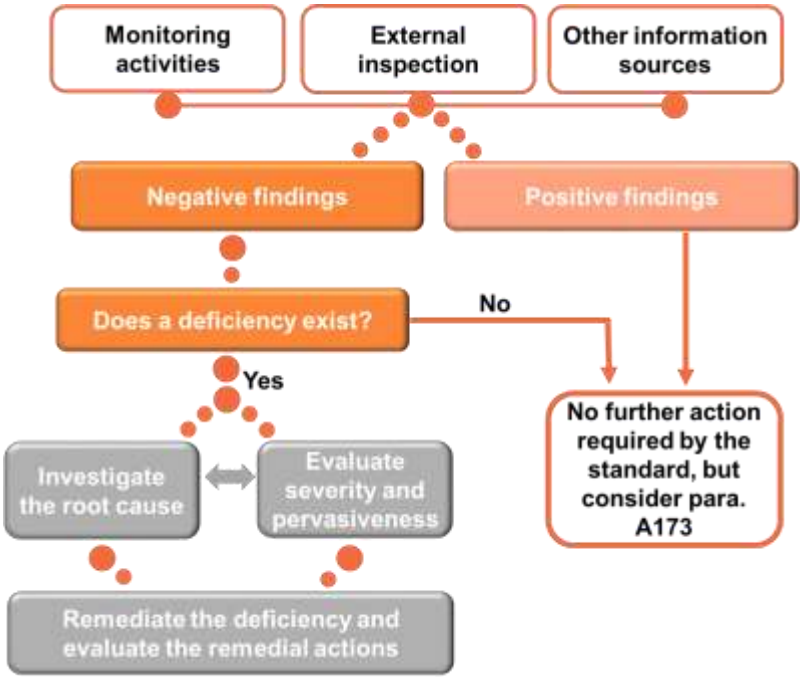
    (c) Although the firm is still required to inspect one completed engagement per engagement partner on a cyclical basis, more emphasis has been given to the fact that the firm determines the length of the cycle. The application material provides examples of factors that the firm may consider in determining the length of the cycle, which includes the extent to which the firm performs other monitoring activities (e.g., inspections of in-process engagements) and the nature and circumstances of the engagements. The application material also acknowledges that the cycle may vary across engagement partners, for example, the cycle may be more frequent for engagement partners who perform audits of financial statements of listed entities.

Monitoring the Monitoring and Remediation Process

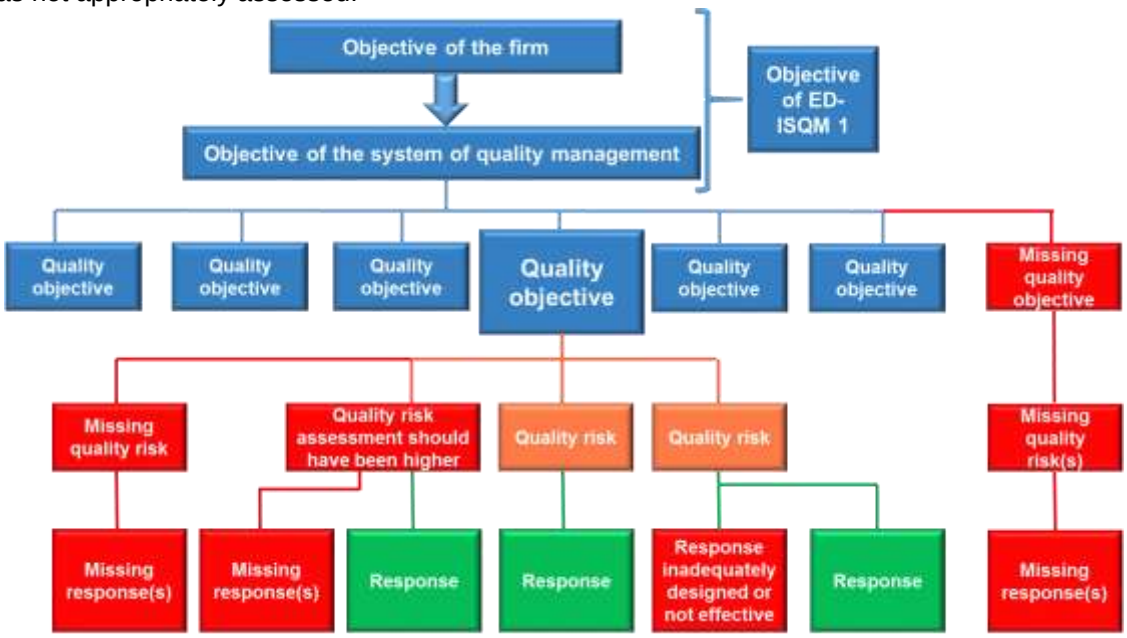
67. The monitoring and remediation process needs to be designed appropriately and operating effectively because without an effective monitoring and remediation process, the firm would not be able to determine whether deficiencies exist and remediate them. The IAASB is of the view that monitoring of the monitoring and remediation component may be accomplished in a variety of ways including through understanding external information (e.g., the results of external inspections may highlight deficiencies not detected by the firm's monitoring activities) or in undertaking the root cause analysis (e.g., the investigation of a deficiency may reveal further deficiencies not detected by the firm's monitoring activities) (see paragraph A177 of ED-ISQM 1). Paragraph 47 of ED-ISQM 1 requires the firm to identify deficiencies through evaluating the findings arising from monitoring activities, results of external inspections, and other information. The identification of deficiencies may include deficiencies in the monitoring and remediation process.

Evaluating Findings and Identifying Deficiencies

68. Findings may be positive or negative in nature, and the severity and pervasiveness of negative findings will vary. The IAASB is of the view that findings that do not rise to the level of a deficiency do not need to be subject to additional actions, such as investigating the root cause of the finding or remediating the finding. As a result, the IAASB identified the need for a clear definition of a deficiency in ED-ISQM 1[12] (see paragraph 19(a) of ED-ISQM 1) and a supporting framework that sets out the process for evaluating negative findings and identifying deficiencies (see paragraphs 47–48 of ED-ISQM 1). The illustration sets out the framework in ED-ISQM 1, and the application material in ED-ISQM 1 provides further guidance to support the firm in working through the framework.



69. The definition of deficiencies was developed taking into consideration how other standards and frameworks, such as ISA 265[13] and the COSO Integrated Framework – 2013, describe deficiencies. The diagram below depicts examples of deficiencies that may arise in the firm's system of quality management in red. This includes circumstances when a response that is necessary to address a quality risk has not been appropriately designed or implemented because the quality objective or quality risk was missing, or the quality risk was not appropriately assessed.



[12] Extant ISQC 1 requires the firm to take certain actions for deficiencies noted in the system of quality control. The term deficiencies is not defined in extant ISQC 1.

[13] ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

Root Cause Analysis

70. Recognizing the increased demand from regulators and audit oversight bodies for firms to take action to understand the causal factors of inspection findings as a means of improving audit quality, the ITC proposed introducing a new requirement for firms to obtain an understanding of the causal factors of audit deficiencies identified by inspections and other reviews. Respondents in general supported this proposal, and therefore ED-ISQM 1 includes a new requirement for firms to investigate the root cause of deficiencies (see paragraph 48(a) of ED-ISQM 1).

71. In developing the new requirement, the IAASB debated the threshold of matters on which the root cause should be performed, including whether the root cause analysis would be undertaken before determining whether a finding is a deficiency. The IAASB is of the view that determining the root cause of every finding would be onerous and consume important resources that should focus on more significant issues in the system of quality management. Therefore, the IAASB concluded that firms should be expected to determine the root cause only of identified deficiencies. However, the IAASB recognizes that in some cases the process may be iterative, i.e., in order to determine whether a finding is a deficiency, the firm may need to have some understanding of the root cause of the finding.

72. ED-ISQM 1 acknowledges that the nature and extent of the firm's process to determine the root cause of a deficiency would vary depending on the nature and possible severity of the deficiency. For example, the causes of some deficiencies may be more obvious and immediately identifiable, whereas other deficiencies may need a more rigorous process to understand the underlying causes. In ED-ISQM 1, the requirement to determine the severity and pervasiveness of the deficiency follows the requirement to investigate the root cause of the deficiency, however investigating the root cause of the deficiency and determining the severity and pervasiveness of the deficiency is likely to be iterative.

73. The IAASB concurred with views expressed by some respondents to the ITC that determining the root cause of positive findings is valuable because it may reveal opportunities for the firm to improve the system of quality management and may assist the firm in determining the root causes of deficiencies and how to remediate such deficiencies. Despite these benefits, the IAASB in general is of the view that ED-ISQM 1 should not require firms to determine the root cause of positive findings because the priority is for firms to remediate deficiencies, such that the objective of the standard is achieved. Furthermore, the nature of the positive findings that may enhance the system of quality management would vary and it would therefore be difficult to establish criteria in the standard for determining positive findings that should be subject to root cause analysis. The application material of ED-ISQM 1 discusses the benefits of investigating the root cause of positive findings to encourage firms to include this as part of their policies or procedures addressing the evaluation of the findings (see paragraph A178 of ED-ISQM 1). Nevertheless, the IAASB is interested in the views of respondents regarding how firms currently deal with positive findings and whether this should be more explicitly addressed in the requirements of the standard, or otherwise be more prominently highlighted (see question 12(d)(ii)).

Leadership Evaluation of the System of Quality Management

74. As explained previously, various enhancements have been made to ED-ISQM 1 to enhance the role of firm leadership as it relates to the system of quality management. Paragraph 55 of ED-ISQM 1 is a new requirement for the individual(s) assigned ultimate responsibility and accountability for the system of quality management to evaluate whether the system of quality management provides the

firm with reasonable assurance that the objectives of the system have been achieved. In circumstances when it is determined that the system does not provide reasonable assurance that the objectives have been achieved, leadership is placed with the responsibility for taking appropriate action. The IAASB is of the view that the new requirements reinforce the responsibility and accountability of leadership for the system of quality management. Furthermore, the requirement implicitly creates the need for the firm to collate all of the information about the system of quality management, and for leadership to evaluate this information in forming an overall view about the system.

75. The IAASB envisages that the evaluation would involve a determination of whether the system provides reasonable assurance that the objectives are achieved at the point in time the evaluation is undertaken. The IAASB debated how often the evaluation should be undertaken and agreed that undertaking the evaluation of the system at least annually would be appropriate (see paragraph 56 of ED-ISQM 1), given the requirement in extant ISQC 1 to communicate the results of the monitoring at least annually. However, the IAASB noted that in some instances the evaluation may need to be undertaken more frequently, particularly in circumstances when there is an indication that the system is not effective.

Section 3I – Networks and Service Providers

Networks

76. The IAASB is of the view that in circumstances when networks share common elements related to the system of quality management (e.g., a common methodology or policies or procedures), such common elements can be instrumental in enhancing engagement quality across the firms that belong to the network. For example, in circumstances when a firm is subject to common policies or procedures established by the network, the network may hold the firm accountable for complying with such policies or procedures. A network may also fulfill functions that the firm would otherwise have to perform, for example, the development of a methodology in accordance with international standards.

77. However, as highlighted in the ITC, concerns have been raised that firms place undue reliance on network requirements or network services (e.g., methodologies, policies or procedures, IT applications or monitoring). Accordingly, new requirements have been introduced in ED-ISQM 1 addressing network requirements or network services (see paragraphs 58–63 of ED-ISQM 1). The aim of the new requirements is to improve the robustness of the firm's responsibilities for the network requirements or network services, so that the firm understands the network requirements or

What is a network?

Some firms operate internationally through a consortium of network firms, referred to as "a network." Each firm that forms part of the consortium is referred to as "a network firm."

The extent to which the network firms share common elements varies. For example, some networks may only share a brand name, while other networks may share common methodologies or policies or procedures. In some circumstances, the network firms may be monitored by the network for compliance with the methodology or policies or procedures. The network functions (i.e., developing and maintaining the methodology or performing monitoring) may be undertaken by a standalone body established by the network to perform the various network functions.

The structure of the network may also vary. For example, within a network there may be a consortium of network firms that form a cluster within a region. Such clusters may share common policies or procedures specific to that region or there may be services used across the cluster (e.g., training).

network services and the effect they have on the firm's system of quality management. Given the varying structure of networks and the nature of the network requirements or network services, the new requirements are principles-based so that they can be adapted to a variety of circumstances. The IAASB is of the view that the new requirements emphasize that the firm is responsible for its own system of quality management, thereby addressing the issue that firms may place undue reliance on network requirements or network services.

78. The IAASB is of the view that although the new requirements are focused on the firm, they are likely to have an effect on the network. The requirements are structured such that the network would likely need to provide information to all network firms so that the firms are able to fulfill their responsibilities under ED-ISQM 1. This is expected to improve the communication and transparency between the network and network firms, and it may encourage improvements in communication across the network.

The network firms are responsible for the engagements they perform and the reports that are issued on behalf of the network firm, i.e., the network does not perform engagements or issue engagement reports. A firm's responsibility is established in the IAASB's Standards,[14] and may be further reinforced by a jurisdictional professional, legal or regulatory body that specifies who has the appropriate authority to perform an engagement and issue the related report.

The network itself is not responsible for the engagements undertaken by network firms or the reports issued by network firms. Furthermore, as the network is a consortium of network firms, it is not usually regulated or subject to inspection at the network level. The individual firms within the network will most likely be regulated and inspected by the regulators and audit oversight bodies within their jurisdications or who have oversight of the engagements performed by the firm.

79. In developing ED-ISQM 1, the IAASB considered establishing requirements for the network instead of, or in addition to, the new requirements for the firm. The IAASB notes that the firm is responsible for the engagements it performs and the reports that are issued on behalf of the firm, and regulatory oversight occurs at the level of the firm. The network does not perform engagements and is generally not subject to regulatory inspections or overseen by oversight authorities.[15] Therefore, the IAASB is of the view that the firm needs to remain solely responsible for the system of quality management, i.e., requirements for networks may have the unintended effect of diluting the firm's responsibility for the system of quality management.

80. The IAASB recognizes that some stakeholders do not have an accurate understanding of the responsibilities of the network and network firms, including the relationship between networks and the network firms, and this has given rise to expectation gaps. As a result, ED-ISQM 1 includes application material to encourage firms to provide transparency about their relationships with the

[14] The ISAs apply to "the auditor" or "engagement partner." ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, defines the auditor as "the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm." ISQC 1 defines the engagmenet partner as "the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body." ISQC 1 also defines the firm as "a sole practitioner, partnership or corporation or other entity of professional accountants."

[15] Regulators are a critical element in the financial reporting supply chain and the requirements of professional standards are most effective if they are properly enforced through the legal status of standards, inspection of engagements, the investigation of allegations of failure, and when appropriate, disciplinary action being taken.

network and the responsibilities of the firm and the network in order to enhance stakeholders' understanding of these relationships and responsibilities (see paragraph A152 of ED-ISQM 1).

Network Firm Independence

81. In the IAASB's coordination with the IESBA, the IESBA questioned whether there should be more direct requirements in ED-ISQM 1 regarding compliance with independence requirements within the network. The IAASB is of the view that network firm independence is appropriately addressed in ED-ISQM 1 through the principles-based requirements addressing relevant ethical requirements.[16] Therefore, including more direct requirements for independence within the network would result in duplicative requirements, and the specificity of the requirement would be in contrast to other requirements in the standard. However, the IAASB is interested in respondents' views as to whether there should be more specific requirements addressing independence within the network (see question 8(b)).

Service Providers

82. Firms may use service providers in the system of quality management, for example, engagement software may be obtained from a service provider or the firm may use a service provider to perform engagement quality reviews. The IAASB is of the view that a service provider provides a resource, and therefore the firm needs to determine that it is appropriate to use that resource in the system of quality management. Accordingly, ED-ISQM 1 includes new requirements addressing the use of service providers in the firm's system of quality management (see paragraphs 64–65 of ED-ISQM 1). The IAASB is of the view that although the new requirements are a responsibility of the firm, they are likely to have an effect on service providers, given the need for service providers to provide information to firms to enable the fulfillment of the new requirements.

83. The IAASB noted that in some cases, a service provider may be obtained through the firm's network, for example, the network may mandate that engagement software has to be acquired from a specific service provider. In such cases, the requirements for service providers would apply to the use of those resources.

Section 3J – Other

84. Many other enhancements have been made to ED-ISQM 1 that although not explicitly highlighted in this EM, are also intended to enhance the robustness of the standard. For example, the documentation requirements of the standard have been enhanced from extant ISQC 1, with the introduction of an overarching principles-based requirement (which has similarities to the documentation principles established in ISA 230[17]) and more specific requirements for matters that firms are expected to document.

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[16] For example, paragraph 33(a) of ED-ISQM 1 requires the firm to identify the relevant ethical requirements and determine the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, personnel in the network or other network firms, or service providers (this is further supported by application material that provides examples specific to networks). The firm is further required by paragraphs 33(b) and 33(c) to establish policies or procedures to address threats to compliance with relevant ethical requirements and breaches of the relevant ethical requirements, which would need to address other firms or persons within the network when there are relevant ethical requirements applicable to them.

[17] ISA 230, *Audit Documentation*

Section 3J – Scalability

85. The scalability of ED-ISQM 1 has been at the forefront of the IAASB's deliberations throughout the project. The ITC highlighted the need for a new approach to managing quality that is scalable to deal with differences in the size and nature of firms or the services they provide. As discussed previously, the new quality management approach drives firms to think about the nature and circumstances of the firm and the engagements it performs in designing, implementing and operating its system of quality management, and the approach is focused on achieving the quality objectives that are outcomes-based. While this approach is expected to generate multiple benefits for engagement quality, one of the most important benefits is a tailored system of quality management that is suitable for the nature and circumstances of the firm and the engagements it performs.

86. The IAASB recognizes that the quality management approach in ED-ISQM 1 is more complex than the approach in extant ISQC 1, and has added to the overall length of the standard. However, the IAASB is of the view that the approach in extant ISQC 1 is no longer fit for purpose and adaptable to the changing environment, given that it is more prescriptive in nature, and does not promote a scalable and tailored system of quality management that focuses on areas of risk. The IAASB acknowledges that firms will need to invest time and resources to implement the revised standard initially, however it is of the view that over time a more tailored and focused system of quality management will result in more effective use of firm resources and improvements in engagement quality.

87. Adding to the length of the standard are various new requirements that have been introduced to enhance the rigor of the standard, in particular to address key issues highlighted in the ITC (e.g., governance and leadership, monitoring and remediation and network requirements or network services) and essential elements needed for a system of quality management (e.g., information and communication). The IAASB acknowledges that the new requirements increase the responsibilities of firms, however they address important issues that are necessary for improvements in engagement quality.

88. While the new quality management approach is the fundamental change introduced in the standard to address scalability, the IAASB has addressed or emphasized the scalability of ED-ISQM 1 in other ways, including:

    (a) An explicit discussion about the scalability of the standard in paragraphs 5 and 6 of ED-ISQM 1.

    (b) A requirement to exercise professional judgment in paragraph 22 of ED-ISQM 1 and increased emphasis on professional judgment throughout the standard.

    (c) Numerous references throughout the standard to consider the nature and circumstances of the firm and the engagements it performs.

    (d) An explicit requirement in paragraph 21 of ED-ISQM 1 that indicates that there may be circumstances when a requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements.

    (e) Application material that provides examples for SMPs, for example, paragraphs A28 and A42 of ED-ISQM 1.

89. The IAASB debated whether to retain the sections in extant ISQC 1, "considerations specific to smaller firms." However, the IAASB is of the view that given the integrated nature of the standard, an understanding of the entire standard is needed to facilitate the implementation of a system of quality

management that is tailored to the circumstances of the firm. As highlighted above, where considered useful and appropriate, the IAASB has included examples specific for SMPs.

Application Material in ED-ISQM 1

90. Throughout the development of ED-ISQM 1, the IAASB has heard mixed views through its outreach about examples and explanations in the standard. While examples and explanations provide useful information to support implementation of the standard, they add extensive content that has resulted in an increase in the length of the standard. The IAASB is interested in respondents' views as to the usefulness of the application material in ED-ISQM 1, in particular areas where the examples or explanations are not useful, and areas where additional examples or explanations would be helpful.

Section 4 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-ISQM 1. In this regard, comments will be most helpful if they are identified with specific aspects of ED-ISQM 1 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

Overall Questions

1) Does ED-ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard? In particular:

   (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?

   (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?

   (c) Are the requirements and application material of proposed ED-ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstance? If not, what further actions should the IAASB take to improve the scalability of the standard?

2) Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?

3) Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

Specific Questions

4) Do you support the structure of the system of quality management and its eight components?

5) Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?

6) Will the application of the firm's risk assessment process result in appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved? In particular:

   (a) Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?

   (b) Do you support the approach for establishing quality objectives? In particular:

      i. Are the required quality objectives appropriate and, when achieved by the firm, will they collectively provide the firm with reasonable assurance that the objectives of the system are achieved?

      ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?

   (c) Do you support the process for the identification and assessment of quality risks?

   (d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks? In particular:

      i. Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?

      ii. Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?

7) Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

8) With respect to matters regarding relevant ethical requirements:

   (a) Should ED-ISQM 1 require firms to assign responsiblitiy for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?

   (b) Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network?

9) Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management and will the standard continue to be fit for purpose, recognizing that technology is continually evolving?

10) Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders? In particular, will the proposals encourage firms to prepare transparency reports when it is appropriate to do so?

11) Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?

12) In your view, will the proposals for monitoring and remediation improve the robustness of firms' monitoring and remediation? In particular:

   (a) Will the proposals improve firms' monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?

(b) Do you agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?

(c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?

(d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:

i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?

ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?

(e) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?

13) Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?

14) Do you support the proposals addressing service providers?

15) With respect to national standard setters and regulators, will the change in title to "ISQM" create significant difficulties in adopting the standard at a jurisdictional level?

PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 1 (PREVIOUSLY INTERNATIONAL STANDARD ON QUALITY CONTROL 1) – QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS

(Effective as of TBD)

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Appendix 1: The Components of a System of Quality Management

International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

Scope of this ISQM

1. This International Standard on Quality Management (ISQM) deals with a firm's responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements. ISQM 2[18] deals with the responsibility of the firm and engagement quality reviewers relating to engagement quality reviews. This ISQM is to be read in conjunction with relevant ethical requirements.

2. Other pronouncements of the International Auditing and Assurance Standards Board (IAASB) include requirements for engagement partners and other personnel regarding quality management at the engagement level. ISA 220 (Revised),[19] for example, deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. (Ref: Para. A1)

3. Law, regulation or relevant ethical requirements may establish responsibilities for the firm's management of quality beyond those described in this ISQM.

4. This ISQM applies to all firms performing audits or reviews of financial statements, or other assurance or related services engagements (i.e., if the firm performs any of these engagements, this ISQM applies).

Scalability

5. This ISQM requires the firm to apply a risk-based approach in the design, implementation and operation of the system of quality management, taking into account:

   (a) The nature and circumstances of the firm, including whether it is part of a network or uses service providers; and (Ref: Para. A22)

   (b) The nature and circumstances of the engagements performed by the firm, including the types of engagements performed by the firm and the types of entities for which such engagements are performed. (Ref: Para. A23)

   Accordingly, the complexity and formality of firms' systems of quality management will vary. For example, a firm that performs different types of engagements for a wide variety of entities, including audits of financial statements of listed entities or entities that are of significant public interest, will likely need to have a more complex and more formal system of quality management than a firm that performs only reviews of financial statements or compilation engagements.

6. The nature and circumstances of the firm and its engagements may change over time. This ISQM requires the firm to identify such changes and respond appropriately.

The Firm's System of Quality Management

7. The purpose of a system of quality management is to support the consistent performance of quality engagements, by providing the firm with reasonable assurance that the objectives of the system, stated in paragraph 18(a) and (b), are achieved. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and

[18] Proposed ISQM 2, *Engagement Quality Reviews*

[19] Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, exercising professional skepticism. (Ref: Para. A2–A4)

8. This ISQM requires professional judgment to be exercised in designing, implementing and operating the firm's system of quality management. A system of quality management is a continual and iterative process and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. However, for the purposes of this ISQM, a system of quality management addresses the following eight components, which are highly integrated: (Ref: Para. A4–A5)

   (a) Governance and leadership;

   (b) The firm's risk assessment process;

   (c) Relevant ethical requirements;

   (d) Acceptance and continuance of client relationships and specific engagements;

   (e) Engagement performance;

   (f) Resources;

   (g) Information and communication; and

   (h) The monitoring and remediation process.

   A further description of each of the eight components and their interrelationships is included in Appendix 1.

9. The firm's governance and leadership component establishes the environment in which the system of quality management operates because this component addresses the firm's culture, decision-making process, actions, organizational structure and leadership. This standard requires that the firm's leadership demonstrate a commitment to quality through their actions and behaviors and establish the expected behavior of personnel within the firm.

10. In taking a risk-based approach to quality management, the firm applies the firm's risk assessment process to the other components. The firm's risk assessment process consists of:

    (a) Establishing quality objectives. The quality objectives established by the firm consist of objectives that, when achieved by the firm, collectively provide the firm with reasonable assurance that the objectives of the system of quality management, stated in paragraph 18(a) and (b), are achieved. The firm is required to establish the quality objectives set out in this ISQM and additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.

    (b) Identifying and assessing risks to the achievement of the firm's quality objectives (referred to in this standard as quality risks). The firm is required to identify and assess quality risks to provide a basis for designing and implementing responses.

    (c) Designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the firm's responses to address the assessed quality risks will be based on, and responsive to, the reasons for the assessments given to the quality risks. The firm is

required to include the responses required by this ISQM, which are organized by component, in its responses to its assessed quality risks. The responses required by this ISQM are relevant to every firm's system of quality management, and are therefore applicable to all firms. However, the responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks for the quality objectives that are required to be established by this ISQM.

11. This ISQM includes components that address specific topics that are fundamental for the performance of audits or reviews of financial statements, or other assurance or related services engagements (i.e., relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, and engagement performance). In addition, it includes components for resources and information and communication, which are necessary to enable the operation of all the other components of the system of quality management.

12. This ISQM requires the firm to evaluate the design, implementation and operation of its system of quality management through a monitoring and remediation process, which involves:

    (a) Designing and performing monitoring activities and evaluating the findings from such activities, the results of external inspections and other relevant information to determine whether deficiencies exist in the system of quality management;

    (b) Investigating the root cause(s) of the identified deficiencies and evaluating the severity and pervasiveness of the identified deficiencies; and

    (c) Remediating the identified deficiencies.

    The findings arising from the monitoring may also highlight positive practices that the firm uses to enhance its system of quality management. The monitoring and remediation process provides information that is the basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

13. All of the components of the system of quality management operating together enable the consistent performance of quality engagements and contribute to the firm achieving the objective of this ISQM. Accordingly, other pronouncements of the IAASB, such as ISA 220 (Revised),[20] are premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding.

Networks

14. In some circumstances, the firm may belong to a network. This ISQM includes requirements for firms that operate as part of a network, in recognition that networks may establish requirements regarding the firm's system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation and operation of its system of quality management. Network requirements or network services are further described in paragraph 58 of this ISQM. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that operate as part of the network. Notwithstanding the firm's compliance with the network requirements or use of the network services, the firm remains responsible for its system of quality management.

[20] Proposed ISA 220 (Revised), paragraph 3

Service Providers

15. This ISQM also includes requirements for circumstances when the firm intends to obtain or use resources provided by a service provider in its system of quality management.

Authority of this ISQM

16. This ISQM contains the objective of the firm in following this ISQM, and requirements designed to enable the firm to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. (Ref: Para. A6–A9)

Effective Date

17. Systems of quality management in compliance with this ISQM are required to be established by TBD.

Objective

18. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:

    (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

    (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Definitions

19. In this ISQM, the following terms have the meanings attributed below:

    (a) Deficiency in the firm's system of quality management (referred to as "deficiency" in this ISQM) – This exists when:

        (i) A quality objective required to achieve the objective of this ISQM is not established;

        (ii) A quality risk has not been appropriately identified or assessed, such that a response that addresses that risk has not been appropriately designed or implemented; or

        (iii) A response to address an assessed quality risk is not properly designed, implemented or operating effectively. (Ref: Para. A10)

    (b) Engagement documentation – The record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "work papers" are sometimes used).

    (c) Engagement partner[21] – The partner or other individual, appointed by the firm, who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

[21] "Engagement partner" and "partner" should be read as referring to their public sector equivalents where relevant.

(d) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.

(e) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

(f) Engagement team – All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an external expert engaged by the firm or by a network firm, and also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).[22]

(g) External inspections – Inspections or investigations undertaken by an external oversight authority related to the firm's system of quality management or engagements performed by the firm. (Ref: Para. A11)

(h) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A12)

(i) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

(j) Network firm – A firm or entity that belongs to a network.

(k) Network[23] – A larger structure: (Ref: Para. A13–A14)

  (i) That is aimed at cooperation, and

  (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(l) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(m) Personnel – Partners and staff.

(n) Professional judgment – The application of relevant training, knowledge and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation and operation of the firm's system of quality management.

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[22] ISA 610 (Revised 2013), *Using the Work of Internal Auditors,* establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistances is restricted to situations where it is permitted.

[23] As defined in the International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants (Including the International Independence Standards)* (Code)

(o) Professional standards – IAASB Engagement Standards, as defined in the IAASB's *Preface to the International Quality Management, Auditing, Review, Other Assurance and Related Services Pronouncements*, and relevant ethical requirements.

(p) 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.

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

(r) Reasonable assurance – In the context of the ISQMs, a high, but not absolute, level of assurance.

(s) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking engagements that are audits or reviews of financial statements or other assurance or related services engagements. Relevant ethical requirements ordinarily comprise the provisions of the IESBA Code related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive. (Ref: Para. A15–A16, A67)

(t) Response (in relation to a system of quality management) – Policies or procedures designed and implemented by the firm to address an assessed quality risk: (Ref: Para. A17–A18, A62)

  (i) Policies are statements of what should, or should not, be done to address an assessed quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.

  (ii) Procedures are actions to implement policies.

(u) Staff – Professionals, other than partners, including any experts the firm employs.

(v) System of quality management – A system designed, implemented and operated by a firm to provide reasonable assurance that:

  (i) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

  (ii) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

Requirements

Applying, and Complying with, Relevant Requirements

20. The individual(s) assigned ultimate responsibility and accountability, and the individual(s) assigned operational responsibility, for the firm's system of quality management shall have an understanding of this ISQM relevant to their responsibilities, including the application and other explanatory material, to understand the objective of this ISQM and to apply its requirements properly. (Ref: Para. A19)

21. The firm shall comply with each requirement of this ISQM unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: Para. A20)

System of Quality Management

22. The firm shall design, implement and operate a system of quality management that complies with the requirements of this ISQM. The requirements are designed to enable the firm to achieve the objective stated in this ISQM. The proper application of the requirements in this ISQM is expected to provide a sufficient basis for the achievement of the objective of this standard. In applying the requirements of this ISQM, the firm shall exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements, such that the objective of this ISQM is achieved. (Ref: Para. A21–A24)

Governance and Leadership

23. The firm shall establish the following quality objectives that address the aspects of the firm's environment that support the design, implementation and operation of the other components of the system of quality management, including the firm's culture, decision-making process, actions, organizational structure and leadership:

    (a) The firm's culture promotes a commitment to quality, including recognizing and reinforcing the importance of professional ethics, values and attitudes throughout the firm and emphasizing the responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A26–A28)

    (b) The firm has leadership who is responsible and accountable for quality. (Ref: Para. A36)

    (c) The firm's strategic decisions and actions, including financial and operational priorities, demonstrate a commitment to quality and to the firm's role in serving the public interest, by consistently performing quality engagements. (Ref: Para. A29–A30)

    (d) The firm has an organizational structure with appropriate assignment of roles, responsibilities and authority that supports the firm's commitment to quality and the design, implementation and operation of the firm's system of quality management. (Ref: Para. A31–A32)

    (e) The firm plans for its resource needs, including financial resources, and obtains, allocates or assigns resources in a manner that supports the firm's commitment to quality and enables the design, implementation and operation of the firm's system of quality management. (Ref: Para. A33–A35)

    (f) The firm fulfills its responsibilities in accordance with law, regulation and professional standards that relate to the governance and leadership of the firm, if applicable. (Ref: Para. A25)

24. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the governance and leadership quality objectives, the firm shall include the following responses:

    (a) Assigning ultimate responsibility and accountability for the system of quality management to the firm's chief executive officer or the firm's managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent). The individual(s) to whom such responsibility and accountability is assigned shall: (Ref: Para. A36)

        (i) Have the appropriate experience and knowledge to fulfill the assigned responsibility.

        (ii) Demonstrate a commitment to quality through their actions and behaviors, including recognizing and reinforcing the importance of professional ethics, values and attitudes,

and establishing the expected behavior of personnel relating to the performance of engagements and activities within the system of quality management. (Ref: Para. A26–A28)

(iii) Establish structures, reporting lines, and appropriate authorities and responsibilities, including assigning operational responsibility for the following matters to personnel who fulfill the requirements in paragraph 25: (Ref: Para. A37–A39)

a. The system of quality management as a whole; and

b. Specific aspects of the system of quality management, as appropriate to the nature and circumstances of the firm, which shall include operational responsibility for compliance with independence requirements and the monitoring and remediation process.

(b) Establishing policies or procedures for periodic performance evaluations of the individual(s) assigned ultimate responsibility and accountability for the firm's system of quality management, and the individual(s) assigned operational responsibility for the matters set out in paragraph 24(a)(iii), in order to hold individuals accountable for the responsibilities assigned to them. (Ref: Para. A40–A43)

(c) Establishing policies or procedures for dealing with complaints and allegations about the commitment to quality of the firm or its personnel, including clearly defining channels within the firm that enable reporting by personnel or external parties to appropriate individual(s) without fear of reprisal and enabling the investigation and resolution of the complaints and allegations. (Ref: Para. A44–A47)

25. The personnel assigned operational responsibility for the matters set out in paragraph 24(a)(iii) shall have: (Ref: Para. A39)

(a) The appropriate experience and knowledge and sufficient time to fulfill their assigned responsibility;

(b) A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management; and

(c) An understanding of their assigned responsibilities and accountability for such responsibilities.

The Firm's Risk Assessment Process

26. The firm shall establish the quality objectives required by this ISQM. The firm shall also establish additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM. (Ref: Para. A48–A51)

27. The firm shall understand the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of its quality objectives, taking into account the nature and circumstances of the firm and its engagements, to provide the basis for the identification and assessment of quality risks. (Ref: Para. A48, A52)

28. Based on the understanding obtained in paragraph 27, the firm shall identify those quality risks, before consideration of any responses, that: (Ref: Para. A48, A53–A54)

(a) Have a reasonable possibility of occurring; and (Ref: Para. A55)

(b) 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(s). (Ref: Para. A56–A57)

29. The firm shall assess the quality risks identified in paragraph 28 to provide a basis for the design and implementation of the related responses. (Ref: Para. A48, A58)

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. (Ref: Para. A48, A59–A64)

Changes in the Nature and Circumstances of the Firm or its Engagements

31. 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. (Ref: Para. A48, A65–A66)

Relevant Ethical Requirements

32. The firm shall establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, which, as defined, include the principles of professional ethics: (Ref: Para. A67)

(a) The firm, its personnel and others subject to relevant ethical requirements understand the relevant ethical requirements, including those related to independence.

(b) The firm, its personnel and others subject to relevant ethical requirements fulfill their responsibilities in relation to the relevant ethical requirements, including those related to independence.

(c) The firm, its personnel and others subject to relevant ethical requirements identify and appropriately respond to breaches of the relevant ethical requirements, including those related to independence, in a timely manner.

33. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the relevant ethical requirements quality objectives, the firm shall include the following responses: (Ref: Para. A68–A69 and A75)

(a) Identifying the relevant ethical requirements and determining the applicability of the relevant ethical requirements to the firm, its personnel and others, including, as applicable, the network, network firms, personnel in the network or network firms, or service providers. (Ref: Para. A15, A70–A71)

(b) Establishing policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed. (Ref: Para. A72)

(c) Establishing policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches. (Ref: Para. A73–A74)

(d) Obtaining, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.

Acceptance and Continuance of Client Relationships and Specific Engagements

34. The firm shall establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances: (Ref: Para. A76)

    (a) The firm obtains sufficient appropriate information about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) and based on such information makes appropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A77–A82)

    (b) The firm makes appropriate judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements when determining whether to accept or continue a client relationship or specific engagement, including that the firm has: (Ref: Para. A83)

        (i) Resources to perform the engagement; and (Ref: Para. A84)

        (ii) Access to information to perform the engagement, or to the persons who provide such information.

    (c) The firm's financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A85–A86)

    (d) The firm responds appropriately in circumstances when the firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement. (Ref: Para. A87–A88)

35. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the acceptance and continuance quality objectives, the firm shall include policies or procedures that address circumstances when the firm is obligated by law or regulation to accept the client relationship or specific engagement, if applicable. (Ref: Para. A89–A90)

Engagement Performance

36. The firm shall establish the following quality objectives that address the performance of quality engagements:

    (a) Personnel understand and fulfill their responsibilities in connection with the engagement, including, as applicable:

        (i) The engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement; and (Ref: Para. A91)

        (ii) The appropriate direction and supervision of the engagement team and review of the work performed. (Ref: Para. A92–A93)

(b) Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism, in planning and performing engagements such that conclusions reached are appropriate. (Ref: Para. A94–A97)

(c) The engagement documentation is appropriately assembled and retained.

37. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the engagement performance quality objectives, the firm shall include the following responses:

(a) Establishing policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members. (Ref: Para. A92–A93)

(b) Communicating to engagement teams their responsibility for planning and performing the engagement in accordance with professional standards and applicable legal and regulatory requirements.

(c) Establishing policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. (Ref: Para. A95, A98–A99)

(d) Establishing policies or procedures addressing differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation. (Ref: Para. A95, A100)

(e) Establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2, and that require an engagement quality review for: (Ref: Para. A101–A107)

(i) Audits of financial statements of listed entities;

(ii) Audits of financial statements of entities that the firm determines are of significant public interest; and

(iii) Audits or other engagements for which:

a. An engagement quality review is required by law or regulation; or

b. The firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.

(f) Establishing policies or procedures addressing assembly and retention of documentation that require:

(i) The engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized; and (Ref: Para. A108)

(ii) The engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards. (Ref: Para. A109–A112)

Resources

38. The firm shall establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources, in a timely manner to enable the design, implementation and operation of the system of quality management: (Ref: Para. A113–A116)

    (a) The firm hires, develops and retains personnel, including engagement partners, who have the competence and capabilities to: (Ref: Para. A117–A119)

        (i) Consistently perform quality engagements, including knowledge or experience regarding professional standards and applicable law or regulation relevant to the engagements the firm performs; or

        (ii) Perform activities or carry out responsibilities in relation to the operation of the firm's system of quality management.

    (b) The firm assigns an engagement partner and other human resources to each engagement who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. (Ref: Para. A120)

    (c) The firm assigns human resources to perform activities within the system of quality management who have appropriate competence and capabilities, including sufficient time, to perform such activities. (Ref: Para. A120)

    (d) Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable through timely evaluations, compensation, promotion and other incentives. (Ref: Para. A121–A123)

    (e) The firm obtains or develops, implements and maintains appropriate technological resources to enable the operation of the firm's system of quality management and the performance of engagements. (Ref: Para. A124–A131)

    (f) The firm obtains or develops, implements and maintains appropriate intellectual resources to enable the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: Para. A132–A133)

    (g) Personnel appropriately use the firm's technological and intellectual resources. (Ref: Para. A134)

39. The firm shall design and implement responses to address the quality risks identified and assessed by the firm relating to the resources quality objectives.

Information and Communication

40. The firm shall establish the following quality objectives that address obtaining, generating or using information regarding the system of quality management, and communicating information within the firm and to external parties on a timely basis to enable the design, implementation and operation of the system of quality management: (Ref: Para. A135)

(a) The firm has an information system that supports the system of quality management by identifying, capturing, processing and maintaining relevant and reliable information, whether from internal or external sources. (Ref: Para. A136–A138)

(b) The firm communicates relevant and reliable information to personnel, the nature, timing and extent of which is sufficient to enable personnel to understand and carry out their responsibilities relating to the performance of engagements or activities within the system of quality management. (Ref: Para. A139)

(c) The firm's culture promotes and emphasizes the responsibility of personnel to exchange information with the firm and with one another. (Ref: Para. A139)

(d) Personnel communicate relevant and reliable information to the firm when performing engagements or activities within the system of quality management. (Ref: Para. A139)

(e) The firm communicates relevant and reliable information to external parties regarding the firm's system of quality management, as the firm determines appropriate. (Ref: Para. A142–A153)

41. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the information and communication quality objectives, the firm shall include the following responses:

(a) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated by the firm with engagement teams. (Ref: Para. A140)

(b) Communicating the responsibility for implementing the firm's responses to relevant personnel, including engagement teams. (Ref: Para. A141)

(c) Establishing policies or procedures that address the nature, timing and extent of communication and matters to be communicated with external parties, including:

(i) Communication to external parties in accordance with law, regulation or professional standards. (Ref: Para. A142)

(ii) Communication with the network. (Ref: Para. A143)

(iii) Communication with service providers. (Ref: Para. A144)

(iv) Other communication to external parties about the firm's system of quality management, in a transparency report or otherwise, when the firm determines it appropriate to do so, taking into account: (Ref: Para. A145, A149–A153)

a. Whether there are external parties who may use such information to support their understanding of the quality of the engagements performed by the firm; and (Ref: Para. A146–A147)

b. The nature and circumstances of the firm, including the nature of the firm's operating environment. (Ref: Para. A148)

Monitoring and Remediation Process

42. The firm shall establish the following quality objectives that address the firm's monitoring and remediation process that enable the evaluation of the design, implementation and operation of the

components of the system of quality management to determine whether the quality objectives have been achieved: (Ref: Para. A154–A155)

(a) The firm's monitoring and remediation process provides relevant, reliable and timely information about the design, implementation and operation of the components of the system of quality management.

(b) The firm takes appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

(c) The individual(s) assigned ultimate responsibility and accountability for the system of quality management evaluates whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

43. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the monitoring and remediation quality objectives, the firm shall include the responses in paragraphs 44–57.

Designing and Performing Monitoring Activities

44. The firm shall determine the nature, timing and extent of the monitoring activities, including the appropriate combination of ongoing and periodic monitoring activities. In designing and implementing the monitoring activities, the firm shall take into account: (Ref: Para. A156–A159)

(a) For a response, the related assessed quality risk(s), the reasons for the assessments given to the quality risk(s) and the design of the response; (Ref: Para. A160–A161)

(b) For monitoring activities over the firm's risk assessment process, the design of that process;

(c) Changes in factors that have affected the firm's system of quality management or changes in the system of quality management; (Ref: Para. A162)

(d) Previous monitoring activities and remedial actions, including whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management; and (Ref: Para. A163–A164)

(e) Other relevant information, including concerns identified regarding the commitment to quality of the firm or its personnel and information from external inspections. (Ref: Para. A165–A167)

45. The firm's monitoring activities shall include the inspection of engagements to determine whether the responses that are required to be implemented at the engagement level have been implemented. Engagement inspections may include the inspection of in-process or completed engagements. In determining the nature, timing and extent of the inspection of engagements, the firm shall: (Ref: Para. A168–A170)

(a) Take into account the relevant factors in paragraph 44; and

(b) Include the inspection of at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.

46. The firm shall establish policies or procedures that:

(a) Require those performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and

(b) Address the objectivity of the individuals performing the monitoring activities. Such policies or procedures shall prohibit the engagement team members or the engagement quality reviewer of an engagement from performing any inspection of that engagement. (Ref: Para. A171)

Evaluating Findings and Identifying Deficiencies

47. The firm shall establish policies or procedures addressing the evaluation of the findings arising from the monitoring activities, the results of external inspections and other relevant information to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: Para. A165, A172–A177)

Evaluating Identified Deficiencies

48. The firm shall establish policies or procedures addressing:

(a) The investigation of the root cause(s) of the identified deficiencies, including that the nature, timing and extent of the procedures to be performed to investigate the root cause(s) take into account the nature of the identified deficiencies and their possible severity; and (Ref: Para. A178–A182)

(b) The evaluation of the severity and pervasiveness of the identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the system of quality management as a whole. (Ref: Para. A183)

Responding to Identified Deficiencies

49. The firm shall design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. In doing so, the firm shall determine whether the firm's quality objectives, assessed quality risks and responses remain appropriate and modify them, as appropriate. (Ref: Para. A184)

50. The individual(s) assigned operational responsibility for monitoring and remediation shall evaluate whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s) and determine whether they have been implemented. The individual shall also evaluate whether the remedial actions implemented to address previously identified deficiencies are effective. (Ref: Para. A163)

Findings About a Particular Engagement

51. In circumstances when a finding relates to an in-process or completed engagement and there is an indication that procedures required were omitted during the performance of the engagement or the report issued may be inappropriate, the firm shall: (Ref: Para. A185)

(a) Take appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements; and

(b) When the report is considered to be inappropriate, consider the implications and take appropriate action, including considering whether to obtain legal advice.

Ongoing Communication Related to Monitoring and Remediation

52. The individual(s) assigned operational responsibility for the monitoring and remediation process shall communicate on a timely basis to the individual(s) assigned ultimate responsibility and accountability

for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management: (Ref: Para. A186)

(a) A description of the monitoring activities performed;

(b) The identified deficiencies, including the severity and pervasiveness of such deficiencies; and

(c) The remedial actions to address the identified deficiencies.

53. The firm shall communicate the matters described in paragraph 52 to personnel to the extent that the information is relevant to their responsibilities to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. (Ref: Para. A187)

54. The firm shall communicate information about the results of the firm's monitoring and remediation process to external parties on a timely basis, in accordance with paragraph 41(c).

Evaluating the System of Quality Management

55. The individual(s) assigned ultimate responsibility and accountability for the system of quality management shall evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved. This evaluation shall take into account: (Ref: Para. A188–A189)

(a) The severity and pervasiveness of identified deficiencies; and

(b) The evaluation in paragraph 50 regarding whether the remedial actions are appropriately designed to address the identified deficiencies and their related root cause(s), and have been implemented.

56. The evaluation in paragraph 55 shall be undertaken at least annually, or more frequently when the identified deficiencies are of a severity and pervasiveness that indicate that the system may not be providing reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

57. If the evaluation indicates that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, the individual(s) assigned ultimate responsibility and accountability for the system of quality management shall:

(a) Take prompt and appropriate action in accordance with their responsibilities; and

(b) Communicate to: (Ref: Para. A190–A191)

(i) Personnel to the extent that it is relevant to their responsibilities; and

(ii) External parties in accordance with the firm's policies or procedures required by paragraph 41(c).

Network Requirements or Network Services

58. When the firm operates as part of a network, the firm shall understand, when applicable:

(a) The requirements established by the network regarding the firm's system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (i.e., network requirements); (Ref: Para. A192)

(b) Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation or operation of the firm's system of quality management (i.e., network services); and (Ref: Para. A193)

(c) The firm's responsibilities for any actions that are necessary to implement the network requirements or use network services. (Ref: Para. A194)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation and operation of the system of quality management. The firm shall not allow compliance with the network requirements or use of network services to contravene the requirements of this ISQM. (Ref: Para. A13, A195–A196)

The Firm's Risk Assessment Process

59. In complying with the requirements in paragraphs 26–30, the firm shall evaluate the effect of the network requirements or network services on the firm's system of quality management, including determining whether they need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management. (Ref: Para. A197–A198)

Monitoring and Remediation Process

60. In circumstances when the network performs monitoring activities relating to the firm's system of quality management, the firm shall:

(a) Determine the effect of the monitoring activities performed by the network on the nature, timing and extent of the firm's monitoring activities performed in accordance with paragraphs 44–45; (Ref: Para. A199)

(b) Determine the firm's responsibilities in relation to the monitoring activities, including any related actions by the firm; and

(c) As part of evaluating findings and identifying deficiencies in paragraph 47, obtain the results of the monitoring activities from the network in a timely manner. (Ref: Para. A200)

61. The firm shall, at least annually, obtain information from the network, about the overall scope and results of the monitoring activities across the network firms' systems of quality management and:

(a) Consider the effect of such information on the nature, timing and extent of the monitoring activities that need to be undertaken by the firm; and (Ref: Para. A201–A202)

(b) Communicate the information to personnel to the extent that it is relevant to their responsibilities such that personnel take prompt and appropriate action in accordance with their responsibilities (including as it relates to the performance of engagements).

62. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the network requirements or network services, the firm shall communicate to the network relevant information about the identified deficiencies. (Ref: Para. A203)

63. As part of designing and implementing remedial actions in paragraph 49, for identified deficiencies related to the network requirements or network services the firm shall: (Ref: Para. A204)

(a) Understand the planned remedial actions by the network;

(b) Understand whether the network's remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s); and

(c) Determine the supplementary remedial actions needed by the firm, if any.

Service Providers

64. When the firm intends to obtain or use resources provided by a service provider in its system of quality management, the firm's responses for resources shall include: (Ref: Para. A205–A207)

(a) Obtaining an understanding of the service provider, including determining that the reputation, competence and capabilities of the service provider are appropriate in the context of the intended use of the resource; (Ref: Para. A208)

(b) Establishing the nature and scope of the resources provided by the service provider, including the firm's responsibilities for any actions that are necessary in using the resources; and (Ref: Para. A209)

(c) Determining whether the resource is appropriate for use in the system of quality management in the context of the quality risks identified and assessed by the firm and the reasons for the assessments given to the quality risks, including when changes are made to the resources provided. (Ref: Para. A210)

Notwithstanding the firm's use of a service provider(s), the firm remains responsible for its system of quality management.

65. As part of evaluating findings and identifying deficiencies in paragraph 47, if the firm identifies deficiencies in the resources provided by the service provider, the firm shall communicate to the service provider relevant information about the identified deficiencies. The firm shall also:

(a) Understand the planned remedial actions by the service provider and consider whether the service provider's remedial actions are designed and implemented to address the identified deficiencies and their related root cause(s);

(b) Determine the supplementary remedial actions needed by the firm, if any; and

(c) Consider whether to continue using the services provided by the service provider.

Documentation

66. The firm shall prepare documentation of its system of quality management that is sufficient to: (Ref: Para. A211–A213)

(a) Support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the firm's system of quality management;

(b) Support the consistent implementation and operation of the responses; and

(c) Provide evidence of the design, implementation and operation of the responses, such that the firm is able to evaluate the system of quality management.

67. The firm shall prepare documentation that includes: (Ref: Para. A214)

(a) The firm's quality objectives and assessed quality risks;

(b) A description of the responses and how the firm's responses address the assessed quality risks; and

(c) Regarding the monitoring and remediation process:

(i) Evidence of the monitoring activities performed;

(ii) The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information, including the identified deficiencies and their related root cause(s);

(iii) Remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions;

(iv) Communications about monitoring and remediation; and

(v) The basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

68. The firm shall document the matters in paragraph 67 as they relate to network requirements or network services or resources provided by service providers and:

(a) The evaluation of the effect of the network requirements or network services in accordance with paragraph 59 and the conclusions reached.

(b) The firm's basis for determining that it is appropriate to use the resources from a service provider in its system of quality management.

69. The firm shall establish a period of time for the retention of documentation for the system of quality management that is sufficient to permit those performing monitoring procedures to evaluate the firm's system of quality management, or for a longer period if required by law or regulation.

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Application and Other Explanatory Material

Scope of this ISQM (Ref: Para. 2)

A1. Other pronouncements of the IAASB, including ISRE 2400 (Revised)[24] and ISAE 3000 (Revised),[25] also establish requirements for the engagement partner for the management of quality at the engagement level.

The Firm's System of Quality Management (Ref: Para. 7–8)

A2. The IESBA Code contains requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance as described in this ISQM, the consistent performance of quality engagements forms part of the professional accountant's responsibility to act in the public interest.

A3. Reasonable assurance is obtained when the firm's system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph 18(a) and (b) are not achieved. Reasonable assurance is not an absolute level of assurance, because there are inherent limitations

[24] International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

[25] International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

of a firm's system of quality management. Such limitations include reality that human judgment in decision making can be faulty and that breakdowns in the firm's system of quality management may occur, for example, due to human error or behavior or failures in the firm's IT applications.

A4. The design, implementation and operation of the system of quality management involves the exercise of professional judgment, including when making decisions about:

- The appropriate organizational structure and assignment of roles, responsibilities and authority that support the firm's commitment to quality.
- Establishing additional quality objectives beyond those required by this ISQM when those objectives are necessary to achieve the objective of this standard.
- The identification and assessment of the quality risks.
- The appropriate nature, timing and extent of the responses to address the assessed quality risks.
- The resources and information and communication that are appropriate to enable the design, implementation and operation of the components of the system of quality management.
- The evaluation of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.
- The effect of the network requirements or network services on the firm's system of quality management.

A5. The firm may use different terminology or frameworks to describe the components of its system of quality management.

Authority of this ISQM (Ref: Para. 16)

A6. The objective of this ISQM provides the context in which the requirements of this ISQM are set, establishes the desired outcome of this ISQM and is intended to assist the firm in understanding what needs to be accomplished and, where necessary, the appropriate means of doing so.

A7. The requirements of this ISQM are expressed using "shall."

A8. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover; and
- Include examples that illustrate how the requirements might be applied.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this ISQM. Where appropriate, additional considerations specific to public sector audit organizations are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in this ISQM. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this ISQM.

A9. This ISQM includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of this ISQM. These definitions are provided to assist in the consistent

application and interpretation of this ISQM, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The Glossary of Terms relating to International Standards issued by the IAASB in the *Handbook of International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC includes the terms defined in this ISQM. The Glossary of Terms also includes descriptions of other terms found in the ISQMs to assist in common and consistent interpretation and translation.

Definitions

Deficiencies (Ref: Para. 19(a))

A10. A response to address an assessed quality risk is not:

- Properly designed when a response necessary to address an assessed quality risk is absent or a response is not properly designed in a manner that effectively addresses an assessed quality risk, such that a quality objective may not be achieved. A deficiency in the design of a response may also arise from a quality objective or assessed quality risk not being appropriately specific, given the nature and circumstances of the firm and its engagements.
- Operating effectively when a response that is properly designed does not operate as designed, which results in the related quality risk not being effectively addressed such that a quality objective may not be achieved.

External Inspections (Ref: Para. 19(g))

A11. In some circumstances, an external oversight authority may undertake other types of reviews, for example, reviews of specific areas of focus that contribute to the improvement of engagement quality. Paragraph A165 describes such reviews as part of other relevant information considered by the firm in the monitoring and remediation component.

Firm (Ref: Para. 19(h))

A12. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this ISQM.

Network (Ref: Para. 19(k), 58)

A13. Networks and the firms within the network may be structured in a variety of ways; however, in all cases networks are external to the firm. In some instances, network firms may provide services (e.g., resources) that are used by the firm in its system of quality management. There may also be circumstances when the network includes other structures or organizations that establish requirements for the firm related to its system of quality management, or provides services. For the purposes of this ISQM, any requirements established by the network regarding the firm’s system of quality management or services or resources provided by the network that the firm chooses to implement or use in its system of quality management that are obtained from the network, network firms or another structure or organization in the network are considered “network requirements or network services.”

A14. The IESBA Code provides guidance in relation to the terms “network” and “network firm.”

Relevant Ethical Requirements (Ref: Para. 19(s), 33(a))

A15. The relevant ethical requirements that are applicable in the context of a system of quality management may vary, depending on the nature and circumstances of the firm and its engagements. The term "professional accountant" may be defined in relevant ethical requirements. For example, the IESBA Code defines the term "professional accountant" and further explains the scope of provisions in the IESBA Code that apply to individual professional accountants in public practice and their firms.

A16. The IESBA Code addresses circumstances when law or regulation precludes the professional accountant from complying with certain parts of the IESBA Code. It further acknowledges that some jurisdictions might have provisions in law or regulation that differ from or go beyond those set out in the IESBA Code and that professional accountants in those jurisdictions need to be aware of those differences and comply with the more stringent provisions, unless prohibited by law or regulation.

Response (Ref: Para. 19(t))

A17. Policies are implemented through the actions of personnel and other individuals whose actions are subject to the policies, or through their restraint from taking actions that would conflict with the firm's policies.

A18. Procedures may be mandated, through formal documentation or other communications, or may be effected by behaviors that are not mandated but are rather conditioned by the firm's culture. Procedures may be enabled through the application of IT, for example, the firm may use an IT application to facilitate obtaining a documented confirmation of compliance with independence requirements from personnel.

Applying, and Complying with, Relevant Requirements (Ref: Para. 20–21)

A19. The individual(s) assigned ultimate responsibility and accountability for the system of quality management may also assume operational responsibility for the system of quality management, for example, in smaller firms.

A20. Examples of when a requirement of this ISQM may not be relevant to the firm include:

- When the firm is a sole practitioner. For example, the requirements addressing the organizational structure and assigning roles, responsibilities and authority within the firm, appropriate direction, supervision and review and addressing differences of opinion may not be relevant.
- When the firm only performs engagements that are related services engagements. For example, if the firm is not required to maintain independence for the related services engagements, the requirement to obtain a documented confirmation of compliance with independence requirements from all personnel would not be relevant.

System of Quality Management (Ref: Para. 22)

A21. Paragraph 55 requires the individual(s) assigned ultimate responsibility and accountability for the system of quality management to evaluate whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

A22. The nature and circumstances of the firm may include consideration of matters such as:

- The size and operating characteristics of the firm, including the geographical dispersion and the extent to which the firm concentrates or centralizes its processes or activities.
- The firm's strategic decisions and actions, including those about financial and operational matters.
- External factors, for example, law or regulation, economic stability, stakeholder expectations and social factors.
- In the case of a firm that belongs to a network, the nature of the network, how the network is organized and the nature and extent of the requirements established by the network regarding the firm's system of quality management or services or resources provided by the network that the firm chooses to implement or use in the design, implementation and operation of the firm's system of quality management.
- The extent to which the firm uses service providers in its system of quality management and the nature of such services.

A23. The nature and circumstances of the engagements performed by the firm may include consideration of matters such as:

- The types of engagements performed by the firm, for example, whether the firm performs only compilation engagements or performs a variety of engagements, including audits of financial statements.
- The types of entities for which such engagements are undertaken, for example, the industries in which the entities operate and whether the entities are owner-managed, listed or of significant public interest. An entity may be of significant public interest because it has a large number and wide range of stakeholders or due to the nature and size of its business.
- External factors, such as relevant professional standards and law or regulation.

A24. The quality of professional judgments exercised by the firm is enhanced when personnel making such judgments demonstrate an attitude that includes a questioning mind, critical assessment of information in formulating decisions, and being alert to changes in the nature and circumstances of the firm or its engagements.

Governance and Leadership (Ref: Para. 23–25)

A25. Law, regulation or other professional standards may prescribe additional matters related to the governance or leadership of the firm, for example, the firm may be required to follow an audit firm governance code that may incorporate specific governance principles and require adherence by the firm to specific provisions.

Culture (Ref: Para. 23(a), 24(a)(ii))

A26. The firm's culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics, and are further addressed in the relevant ethical requirements component of this ISQM. Professional values and attitudes may include, for example:

- Professional manner, for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability;

- A commitment to teamwork;
- Maintaining an open mind to new ideas or different perspectives in the professional environment;
- Pursuit of excellence;
- A commitment to continual improvement (e.g., setting expectations beyond the minimum requirements); and
- Social responsibility.

A27. A culture that promotes a commitment to quality is likely to involve clear, consistent, frequent and effective actions, including communications, at all levels within the firm, that emphasize the firm's commitment to quality. The tone at the top and the attitude towards quality, including reinforcing the importance of professional ethics, values and attitudes, are set by the individual(s) assigned ultimate responsibility and accountability for the system of quality management through their personal conduct, communication and actions. The attitude towards quality is further shaped and reinforced by other personnel who are expected to embed or demonstrate the behaviors that reflect the firm's commitment to quality.

A28. The nature and extent of the actions of the individual(s) assigned ultimate responsibility and accountability for the system of quality management in establishing the firm's culture may depend on factors such as the size, structure, geographical dispersion and complexity of the firm. For example, a smaller firm may be able to establish the desired culture through the direct interaction of firm leadership with other personnel. For a larger firm in which personnel are dispersed across many geographical locations, more formal communication may be necessary. Other actions that may be taken to establish the expected behavior of personnel include creating a code of conduct.

Strategic Decisions and Actions (Ref: Para. 23(c))

A29. It is important that the firm's strategic decision-making process, which may include establishing a business strategy, takes into consideration how the firm's decisions about financial and operational matters (e.g., the firm's profitability or strategic focus, such as growth of the firm's market share, industry specialization or new service offerings) affect the performance of quality engagements.

Public Sector Considerations

A30. In the public sector, although the firm's strategic decisions and actions may be less influenced by matters such as profitability or strategic focus areas, they are nevertheless affected by financial and operational priorities, for example, the allocation of financial resources.

Organizational Structure (Ref: Para. 23(d), 24(a)(iii))

A31. The organizational structure of the firm may include operating units, operational processes, divisions or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, for example, engagement teams may include human resources from service delivery centers who perform specific tasks that are repetitive or specialized in nature.

A32. How the firm assigns roles, responsibilities and authority within the firm may vary. For example, the leadership structure of a smaller firm may comprise a single managing partner with sole responsibility

for the oversight of the firm. Larger firms may have multiple levels of leadership, such as a chief executive officer (or equivalent) and a managing board of partners (or equivalent), and further levels that reflect the organizational structure of the firm. Some firms may also have an independent governing body that has non-executive oversight of the firm. At a jurisdictional level, law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities.

Resources (Ref: Para. 23(e))

A33. The quality objective in this component for resources addresses all categories of resources. The resources component includes quality objectives that address specific aspects of human resources, technological resources and intellectual resources. Financial resources are necessary for obtaining, developing, using and maintaining human resources, technological resources and intellectual resources. The quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources.

A34. The individuals(s) assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are in most cases able to influence the nature and extent of resources that the firm obtains, develops, uses and maintains, and how those resources are allocated or assigned, including the timing of when they are used. The firm's strategic decisions and actions may affect decisions about obtaining, allocating or assigning resources. Paragraph 23(c) requires that the strategic decisions and actions, including the firm's financial and operational priorities, demonstrate a commitment to quality, including not leading to inappropriate decisions about obtaining, allocating or assigning resources for the system of quality management.

A35. Resource needs may change over time as a result of changes in the nature and circumstances of the firm (e.g., the emergence of new or advanced technology or evolution in the firm's business model) and the engagements performed by the firm. The firm's resource planning involves determining the resources currently required and forecasting the firm's future resource needs. However, given the continual changes in the nature and circumstances of the firm and its engagements, it may not be practicable for the firm to anticipate all possible resource needs or changes to the resource needs and therefore, in most cases, the firm's resource planning includes processes to deal with resource needs that cannot be anticipated as and when they arise.

Firm Leadership Responsibility and Accountability (Ref: Para. 23(b), 24(a))

A36. Paragraph A32 explains the various leadership structures that may exist in a firm. Ordinarily the person with ultimate responsibility and accountability for the system of quality management is the chief executive officer (or equivalent), or the firm's managing partner (e.g., in the case of a smaller firm). However, some firm management structures may share the responsibility and accountability for the system of quality management among the firm's managing board of partners (or equivalent).

Operational Responsibility (Ref: Para. 24(a)(iii), 25)

A37. The individual(s) assigned ultimate responsibility and accountability for the system of quality management is responsible and accountable for the firm achieving the objective of this ISQM. The individual(s) assigned operational responsibility for the system of quality management as a whole is responsible and accountable for the design, implementation and operation of the firm's system of quality management. In some instances, operational responsibility for the matters in paragraph

24(a)(iii) may be assigned to one individual, particularly in the case of a smaller firm. These responsibilities may also be fulfilled by the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

A38. In some instances, the individual assigned operational responsibility for the system of quality management may further assign specific roles, procedures, tasks or actions to other individuals within the firm. For example, in addition to assigning responsibility for compliance with independence requirements and the monitoring and remediation process, the individual may assign responsibility for technological resources.

A39. In some circumstances, the firm may establish additional criteria for the eligibility of the individual(s) assigned operational responsibility for the matters set out in paragraph 24(a)(iii).

Performance Evaluations (Ref: Para. 24(b))

A40. Periodic performance evaluations of individual(s) within the firm are a required response to promote the accountability of such individual(s) for their assigned responsibilities. In considering the performance of individuals, the firm may take into account:

- The results of the firm's monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. For example, the firm may set targets for the individual and measure the results of the firm's monitoring activities against those targets.
- The actions taken by the individual(s) in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.

A41. A positive performance evaluation may be rewarded through compensation, promotion and other incentives that focus on the individual's commitment to quality, and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm's achievement of its quality objectives.

A42. Given the unique position of the individual(s) assigned ultimate responsibility and accountability for the system of quality management, the performance evaluations may be undertaken by an independent non-executive member of the firm's governing body, or a special committee overseen by the firm's governing body, or the firm may engage a service provider to perform the evaluation. In the case of smaller firms, it may not be practicable to perform performance evaluations; however, in such cases, the results of the firm's monitoring activities may provide an indication of the performance of the individual(s).

Public Sector Considerations

A43. In the case of the public sector, it may not be practicable to perform a performance evaluation of the individual assigned ultimate responsibility and accountability for the system of quality management, or to take actions to address the results of the performance evaluation, given the nature of the individual's appointment. Nevertheless, performance evaluations may still be undertaken for other individuals in the firm who are assigned operational responsibility for aspects of the system of quality management.

Complaints and Allegations (Ref: Para. 24(c))

A44. Establishing policies or procedures for dealing with complaints and allegations supports the firm's commitment to quality. Complaints and allegations may originate from within or outside the firm and

they may be made by personnel or external parties, such as clients or others within the firm's network. Complaints and allegations may relate to the failure to perform work in accordance with professional standards and applicable legal and regulatory requirements, or non-compliance with the firm's policies or procedures. A complaint or allegation may indicate that there is a deficiency in the firm's system of quality management, which would be other relevant information considered by the firm as part of its monitoring and remediation process, as required by paragraph 44(e).

A45. Law, regulation or relevant ethical requirements may establish responsibilities for the firm or its personnel in circumstances when complaints or allegations arise, such as an obligation on the firm or its personnel to report the matter to an authority outside the firm. For example, sections 260 and 360 of the IESBA Code address the approach to be taken by the firm or its personnel in responding to non-compliance or suspected non-compliance with laws or regulations, which may include communications external to the firm that are addressed through the firm's policies or procedures for external communication in paragraph 41(c).

A46. In identifying an appropriate individual(s) to whom complaints and allegations are to be communicated, the firm may consider whether the individual(s) has:

- The experience, knowledge, time and appropriate authority within the firm needed to assume the role; and
- A direct line of communication to the individual(s) assigned ultimate responsibility and accountability for the system of quality management.

The firm may use a service provider to facilitate the reporting of complaints and allegations.

A47. The firm may also identify an individual(s) to be responsible for supervising the investigation of complaints and allegations and may consider:

- The factors described in paragraph A46; and
- Whether the individual(s) is not otherwise involved in the engagement to which a complaint or allegation pertains or has sufficient objectivity from the area or personnel subject to the investigation.

The individual(s) supervising an investigation may involve legal counsel as necessary. In the case of a smaller firm, it may not be practicable to identify an individual to supervise an investigation of an allegation or complaint who is not involved in the related engagement or area of the investigation. As a result, such firms may use a service provider to carry out the investigation into complaints and allegations, for example, legal counsel or a suitably qualified consultant.

The Firm's Risk Assessment Process (Ref: Para. 26–31)

A48. The approach that the firm takes to the risk assessment process may vary according to many factors, including how the firm is structured and organized. For example, the firm's risk assessment process may be centralized (e.g., the quality objectives, quality risks and responses are established centrally for all business units, functions and service lines) or may be decentralized (e.g., the quality objectives, quality risks and responses are established at a business unit, function or service line level, with the outputs combined at the firm level). Although this ISQM is organized by components, the firm's risk assessment process may be undertaken for the system of quality management as a whole.

Establish Quality Objectives (Ref: Para. 26)

A49. The quality objectives that the firm is required to establish are set out in paragraphs 23, 32, 34, 36, 38, 40 and 42. In addition, given the nature and circumstances of the firm and its engagements the firm:

- Is required to establish additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.
- May decide that more granular quality objectives than those set out in this ISQM are appropriate. Establishing more granular quality objectives may enhance the firm's identification and assessment of quality risks.

A50. Given the iterative nature of the firm's risk assessment process, the firm may determine that additional quality objectives are necessary to achieve the objective of this ISQM at any stage in the process of establishing quality objectives, identifying and assessing quality risks and designing and implementing responses. The results of the firm's monitoring and remediation process may also highlight that additional quality objectives are necessary to achieve the objective of this ISQM, including in circumstances when it is determined that the system of quality management does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

A51. Although the quality objectives set out in this ISQM are organized by component, an objective in one component may overlap, be related to, support or be supported by a quality objective in another component. For example, the quality objective in information and communication addressing the communication of relevant and reliable information in a timely manner to personnel supports the quality objective in the relevant ethical requirements component addressing the understanding of relevant ethical requirements by the firm, its personnel and others subject to relevant ethical requirements.

Conditions, Events, Circumstances, Actions or Inactions That May Affect the Achievement of the Quality Objectives (Ref: Para. 27)

A52. In understanding the conditions, events, circumstances, actions or inactions that may affect the achievement of its quality objectives, the firm may consider what could go wrong in relation to the matters identified in paragraphs A22–A23 that could affect the achievement of such objectives. Such consideration may also assist with identifying quality risks.

Identify and Assess Quality Risks (Ref: Para. 28–29)

A53. The firm exercises professional judgment in identifying and assessing quality risks. The process for identifying and assessing quality risks may involve a combination of ongoing and periodic risk identification and assessment procedures. In some circumstances, the identification and assessment of quality risks may be undertaken concurrently.

A54. Under this ISQM, not every quality risk needs to be identified and further assessed. The firm identifies which quality risks need to be further assessed based on a preliminary consideration of the possibility of the quality risks occurring and the effect on the achievement of the quality objectives. Only those quality risks that meet both of the criteria in paragraph 28(a) and (b) need to be identified and further assessed. The further assessment of the quality risks involves a more detailed consideration of the

degree of the likelihood of the quality risks occurring and the significance of the effect of the quality risks on the achievement of the quality objectives.

A55. There is a reasonable possibility of a quality risk occurring when the likelihood of its occurrence is more than remote.

A56. The significance of the effect of a quality risk on the achievement of a quality objective(s) is judged in the context of the underlying conditions and events that gave rise to the quality risk, as well as the nature and circumstances of the firm and its engagements, which are further described in paragraphs A22–A23.

A57. The firm may determine that a quality risk that has a reasonable possibility of occurring does not, on its own, have a significant effect on the achievement of a quality objective(s). However, a quality risk is required to be identified and further assessed in circumstances when the quality risk, in combination with other quality risks that have a reasonable possibility of occurring, have a significant effect on the achievement of a quality objective(s).

A58. The assessment of identified quality risks need not comprise formal ratings or scores, and may involve taking into consideration:

- The expected frequency of the quality risk occurring.
- The rate at which the effect of the quality risk would take place, or the amount of time that the firm has to respond to the quality risk.
- The duration of time of the effect of the quality risk after it has occurred.

Design and Implement Responses to Assessed Quality Risks (Ref: Para. 19(t), 30)

A59. The responses required by this ISQM are set out in paragraphs 24, 25, 33, 35, 37, 41 and 43 and represent responses that are relevant to every firm's system of quality management and are therefore applicable to all firms. However, the responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks, as explained in paragraph 10(c). Accordingly the firm is required to design and implement responses in addition to those required by this ISQM. For example, paragraph A69 identifies additional responses that may be appropriate to address quality risks for relevant ethical requirements.

A60. The firm exercises professional judgment in designing and implementing responses to address the assessed quality risks. The nature, timing and extent of the responses are affected by the reasons for the assessment given to the assessed quality risks, which includes:

- The likelihood of the assessed quality risk occurring. For example, a more robust response may be needed for an assessed quality risk that has a higher likelihood of occurring.
- The significance of the effect on the achievement of the quality objectives. For example, a more robust response may be needed for an assessed quality risk that has a more significant effect on the achievement of a quality objective.
- The conditions, events, circumstances, actions or inactions that give rise to the assessed quality risks. For example, if the assessed quality risk relates specifically to engagements performed for a category of entities (e.g., audits of financial statements of listed entities), the responses may require specific actions for entities in that category, rather than all engagements performed by the firm.

A61. The nature and circumstances of the firm and its engagements affect the reasons for the assessment given to the assessed quality risks, and the nature, timing and extent of the responses designed and implemented to address the assessed quality risks. For example, in demonstrating a commitment to quality through their actions and behaviors, as required by paragraph 24(a)(ii), leadership of a smaller firm may engage in direct and frequent interactions with personnel throughout the firm. However, in the case of a larger firm, frequent and direct interactions by leadership with all personnel may not be practicable and therefore the actions taken to demonstrate a commitment to quality may involve multiple actions, including establishing firm values in a code of conduct that all personnel are required to comply with and a series of formal communications from firm leadership that emphasize the importance of quality.

A62. The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level in order for a response to operate as designed. For example, the firm may appoint suitably qualified and experienced personnel to provide technical advice to engagement teams and, in doing so, may prescribe specific matters for which consultation by the engagement team is required. The engagement team may have a responsibility to identify when such matters occur and to initiate such consultation as required by the firm's policies or procedures. Communicating to engagement teams about their responsibilities for the implementation of the responses is therefore important for the functioning of the system of quality management, and is a response required by paragraph 41(b).

A63. The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.

A64. In some cases, the response designed and implemented by the firm may address multiple assessed quality risks across multiple components of the system of quality management. Furthermore, the responses designed and implemented to address an assessed quality risk in one component may affect the assessed quality risks and responses of another component. For example, engaging a service provider to manage all aspects of the firm's IT environment may create new quality risks for relevant ethical requirements (e.g., the service provider may have access to confidential information).

Changes in the Nature and Circumstances of the Firm or Its Engagements (Ref: Para. 31)

A65. In some circumstances, changes in the nature and circumstances of the firm's engagements may affect the design, implementation and operation of the system of quality management. For example, the firm may accept an engagement to perform an audit of financial statements for an entity involved in an industry for which the firm has not previously performed audit engagements that may create new quality risks (e.g., personnel do not have the knowledge or experience relevant to the engagement).

A66. Quality objectives, quality risks or responses may also need to be modified as a result of:

- Changes that affect specific components of the system of quality management, for example, changes in the firm's resources.
- Information from the firm's monitoring and remediation, including identified deficiencies from monitoring activities, external inspections or other relevant information.

Relevant Ethical Requirements (Ref: Para. 32–33)

A67. The IESBA Code sets out the fundamental principles of ethics that establish the standard of behavior expected of a professional accountant and establishes the International Independence Standards. The fundamental principles are integrity, objectivity, professional competence and due care, confidentiality and professional behavior. The IESBA Code also specifies the approach that a professional accountant is required to apply to comply with the fundamental principles and the International Independence Standards and addresses specific topics relevant to complying with the fundamental principles. Law or regulation in a jurisdiction may also contain provisions addressing ethical requirements, including independence, for example, privacy laws affecting the confidentiality of information.

A68. In some cases, the firm may determine that it is appropriate to design and implement responses that are more specific than the provisions of relevant ethical requirements. For example, having regard to the nature and circumstances of the firm and its engagements, a firm may:

- Prohibit the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- Set rotation periods for the engagement partner and other senior personnel for all engagements performed by the firm, including other assurance or related services engagements.

A69. Other components include responses that may affect or relate to the relevant ethical requirements component. For example, the following are examples of responses for information and communication and resources that may address assessed quality risks for relevant ethical requirements:

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
- Providing training for personnel on relevant ethical requirements.
- Establishing manuals and guides (i.e., intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
- Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.
- Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner related to:
    - Personal or firm situations that may create threats to independence, for example, financial interests, loans, employment relationships or personal appointments.
    - Client engagements, including non-assurance engagements. For example, this may include the scope of services, fees or information about long association.
    - Business relationships.
    - Any breaches of the relevant ethical requirements, including those related to independence.

- Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

Furthermore, the individual in the firm assigned operational responsibility for compliance with independence requirements is ordinarily responsible for the oversight of all matters related to independence, including the policies or procedures addressing communication of breaches of independence requirements and determining that appropriate actions have been taken to address the causes and consequences of the breach.

A70. Various provisions of the relevant ethical requirements may apply only to personnel and not the firm itself. For example, Part 2 of the IESBA Code applies to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm. The firm's system of quality management may need to address personnel's compliance with such relevant ethical requirements, for example, the firm may need to establish policies or procedures to facilitate personnel's compliance with Part 2 of the IESBA Code (e.g., policies or procedures addressing section 260 of the IESBA Code regarding non-compliance with laws and regulations).

A71. The applicability of the relevant ethical requirements to others (i.e., the network, network firms, personnel in the network or network firms, or service providers) depends on whether those requirements contain specific provisions addressing others, and how the firm uses others in its system of quality management. For example:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms.
- The definition of engagement team under relevant ethical requirement may include any individuals engaged by the firm who perform assurance procedures on the engagement (e.g., a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team may also be relevant to such individuals.
- The principle of confidentiality may apply to a network, network firm or service provider, given that they may have access to client information obtained by the firm.

A72. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the IESBA Code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third party test.

A73. The policies or procedures addressing breaches of the relevant ethical requirements, including those related to independence, may address matters such as:

- The communication of breaches of the relevant ethical requirements to appropriate individual(s) within the firm;
- The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements;
- The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable;
- Determining whether to report a breach to external parties; and

- Determining the appropriate actions to be taken in relation to the individual(s) responsible for the breach.

A74. Relevant ethical requirements may specify how the firm is required to respond to a breach. The IESBA Code sets out requirements for the firm in the event of a breach of the IESBA Code and includes specific requirements addressing breaches of the International Independence Standards, which includes requirements for communication with external parties.

Public Sector Considerations

A75. Statutory measures may provide safeguards for the independence of public sector auditors. However, threats to independence may still exist regardless of any statutory measures designed to protect the firm's independence that will require an appropriate response by the organization.

Acceptance and Continuance of Client Relationships and Specific Engagements (Ref: Para. 34–35)

A76. Other components include responses that may affect or relate to the acceptance and continuance of client relationships and specific engagements component. For example:

- The information necessary to support the firm's decisions about the acceptance and continuance of client relationships and specific engagements is identified, captured, processed and maintained through the information and communication component, and may include intellectual resources such as databases of client information or access to external information databases.
- The firm may use technological resources in the form of IT applications to facilitate the approval of client relationships or specific engagements at appropriate levels within the firm.
- Governance and leadership addresses the responsibility of the firm with respect to appropriate resource planning and obtaining, allocating or assigning resources.

The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client (Ref: Para. 34(a))

A77. The information obtained about the nature and circumstances of the engagement may include:

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors;
- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model and how it is financed; and
- The nature of the underlying subject matter and the criteria to be applied in the preparation of the subject matter information, for example, in the case of integrated reporting, the underlying subject matter may include social, environmental and health and safety information and the criteria may be performance measures established by a recognized body of experts.

A78. In some circumstances the firm may establish policies or procedures that specify, or prohibit, the types of engagements that may be performed by the firm, for example, the firm may prohibit the performance of assurance engagements over a certain subject matter. The policies or procedures may also prohibit the performance of engagements for certain types of entities, for example, the firm may prohibit the performance of engagements in certain industries.

A79. The information obtained to support the firm's judgments about the integrity and ethical values of the client may include the identity and business reputation of the client's principal owners, key management, and those charged with its governance. The nature and extent of information obtained may depend on factors such as:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of a client-imposed limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The identity and business reputation of related parties.

A80. The firm may obtain the information from a variety of internal and external sources, for example:

- In the case of an existing client, consideration of matters that have arisen during the current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.
- In the case of a new client, inquiry of existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel and industry peers.
- Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

A81. Information that is obtained during the firm's acceptance and continuance process about the nature and circumstances of the engagement and the integrity and ethical values of the client's management, and, when appropriate, those charged with governance is in most cases relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, ISA 220 (Revised)[26] requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of ISA 220 (Revised).

A82. Professional standards or legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an

[26] Proposed ISA 220 (Revised), paragraph 21

engagement. For example, when there has been a change of auditors, ISA 300[27] requires the auditor, prior to starting an initial audit, to communicate with the predecessor auditor in compliance with relevant ethical requirements. The IESBA Code also includes requirements for the consideration of conflicts of interests in accepting or continuing a client relationship or specific engagement and communication with the existing or predecessor firm when accepting an engagement that is an audit or review of financial statements.

The Firm's Ability to Perform Engagements (Ref: Para. 34(b))

A83. The consideration of whether the firm is able to perform engagements in accordance with professional standards and applicable legal and regulatory requirements includes determining that the firm, its personnel and others are able fulfill their responsibilities in relation to the relevant ethical requirements.

A84. The judgments about whether the firm has the resources to perform the engagement may involve reviewing the specific circumstances of the engagement and considering whether the firm has the resources to perform the engagement within the reporting deadline, including whether there are:

- Human resources with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes:
  - Personnel to direct and supervise the engagement and take overall responsibility; and
  - Human resources with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements.
- Experts that are available, if needed.
- Engagement quality reviewers who meet the eligibility requirements in ISQM 2, if applicable.
- Technological resources, for example, IT applications that enable the engagement team to perform procedures on the entity's data.
- Intellectual resources, for example, a methodology, industry or subject matter-specific guides, or access to information sources.

The Firm's Financial and Operational Priorities (Ref: Para. 34(c))

A85. Financial priorities may focus on the profitability of the firm, and fees obtained for the performance of engagements have an effect on the firm's financial resources. Operational priorities may include strategic focus areas, such as growth of the firm's market share, industry specialization or new service offerings. There may be circumstances when the firm is satisfied with the fee quoted for an engagement but, notwithstanding the firm's operational and financial priorities, it is not appropriate for the firm to accept or continue the engagement or client relationship (e.g., when the client lacks appropriate integrity and ethical values).

A86. There may be other circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The IESBA Code addresses fees and other types of remuneration, including

[27] ISA 300, *Planning an Audit of Financial Statements,* paragraph 13(b)

circumstances that may create a threat to compliance with the fundamental principle of professional competence and due care if the fee quoted for an engagement is too low.

Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement (Ref: Para. 34(d))

A87. Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may:

- Have existed at the time of the firm's decision to accept or continue the client relationship or specific engagement and the firm was not aware of such information; or
- Relate to new information that has arisen since the decision to accept or continue the client relationship or specific engagement.

The information may come to the attention of the firm in a variety of ways, including through the engagement partner or engagement team. For example, ISA 220 (Revised)[28] requires the engagement partner to communicate information to the firm that the engagement partner obtains that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement.

A88. The firm's response to address circumstances when information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm's decision to accept or continue a client relationship or specific engagement may include policies or procedures that set out the actions to be taken, including:

- Undertaking appropriate consultation within the firm or with legal counsel.
- Considering whether there is a professional, legal or regulatory requirement for the firm to continue the engagement.
- Discussing with the appropriate level of the client's management and with those charged with governance or the engaging party the appropriate action that the firm might take based on the relevant facts and circumstances, and when it is determined that withdrawal is an appropriate action, informing them of this decision and the reasons for the withdrawal.
- If the firm withdraws from the engagement, considering whether there is a professional, legal or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- If the firm does not withdraw from the engagement, considering the effect of the information on the performance of the engagement and the additional actions to be taken by the firm or the engagement partner in managing quality at the engagement level (e.g., assigning more experienced personnel to the engagement, requiring an engagement quality review or increasing the extent and frequency of the engagement partner's direction and supervision of engagement team members and review of their work).

[28] Proposed ISA 220 (Revised), paragraph 22

Circumstances When the Firm is Obligated to Accept or Continue a Client Relationship or Specific Engagement (Ref: Para. 35)

A89. There may be circumstances when the firm is obligated to accept or continue a client relationship or specific engagement. For example, jurisdictional law or regulation may impose an obligation on the firm to accept or continue a client engagement, or in the case of the public sector, the firm may be appointed through statutory provisions. In such circumstances, when the firm becomes aware of information that would otherwise have caused the firm to decline or discontinue the engagement, the firm may design and implement additional responses to address the assessed quality risk(s) arising from the performance of such engagements. For example, the firm may assign more experienced personnel to the engagement or may require that an engagement quality review be performed in respect of the engagement. There may also be actions at the engagement level to manage quality when performing such engagements, for example, increasing the extent and frequency of the engagement partner's direction and supervision of engagement team members and review of their work.

A90. In some circumstances, a threat to the firm's integrity may arise as a result of being associated with the subject matter of the engagement. Relevant ethical requirements may include requirements addressing circumstances when the firm becomes associated with information that is false or misleading. For example, the IESBA Code contains requirements addressing circumstances when the professional accountant becomes associated with information that contains a materially false or misleading statement, contains statements that have been provided recklessly or omits or obscures required information where such omission or obscurity would be misleading.

Engagement Performance (Ref: Para. 36–37)

A91. ISA 220 (Revised)[29] requires the engagement partner to take overall responsibility for managing and achieving quality on the audit engagement.

Direction, Supervision and Review (Ref: Para. 36(a)(ii), 37(a))

A92. The firm's policies or procedures addressing engagement supervision may include responsibilities for:

- Tracking the progress of the engagement;
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement;
- Addressing matters arising during the engagement, considering their significance and modifying the planned approach appropriately; and
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

A93. The policies or procedures addressing the review of the work of engagement teams may address matters such as the reviewer's consideration of whether:

[29] Proposed ISA 220 (Revised), paragraph 11

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have been undertaken and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

Judgments and Conclusions (Ref: Para. 36(b))

A94. The system of quality management creates an environment that supports engagement teams in making informed decisions about the courses of action that are appropriate given the nature and circumstances of the engagement. For example, the responses designed and implemented by the firm to establish a culture that promotes a commitment to quality or the responses addressing the hiring, development, retention and assignment of personnel with the competence and capabilities to perform engagements are important in supporting the engagement team in exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism.

A95. The firm's policies or procedures for consultation and differences of opinion and the performance of engagement quality reviews may also address assessed quality risks related to exercising appropriate professional judgment and, when applicable to the type of engagement, professional skepticism in planning and performing engagements. The firm may also design and implement other types of responses, including other forms of engagement reviews that are not engagement quality reviews. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures on significant risks or reviews of certain matters by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

A96. Professional skepticism supports the quality of judgments made on the engagement and, through these judgments, the overall effectiveness of the engagement team in performing the engagement. Other pronouncements of the IAASB may address the exercise of professional judgment or professional skepticism at the engagement level. For example, ISA 220 (Revised)[30] explains the impediments to the exercise of professional skepticism at the engagement level and actions that the engagement partner may take to deal with such impediments.

A97. In performing related services engagements, a practitioner is not required to gather evidence to express an opinion or conclusion on the information. However, the practitioner may form conclusions related to the performance of the engagement, for example, in a compilation engagement the practitioner may conclude that the compiled financial information is misleading and be required to take the appropriate actions set out in ISRS 4410 (Revised).[31]

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[30] Proposed ISA 220 (Revised), paragraphs A27–A29

[31] International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, paragraphs 34–36

Consultation (Ref: Para. 37(c))

A98. Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. While the firm establishes policies or procedures regarding the matters on which consultation is required, the engagement team may identify other matters that require consultation.

A99. In considering its resource needs, the firm may consider the resources needed to enable consultation, for example, appropriate access to intellectual resources to facilitate research and personnel with the competence and capabilities to provide consultations. In some instances, such as a smaller firm, human resources to support consultation may only be available externally, for example, other firms, professional and regulatory bodies, or commercial organizations that provide such services. In such cases, paragraphs 64–65 apply.

Differences of Opinion (Ref: Para. 37(d))

A100. The policies or procedures addressing differences of opinion may be established in a manner that encourages identification of differences of opinion at an early stage. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

Engagements Subject to an Engagement Quality Review (Ref: Para. 37(e))

A101. The categories of engagements for which an engagement quality review is required are not mutually exclusive. For example, many listed entities may be considered to be of significant public interest based on the characteristics described in paragraph A102. In addition, law or regulation may require engagement quality reviews to be performed for certain types of entities (e.g., entities with public accountability as defined in certain jurisdictions), or may include different criteria or characteristics that firms may use in determining whether an entity is of significant public interest.

A102. In determining whether an entity is of significant public interest, the firm may take into account, for example, whether the entity has a large number and wide range of stakeholders, and the nature and size of the business. The firm also may consider the relative significance of factors such as these in the context of the jurisdiction or region in which the entity operates. Entities that the firm determines to be of significant public interest may include entities such as financial institutions (e.g. certain banks, insurance companies, and pension funds), and other entities such as certain not-for-profit organizations.

A103. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:

- Are characterized as public interest entities;
- Operate in the public sector or which are recipients of government funding;
- Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
- Meet a specified asset threshold; or
- Are under the management of a court or judicial process (e.g., liquidation).

A104. Audits or other engagements for which the firm may determine that an engagement quality review is an appropriate response to assessed quality risks may include, for example, engagements:

- That involve a high level of complexity or judgment, such as:
  - An audit of financial statements for an entity operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g., certain large financial institutions or mining entities), or for which uncertainties exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
  - An assurance engagement that requires specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (e.g., a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein).
- Where issues have been encountered on the engagement, for example, audit engagements with recurring internal or external inspection findings, unremediated deficiencies in internal control, or a material restatement of comparative information in the financial statements.
- For entities in emerging industries or that involve emerging technologies, or for which the firm has no previous experience.
- For which unusual circumstances are identified during the firm's acceptance and continuance of client relationships and specific engagements (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- That involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.
- For entities for which concerns were expressed in communications from securities or prudential regulators.

A105. In some cases, there may be no engagements for which an engagement quality review is required to be performed (e.g., when a firm does not perform audits of listed entities or entities of significant public interest and other responses to assessed quality risks are determined by the firm to be appropriate).

Considerations Specific to Public Sector Audit Organizations

A106. Public sector entities may be of significant public interest due to their size and complexity, the range of their stakeholders and the nature of the services they provide. Factors to consider in determining whether a public sector entity is of significant public interest may include whether the entity is a national, regional or local government, or whether an opinion is being expressed on the entire entity or only certain units. Other factors to consider may include whether the entity is a corporation that is state owned or in which the state has a controlling stake or a stake with significant influence. Larger public sector entities may be determined to be of significant public interest due to their social or economic influence on the community or region in which the entity operates.

A107. The firm may determine that an engagement quality review is an appropriate response to a quality risk for engagements in the public sector for which law or regulation establishes additional reporting requirements (e.g., a separate report on instances of non-compliance with law or regulation to the

legislature or other governing body or communicating such instances in the auditor's report on the financial statements).

Engagement Documentation (Ref: Para. 37(f))

A108. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. Where no such time limits are prescribed in law or regulation, the firm ordinarily establishes an appropriate time limit. In the case of an audit of financial statements, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.

A109. The retention and maintenance of engagement documentation includes managing the safe custody, integrity, accessibility or retrievability of the underlying data. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation may be compromised if it is altered, supplemented or deleted without the appropriate authorization to do so, or if it is permanently lost or damaged. The firm's responses may therefore include actions to prevent unauthorized access and create audit trails that indicate access and changes to engagement documentation.

A110. Relevant ethical requirements generally include provisions relating to confidentiality of client information, unless specific client authority has been given to disclose information, or there is a legal or professional duty or right to disclose the information. Specific law or regulation may impose additional obligations on personnel to maintain client confidentiality, particularly where data of a personal nature is concerned. Accordingly, the firm's responses for relevant ethical requirements may include responses for the retention and maintenance of engagement documentation. The firm's responses to address the confidentiality of client information may need to address all possible locations of client information, including engagement documentation, emails, firm servers or hard copy.

A111. Law or regulation may prescribe the retention period for engagement documentation, or there may be generally accepted retention periods. If the retention periods are not prescribed in law or regulation, the firm may, in determining an appropriate retention period, consider the nature of the engagements performed by the firm and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of audits of financial statements, the retention period would ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the auditor's report on the group financial statements, when applicable.

A112. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Resources (Ref: Para. 38–39)

A113. Resources for the purposes of the resources component include:

- Human resources.
- Technological resources, for example, IT applications.
- Intellectual resources, for example, written policies or procedures, a methodology or guides.

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing and maintaining the firm's human resources, technological resources and intellectual resources. The governance and leadership component addresses appropriate resource planning for all resources. Given the nature of financial resources, the quality objectives and responses in governance and leadership, such as those that address financial and operational priorities, address financial resources. This component addresses specific aspects of human resources, technological resources and intellectual resources.

A114. Resources are pervasive to all components of the system of quality management and therefore the firm's responses for resources will address assessed quality risks specific to resources, as well as assessed quality risks for other components. Such responses may be designed and implemented individually for each component, or they may be designed and implemented for all components holistically.

A115. Resources may be internal to the firm, or may be obtained externally from a network, network firm or service provider. In such circumstances, in addition to complying with the requirements for resources set out in this component, the firm is also required to comply with paragraphs 58–63 addressing network requirements or network services or paragraphs 64–65 addressing the use of resources from a service provider.

A116. Other components include responses that may affect or relate to the resources component. For example, the information necessary to facilitate the appropriate assignment of personnel or the evaluation of personnel is identified, captured, processed and maintained through the information and communication component.

Human Resources (Ref: Para. 38(a)–38(d))

A117. Competence is the ability of the individual to perform a role to a defined standard and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values and attitudes. Competence can be developed through a variety of methods, including professional education, continuing professional development, training, work experience or coaching of less experienced engagement team members by more experienced engagement team members.

A118. Professional standards, law or regulation may establish requirements addressing competence and capabilities. For example, law or regulation of a jurisdiction may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.

A119. The firm's responses that relate to the hiring, development and retention of personnel may include:

- Recruitment strategies that focus on selecting individuals who have the ability to develop the competence necessary to consistently perform quality engagements or activities in relation to the operation of the system of quality management.
- Training programs, which may form part of the firm's intellectual resources, to develop personnel's competence to enable them to perform their roles and responsibilities.
- Policies addressing the continuing professional development of personnel, including personnel's responsibility to maintain an appropriate level of continuing professional development, and training resources and other assistance provided by the firm.

- Evaluation mechanisms that establish competency areas and other performance measures, and facilitate the evaluation of personnel at appropriate intervals.
- Compensation, promotion and other incentives, appropriate to the nature and circumstances of the firm, for all personnel, including engagement partners, the individuals assigned ultimate responsibility and accountability for the firm's system of quality management, and the individual(s) assigned operational responsibility the firm's system of quality management or other aspects of the system of quality management.

A120. Human resources assigned to engagements or other roles may include personnel in a service delivery center, human resources engaged by the firm (i.e., a service provider) or human resources from a network or network firm.

A121. Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, for example, in the case of smaller firms with fewer personnel.

A122. Evaluations of personnel may be used by the firm in determining the compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

A123. The firm may take action for personnel who demonstrate actions or behaviors that negatively affect quality, including failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role or implement the firm's responses as designed (e.g., an individual breaches the firm's policies or procedures related to independence). The consequences or actions taken by the firm may depend on the severity of the failure and the frequency of occurrence and may include, for example:

- Training or other professional development;
- Considering the effect of the matter on the evaluation, compensation, promotion or other incentives of the individual(s); or
- Taking disciplinary action against the individual(s), if appropriate, depending on the severity of the failure and the frequency of occurrence.

Technological Resources (Ref: Para. 38(e))

A124. Technological resources, which are typically IT applications, form part of the firm's IT environment. The firm's IT environment also includes the supporting IT infrastructure and the IT processes and human resources involved in those processes that the firm uses in the operation of its system of quality management:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.
- The IT processes are the firm's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations, which includes monitoring the IT environment.

A125. An IT application, IT infrastructure or IT process may serve multiple purposes within the firm and some of the purposes may be unrelated to the system of quality management. Only IT applications, IT infrastructure or IT processes that support the firm's system of quality management are relevant for the purposes of this ISQM.

A126. In some cases, the network may require the firm to use an IT application, the firm may choose to use an IT application provided by the network, or the firm may purchase an IT application from a service provider. The firm may also use the network or a service provider to manage certain aspects of the IT processes.

A127. Paragraph 40(a) addresses the firm's responsibility to establish an information system that supports the system of quality management, which may include the use of IT elements and records in the form of digital information. The firm may also use certain IT applications to enable the operation of various aspects of its system of quality management, for example, IT applications used to monitor compliance with relevant ethical requirements and record and maintain information about independence. Other IT applications may be implemented by the firm for use by engagement teams in performing engagements, for example, the firm may mandate the use of an IT application that facilitates the documentation of work performed or the firm may offer an IT application to perform analyses of the client's information that engagement teams may choose to use.

A128. The IT environment for a larger firm may be comprised of customized or integrated IT applications, with dedicated human resources to manage the IT infrastructure and IT processes. The IT environment for smaller firms may comprise IT applications that are commercial software, and the IT processes may involve authorizing access to the IT applications and processing updates to the IT applications.

A129. The use of IT applications or other aspects in the IT environment may give rise to quality risks, for example:

- Inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorized access to data that may result in breaches in confidentiality of information contained in the data, destruction of data or improper changes to data.
- Potential loss of data or inability to access data or IT applications as required.
- Unauthorized changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.

The nature and significance of these quality risks may vary based on whether, and the extent to which, the firm relies on IT, including automated controls, to enable the design, implementation and operation of the system of quality management. General IT controls may be part of the responses designed and implemented by the firm to address quality risks identified and assessed by the firm.

A130. When implementing an IT application, particularly a customized IT application that has been developed specifically for the firm, it is necessary for the firm to determine that the IT application operates appropriately. This determination may involve consideration of whether:

- The data inputs are appropriate and confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.

- The outputs of the IT application achieve the purpose for which they will be used.
- It is clear how users are required to interact with and use the IT application and users have appropriate support.
- The general IT controls necessary to support the IT application's continued operation as designed are appropriate.

The firm may specifically prohibit the use of IT applications or features of IT applications, until such time that it has been determined that they operate appropriately and have been approved for use by the firm.

A131. Engagement teams may need training on how to use the IT applications appropriately. Furthermore, for certain IT applications, specialized skills may be needed to utilize the IT application effectively and the firm may need to specify procedures that set out how the engagement team operates the IT application. For example, in some instances the firm's IT application for the performance of engagements may require that the engagement team complete certain information about the client and the circumstances of the engagement in order to generate an appropriate engagement file template for the circumstances of the engagement.

Intellectual Resources (Ref: Para. 38(f))

A132. Intellectual resources include the information the firm uses to promote consistency in the performance of engagements, for example, written policies or procedures, a methodology, industry or subject matter-specific guides, accounting guides, standardized documentation or access to information sources (e.g., subscriptions to websites that provide in-depth information about entities or other information that is typically used in the performance of engagements).

A133. The intellectual resources may be made available to personnel through technological resources, for example, the firm's audit methodology may be embedded in the audit IT application that facilitates the planning and performance of the engagement. The firm may also need human resources to develop, implement and maintain its intellectual resources. Intellectual resources may also be dependent on relevant and reliable information that is identified, captured, processed and maintained through the firm's information and communication component.

Personnel's Use of Technological and Intellectual Resources (Ref: Para. 38(g))

A134. The firm may establish policies or procedures regarding the use of the firm's technological and intellectual resources. Such policies or procedures may:

- Require the use of certain IT applications or intellectual resources in performing engagements, for example, engagement teams may be required to use the firm's methodology when performing the engagement. They may also be required to use IT applications that facilitate the performance of the engagement and the archival of the engagement file.
- Specify the qualifications or experience of personnel that are needed to use the IT application, for example, the firm may specify the qualifications or expertise needed to use an IT application for the performance of automated techniques and to interpret the results.
- Set out how the technological or intellectual resources are to be used.

Information and Communication (Ref: Para. 40–41)

A135. Obtaining, generating or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication is pervasive to all components of the system of quality management and therefore the firm's responses for information and communication address assessed quality risks specific to information and communication, as well as assessed quality risks for the other components. Such responses may be designed and implemented individually for each component, or for all components holistically. Paragraphs A51, A69, A76 and A116 explain and provide examples of how the information and communication component supports the design, implementation and operation of the other components of the system of quality management.

The Firm's Information System (Ref: Para. 40(a))

A136. Reliable information includes information that is accurate, complete, timely and valid to enable the proper functioning of the firm's system of quality management and to support decisions regarding the system of quality management.

A137. The information system in smaller firms is likely to be less sophisticated than in larger firms and involve a less complex IT environment.

A138. The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained and communicated. The procedures to identify, capture, process, maintain and communicate information may be enforced through IT applications, and in some cases may be embedded within the firm's responses for other components. For example, the firm's responses for monitoring and remediation may define how information from the results of the firm's monitoring activities is captured, processed, maintained and communicated. In addition, digital records may replace or supplement physical records. For example, the firm may use an IT application to obtain a documented confirmation of compliance with independence requirements from personnel.

Communication Within the Firm (Ref: Para. 40(b)–40(d), 41(a)–41(b))

A139. The firm and its personnel share relevant information to enable the proper functioning of the firm's system of quality management. For example:

- The firm communicates information to engagement teams, such as information that is obtained during the firm's acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.
- Engagement teams communicate information to the firm, for example, information about:
  - The client obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement.
  - The operation of the firm's responses to assessed quality risks (e.g., concerns about the firm's processes for assigning personnel to engagements).

  In some cases, the information communicated by the engagement team may indicate a deficiency in the firm's system of quality management.

- Personnel performing activities within the firm's system of quality management share information. For example, the individual(s) assigned operational responsibility for compliance with independence requirements may communicate to the person with ultimate responsibility for the system of quality management changes in the independence requirements and how the firm's policies or procedures have been updated in response to such changes.

Two-way communication may also be among the various parties, for example, engagement teams may communicate information directly to the personnel performing activities within the firm's system of quality management.

A140. Matters communicated by the firm to engagement teams or other personnel performing activities within the firm's system of quality management may include changes to the system of quality management, to the extent that the changes are relevant to their responsibilities and enables the personnel to take prompt and appropriate action in accordance with their responsibilities.

A141. Responsibility for operating the responses designed and implemented by the firm may be assigned to:

- The engagement team, as described in paragraph A62;
- Personnel performing activities within the firm's system of quality management (e.g., assigning responsibility for the performance of an engagement quality review to an engagement quality reviewer); or
- A combination of the engagement team and personnel performing activities within the firm's system of quality management.

The firm may also use human resources external to the firm to assist in operating the responses.

Communication with External Parties (Ref: Para. 40(e), 41(c))

Communication Required by Law or Regulation (Ref: Para. 41(c)(i))

A142. Law, regulation or professional standards may require the firm to communicate information to external parties. For example:

- In circumstances when the firm becomes aware of non-compliance with laws and regulations by a client, relevant ethical requirements may require the firm to report the non-compliance with laws and regulations to an appropriate authority outside the client entity, or to consider whether such reporting is an appropriate action in the circumstances.
- Law, regulation or professional standards may require the firm to publish a transparency report and may specify the nature of the information that is required to be included in the transparency report.

Communication with the Network (Ref: Para. 41(c)(ii))

A143. When the firm belongs to a network, frequent communication with the network supports the network in establishing network requirements and providing network services that promote the consistent performance of quality engagements. Furthermore, the network's communication of relevant information supports the firm in the design, implementation and operation of its system of quality management. Such communication may include matters related to independence, for example, in

circumstances when relevant ethical requirements include requirements for independence that apply to network firms or employees of network firms.

Communication with Service Providers (Ref: Para. 41(c)(iii))

A144. When the firm uses a service provider, the service provider's communication of relevant information to the firm that affects the firm's system of quality management supports the firm in the design, implementation and operation of its system of quality management.

Communication to External Parties About the Firm's System of Quality Management (Ref: Para. 41(c)(iv))

A145. The firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through effective two-way communication between the firm and its stakeholders. For example, stakeholders' perception of the quality of engagements performed by the firm may be improved when the firm is transparent about the activities that it has undertaken to address quality, and the effectiveness of those activities.

External parties who may use information about the firm's system of quality management (Ref: Para. 41(c)(iv)(a))

A146. External parties may include management or those charged with governance of the firm's clients, the firm's network or network firms, external oversight authorities, other firms who use the work of the firm in the performance of engagements (e.g., in relation to a group audit) or service providers. External parties may also include users of the firm's engagement reports, for example, current shareholders and credit providers of the entities for whom the firm performs engagements.

A147. The firm exercises professional judgment when taking into account whether there are external parties who may use information about the firm's system of quality management. Whether there are such external parties may depend on the nature of the engagements the firm performs and the types of entities for which such engagements are performed. For example, for a firm that performs audits of financial statements of listed entities or entities that may be of significant public interest described in paragraph A23, external parties such as shareholders of such entities may use a transparency report or similar publication to inform their understanding of the quality of engagements performed by the firm. On the other hand, for a firm that only performs compilation engagements, external parties who may use information about the firm's system of quality management may be limited, and they may obtain such information through discussions and direct interaction with the firm.

Nature and circumstances of the firm (Ref: Para. 41(c)(iv)(b))

A148. Factors that may affect the firm's operating environment include the nature and circumstances of the financial markets in which the firm operates and the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm's processes in performing the engagements.

Nature, timing, extent and content of communications to external parties about the system of quality management (Ref: Para. 41(c)(iv))

A149. The form of communication to external parties may include a publication such as a transparency report or audit quality report, webpage, targeted communication to specific stakeholders (e.g.,

information about the results of the firm's monitoring and remediation process), or direct conversations with the external party.

A150. The information that is communicated to external parties about the firm's system of quality management may depend on a variety of factors, including the form of the communication, the nature and circumstances of the firm and the external parties with whom the communication is being undertaken. For example, the communication may contain information about:

- The nature and circumstances of the firm, such as the organizational structure and operating environment and whether it is part of a network.
- The firm's governance and leadership, such as its culture and commitment to quality and information about the individuals responsible for the leadership of the firm.
- Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with appropriate narrative to explain the indicators.
- The results of the firm's monitoring activities and external inspections, and how the firm has remediated identified deficiencies or is otherwise responding to them.
- The evaluation undertaken in accordance with paragraph 55 of whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved, including the basis for the judgments made in undertaking the evaluation.
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes.

A151. Information that is communicated to external parties about the firm's system of quality management that has the following attributes contributes to an enhanced understanding of the quality of the engagements performed by the firm:

- The information is specific to the circumstances of the firm and is prepared and presented in a timely manner. Relating the matters in the firm's communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time.
- The information is presented in a clear and understandable manner that is neither misleading nor would inappropriately influence the users of the communication (e.g. the information is appropriately balanced towards positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources, for example, information located on the firm's website.

A152. In circumstances when the firm is part of a network, it may be useful to provide information about the relationship between the firm and the network in certain external communications, such as a transparency report. Such information helps facilitate an understanding of the responsibilities of the firm and the network, and clarifies how the network requirements or network services promote the consistent performance of quality engagements across the network firms. Such information may include:

- The nature of the relationship between the firm and the network and the overall structure of the network.
- Requirements established by the network for the firm or network services that are used by the firm in its system of quality management.
- Information about the overall scope and results of network monitoring activities across the network firms that the network has provided to the firm in accordance with paragraph 61, if applicable.

In some circumstances, the network may provide external communication about the above matters, for example, in the form of a network transparency report, which may support the firm in communicating the information.

A153. In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. For example, certain information may be subject to privacy or secrecy laws or regulations or the firm may be precluded from communicating certain information because of the duty of confidentiality under law, regulation or relevant ethical requirements.

Monitoring and Remediation Process (Ref: Para. 42–57)

A154. In addition to enabling the firm's evaluation of the system of quality management, the monitoring and remediation process facilitates the improvement of engagement quality and the system of quality management.

A155. Professional judgment is exercised in making various decisions within the monitoring and remediation process, including decisions about:

- The nature, timing and extent of the monitoring activities, including the scope of inspection of engagements.
- The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information to determine whether deficiencies exist.
- How to respond to the findings from the monitoring activities, results of external inspections and other relevant information.
- The evaluation of the severity and pervasiveness of the identified deficiencies.
- Whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

Designing and Performing Monitoring Activities (Ref: Para. 44–46)

A156. The firm's monitoring activities may comprise ongoing monitoring activities, periodic monitoring activities or a combination of both. Ongoing monitoring activities are generally routine activities, built

into the firm's processes and performed on a real-time basis, reacting to changing conditions, for example:

- An IT application that continually monitors the permissibility of financial investments recorded by personnel as part of the firm's independence responses.
- Inspection of in-process engagements that are focused on specific aspects of completed work.

Periodic monitoring activities are conducted at certain intervals by the firm, for example, inspection of training records to determine that personnel have attended training in accordance with the firm's policies or procedures or inspection of completed engagements. In most cases, ongoing monitoring activities identify deficiencies in the system of quality management in a timelier manner.

A157. The purpose of a monitoring activity is to monitor the responses in the system of quality management. The system of quality management may include responses that are similar in nature to a monitoring activity but have a different purpose (e.g., responses that are designed to detect failures or shortcomings in the system of quality management so that they can prevent an assessed quality risk from occurring). For example, in some circumstances, an in-process review of engagement documentation may be designed as a monitoring activity as part of paragraph 45, in which case the findings from that review are subject to the requirements in paragraph 47. In other circumstances, an in-process review may be designed as a response to address an assessed quality risks in the engagement performance component or other components. Determining the purpose of the response is necessary in determining its design and implementation, and where it fits within the system of quality management (i.e., whether it is a response in monitoring and remediation or a response in another component).

A158. The nature, timing and extent of the monitoring activities may be affected by factors such as:

- The size, structure and organization of the firm.
- The involvement of the network in monitoring activities.
- The resources that the firm intends to use to enable monitoring activities, for example, the use of IT applications in addition to human resources.
- The design of the response subject to monitoring. For example, the response may comprise in-process reviews of engagement documentation of selected engagements by personnel who are not members of the engagement team. The extent of the review of the engagement documentation, the nature of the matters considered in the review, and how the results of the review are collated may affect the nature, scope and frequency of the monitoring activities over the in-process review.

A159. When performing monitoring activities, the firm may determine that changes to the nature, timing and extent of the monitoring activities are needed. For example, the firm may identify findings that indicate the need for more extensive monitoring activities.

The Design of the Response and the Assessed Quality Risks (Ref: Para. 44(a))

A160. The nature, timing and extent of the firm's monitoring activities may be more robust for areas of the system of quality management where the assessed quality risks are greater and the related responses are more extensive or rigorous. For example, the firm may perform more extensive monitoring activities over compliance with independence requirements for audits of financial statements than for other types of engagements.

A161. The reasons for the assessments given to the assessed quality risks may include characteristics associated with certain engagements, for example:

- Engagements performed in respect of certain entities (e.g., a listed entity or entity that may be of significant public interest).
- Engagements where the firm or engagement partner are inexperienced, for example, a new industry, a new service offering or new engagement partner.
- Engagements that have been subject to external inspection and which had negative findings, or engagements where the findings of previous monitoring activities resulted in identified deficiencies.
- Engagements where the firm's engagement acceptance and continuance procedures indicated that matters may exist that may increase the engagement risk.

Changes in Factors That Have Affected the System of Quality Management or Changes in the System of Quality Management (Ref: Para. 44(c))

A162. Changes in factors that have affected the firm's system of quality management include changes in the nature and circumstances of the firm and its engagements (e.g., a new service offered by the firm or changes in the firm's environment). Changes in the system of quality management include:

- Changes to address an identified deficiency in the system of quality management.
- Changes to the responses, for example, because they have become obsolete over time or more effective responses are designed and implemented, such as the use of IT applications to replace manual processes.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm's monitoring activities may include monitoring of those areas of change.

Previous Monitoring Activities (Ref: Para. 44(d), 50)

A163. The findings from the firm's previous monitoring activities may indicate areas of focus for the monitoring activities, for example, monitoring activities may need to continue to be undertaken in certain areas where there is a history of deficiencies. Furthermore, the monitoring activities may need to evaluate the effectiveness of the remedial actions that have been implemented to address deficiencies previously identified.

A164. Although areas of the system of quality management may not have changed, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of areas that have not changed, for example, because of the time that has elapsed since the monitoring activities were undertaken.

Other Relevant Information (Ref: Para. 44(e), 47)

A165. Examples of sources of other relevant information may include:

- Information communicated by the network in accordance with paragraphs 60(c) and 61 about the firm's system of quality management, including the network requirements or network services that the firm has included in its system of quality management.

- Information communicated by a service provider about the resources the firm uses in its system of quality management.
- Concerns about the commitment to quality of the firm or its personnel, communicated in accordance with paragraph 24(c).
- The results of industry-wide reviews undertaken by an external oversight authority of focus areas related to systems of quality management or the performance of engagements.
- Other reviews undertaken by an external oversight authority, for example, informal reviews undertaken by an external oversight authority to assess a firm's preparation for the implementation of a new professional standard, or reviews of specific areas of focus that contribute to the improvement of engagement quality.
- Information from regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider.
- A material restatement of financial statements, an engagement report that required reissuance or litigation against the firm.

A166. The results of external inspections or other relevant information may indicate findings or deficiencies in previous monitoring activities undertaken by the firm, which may affect the firm's consideration of whether the nature, scope and frequency of previous monitoring activities were appropriate.

A167. External inspections are not a substitute for the firm's internal monitoring activities. Nevertheless, the results of external inspections may inform the nature, timing and extent of the monitoring activities.

Engagement Inspections (Ref: Para. 45)

A168. The relevant factors in paragraph 44 affect the extent and frequency of selection of in-process or completed engagements or engagement partners for inspection. Other factors that may also affect the extent and frequency of selection of in-process or completed engagements or engagement partners for inspection include:

- The nature, timing and extent of other monitoring activities undertaken by the firm at the engagement level.
- The varying nature of the engagements performed by the firm.
- The size of the firm, including the number and geographic location of offices and the nature and complexity of the firm's practice and organization.

A169. The firm may establish different cyclical periods for inspecting engagement partners according to the categories of engagements they perform, for example, the firm may determine that the cyclical period for an engagement partner performing audits of financial statements is every three years, whereas a longer period may be appropriate for engagement partners performing only compilation engagements. The cycle of the inspection may be based on time (i.e., every three years as illustrated) or another factor, such as the number of engagements performed. The cyclical period may also be affected by the nature, timing and extent of inspection of in-process engagements and the results thereof.

A170. The purpose of an inspection of an in-process or completed engagement depends on how the inspection has been designed by the firm. Ordinarily, the inspection of an in-process or completed engagement includes determining that responses designed to be implemented at the engagement

level have been implemented, for example, the firm may determine whether engagement teams have applied the firm's methodology appropriately.

Individuals Performing the Monitoring Activities (Ref: Para. 46)

A171. As described in paragraph A65, objectivity is a fundamental principle of the IESBA Code, and the provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. For example, a self-review threat may arise when an individual who performs:

- An inspection of an engagement was:
  - In the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period; or
  - For all other engagements, an engagement team member or the engagement quality reviewer of that engagement.
- Another type of monitoring activity had participated in designing, executing or operating the response being monitored.

Evaluating Findings and Identifying Deficiencies (Ref: Para. 47)

A172. Findings represent the information accumulated from the performance of monitoring activities and may also include the results of external inspections and other relevant information about the firm's system of quality management. Findings may be positive or negative in nature.

Positive Findings

A173. Positive findings may be useful to the firm as they indicate practices that the firm can support or apply more extensively, for example, across all engagements. They may also highlight opportunities for the firm to enhance the system of quality management.

Negative Findings

A174. Negative findings are considered by the firm in accordance with paragraph 47 to determine whether there are deficiencies in the system of quality management. Not all negative findings are a deficiency in the system of quality management.

A175. Factors that a firm may consider in determining whether a finding is a deficiency include:

- The nature of the finding, for example, a finding that indicates that personnel have not adhered to the firm's policies or procedures may be indicative of a deficiency in the culture of the firm.
- The design of the monitoring activity from which the finding arose, for example, the firm may consider the tolerable error rate of the activity and whether it was designed to focus on specific areas of risk or the whole population.
- The extent of the monitoring activity from which the finding arose, including the size of sample selected relative to the size of the entire population.
- The extent of the findings in relation to the sample of the population covered by the monitoring activity.

- If the finding relates to a response:
  - The nature of the assessed quality risk to which the response relates, and the extent to which the finding indicates that the assessed quality risk has not been addressed.
  - Whether there are other responses that address the same assessed quality risk and whether there are findings for those responses.
- Whether the finding, in combination with other findings, indicate a trend or systemic issue.

A176. A finding may affect multiple responses across different components. For example, a finding that suggests that personnel assigned to an engagement were not knowledgeable about the procedures they performed in the engagement may indicate deficiencies in responses related to human resources (i.e., inappropriate competence and capabilities) as well as those related to engagement performance (i.e., inappropriate direction, supervision and review).

A177. The effectiveness of the monitoring and remediation process may be evaluated through considering the findings arising from the monitoring activities, the results of external inspections and other relevant information source (e.g., network monitoring activities or complaints and allegations). For example, external inspection findings may indicate deficiencies in the system of quality management that have not been identified by the firm's monitoring and remediation process, which highlight a deficiency in that process.

Root Cause of the Identified Deficiencies (Ref: Para. 48(a))

A178. This ISQM requires the firm to investigate the root cause(s) of identified deficiencies. As highlighted in paragraph A174, not all negative findings from the performance of monitoring activities, results of external inspections and other relevant information are a deficiency in the system of quality management. Although not required by this ISQM, investigating the root cause of positive findings may reveal opportunities for the firm to improve, or further enhance, the system of quality management. Identifying the root cause of positive findings on engagements where identified deficiencies did not exist may also help the firm to identify the root causes of identified deficiencies that existed in other engagements and may assist the firm in determining how to remediate identified deficiencies.

A179. The objective of investigating the root cause(s) of identified deficiencies is to understand the underlying circumstances that caused the deficiencies. An improved understanding of the underlying cause(s) of identified deficiencies may:

- Facilitate the design and implementation of more effective actions to address identified deficiencies.
- Directly contribute to the improvement of quality at the engagement level through the participation of engagement teams in the root cause analysis process.
- Enable those assigned ultimate responsibility and accountability or operational responsibility for the system of quality management to proactively monitor actions taken to address identified deficiencies.
- Facilitate more effective communication to personnel by explaining the actual root cause(s) of identified deficiencies, rather than the deficiencies themselves.

A180. Performing a root cause analysis generally involves those performing the assessment exercising professional judgment based on the evidence available. The firm's policies or procedures for the nature, timing and extent of the procedures to investigate the root cause(s) of identified deficiencies are required to take into account the nature of the deficiencies and their possible severity which may include:

- The nature and extent of the deficiency, for example, a deficiency that results in an engagement report being inappropriate has greater severity than a deficiency that resulted in the firm's policies or procedures not being followed but the engagement report was still appropriate.
- Whether the deficiency, in combination with all other identified deficiencies, indicates a trend or systemic issue, for example, there are multiple engagement reports affected by the same deficiency or certain policies or procedures appear to have high rates of non-compliance.

The procedures undertaken to understand the root cause(s) of an identified deficiency may be simple, for example, in circumstances when the possible severity of the deficiency is not significant, the root cause is apparent or, in the case of a smaller firm, those performing the root cause analysis are familiar with a variety of information to inform their understanding.

A181. There may be multiple root cause(s) of an identified deficiency, the root cause(s) may be complex and interrelated, and the root cause(s) may exist across various components of the firm's system of quality management. Furthermore, a root cause of an identified deficiency may relate to more than one identified deficiency or affect multiple components, for example, in circumstances when the root cause relates to an aspect of the firm's risk assessment process. There may also be circumstances when a single root cause relates to multiple identified deficiencies.

A182. Identifying a root cause(s) that is appropriately specific may support the firm's process for remediating identified deficiencies. For example, it may be identified that an engagement team did not exercise sufficient professional skepticism in complex areas of management judgment. However, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to challenge individuals with greater authority or insufficient direction, supervision and review on the engagement.

Evaluating the Severity and Pervasiveness of Identified Deficiencies (Ref: Para. 48(b))

A183. Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include:

- The nature of the identified deficiency, including whether it relates to a quality objective, quality risk or a response;
- The root cause(s) of the identified deficiency;
- The frequency with which the underlying finding occurred; and
- The magnitude of the identified deficiency, the rate at which it occurred and the duration of time that it existed.

Responding to Identified Deficiencies (Ref: Para. 49–50)

A184. The nature, timing and extent of remedial actions may depend on a variety of other factors, including:

- The root cause(s), for example, whether it relates to an individual engagement, a certain category of engagements, or is more pervasive throughout the firm.

- The severity and pervasiveness of the identified deficiency and therefore the urgency in which it needs to be addressed.
- The effectiveness of the remedial actions in addressing the root cause(s), for example, the firm may need to implement more than one remedial action in order to effectively address the root cause(s), or may need to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions.

Findings About a Particular Engagement (Ref: Para. 51)

A185. In circumstances when procedures were omitted or the report issued is inappropriate, the action taken by the firm may include:

- Consulting with appropriate individuals within the firm regarding the appropriate action.
- Discussing the matter with management of the entity or those charged with governance.
- Performing the omitted procedures.

The actions taken to correct the work performed for a specific engagement does not relieve the firm of the responsibility to investigate the root cause(s) of the identified deficiency related to the engagement.

Ongoing Communication Related to the Monitoring and Remediation (Ref: Para. 52–54)

A186. The information communicated about the monitoring and remediation to the individual(s) assigned ultimate responsibility and accountability for the system of quality management and the individual(s) assigned operational responsibility for the system of quality management provides the basis for the evaluation of the system of quality management, as required by paragraph 55.

A187. In determining the information to be communicated to personnel, including the nature and extent of such communication, the firm may consider the type of information that is relevant to the particular recipients, including the information needs of the recipients, as a result of their defined roles and responsibilities. For example:

- Information communicated to engagement teams may be focused on deficiencies that have been identified at an engagement level and therefore are likely to be relevant. It may also include positive findings that indicate practices that engagement teams could apply more extensively. In considering the information needs of the engagement team, the firm may take into account the responsibilities of the engagement team regarding such information. For example, proposed ISA 220 (Revised)[32] requires the engagement team to determine the relevance and effect on the audit of the results of the monitoring and remediation process, and to take appropriate action.
- Information communicated to all personnel may relate to matters relevant to compliance with the firm's independence policies or procedures as such policies or procedures may apply to all personnel.

Communicating the root cause(s) of identified deficiencies may increase awareness and understanding of why deficiencies occurred, which may influence the behavior of engagement teams

[32] Proposed ISA 220 (Revised), paragraph 36(b)

and personnel. Communicating remedial actions may enable the implementation of such actions in a more proactive manner.

Evaluating the System of Quality Management (Ref: Para. 55–57)

A188. An effective system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

A189. The individual(s) assigned ultimate responsibility and accountability for the system of quality management uses the information obtained in accordance with paragraph 52 in evaluating the effectiveness of the system of quality management. The nature and extent of the information, including how the information is communicated, will vary based on the nature and circumstances of the firm. For example, in a smaller firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and will therefore be aware of the information that supports the evaluation of the system of quality management. However, in a larger firm, the individual(s) assigned ultimate responsibility and accountability for the system of quality management may not have direct involvement in the monitoring and remediation process. Therefore, the individuals assigned operational responsibility for various aspects of the system of quality management may need to collate, summarize and present the information that supports the evaluation of the system of quality management in a manner that enables the individual(s) assigned ultimate responsibility and accountability for the system of quality management to form an appropriate conclusion.

A190. Prompt and appropriate action when the evaluation indicates that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved may include:

- Taking steps to determine whether the reports already issued by the firm were appropriate.
- Taking measures to confirm that reports not yet issued by the firm are appropriate in the circumstances.
- Obtaining legal advice.

A191. Circumstances when it may be appropriate for the firm to communicate to external parties that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved include:

- When the firm belongs to a network and the information is relevant to the network or other firms within the network who use the work performed by the firm, for example, in the case of a group audit.
- When a report issued by the firm is determined to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed.

In some circumstances, the firm may be required by law or regulation to communicate to an oversight authority or a regulatory body that the system does not provide reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

Network Requirements or Network Services (Ref: Para. 58–63)

A192. Network requirements may include, for example:

- Requirements for the firm to include quality objectives or identified quality risks in the firm's system of quality management that are common across the network firms.
- Requirements for the firm to include responses, including resources, in the firm's system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, network developed methodologies for the performance of engagements or IT applications.
- Requirements that the firm be subject to the network's monitoring activities. These monitoring activities may relate to network requirements (e.g., monitoring that the firm has implemented the network's methodology appropriately), or to the firm's system of quality management in general.

A193. Examples of network services include services or resources that are optional for the firm to use as a response in its system of quality management, such as voluntary training programs, or a service delivery center established at the network level, or by another firm or group of firms within the same network.

A194. The network may establish responsibilities for the firm in implementing the network requirements or network services. For example, in the case of implementing an IT application developed by the network, the firm may need to have the appropriate IT infrastructure and IT processes in place.

A195. The firm's understanding of the network requirements or network services and the firm's responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as:

- The network's governance and leadership.
- The procedures undertaken by the network in designing, implementing and, if applicable, operating, the network requirements or network services.
- How the network identifies and responds to changes that affect the network requirements or network services or other information, for example, changes in the professional standards or information that indicates a deficiency in the network requirements or network services;
- How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms' monitoring activities, and the network's processes for remediating identified deficiencies.

A196. Paragraph 41(c) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the network, for example, the matters described in paragraphs 58 and A195.

The Firm's Risk Assessment Process (Ref: Para. 59)

A197. The network requirements or network services may affect the firm's system of quality management in the following ways:

- The firm may need to identify and assess quality risks for quality objectives provided by the network.

- The firm may need to design and implement responses to address quality risks provided by the network, or the firm may need to assess the quality risks provided by the network.
- The firm may identify additional quality risks arising from responses provided by the network, for example, quality risks may arise from the implementation of a network IT application.

A198. The network requirements or network services may need to be adapted or supplemented by the firm to appropriately address the nature and circumstances of the firm and its engagements, for example:

- The quality objectives provided by the network may not be at a sufficient level of granularity for the firm, or additional quality objectives may need to be established.
- The firm may identify additional quality risks that have not been identified by the network.
- The responses provided by the network may not be designed to address the assessed quality risks and the reasons for the assessments given to the quality risks.

Monitoring and Remediation Process (Ref: Para. 60–63)

A199. The monitoring activities undertaken by the network may affect the nature, timing and extent of the firm's monitoring activities. For example, the network may undertake cyclical inspections of completed engagements of the firm, which may affect the extent of inspections of in-process or completed engagements undertaken by the firm.

A200. The results of the network's monitoring activities of the firm's system of quality management may include information such as:

- A description of the monitoring activities, including their nature, timing and extent;
- Findings from the monitoring activities and deficiencies identified; and
- The network's evaluation of the root cause(s) of the identified deficiencies, the assessed effect of the deficiencies and recommended remedial actions.

A201. The information about the overall scope and results of the monitoring activities across the network firms' systems of quality management may highlight trends and common areas of identified deficiencies across the network, or examples of quality that may be replicated across the network. Such information may be used by the firm to determine the nature, timing and extent of its monitoring activities. It may also indicate deficiencies in network requirements or network services used by the firm in its system of quality management.

A202. In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm's system of quality management that affects the firm, for example, when the network firm performs work for the firm's engagements, such as in the capacity of a component auditor. The network may also gather information from the network firms regarding the results of external inspections over the network firms' systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other firms within the network or may restrict the specificity of such information.

A203. Paragraph 42 requires the firm to evaluate the design, implementation and operation of the components of the system of quality management, which includes the network requirements or network services used by the firm. The network requirements or network services may be monitored by the network, the firm, or a combination of both. For example, the network may undertake monitoring activities at a network level for a common methodology, however various monitoring

activities at a firm level may support the evaluation of the methodology, including engagement inspections.

A204. In some cases the firm may determine that the remedial actions by the network are inadequate, or such remedial actions may take time to effectively address the identified deficiency. In such cases, the firm may need to implement its own remedial actions to address the identified deficiency until such time as the network has effectively addressed the deficiency.

Service Providers (Ref: Para. 64–65)

A205. The firm may use human resources, technological resources or intellectual resources that are obtained from a service provider. The service providers used by the firm include individuals or organizations that are external to the firm, excluding networks, network firms or other structures or organizations in the network. Examples of resources from a service provider include:

- Human resources used to perform the firm's monitoring activities or engagement quality reviews, or to provide consultation on technical matters.
- A commercial IT application used to perform audit engagements.
- Human resources used in the performance of engagements, for example, to attend a physical inventory count or inspect physical fixed assets at a remote location.
- External experts used in the performance of engagements. In such cases, there may be requirements in the other IAASB standards that address the competence, capabilities and objectivity of the external expert, understanding of the expert and agreement with the expert which apply in conjunction with the requirements of this ISQM.[33]
- The use of resources from a service provider does not include using the work of an entity's internal audit function in the performance of engagements, in accordance with ISA 610 (Revised 2013).[34]

A206. The determination of whether the matters described in paragraph 64 are relevant for a service provider depends on a variety of factors including:

- The nature of the resources provided by the service provider, including how and the extent to which it will be used within the firm.
- The reasons for the assessments given to the assessed quality risks to which the resource relates.
- Whether the resource itself gives rise to quality risks. For example, when the firm uses human resources from a service provider in the performance of engagements, there may be a quality risk that such resources do not have the competence and capabilities to perform the engagement, exercise inappropriate judgment when performing the engagement, do not implement the firm's responses at the engagement level or do not fulfill their responsibilities in accordance with relevant ethical requirements. Such quality risks may also affect the management of quality at the engagement level. For example, in circumstances when the firm uses human resources from a service provider to assist in the performance of engagement

[33] See, for example, ISA 620, *Using the Work of an Auditor's Expert*.

[34] ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

procedures, there may be a need for the engagement partner to have greater oversight on a more frequent basis and perform more in-depth reviews of work performed by the individual.

A207. The firm may establish policies or procedures that address circumstances when a service provider is used in the performance of engagements that set out the responsibility of the engagement team when engaging a service provider, which may include responsibility for certain matters in paragraph 64.

A208. Obtaining an understanding of the service provider may include understanding the conditions of the service, for example, how often updates will be provided for an IT application, limitations on the use of the IT application and how the service provider addresses confidentiality of data. Paragraph 41(c)(iii) requires the firm to establish policies or procedures that address the nature, timing, extent and content of communication with the service provider, for example, information to support the firm's understanding of the service provider and use of the resource (e.g., updates or changes to the resource or deficiencies in the resource).

A209. The firm's responsibilities in using the service provider may include matters such as the actions the firm needs to take in order to implement the resource or information the firm needs to communicate to the service provider in order that the resource can function effectively. For example, in the case of an IT application, the firm may need to have appropriate supporting IT infrastructure and IT processes in place.

A210. In determining whether the resource is appropriate, the firm may make inquiries of the service provider or request documentation from the service provider about matters such as:

- For human resources, the qualifications, experience and location of the individuals, including professional licenses or membership obligations, and how they develop and maintain the appropriate competence to perform the services.
- For technological or intellectual resources, the procedures undertaken by the service provider in designing, implementing and operating the resources.
- How the service provider identifies and responds to changes that affect the resources, for example, changes in the professional standards or information that indicates a deficiency in the resources;
- How the resource will be evaluated, monitored or remediated by the service provider.

There may be circumstances when the service provider supplies the firm with an assurance report on the description and design of their controls over the resource, and in some circumstances, it may also include assurance on the operating effectiveness of such controls.

Documentation (Ref: Para. 66–69)

A211. Documentation provides evidence that the firm complies with this ISQM, as well as law, regulation or relevant ethical requirements. It may also be useful for training personnel, ensuring the retention of organizational knowledge and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this ISQM may be evidenced by the firm through its information and communication component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

A212. Documentation may take the form of formal written manuals, checklists and forms, may be informally documented (e.g., e-mail communication or postings on websites), or may be held in IT applications or other digital forms (e.g., in databases). Factors that may affect the firm's judgments about the form, content and extent of documentation may include:

- The size of the firm and the number of offices;
- The nature and complexity of the firm's practice and organization;
- The types of services the firm provides and the nature of the clients to whom services are provided; and
- The nature and complexity of the matter being documented, for example, whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk.

In a smaller firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may be effective. Nevertheless, the firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

A213. In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the IESBA Code requires documentation of particular matters, including certain situations related to conflicts of interest, non-compliance with laws and regulations and independence.

A214. In some circumstances, it may be appropriate for the firm to document its process and analyses for establishing the quality objectives, identifying and assessing quality risks and designing responses to such risks, to provide a history of the basis for decisions made by the firm about its system of quality management.

Appendix 1

The Components of a System of Quality Management

1. This appendix describes the eight components of a firm's system of quality management. The components in this ISQM have similarities to the components of internal control described in the Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework*. For example, the governance and leadership component is similar to the entity's control environment and the firm's risk assessment process is similar to the entity's risk assessment process.

Governance and Leadership

2. The governance and leadership component creates the environment in which the other components of the system of quality management operate because it addresses the firm's culture, decision-making process, actions, organizational structure and leadership. The governance and leadership component also provides the basis for the system of quality management because the firm needs to establish structures, reporting lines and appropriate authority and responsibility in order that the other components of the system of quality management can be developed. For example, in order to establish a system of quality management, the firm needs to identify the individual(s) responsible for its development. Accordingly, the governance and leadership component has a pervasive effect on the system of quality management and the other components cannot be effective if the environment in which they operate is not appropriate.

The Firm's Risk Assessment Process

3. The firm's risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, which consists of establishing quality objectives, identifying and assessing quality risks to the achievement of the quality objectives and designing and implementing responses to address the assessed quality risks.

4. The firm is required to establish the quality objectives set out in this ISQM and additional quality objectives beyond those required by this ISQM, when those objectives are necessary to achieve the objective of this ISQM.

5. Quality risks arise from conditions, events, circumstances, actions or inactions that affect the achievement of the quality objectives, and which are associated with the nature and circumstances of the firm and its engagements. For example:

   (a) *Nature and circumstances of the firm*: The firm may have a service delivery center that includes personnel who perform specific tasks for engagement teams. This may create, or increase the likelihood of, the quality risks for the appropriate direction and supervision of the engagement team and review of the work performed because the personnel may not be in the same location as the engagement partner or the engagement team.

   (b) *Nature and circumstances of the engagements*: The firm may only perform related services engagements and because of the nature of such engagements, the firm may not identify any quality risks relating to compliance with independence requirements, because independence may not be relevant. In relation to the types of entities for which engagements are undertaken, the firm may perform engagements for entities in a particular industry, such as banks, insurance companies and pension funds. This may create the quality risk that personnel do not have the appropriate knowledge of the industry to perform the engagement.

The nature and circumstances of the firm and its engagements also affect the assessment of the likelihood of the identified quality risks occurring and the significance of the effect of the identified quality risk on the achievement of the quality objectives.

6. The responses designed and implemented by the firm consist of:

   (a) The responses required by this ISQM, which are organized by component; and

   (b) Additional responses determined by the firm.

   The responses required by this ISQM alone will not be sufficient to address all of the firm's assessed quality risks for the quality objectives that are required to be established by this ISQM.

7. The responses designed and implemented by the firm, including the responses required by this ISQM, are affected by the nature and circumstances of the firm and its engagements. For example:

   (a) *Nature and circumstances of the firm*: In circumstances when the firm has a service delivery center that includes personnel who perform specific tasks for engagement teams, the firm may obtain technology to facilitate interaction between the engagement partner and personnel located in the central location, to support appropriate direction and supervision.

   (b) *Nature and circumstances of the engagements*: In circumstances when the firm performs engagements in a particular industry, the firm may provide training for personnel on matters unique to that industry, or recruit personnel with experience in the industry.

8. The firm's processes for establishing quality objectives, identifying and assessing quality risks and designing and implementing responses includes identifying changes in the nature and circumstances of the firm or its engagements and modifying the quality objectives, quality risks or responses, as appropriate, for changes in the matters described above.

Relevant Ethical Requirements

9. The relevant ethical requirements component comprises the firm's processes for managing compliance with relevant ethical requirements, in order that the firm, its personnel and others subject to relevant ethical requirements, as applicable, fulfill their responsibilities in accordance with relevant ethical requirements. The processes include how threats to complying with relevant ethical requirements are identified, assessed and addressed and the firm's responses to breaches of the relevant ethical requirements. Relevant ethical requirements include those related to independence.

Acceptance and Continuance of Client Relationships and Specific Engagements

10. The acceptance and continuance of client relationships and specific engagements comprises the firm's processes for consideration of matters in determining whether to accept or continue a client relationship or specific engagement. Such matters include the nature and circumstances of the engagement, the integrity and ethical values of the client, including management, and, when appropriate, those charged with governance and the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. This component also requires that the firm's financial and operational priorities do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

Engagement Performance

11. The engagement performance component comprises the firm's actions to promote and support the consistent performance of quality engagements in accordance with professional standards and legal and regulatory requirements. This includes how the firm supports engagement teams in exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism. Matters addressed in this component include the responsibilities of the engagement team, including in relation to direction, supervision and review, consultation, differences of opinion, the assembly and retention of documentation and engagement quality reviews.

Resources

12. The resources component comprises the firm's processes for obtaining, developing, using, maintaining, allocating or assigning resources to enable the design, implementation and operation of the system of quality management. The resources relevant to the firm's system of quality management include human resources, technological resources and intellectual resources. Furthermore, financial resources are needed for obtaining, developing and maintaining the other types of resources. The firm may have competing priorities that affect the allocation or assignment of resources, however, the firm is required to have resource planning, and obtain, allocate or assign resources in a manner that supports the firm's commitment to quality and enables the design, implementation and operation of the firm's system of quality management.

Information and Communication

13. The information and communication component comprises the firm's actions to obtain, generate or use relevant information to enable the design, implementation and operation of the system of quality management. This includes establishing an information system, whether through the use of manual or automated elements, to identify, capture, process and maintain relevant and reliable information.

14. The information and communication component also comprises two-way communication within the firm and communication with external parties, such as information about the firm's system of quality management. Such communication assists external parties in understanding the firm's activities to address quality through its system of quality management and the effectiveness of the firm's system.

Monitoring and Remediation Process

15. Monitoring comprises the firm's processes for evaluating the design, implementation and operation of the system of quality management. It involves undertaking ongoing and periodic monitoring activities, and identifying and evaluating deficiencies in the system of quality management based on the findings from the monitoring activities, results of external inspections or other information sources (e.g., through the firm's complaints and allegations process). In order to understand how the deficiencies arose, this ISQM also requires the firm to understand the root cause of the identified deficiencies.

16. Remediation comprises the firm's actions for responding to identified deficiencies, which includes designing and implementing remedial actions and monitoring those actions to determine whether they appropriately address the identified deficiency. Remediation may also involve addressing the specific engagement, for example, when the identified deficiency indicates that the engagement report is inappropriate. Communication of the results of monitoring and remediation within the firm

also forms part of the firm's remedial actions, since personnel often need to be aware of the results in order to fulfill their roles and responsibilities.

17. This component also includes the responsibilities of the individual(s) assigned ultimate responsibility and accountability for the system of quality management to determine whether the system of quality management provides reasonable assurance that the objectives stated in paragraph 18(a) and (b) have been achieved.

Interrelationship of the Components

18. The firm's risk assessment process sets out the process the firm is required to follow in implementing the risk-based approach to quality management, and in doing so the firm is required to include the quality objectives and responses set out in each of the components of this ISQM.

19. The governance and leadership component is important to the design, implementation and operation of the other components of the system of quality management because it provides the basis for the system of quality management and also creates the environment in which the other components of the system of quality management operate.

20. Other components such as information and communication and resources have quality objectives that enable the design, implementation and operation of the system of quality management, and therefore such components may include responses that affect or relate to the other components of the system of quality management. For example, the information and communication component contains the information system that provides the information needed for the operation of the other components or the resources component addresses the establishment of human resources that are needed to operate the various aspects of the system of quality management. There may be interrelationships within the components as well, for example, human resources are needed for the development of intellectual resources.

21. There are also relationships between components because there are matters that relate to each other, for example, aspects of the relevant ethical requirements component may be relevant when accepting and continuing client relationships and specific engagements.

22. The monitoring and remediation process monitors the entire system of quality management, and therefore the monitoring activities are undertaken over all of the components of the system of quality management.

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Exposure Draft
February 2019
Comments due: July 1, 2019

International Standard on Quality Management

Proposed International Standard on Quality Management 2

Engagement Quality Reviews

IAASB
International Auditing and Assurance Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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IAASB International Auditing and Assurance Standards Board.

REQUEST FOR COMMENTS

This Exposure Draft, proposed ISQM 2, *Engagement Quality Reviews,* was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

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Section 1 Introduction

1. This memorandum provides background to, and an explanation of, the exposure draft of ISQM 2, *Engagement Quality Review*s (ED-ISQM 2), which the IAASB approved for exposure in December 2018. The sections that follow describe the key elements of the proposed requirements for engagement quality reviews set forth in proposed ED-ISQM 2, including key issues considered by the IAASB in developing the standard. The proposed revisions address the most relevant public interest issues related to engagement quality reviews, including those highlighted in the Invitation to Comment (ITC) released in December 2015, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*.

2. ED-ISQM 2 is part of a package of proposed quality management standards for which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level*, which is available at www.iaasb.org. The overall explanatory memorandum includes background to the IAASB's three quality management[1] exposure drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISA).

Section 2 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-ISQM 2, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are free to address only questions relevant to them. When a respondent agrees with proposals in ED-ISQM 2, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

Section 3 Significant Matters

Section 3-A – Overall Matters

Public Interest Matters

3. The proposals in ED-ISQM 2 and the aspects of ED-ISQM 1[2] regarding engagement quality reviews are made with the public interest in the forefront. The IAASB noted in the ITC the public interest importance ascribed to engagement quality reviews by certain stakeholders, such as regulators. The

[1] The IAASB has changed the terms "quality control" and "engagement quality control review" to "quality management" and "engagement quality review," respectively. In addition, the name of the standards has been changed from "International Standard on Quality Control" to "International Standard on Quality Management". As explained in paragraph 11 of the explanatory memorandum for ED-ISQM 1,these changes were made to reflect the new quality management approach proposed for the firm's system of quality management in ED-ISQM 1, proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

[2] Paragraph 37(e) and related application material in proposed ISQM 1 address engagement quality reviews.

overall EM describes the overarching public interest matters the IAASB has considered in developing the quality management exposure drafts. The IAASB also sought to address the following specific public interest issues relevant to engagement quality reviews:

- Extending the requirement for an engagement quality review to more engagements in addition to audits of financial statements.
- Enhancing the eligibility criteria for an individual to be appointed as an engagement quality reviewer.
- Enhancing the requirements and application material regarding the engagement quality reviewer's responsibilities, including the nature, timing and extent of the engagement quality review procedures performed.
- Consideration of the effect of engagement quality reviews, and other forms of engagement reviews, on the appropriate exercise of professional skepticism by engagement teams.

4. The IAASB considered the importance of engagement quality reviews in the overall context of quality management and sought to address these public interest matters, as further discussed in this explanatory memorandum.

Professional Judgment and Professional Skepticism

5. The IAASB recognizes that engagement quality reviews support the exercise of professional skepticism at the engagement level by providing an objective evaluation of engagement teams' significant judgments made in performing an engagement. ED-ISQM 2 addresses the importance of this objective evaluation by requiring that firm policies or procedures set forth criteria for the eligibility of an individual to be appointed as an engagement quality reviewer. Such criteria include compliance with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer are eliminated or reduced to an acceptable level.

6. Further, ED-ISQM 2 requires firm policies or procedures to include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. This limitation is necessary to make sure that the engagement quality reviewer is in a position to objectively evaluate and, where appropriate, challenge the significant judgments made and the exercise of professional skepticism by the engagement team. The IAASB believes that this separation from the previous role as engagement partner is necessary for the engagement quality review to be an appropriate response to the assessed quality risk(s) for the engagement.

7. The IAASB also considered whether the concept of professional skepticism is relevant to professional judgments made by an engagement quality reviewer. Professional skepticism is generally described in the context of obtaining and evaluating audit evidence. ED-ISQM 2 notes that the engagement quality reviewer is not a member of the engagement team and is not required to obtain evidence to support the opinion or conclusion on the engagement. However, because the role of the engagement quality reviewer is to evaluate the significant judgments made by the engagement team, some might argue that, at least indirectly, the engagement quality reviewer also exercises professional skepticism in reviewing selected engagement documentation supporting those significant judgments and the conclusions reached thereon. Accordingly, the IAASB is seeking respondents' views on how ED-ISQM 2 addresses professional judgment and professional skepticism by the engagement quality reviewer, and whether additional guidance would be helpful in this area.

8. The IAASB also notes that the IESBA's project addressing the role, mindset and behavioral characteristics expected of all professional accountants when performing their professional activities may be relevant to professional judgments made about the system of quality management. Therefore, the IAASB will continue to coordinate with IESBA in considering the effects of that project on ED-ISQM 2.

Scalability for Firms of Different Sizes

9. ED-ISQM 2 is intended to be applied by firms of all sizes based on the nature and circumstances of the engagements performed by the firm. The Appendix to this explanatory memorandum lists paragraphs that highlight how the proposed ISQM is scalable to the nature and circumstances of engagements that the firm performs.

Section 3-B – The Interrelationship Between Proposed ISQM 2 and Proposed ISQM 1 and Proposed ISA 220 (Revised)

10. The explanatory memorandum for ED-ISQM 1 explains the firm's responsibility for establishing a system of quality management, including the new quality management approach. An engagement quality review is a response, among others, that is designed and implemented by a firm to address its assessed quality risks. Although the performance of an engagement quality review is undertaken at the engagement level, it is a response that is implemented by the engagement quality reviewer on behalf of the firm.

Basis for Developing a Separate Standard for Engagement Quality Reviews

11. The requirements for engagement quality control reviews currently reside in extant ISQC 1[3] and ISA 220.[4] The IAASB concluded that having a separate standard for engagement quality reviews would provide a number of benefits, including placing emphasis on the importance of the engagement quality review, more clearly differentiating the responsibilities of the firm and the engagement quality reviewer, and providing the ability to enhance the robustness of the requirements for eligibility of engagement quality reviewers and the performance of engagement quality reviews.

12. ED-ISQM 2 has been designed to operate as part of the firm's system of quality management, and therefore the IAASB observed the need for the requirements in ED-ISQM 1 and ED-ISQM 2 to be organized in a manner that provides appropriate linkages between the standards. The IAASB agreed that since the engagement quality review is a response to an assessed quality risk(s), ED-ISQM 1 should address the circumstances in which an engagement quality review should be performed. ED-ISQM 2 addresses the specific requirements for the appointment and eligibility of the engagement quality reviewer and the performance and documentation of the review. The explanatory memorandum for ED-ISQM 1 discusses the IAASB's considerations regarding the scope of engagements that are required to be subject to an engagement quality review in accordance with paragraph 37(e) of proposed ISQM 1.

13. Although there will no longer be requirements for the performance of engagement quality reviews in proposed ISA 220 (Revised), ED-220 contains requirements regarding the engagement partner's responsibilities relating to the engagement quality review, which largely focus on how the engagement partner and the engagement team interact with the engagement quality reviewer.

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[3] International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits or Reviews of Financial Statements and Other Assurance or Related Services Engagements*

[4] International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*

Section 3-C – Objective of the Standard (Paragraph 10 of proposed ISQM 2)

16. ED-ISQM 2 is a unique standard because it addresses the responsibilities of multiple parties, i.e., the firm and the engagement quality reviewer. However, since the engagement quality reviewer is acting on behalf of the firm, the IAASB is of the view that the objective of the standard should be framed as the objective of the firm.

10. In its deliberations on the objective of ED-ISQM 2, the IAASB recognized that the objectives in the IAASB's International Standards are intended to be outcome-oriented (i.e., the desired outcome of applying the requirements in the standard, and not an "executive summary" of those requirements). Accordingly, the objective of ED-ISQM 2 reflects the intended outcome (i.e., the performance of an engagement quality review).

Section 3-D – Appointment and Eligibility of Engagement Quality Reviewers (Paragraphs 15–20 of proposed ISQM 2)

11. The IAASB recognized in the ITC concerns that had been expressed regarding the selection of the engagement quality reviewer, including the qualifications, experience and objectivity of the individual selected to perform the engagement quality review. Respondents to the ITC believed that the independence, integrity and objectivity of the engagement quality reviewer should be addressed. There was also a suggestion that the ability of the engagement quality reviewer to challenge the engagement team's judgements with confidence should be addressed, as well as the authority of the engagement quality reviewer. It was also highlighted that the engagement quality reviewer role should not be restricted to partners. Respondents also cautioned that the requirements should not be so onerous that the availability of suitable engagement quality reviewers is limited or non-existent, especially for small and medium-sized practices (SMPs). The ITC also explored whether a cooling-off period should be required for an engagement quality reviewer who had previously been involved in the engagement.

12. In response to feedback from the ITC, the requirements in ED-ISQM 2 for the appointment and eligibility of the engagement quality reviewer (whether internal to the firm or external) are more robust than those in extant ISQC 1, as described in the subsections below. In addition, requirements and application material have been added to address:

    - The eligibility of the individual(s) within the firm responsible for the appointment of engagement quality reviewers.
    - The eligibility of individuals to assist the engagement quality reviewer in performing the engagement quality review.
    - The engagement quality reviewer taking responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate.
    - Limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement for which the individual previously served as the engagement partner.

Competence and Capabilities, Including Sufficient Time (Paragraph 16 of proposed ISQM 2)

13. Extant ISQC 1 includes requirements regarding the criteria for eligibility of engagement quality control reviewers that focus on technical qualifications, including necessary experience and authority, and maintaining the reviewer's objectivity. ED-ISQM 2 expands the eligibility requirements and describes competence and capabilities of the engagement quality reviewer in a manner similar to other roles described in ED-ISQM 1. The application material provides further explanation of considerations in

determining whether an individual has the competence and capabilities needed to perform the engagement quality review for a particular engagement.

14. The IAASB highlighted in the ITC that the timing of the performance of the engagement quality review is important with respect to both when the engagement quality reviewer becomes involved in the engagement quality review and the time allocated to the engagement quality control reviewer for the performance of the review. Respondents supported the importance of the reviewer being involved at the right time. The IAASB agreed and accordingly has included a new explicit requirement in paragraph 16(a) of ED-ISQM 2 that the firm's policies or procedures require that the engagement quality reviewer has sufficient time to perform the review.

Appropriate Authority (Paragraph 16 of proposed ISQM 2)

15. Although extant ISQC 1 refers to having the necessary authority to perform the review, it does not provide further information about how such authority is attained.

16. The IAASB is of the view that authority may be established through different means, not only through having a particular title or position within the firm. ED-ISQM 2 highlights that the firm's culture, which is addressed in ED-ISQM 1, can enhance the authority of the engagement quality reviewer by creating a culture of respect for the role of the engagement quality reviewer, which also reduces the likelihood that the engagement quality reviewer is inappropriately influenced in a way that would compromise the reviewer's evacuation of significant judgments made by the engagement team. In addition, ED-ISQM 2 notes that the firm's policies or procedures addressing differences of opinion, which are required by ED-ISQM 1, may also enhance the authority of the engagement quality reviewer by providing a mechanism for the engagement quality reviewer to resolve issues when differences of opinion arise.

Relevant Ethical Requirements, Including Objectivity (Paragraph 16 of proposed ISQM 2)

17. In order to improve the focus on the objectivity of the engagement quality reviewer and address the more specific threats that may arise, ED-ISQM 2 requires that the engagement quality reviewer comply with relevant ethical requirements, and specifically highlights in the application material the threats to objectivity that may arise in relation to the engagement or the engagement team.

Appointment as the Engagement Quality Reviewer After Serving as the Engagement Partner ("Cooling-off" Period) (Paragraph 16 of proposed ISQM 2)

18. In the ITC, the IAASB recognized concerns regarding the need to address circumstances when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner. The IAASB noted that relevant ethical requirements, such as the IESBA Code, do not specifically address threats to objectivity that may arise in these circumstances. For example, a self-review or self-interest threat may arise, particularly in circumstances when judgments made by the individual in the previous engagement continue to have an effect on subsequent periods, as is often the case in an audit of financial statements. Accordingly, the ITC suggested that this concern could be addressed through a mandatory cooling-off period.

19. Respondents to the ITC had mixed views regarding whether the IAASB should address the cooling-off period, including whether the IAASB should prescribe a cooling-off period or require firms to determine the period; whether it should be addressed by the IESBA; or whether there should be collaboration between the two Boards.

20. Given the varying views of respondents, and the need to ensure appropriate consideration of the IESBA Code, a joint working group was formed between the IAASB and IESBA to provide

suggestions to the respective Boards about an appropriate way forward, recognizing each Board's mandate. Paragraphs 21-23 below further explain how the issue has been addressed in ED-ISQM 2. The IESBA is continuing to explore whether a specific provision or application material is also needed in the Code and respondents are asked to provide further input to assist the IESBA in determining its appropriate course of action.

21. The IAASB is of the view that when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner, there are no safeguards or other actions that would eliminate the threats to the individual's objectivity or reduce them to an acceptable level. This view recognizes that the engagement quality reviewer is responsible for *objectively* evaluating the significant judgments made by the engagement team. In the case of an audit of financial statements, significant judgments made in prior periods often affect judgments made in subsequent periods, albeit that the facts and circumstances may change over time. The ability of the engagement quality reviewer to objectively evaluate the significant judgments is affected by previous involvement with those judgments.

22. Accordingly, ED-ISQM 2 includes a new requirement for the firm to establish policies or procedures that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as the engagement partner. Furthermore, the application material in ED-ISQM 2 suggests such limitations may be accomplished by establishing a cooling-off period and notes that determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation and relevant ethical requirements. The application material further notes that, for an audit of a listed entity, it is unlikely that an engagement partner would be able to serve as the engagement quality reviewer until two subsequent audits have been conducted. The IAASB believes this application material recognizes that audits of listed entities generally involve more complex judgments by engagement teams and that a cooling-off period would be in the public interest. The IAASB considered, but rejected, the view that including such guidance would result in a *de facto* cooling-off requirement. Rather, the IAASB was of the view that including a guideline will help to support consistent application in practice.

23. The IAASB recognizes that circumstances may differ for engagements other than audits of listed entities and therefore the firm may determine that no cooling-off period is necessary for certain types of engagements, or the firm's policies or procedures may specify a different cooling-off period. The IAASB is of the view that ED-ISQM 2 provides appropriate flexibility because it places the onus on the firm to establish policies or procedures that are appropriate to address the issue.

Discussions with the Engagement Team (Paragraph 21 of proposed ISQM 2)

24. The IAASB recognizes the importance of encouraging discussions between the engagement partner and the engagement quality reviewer to support an effective and timely review, but also recognizes that a potential threat to the engagement quality reviewer's objectivity could arise in some circumstances, for example, when the nature, timing or extent of the discussions create a perception that the engagement quality reviewer is making, or perceived to be making, decisions on behalf of

the engagement team. Accordingly, ED-ISQM 2 requires the firm's policies or procedures to address, and appropriate actions to take in, these circumstances.

Use of External Resources to Perform the Engagement Quality Control Review (Paragraphs 11 and 16 of proposed ISQM 2)

25. The IAASB noted in the ITC that SMPs may need to use third-party resources as engagement quality reviewers. Respondents to the ITC cautioned that the requirements should not be so onerous that the availability of suitable engagement quality reviewers is limited or non-existent, especially for SMPs. Accordingly, the application material supporting the appointment and eligibility requirements in paragraph 16 of ED-ISQM 2 clarifies that the same eligibility requirements apply to any individual to be appointed as engagement quality reviewer, whether within the firm or external (as may be the case when there is not a partner or other individual within the firm who is eligible to perform the engagement quality review).

Section 3-E – Performance and Documentation of the Engagement Quality Review (Paragraphs 21–24 of proposed ISQM 2)

26. In the ITC, the IAASB identified issues regarding the nature, timing and extent of the procedures in performing an engagement quality review, including at what point in the engagement the engagement quality review is performed and the depth and focus of the review. Respondents to the ITC supported enhancing the requirements and application material addressing the nature, timing and extent of the procedures in performing an engagement quality review.

27. The IAASB agreed it was necessary to clarify and improve the requirements addressing the performance of the engagement quality reviews to enhance their robustness. The IAASB acknowledges the concerns raised by some respondents regarding the appropriate balance of responsibilities between the engagement quality reviewer and the engagement partner, i.e., that the responsibilities of the engagement quality reviewer should not outweigh those of the engagement partner. Recognizing the proposals in ED-220 that have enhanced the responsibilities of the engagement partner, the IAASB is seeking respondents' views on whether the requirements imposed on the engagement quality reviewer in ED-ISQM 2 are appropriate in light of the responsibilities of the engagement partner.

Timing of the Engagement Quality Review (Paragraph 21 of proposed ISQM 2)

28. The IAASB is of the view that an effective engagement quality review is achieved when the engagement quality reviewer is involved at appropriate points in the engagement, consistent with when significant judgments are being made by the engagement team, because doing so facilitates the resolution of issues in a timely manner. Accordingly, ED-ISQM 2 includes a new requirement addressing the engagement quality reviewer's responsibility to perform the procedures at appropriate points in time during the engagement.

Significant Judgments and Significant Matters (Paragraph 22 of proposed ISQM 2)

29. In the ITC, the IAASB recognized concerns regarding the extent to which the engagement quality reviewer evaluates the assessment of, and response to, areas of significant risk or significant judgment made by the engagement partner and the engagement team. The IAASB affirmed its view in extant ISQC 1 that the engagement quality review provides an objective evaluation of the significant judgments made by the engagement team, which in the case of audits of financial statements, include significant risks.

30. The IAASB noted that extant ISQC 1 requires the engagement quality reviewer to discuss significant matters with the engagement partner, and there sometimes is confusion between the population of matters that would be considered "significant matters" versus those that are "significant judgments." The IAASB further noted that significant judgments could include those that are not related to significant matters. The IAASB agreed that significant judgments are identified through reading and understanding the information obtained from the engagement team and the firm about the engagement, and discussing the significant matters with the engagement partner, and if applicable, other members of the engagement team.

31. The IAASB observed that the concept of "significant matters" is addressed in ISA 230.[5] The concept of "significant judgments," which is integral to the definition of an engagement quality review, is addressed in proposed ISA 220 (Revised).[6] The IAASB's concluded that the engagement quality reviewer's review of the engagement team's significant judgments in ED-ISQM 2 needed to be consistent with the approach taken in relation to the engagement partner's review of audit documentation in ED-220. As a result, ED-ISQM 2 includes application material to draw attention to these standards. The concepts of significant judgments and significant matters are not explicitly addressed in the standards for other types of engagements; however, the engagement quality reviewer would take into account the nature and circumstances of the engagement in identifying significant matters and significant judgments made by the engagement team. In doing so, the descriptions of those terms in ED-220 and ISA 230 may serve as useful guidance.

Documentation (Paragraphs 25–27 of proposed ISQM 2)

32. In the ITC, the IAASB recognized concerns regarding the robustness of the documentation of the engagement quality review, including the issues raised as part of the review and the disposition of those issues.

33. ED-ISQM 2 includes a specific requirement for the engagement quality reviewer to take responsibility for documentation of the engagement quality review, and also adds a requirement that the documentation be filed with the engagement documentation. The IAASB also added an overarching requirement in ED-ISQM 2 for the documentation to be sufficient to enable an experienced practitioner, having no previous connection to the engagement, to understand the nature, timing and extent of the engagement quality review procedures performed.

Section 4 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material in ED-ISQM 2. Comments are most helpful if they are identified with specific aspects of ED-ISQM 2 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

1) Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

2) Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?

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[5] ISA 230, *Audit Documentation*

[6] Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

3) Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?

4) Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

   (a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off period” for that individual before being able to act as the engagement quality reviewer?

   (b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?

5) Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?

6) Do you agree that the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional skepticism? Do you believe that ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

7) Do you agree with the enhanced documentation requirements?

8) Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

Appendix

Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ

Note: This Appendix includes the relevant references to the material located within proposed ISQM 2 that incorporate scalability for firms of different sizes and for engagements where the nature and circumstances differ.

How Proposed ISQM 2 Addresses Scalability	Reference
• Engagement quality reviews are not required for all of a firm's engagements, but only for specified engagements in accordance with ED-ISQM 1.[7] • ED-ISQM 1 sets forth the engagements for which engagement quality reviews are required. Those requirements apply if the firm's portfolio includes audits of financial statements of listed entities or audits or other engagements for which an engagement quality review is required by law or regulation. In addition, engagement quality reviews are required for engagements for entities the firm determines are of significant public interest, and engagements for which an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.	• Proposed ISQM 1 Engagement Performance – Paragraph 37(e). • Proposed ISQM 2 Scope of this ISQM – Paragraph 2.
• Engagement quality reviews are not an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements, or with the firm's policies or procedures.	• The Firm's System of Quality Management and Role of Engagement Quality Reviews – Paragraph 6.
• Certain requirements may not be relevant depending on the nature and circumstances of the engagement.	• Applying, and Complying with, Relevant Requirements – Paragraph 13. • Performance of the Engagement Quality Review – Paragraphs 22(f) and 22(g).
• Explicit acknowledgment of circumstances of smaller firms or different types of engagements, including:	Appointment and Eligibility of Engagement Quality Reviewers

[7] Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 37(e)

How Proposed ISQM 2 Addresses Scalability	Reference
○ Obtaining the services of external individuals to perform the engagement quality review; ○ Firm policies or procedures to determine limitations on an individual being appointed as engagement quality reviewer immediately after serving as the engagement partner, for example, specifying a suitable cooling-off period; ○ Consideration of the reasons for the assessments given to the quality risks in determining competence and capabilities required for an engagement; and ○ Impact of firm culture on authority of the engagement quality reviewer.	• Assignment of Responsibility for the Appointment of Engagement Quality Reviewers – Paragraphs A2 and A3. • Eligibility of the Engagement Quality Reviewer, Including Limitations on the Eligibility to be Appointed as the Engagement Quality Reviewer – Paragraphs A4 and A5. • Eligibility Criteria for the Engagement Quality Reviewer – Paragraphs A7 and A8.
• Relevant ethical requirements depend on the nature and circumstances of engagements subject to an engagement quality review.	• Relevant Ethical Requirements – Paragraphs A13 and A14.
• Recognition that it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer in certain circumstances.	• Assignment of Responsibility for the Appointment of Engagement Quality Reviewers – Paragraph A3.
• Use of assistants to perform the engagement quality review is permitted.	• Circumstances when the Engagement Quality Reviewer is Assisted by Other Individuals – Paragraphs 17 and A18.
• The nature, timing and extent of engagement quality review procedures may vary depending on the firm's policies or procedures or the nature and circumstances of the engagement.	• Performance of the Engagement Quality Review – Paragraph 21. • Procedures Performed by the Engagement Quality Reviewer – paragraphs A25, A26, A27. • Significant Matters and Significant Judgments – Paragraphs A29–A31.
• The form, content and extent of the documentation of the engagement quality review may vary, • The engagement quality review may be documented in a number of ways.	• Documentation – Paragraphs A37 and A38.

PROPOSED INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 2 – ENGAGEMENT QUALITY REVIEWS

(Effective as of TBD)

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Proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*, should be read in conjunction with the *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

Scope of this ISQM

1. This International Standard on Quality Control (ISQM) deals with:

   - The appointment and eligibility of the engagement quality reviewer; and
   - The engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review.

2. This ISQM applies to all engagements for which an engagement quality review is required to be performed in accordance with proposed ISQM 1.[8] This ISQM is premised on the basis that the firm is subject to proposed ISQM 1 or to national requirements that are at least as demanding.

The Firm's System of Quality Management and Role of Engagement Quality Reviews

3. Proposed ISQM 1 establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to assessed quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with this ISQM.

4. The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:

   (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and

   (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.[9]

5. The public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the nature and circumstances of the engagement, exercising professional skepticism.

6. An engagement quality review is an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached thereon. The engagement quality reviewer's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements. However, an engagement quality review is not intended to be an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements, or with the firm's policies or procedures.

7. The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not reduce the responsibilities of the engagement partner for managing and achieving quality on the engagement, nor does it change the nature, timing and extent

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[8] Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 40(e)

[9] Proposed ISQM 1, paragraph 21

of procedures that need to be performed by the engagement team. The engagement quality reviewer is not required to obtain evidence to support the opinion or conclusion on the engagement, but the engagement team may obtain further evidence through its responses to matters raised in the engagement quality review.

Authority of this ISQM

8. This ISQM contains the objective for the firm in following this ISQM, and requirements designed to enable the firm and the engagement quality reviewer to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this ISQM, and definitions. Proposed ISQM 1 explains the terms objective, requirements, application material and other explanatory material, introductory material, and definitions.

Effective Date

9. This ISQM is effective for:

   (a) Audits and reviews of financial statements for periods beginning on or after TBD; and

   (b) Other engagements beginning on or after TBD.

Objective

10. The objective of the firm is to perform an engagement quality review for the engagement.

Definitions

11. In this ISQM, the following terms have the meanings attributed below:

   (a) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.

   (b) Engagement quality reviewer – A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

   (c) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to a professional accountant when undertaking an engagement quality review. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to audits or reviews of financial statements, or other assurance or related services engagements, together with national requirements that are more restrictive.

Requirements

Applying, and Complying with, Relevant Requirements

12. The firm and the engagement quality reviewer shall have an understanding of this ISQM, including the application and other explanatory material, to understand the objective of this ISQM and to properly apply the requirements relevant to them.

13. The firm or the engagement quality reviewer, as applicable, shall comply with each requirement of this ISQM, unless the requirement is not relevant in the circumstances of the engagement.

14. The proper application of the requirements is expected to provide a sufficient basis for the achievement of the objective of this standard. However, if the firm or the engagement quality reviewer determines that the application of the relevant requirements does not provide a sufficient basis for the achievement of the objective of this standard, the firm or the engagement quality reviewer, as applicable, shall take further actions to achieve the objective.

Appointment and Eligibility of Engagement Quality Reviewers

15. The firm shall establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual(s) with the competence, capabilities and appropriate authority within the firm to fulfill the responsibility. Those policies or procedures shall require such individual(s) to appoint the engagement quality reviewer. (Ref: Para. A1–A3)

16. The firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer and that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. Those policies or procedures shall require that the engagement quality reviewer not be a member of the engagement team, and: (Ref: Para. A4–A5)

    (a) Have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review; (Ref: Para. A6–A12)

    (b) Comply with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer related to the engagement or the engagement team are eliminated or reduced to an acceptable level; and (Ref: Para. A13–A16)

    (c) Comply with requirements of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: Para. A17)

17. The firm shall establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer. Those policies or procedures shall require that such individuals not be members of the engagement team, and:

    (a) Have the competence and capabilities, including sufficient time, to perform the duties assigned to them; and

    (b) Comply with relevant ethical requirements and, if applicable, the requirements of law and regulation. (Ref: Para. A18-A19)

18. The firm shall establish policies or procedures that require the engagement quality reviewer to take responsibility for the performance of the engagement quality review, including that the work of individuals assisting in the review is appropriate.

19. The firm shall establish policies or procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances. (Ref: Para. A20)

20. When the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility, the engagement quality reviewer shall notify the appropriate individual(s) in the firm, and: (Ref: Para. A21)

    (a) If the engagement quality review has not commenced, decline the appointment to perform the engagement quality review; or

(b) If the engagement quality review has commenced, discontinue the performance of the engagement quality review.

Performance of the Engagement Quality Review

21. The firm shall establish policies or procedures regarding the performance of the engagement quality review that address:

(a) The engagement quality reviewer's responsibilities to perform procedures in accordance with paragraphs 22–23 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon;

(b) The responsibilities of the engagement partner in relation to the engagement quality review, including prohibiting the engagement partner from dating the engagement report until the completion of the review; and (Ref: Para. A22–A23)

(c) Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer, and appropriate actions to take in these circumstances. (Ref: Para. A24)

22. In performing the engagement quality review, the engagement quality reviewer shall: (Ref: Para. A24–A34)

(a) Read and understand information:

(i) Obtained from the engagement team about the nature and circumstances of the engagement; and

(ii) Provided by the firm about the results of its monitoring and remediation, in particular about identified deficiencies that may relate to, or affect, the areas involving significant judgments by the engagement team.

(b) Discuss significant matters with the engagement partner and, if applicable, other members of the engagement team. (Ref: Para. A29)

(c) Based on the information obtained in (a) and (b), identify the areas involving significant judgments made by the engagement team, including those related to: (Ref: Para. A30–A31)

(i) The overall strategy and plan for performing the engagement;

(ii) The performance of the engagement; and

(iii) Forming an opinion or conclusion, when applicable, and reporting on the engagement.

(d) Review selected engagement documentation that supports the significant judgments made by the engagement team and the conclusions reached thereon and evaluate:

(i) The engagement team's basis for making the significant judgments, including when applicable, the appropriate exercise of professional skepticism;

(ii) Whether the engagement documentation supports the conclusions reached; and

(iii) Whether the conclusions reached are appropriate.

(e) Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations. (Ref: Para. A32)

(f) For audits of financial statements, evaluate the basis for the engagement partner's conclusion that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. (Ref: Para. A33–A34)

(g) Review:

(i) For an audit of financial statements, the financial statements and the auditor's report thereon, including, if applicable, the description of the key audit matters; or

(ii) For an assurance or related services engagement, the engagement report, and when applicable, the subject matter information.

23. If the engagement quality reviewer has concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate, the engagement quality reviewer shall notify the engagement partner. If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer shall notify an appropriate individual(s) in the firm that the engagement quality review cannot be completed. (Ref: Para. A35)

Completion of the Engagement Quality Review

24. The engagement quality reviewer shall determine whether the requirements in this ISQM with respect to the performance of the engagement quality review have been fulfilled, and whether the engagement quality review is complete. If so, the engagement quality reviewer shall notify the engagement partner that the engagement quality review is complete.

Documentation

25. The firm shall establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review. (Ref: Para. A36–A39)

26. The firm shall establish policies or procedures that require documentation of the engagement quality review in accordance with paragraph 27, and that such documentation be included with the engagement documentation.

27. The engagement quality reviewer shall determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing and extent of the procedures performed by the engagement quality reviewer and, when applicable, individuals who assisted the reviewer, and the conclusions reached in performing the review. The engagement quality reviewer also shall determine that the documentation of the engagement quality review includes:

(a) The names of the engagement quality reviewer and individuals who assisted with the engagement quality review;

(b) An identification of the engagement documentation reviewed;

(c) The engagement quality reviewer's determination in accordance with paragraph 24; and

(d) The notifications required in accordance with paragraphs 23 and 24; and

(e) The date of completion of the engagement quality review.

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Application and Other Explanatory Material

Appointment and Eligibility of Engagement Quality Reviewers

Assignment of Responsibility for the Appointment of Engagement Quality Reviewers (Ref: Para. 15)

A1. Competence and capabilities that are relevant to an individual's ability to fulfill responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about:

- The responsibilities of an engagement quality reviewer;
- The criteria in paragraph 16 regarding the eligibility of engagement quality reviewers; and
- The nature and circumstances of the engagement subject to an engagement quality review (e.g., the nature of the entity and the composition of the engagement team).

A2. The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm's policies or procedures may specify a different process for appointing engagement quality reviewers for audits of listed entities than for audits of non-listed entities or other engagements.

A3. In certain circumstances, it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer, for example, in the case of a smaller firm or a sole practitioner.

Eligibility of the Engagement Quality Reviewer, Including Limitations on the Eligibility to be Appointed as the Engagement Quality Reviewer (Ref: Para. 16)

A4. In some circumstances, there may not be a partner or other individual within the firm who is eligible to perform the engagement quality review and the firm may therefore contract with, or obtain the services of, external individuals to perform the engagement quality review. An external individual may be a partner or an employee of another firm within the firm's network or a service provider. When using such an external individual, the firm is subject to the requirements for network requirements or network services in paragraphs 59–60 of proposed ISQM 1, or the requirements for service providers in paragraph 65 of proposed ISQM 1, respectively.

A5. An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level. In recurring engagements, the matters on which significant judgments are made and the facts and circumstances around those significant judgments are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period. Accordingly, this ISQM requires the firm to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation or relevant ethical requirements. In the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner

would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

Eligibility Criteria for the Engagement Quality Reviewer

Competence and Capabilities, Including Sufficient Time (Ref: Para. 16(a))

A6. Competence refers to the integration and application of technical competence, professional skills, and professional ethics, values and attitudes, and the appropriate experience relevant to the nature and circumstances of the engagement, including:

- An understanding of professional standards and applicable legal and regulatory requirements and of the firm's policies or procedures relevant to the engagement;
- Knowledge of the entity's industry;
- An understanding of, and experience relevant to, engagements of a similar nature and complexity; and
- An understanding of the responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review, which may be attained or enhanced by receiving relevant training from the firm.

A7. An engagement quality review is a response to assessed quality risks relating to engagement performance. Accordingly, an understanding of the reasons for the assessments given to the quality risks may be an important consideration in the firm's determination of the competence and capabilities required to perform the engagement quality review for that engagement. Other factors to consider in determining whether the engagement quality reviewer has the competence and capabilities, including sufficient time, needed to evaluate the significant judgments made by the engagement team and the conclusions reached thereon include, for example:

- The nature of the entity.
- The specialization and complexity of the industry or regulatory environment in which the entity operates.
- The extent to which the engagement relates to matters requiring specialized expertise (e.g., with respect to information technology or specialized areas of accounting or auditing), or scientific and engineering expertise, such as may be needed for certain assurance engagements. Also see paragraph A18.

A8. In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (e.g., findings from the inspection of in-process or completed engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.

A9. A lack of appropriate competence or capabilities may affect the ability of the engagement quality reviewer to exercise appropriate professional judgment in performing the review. For example, an engagement quality reviewer who lacks relevant industry experience may not possess the ability or confidence necessary to evaluate and, where appropriate, challenge significant judgments made, and the exercise of professional skepticism, by the engagement team on a complex, industry-specific accounting or auditing matter.

Appropriate Authority (Ref: Para. 16(a))

A10. Actions at the firm level help to establish the authority of the engagement quality reviewer. For example, by creating a culture of respect for the role of the engagement quality reviewer, the engagement quality reviewer is less likely to experience pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In some cases, the engagement quality reviewer's authority may be enhanced by the firm's policies or procedures to address differences of opinion, which may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.

A11. The authority of the engagement quality reviewer may be diminished when:

- The culture within the firm promotes respect for authority only of individuals at a higher level of hierarchy within the firm.
- The engagement quality reviewer has a reporting line to the engagement partner, for example, when the engagement partner holds a leadership position in the firm or is responsible for determining the compensation of the engagement quality reviewer.

Public Sector Considerations

A12. In the public sector, an auditor (e.g., an Auditor General, or other suitably qualified individual appointed on behalf of the Auditor General) may act in a role equivalent to that of the engagement partner with overall responsibility for public sector audits. In such circumstances, when applicable, the selection of the engagement quality reviewer may include consideration of the need for independence and the ability of the engagement quality reviewer to provide an objective evaluation.

Relevant Ethical Requirements (Ref: Para. 16(b))

A13. The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of engagements subject to an engagement quality review. Various provisions of relevant ethical requirements may apply only to individual professional accountants, such as an engagement quality reviewer, and not the firm.

A14. Relevant ethical requirements may establish requirements addressing threats created by the long association of the engagement quality reviewer with an audit client. For example, in relation to audits of public interest entities, the IESBA Code contains requirements for an engagement quality reviewer to serve a required cooling-off period after that individual has served in that role, or any combination of engagement partner, engagement quality reviewer or any other key audit partner role, for specified periods.

Threats to the Objectivity of the Engagement Quality Reviewer

A15. Threats to the engagement quality reviewer's objectivity may be created by a broad range of facts and circumstances. For example:

- A familiarity or self-interest threat may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team.
- An intimidation threat (either implicit or explicit) may be created when pressure is exerted on the engagement quality reviewer (e.g., when the engagement partner is an aggressive or

dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner).

A16. Relevant ethical requirements may include requirements and guidance to identify, evaluate and address threats to objectivity. For example, the IESBA Code specifically addresses intimidation threats in certain circumstances.

Law or Regulation Relevant to Eligibility of the Engagement Quality Reviewer (Ref: 16(c))

A17. Law or regulation may prescribe additional requirements regarding the eligibility of the engagement quality reviewer. For example, in some jurisdictions, the engagement quality reviewer may need to possess certain qualifications or be licensed to be able to perform the review.

Circumstances when the Engagement Quality Reviewer is Assisted by Other Individuals (Ref: Para. 17)

A18. In certain circumstances, it may be appropriate for the engagement quality reviewer to be assisted by an individual or team of individuals, either internal or external, with the relevant expertise. For example, highly specialized knowledge, skills or expertise may be useful for understanding certain transactions undertaken by the entity to help the engagement quality reviewer evaluate the significant judgments made by the engagement team related to those transactions.

A19. When the engagement quality reviewer is assisted by an external individual, the assistant's responsibilities, including those related to compliance with relevant ethical requirements, may be set out in the contract or other agreement between the firm and the assistant.

Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review (Ref: Para. 19–20)

A20. Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review is impaired include:

- Whether changes in the circumstances of the engagement result in the engagement quality reviewer no longer having the appropriate competence and capabilities to perform the review;
- Whether changes in the other responsibilities of the engagement quality reviewer indicate that the individual no longer has sufficient time to perform the review; or
- Notification from the engagement quality reviewer in accordance with paragraph 20.

A21. In circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review becomes impaired, the firm's policies or procedures may set out a process by which alternative eligible individuals are identified or may specify the period of time after notification within which the firm is required to appoint a replacement.

Performance of the Engagement Quality Review (Ref: Para. 21–23)

Engagement Partner Responsibilities in Relation to the Engagement Quality Review (Ref: Para. 21(b))

A22. Proposed ISA 220 (Revised)[10] establishes the requirements for the engagement partner[11] in audit engagements for which an engagement quality review is required, including:

- Being satisfied that an engagement quality reviewer has been appointed;
- Cooperating with the engagement quality reviewer and informing members of the engagement team of their responsibility to do so;
- Discussing significant matters arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
- Not dating the auditor's report until the completion of the engagement quality review.

A23. ISAE 3000 (Revised)[12] also establishes requirements for the engagement partner in relation to the engagement quality review.

Discussions Between the Engagement Quality Reviewer and the Engagement Team (Ref: Para. 21(c))

A24. Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may assist in facilitating an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created depending on the timing and extent of the discussions with the engagement team about a significant judgment. The firm's policies or procedures may set forth the actions to be taken by the engagement quality reviewer or the engagement team to avoid situations in which the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team. For example, in these circumstances the firm may require consultation about such significant judgments with other relevant personnel in accordance with the firm's consultation policies or procedures.

Procedures Performed by the Engagement Quality Reviewer (Ref: Para. 21–24)

A25. The firm's policies or procedures may specify the nature, timing and extent of the procedures performed by the engagement quality reviewer and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.

A26. The timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement, including the nature of the matters subject to the review. Timely review of the engagement documentation by the engagement quality reviewer at appropriate points in time throughout all stages of the engagement (e.g., planning, risk assessment, performance, completion, reporting) allows matters to be promptly resolved to the engagement quality reviewer's satisfaction, on or before the date of the engagement report. For example, the engagement quality reviewer may perform procedures in relation to the overall strategy and plan for the engagement at the completion of the planning phase. In other circumstances, it may be appropriate for the engagement quality reviewer to perform the procedures near the end of the engagement (e.g., when the engagement is not complex and is completed

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[10] Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Control for an Audit of Financial Statements*, paragraph 33

[11] Similar requirements exist in paragraph 36 of International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

[12] ISAE 3000 (Revised), paragraph 36

within a short period of time). Timely performance of the engagement quality review also may reinforce the exercise of professional judgment and, as applicable, professional skepticism, by the engagement team in planning and performing the engagement.

A27. The nature and extent of the engagement quality reviewer's procedures for a specific engagement may depend on, among other factors:

- The reasons for the assessments given to quality risks, for example, engagements performed for entities in emerging industries or with complex transactions.
- The findings arising from the firm's monitoring activities, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer.
- The complexity of the engagement.
- The nature and size of the entity, including whether the entity is a listed entity.
- Other information relevant to the engagement, such as the results of inspections undertaken by an external oversight authority in a prior period, or concerns raised about the commitment to quality of the firm or its personnel.
- The firm's acceptance and continuance of client relationships and specific engagements, which may indicate new risks to achieving quality for an engagement.
- Whether members of the engagement team have cooperated with the engagement quality reviewer. The firm's policies or procedures may address the actions the engagement quality reviewer takes in circumstances when the engagement team has not cooperated with the engagement quality reviewer, for example, informing an appropriate individual in the firm so appropriate action can be taken to resolve the issue.
- For assurance engagements, the engagement team's consideration of, and responses to, areas of risks of material misstatement in the engagement.

A28. The nature, timing and extent of the engagement quality reviewer's procedures may need to change based on circumstances encountered in performing the engagement quality review.

Significant Matters and Significant Judgments (Ref: Para. 22(b)–(d))

A29. For audits of financial statements, proposed ISA 220 (Revised) requires the engagement partner to review audit documentation relating to significant matters[13] and other areas involving significant judgments, especially those relating to difficult or contentious matters identified during the course of the engagement, and the conclusions reached.[14]

A30. For audits of financial statements, proposed ISA 220 (Revised) provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team.[15]

A31. For engagements other than audits of financial statements, the engagement quality reviewer may consider the nature and circumstances of the engagement in identifying significant matters, and

[13] ISA 230, *Audit Documentation*, paragraph A8

[14] Proposed ISA 220 (Revised), paragraph 29

[15] Proposed ISA 220 (Revised), paragraph A80

significant judgments made by the engagement team. For example, in an assurance engagement performed in accordance with ISAE 3000 (Revised), the engagement team's determination of whether the criteria to be applied in the preparation of the subject matter information are suitable for the engagement may involve or require significant judgment. The examples in proposed ISA 220 (Revised)[16] also may be useful to the engagement quality reviewer in identifying significant judgments in engagements other than audits of financial statements.

Whether Consultation Has Taken Place on Difficult or Contentious Matters or Matters Involving Differences of Opinion (Ref: Para. 22(e))

A32. Proposed ISQM 1[17] sets out requirements for the firm to establish policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. Proposed ISQM 1[18] also sets out requirements for the firm to establish policies or procedures to address differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing duties within the firm's system of quality management, including those who provide consultation.

Overall Responsibility of the Engagement Partner for Managing and Achieving Quality on the Engagement (Ref: Para. 22(f))

A33. Proposed ISA 220 (Revised) requires the engagement partner to determine, prior to dating the auditor's report, that:

- The engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
- The firm's policies or procedures, and the nature and circumstances of the audit engagement, and any changes thereto, have been taken into account in complying with the requirements of proposed ISA 220 (Revised).[19]

A34. Other pronouncements of the IAASB, including ISRE 2400 (Revised), [20] ISAE 3000 (Revised),[21] and ISRS 4410 (Revised)[22] also require the engagement partner to take responsibility for the overall quality on the engagement.

The Engagement Quality Reviewer's Evaluation (Ref: Para. 23)

A35. The firm's policies or procedures may specify the individual(s) in the firm to be notified if the engagement quality reviewer has unresolved concerns that the significant judgments made by the

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[16] Proposed ISA 220 (Revised), paragraph A80

[17] Proposed ISQM 1, paragraph 40(c)

[18] Proposed ISQM 1, paragraph 40(d)

[19] Proposed ISA 220 (Revised), paragraph 37

[20] International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements,* paragraph 25

[21] ISAE 3000 (Revised), paragraph 33

[22] International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements,* paragraph 23

engagement team, or the conclusions reached thereon, are not appropriate. Such individual(s) may include the individual assigned the responsibility for the appointment of engagement quality reviewers.

Documentation (Ref: Para. 25–27)

A36. Paragraphs 67 and 68 of proposed ISQM 1 require the firm to prepare documentation of the firm's system of quality management. Engagement quality reviews performed in accordance with this proposed ISQM are one response, among others, to a firm's quality risks related to the performance of engagements, and are therefore subject to those documentation requirements.

A37. The form, content and extent of the documentation of the engagement quality review may depend on factors such as:

- The nature and complexity of the engagement;
- The nature of the entity;
- The nature and complexity of the matters subject to the engagement quality review; and
- The extent of the engagement documentation reviewed.

A38. The engagement quality review may be documented in a number of ways. For example, the engagement quality reviewer may document the review of engagement documentation electronically in the IT application for the performance of the engagement. Alternatively, the engagement quality reviewer may document the review through means of a memorandum. The engagement quality reviewer's procedures may also be documented as part of other engagement documentation, for example, minutes of the engagement team's discussions where the engagement quality reviewer was present.

A39. Paragraph 21(b) requires that the firm's policies or procedures preclude the engagement partner from dating the engagement report until the completion of the engagement quality review, which includes resolving matters raised by the engagement quality reviewer. The documentation of the engagement quality review may be completed after the date of the engagement report, but before the assembly of the final engagement file.

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Exposure Draft
February 2019
Comments due: July 1, 2019

International Standard on Quality Management

Proposed International Standard on Auditing 220 (Revised)

Quality Management for an Audit of Financial Statements

IAASB
International Auditing and Assurance Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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ISA.

IAASB International Auditing and Assurance Standards Board.

REQUEST FOR COMMENTS

This Exposure Draft, proposed ISA 220 (Revised)*, Quality Management for an Audit of Financial Statement* was developed and approved by the International Auditing and Assurance Standards Board® (IAASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 1, 2019.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

CONTENTS

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Introduction

1. This memorandum provides background to, and an explanation of, the exposure draft of proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* (ED-220), which was approved for exposure by the IAASB in December 2018.

2. ED-220 is part of a package of proposed quality management standards in respect of which the IAASB is seeking public comment. This memorandum supplements the overall explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level*, which is available at www.iaasb.org. The overall explanatory memorandum includes background to the IAASB's three quality management exposure drafts, discusses the scalability of the standards and sets forth the IAASB's considerations regarding the possible effective dates of the three standards following final approval by the IAASB and approval of due process by the Public Interest Oversight Board. The overall explanatory memorandum also explains the linkages between the three quality management standards and addresses the related conforming amendments to the IAASB's International Standards on Auditing (ISAs).

Section 1 Guide for Respondents

The IAASB welcomes comments on all matters addressed in ED-220, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are also free to address only questions relevant to them. When a respondent agrees with proposals in ED-220, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not stated.

Section 2 Significant Matters

Section 2-A – Overall Matters

Public Interest Matters

3. In revising ISA 220, the IAASB sought to address public interest considerations by emphasizing the importance of the exercise of professional skepticism, enhancing the documentation of the auditor's judgments, keeping ISA 220 fit for purpose in a wide range of circumstances and in a complex environment, encouraging proactive management of quality at the engagement level, and reinforcing the need for robust communications during the audit.[1]

4. In support of these goals, the IAASB agreed to:

   - Highlight the importance of the public interest role of audits, and improve the emphasis on the importance of the appropriate application of professional judgment and exercise of professional skepticism (see paragraph 5–6 below);
   - Clarify the role and responsibilities of the engagement partner, particularly the required involvement of the engagement partner throughout the audit, and retain the emphasis on the

[1] The public interest issues that the IAASB was seeking to address are explained further in the Project Proposal, paragraph 21, which is available at www.iaasb.org/system/files/meetings/files/20161205-IAASB_Agenda_Item_9A-GA-and-QC-Project-Proposal.pdf

engagement partner's responsibility for managing and achieving quality at the engagement level (see Section 2-B below);

- Modernize ISA 220 for an evolving environment, including changes in audit delivery models and the use of technology (see paragraph 7–9 below); and
- Clarify the relationship between ED-220 and the ISQMs, including additional clarification of the engagement partner's and engagement team's interaction with firm and the engagement team's ability to depend on the firm's quality management policies or procedures (see paragraphs 10–11 below).

The Public Interest Role of Audits and the Exercise of Professional Skepticism

5. The IAASB believes that it is important to emphasize that the public interest is served by the consistent performance of quality engagements. Accordingly, ED-220 highlights that the public interest is served by the consistent performance of quality audit engagements (see paragraph 6 of ED-220 and paragraphs 17–19 of the explanatory memorandum in ED-ISQM 1).

6. In addition, the IAASB has included new introductory material on the importance of the use of professional skepticism and professional judgment in performing audit engagements (see paragraph 7 of ED-220). This introductory material is further supported by application material that describes impediments to professional skepticism, auditor biases, and actions the engagement partner can take to deal with impediments to the exercise of professional skepticism.

Modernizing ISA 220 for an Evolving Environment

7. The Invitation to Comment (ITC), *Enhancing Audit Quality in the Public Interest*, noted that the project to revise ISA 220 could acknowledge the evolving use of audit delivery models[2] and emphasize the need for appropriate policies and procedures for these structures as part of the firm's system of quality control and at the engagement level. Respondents to the ITC were supportive of this suggestion.

8. ED-220 now recognizes that engagement teams may be organized in a variety of ways including being located together or across different geographic locations, or organized by the activity they are performing. ED-220 also recognizes that individuals who are involved in the audit engagement may not necessarily be engaged or employed directly by the firm. Importantly, the change recognizes that, regardless of the location or employment status of such individuals, if they are performing audit procedures, then their work needs to be appropriately directed, supervised and reviewed. As a consequence, changes have been made to the definition of the engagement team to recognize different and evolving engagement team structures (see Section 2-E below).

9. ED-220 also highlights the growing role of technology in audits of financial statements. The requirements in the Resources section have been enhanced and cover not only the human resources involved in an audit engagement, but also the technology and intellectual resources. Paragraphs A56–A58 explain how technological resources may be used on the audit (see also Section 2-D below). The ED also notes the role of specialized skills or knowledge in the use of automated tools. In proposing amendments to the ISA, the IAASB took into account the learnings of the IAASB's Data Analytics Working Group, which is exploring the use of technology on audits.

[2] See paragraph 117 of the ITC for an explanation of audit delivery models.

The Interaction Between ED-220 and Proposed ISQM 1 and Proposed ISQM 2

10. ED-220 is designed to operate as part of the broader system of quality management established by ISQM 1[3]. Under ED-ISQM 1, the firm establishes quality objectives, identifies and assesses quality risks and designs responses to address the quality risks in relation to the components of the firm's system of quality management. The responses may be implemented at the firm level or at the engagement level, depending on the nature and circumstances of the firm and the engagement.[4] Accordingly, ED-ISQM 1 requires the firm to communicate information to the engagement team about their responsibilities regarding the firm's responses that are required to be implemented at the engagement level.

11. Extant ISA 220 includes requirements and guidance on the performance of an engagement quality review (formerly known as an engagement quality control review) of the audit, including requirements directed at the engagement quality reviewer. These requirements and guidance are now proposed to be moved to proposed ISQM 2[5] and, therefore, ED-220 is focused only on the responsibilities of the engagement partner in this regard, including how the engagement partner and engagement team interact with the engagement quality reviewer.

The role of the firm's policies or procedures at the engagement level

12. Extant ISA 220 notes that engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. The IAASB has proposed removing this material, and replacing it with application material that explains that in certain circumstances, the engagement partner may "depend on the firm's policies or procedures" in complying with the requirements of ED-220. This approach is intended to avoid the risk that the engagement team blindly relies on the firm's system of quality management without taking into account whether the firm's quality management policies or procedures are "fit-for-purpose" in addressing requirements at the engagement level. To assist the engagement partner in making the determination as to whether, and the degree to which, the engagement partner may depend on the firm's policies or procedures, the IAASB has also proposed application material that provides examples of 'matters' that the engagement partner may take into account when determining whether it is appropriate to depend on the firm's policies or procedures (see paragraphs A7–A8 of ED-220).

13. In certain places in ED-220, the engagement partner or ET is required to comply with the firm's policies or procedures in addressing the requirements of ED-220. This is because in such cases the firm's policies or procedures are considered integral to the fulfillment of the requirements of ED-220. For example, paragraph 16 of ED-220 requires the engagement partner to evaluate threats to compliance with relevant ethical requirements through complying with the firm's policies or procedures. Complying with the firm's policies or procedures in these circumstances is considered necessary because the engagement partner would likely not have the necessary information or tools to evaluate the threats, and would therefore need to draw upon the firm's resources to assist in this regard. The IAASB concluded that the requirements that reference the firm's policies and procedures are aligned with requirements in ISQM 1 for the firm to establish responses to risks to engagement

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[3] See [link] for ED-ISQM 1.

[4] See [link to covering EM] for an explanation of how the quality management approach can be implemented in a scalable manner and the implementation support tools available.

[5] See [link] for ED-ISQM 2.

quality[6] and this approach is consistent with extant ISA 220, . In addition, understanding and complying at the engagement level with applicable firm policies and procedures is critical to establishing and maintaining the relationship between quality management at the firm level and quality management at the engagement level.

14. In ED-220, the phrase "shall be satisfied" has been used in requirements that refer to the engagement partner's responsibility in relation to actions that occur (or should have occurred) at the firm level, but which are relevant to managing and achieving quality at the engagement level. The phrase "shall determine" has been used in requirements that refer directly to actions that the engagement partner is required to take.

Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ

15. ED-220 is intended to be applied by firms of all sizes and circumstances and it is intended to be scalable based on the nature and circumstances of the audit engagement. The Appendix to this Explanatory Memorandum lists paragraphs that highlight how the proposed ISA can be applied in the different circumstances. In addition, the IAASB is developing support materials to show how ISA 220 and ISQM 1 can be applied together in a scalable manner in smaller firms.[7]

Section 2-B – The Engagement Partner's Overall Responsibility for Managing and Achieving Quality on Audits, Including Engagement Performance and Standing Back

16. Extant ISA 220 requires the engagement partner to take responsibility for the overall quality of each audit engagement to which that partner is assigned and provides guidance on the actions and messages to emphasize. The ITC noted that the project to revise ISA 220 may result in updating requirements and application material in ISA 220 to make the engagement partner's responsibilities for leadership and project management (including the assessment of the competence and objectivity of the engagement team) more explicit.

17. The IAASB believes that the engagement partner needs to be sufficiently and appropriately involved throughout the engagement as this is fundamental to providing the engagement leadership required to achieve high quality audits and, therefore, to meeting the objective of ISA 220. The diagram below illustrates how the engagement partner's overall responsibility to manage and achieve quality on the engagement is demonstrated through sufficient and appropriate involvement throughout the engagement, such that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the audit. This overall responsibility includes:

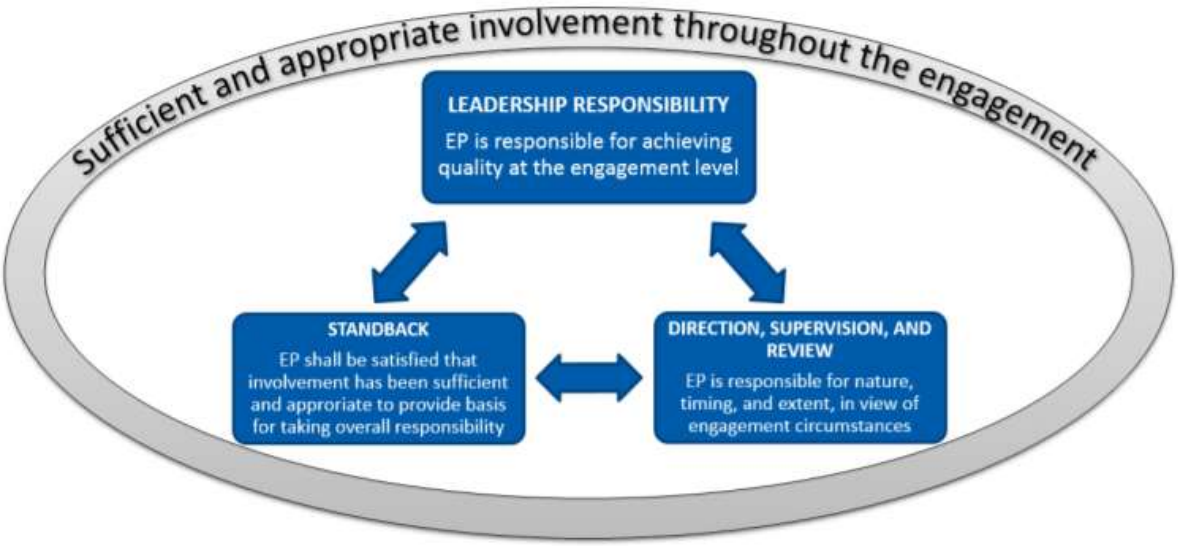
    a) **Fulfilling leadership responsibilities**, including taking actions to create an environment for the engagement that emphasizes the firm's culture and the expected behavior of engagement team members and assigning procedures, tasks or actions to other members of the engagement team;

    b) **Supporting engagement performance**, including taking responsibility for the nature, timing and extent of direction, supervision and review of the work performed; and

[6] See Section 6 of the explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*.

[7] The support materials will be available at www.iaasb.org during the public exposure period for ED-220.

c) **Standing back**, to determine whether the engagement partner has taken overall responsibility for managing and achieving quality, including determining that the engagement partner's involvement has been sufficient and appropriate throughout the engagement and that the nature and circumstances of the engagement have been taken into account.



Fulfilling Leadership Responsibilities (Paragraphs 11–13 of ED-220)

18. In clarifying the role and responsibilities of the engagement partner, the IAASB determined that ED-220 needed to highlight early in the ISA that achieving quality on the audit engagement requires the engagement partner to demonstrate sufficient and appropriate involvement in the engagement, which includes being responsible for creating an environment that emphasizes the firm's culture and expected behavior of engagement team members (see paragraph 11 of ED-220). The engagement partner is also required to take clear, consistent and effective actions that reflect the firm's commitment to quality and communicate the expected behavior of engagement team members (see paragraph 12 of ED-220. The focus on the link between the firm's culture and the tone set by leadership is aligned with the requirements of ED-ISQM 1 (see, for example, paragraph 22 of the explanatory memorandum of ED-ISQM 1).

19. Another aspect of leadership responsibilities is assigning responsibilities to other engagement team members. ED-220 recognizes that the engagement partner may assign aspects of the engagement to other members of the engagement team, but that the engagement partner is still required to take overall responsibility for the quality of the engagement. The engagement partner is therefore required to inform assignees about their responsibilities, to monitor the performance of the assignees' work, and to review related documentation (see paragraph 12 of ED-220). The IAASB discussed whether the leadership requirements, collectively, placed too much emphasis on the role of the engagement partner, but concluded that the public interest was best served by requirements that continue to emphasize the importance of overall responsibility for managing and achieving quality being in the hands of the engagement partner.

Supporting Engagement Performance (Paragraphs 27–31 of ED-220)

20. The IAASB revised the engagement performance section extensively to improve the quality of audits by enhancing the requirements and emphasizing the importance of taking the nature and circumstances of the audit into account in addressing them. To this end:

- The requirements and application material on direction, supervision and review have been strengthened and include greater specificity on how the engagement partner needs to be involved. In addition, the revised requirements include linkages with other requirements in ED-220 (e.g. the requirements on engagement resources) and to other ISAs (e.g. the guidance in ISA 230 on significant matters). The proposed standard also includes new guidance on these requirements, including guidance on matters that may constitute a significant judgment, and which matters therefore need to be reviewed by the engagement partner.
- New requirements require the engagement partner to review the financial statements and the auditor's report prior to dating the auditor's report and, prior to their issuance, to review formal written communications to management, those charged with governance, or regulatory authorities.
- The proposed ISA includes improved links with proposed ISQM 1 and ISQM 2, for example:
    - Requiring the engagement partner to take responsibility for the ET consulting on matters where the firm's policies or procedures require consultation.
    - Aligning the requirements to cooperate with the engagement quality reviewer with proposed ISQM 2.
    - Referring in paragraph A29 of ED-ISQM 2 to the new focus and guidance on significant judgments in ED-220, which provides assistance to the engagement quality reviewer in addressing the requirements of ISQM 2
- A new requirement on addressing differences of opinion has been included to provide greater specificity on the engagement partner's role in handling differences of opinion. This requirement is supported by guidance on how to handle differences of opinion.

Standing Back (Paragraph 37 of ED-220)

21. Paragraph 37 of ED-220 requires the engagement partner to "stand-back" and prior to forming an opinion, determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. The IAASB concluded that it was appropriate for the engagement partner to determine that the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement and that the nature and circumstances of the engagement (any changes thereto) have been taken into account in complying with the proposed ISA. The IAASB believes that including such a stand-back requirement would also assist in supporting the exercise of professional skepticism by the engagement partner and other members of the ET. Paragraph A101 of ED-220 provides guidance that appropriate consideration of the requirements of ED-220, and how the audit documentation evidences the engagement partner's involvement in the audit, would provide the basis for whether the engagement partner has taken overall responsibility for managing and achieving quality.

Section 2-C – Relevant Ethical Requirements

22. Extant ISA 220 requires that the engagement partner remain alert for non-compliance with relevant ethical requirements by members of the engagement team, determine the appropriate action if non-compliance comes to the engagement partner's attention, and conclude on compliance with independence requirements. The ITC noted that ISA 220 could include further material on the responsibilities of the engagement partner in relation to relevant ethical requirements for members of the engagement team.

23. In response to the ITC and the comments thereon, the IAASB determined that the requirements should be strengthened regarding relevant ethical requirements and the engagement partner's role in dealing with relevant ethical requirements. Accordingly, in addition to enhancing the extant requirements, ED-220 includes requirements regarding:

- Understanding of the relevant ethical requirements and whether other members of the engagement team are aware of those requirements and the firm's related policies or procedures;
- Threats to compliance with relevant ethical requirements; and
- Determining whether relevant ethical requirements, including those related to independence, have been fulfilled.

24. ED-220 also includes new application material that links with the firm level requirements in proposed ISQM 1, describes possible appropriate actions if non-compliance is indicated, and links to the requirement in ISA 700 (Revised)[8] for the auditor's report to include a statement regarding the auditor's independence.

Section 2-D – Engagement Resources

25. Extant ISA 220 contains requirements and guidance about the assignment of the engagement team, but does not otherwise address the engagement level resources. In paragraph 78 of the ITC, it was noted that extant ISA 220 does not explicitly address the need for the engagement partner to be satisfied that sufficient time and resources are available to the engagement team such that it will be possible to perform the necessary work to obtain sufficient appropriate audit evidence before the reporting deadline.

26. Consistent with the approach taken in ED-ISQM 1, proposed ISA 220 addresses this gap through a new section on human, technological and intellectual resources (see paragraphs 23–26 of ED-220). The engagement partner is responsible for determining that there are sufficient and appropriate resources assigned or made available on a timely basis. The engagement partner is also responsible for taking appropriate action when insufficient or inappropriate resources in the context of the audit engagement are provided by the firm and for the appropriate use of the resources by the engagement team. New application material describes how human, technological, and intellectual resources may be used to support the performance of audit engagements, how project management skills can assist in managing the quality of the audit engagement, and the appropriate actions if the engagement partner determines that the resources are insufficient or inappropriate.

[8] ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 28(c)

Section 2-E – Other Matters

27. Other enhancements included in ED-220 include that:

- Information learned in the acceptance and continuance process is required to be taken into account in planning and performing the audit engagement in accordance with the ISAs (see paragraph 21 of ED-220). For example, ED-220 now explicitly recognizes that information obtained in the acceptance and continuance process will be relevant to the auditor's risk assessment process.
- The monitoring and remediation requirement has been enhanced and clarified. The IAASB has also aligned ED-220 with the new requirements in proposed ISQM 1, and are premised on the basis that the engagement partner is responsible for dealing with the relevant aspects of the monitoring and remediation process as communicated by the firm including, as applicable, the results of the monitoring and remediation process of the network or network firms (see paragraph 21 of ED-220).. In addition, the engagement partner is also required to be satisfied that the engagement team is aware of the results of the firm's monitoring and remediation process and to remain alert throughout the engagement for information that may be relevant to the monitoring and remediation approach

28. Regardless of how the engagement team is organized, the IAASB has also emphasized the engagement partner's overall responsibility for managing and achieving quality on the engagement (see Section 2-B above). In light of this, the role and responsibilities of the engagement partner and engagement team in a group audit are also a key focus for the IAASB. The IAASB is currently undertaking a project to revise ISA 600,[9] which may result in further amendments to ED-220 in due course as the project progresses.

Section 3 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-220. In this regard, comments will be most helpful if they are identified with specific aspects of ED-220 and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement.

1) Does you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?

2) Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm's policies and procedures and the material referring to when the engagement partner may depend on the firm's policies or procedures?

3) Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level? (see paragraph 7 and A27–A29 of ED-220)

4) Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

5) Do you support the revised requirements and guidance on direction, supervision and review? (see paragraphs 27–31 and A68–A80)

[9] ISA 600, *Special Considerations in the Audit of Group Financial Statements (Including the Work of Component Auditors)*

6) Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?

Appendix

Scalability for Firms of Different Sizes and for Engagements Where Nature and Circumstances Differ

Note: This Appendix includes the relevant references to the material located within ED-220 that incorporate scalability for firms of different sizes and for engagements where the nature and circumstances differ.

How ED-220 Covers Scalability	Reference to ED-220
• In larger firms, responsibility for elements of the system of quality management are dispersed throughout the firm, the engagement partner may not have direct involvement or detailed knowledge of those elements. In such cases, the engagement partner may use information provided by the firm and personal knowledge, supplemented with additional inquiries or other procedures to have the necessary basis to depend on the firm's policies and procedures, In a smaller firm, the engagement partner may have more direct involvement in the firm processes which may provide the basis for depending on the firm's policies or procedures in certain circumstances. • For example, if the engagement partner is directly involved throughout the firm's acceptance and continuance process the engagement partner will therefore be aware of the information obtained, or used by the firm, in reaching the related conclusions. Such involvement may also therefore provide a basis for the engagement partner being satisfied that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.	• The Firm's System of Quality Management and Role of Engagement Teams – Paragraphs A7–A8 • Acceptance and Continuance of Client Relationships and Audit Engagements – Paragraph A45. • Engagement Resources – Paragraphs A52 and A61.

How ED-220 Covers Scalability	Reference to ED-220
• In a smaller firm, the design and implementation of many responses to the firm's quality risks may be most effectively dealt with by the engagement partner at the engagement level. • The firm's responses to quality risks, including policies or procedures, may be less formal in a smaller firm (e.g., in a very small firm with a relatively small number of audit engagements, firm leadership may determine that there is no need to establish a firm-wide system to monitor independence, and rather, independence would be monitored at the engagement level by the engagement partner.)	• The Firm's System of Quality Management and Role of Engagement Teams – Paragraph A14.
• Some requirements of ED-220 may not be relevant if the audit is carried out entirely by the engagement partner because they are conditional on the involvement of other members of the ET (e.g., requirements related to direction, supervision, and review).	• The Firm's System of Quality Management and Role of Engagement Teams – Paragraph A15.
• For a smaller ET that consists of only a few ET members, the engagement partner's actions influence the desired culture through direct interaction and conduct, which may be sufficient to reflect the firm's commitment to quality. For a larger ET that is dispersed over many locations, more formal communications may be necessary.	• Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraph A23.
• The requirements relating to nature, timing and extent of direction and supervision of the members of the ET and the review of the work performed are required to be responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement (i.e., the direction, supervision and review is to be specifically tailored or scaled for each engagement, depending on its size and complexity).	• Engagement Performance – Paragraph 27–29.

How ED-220 Covers Scalability	Reference to ED-220
• For larger engagements, the engagement partner may assign certain procedures, tasks or other actions to other members of the ET to assist the engagement partner in complying with the requirements of ED-220.	• Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraphs 13 and A30.
• In situations where there are many ET members, for example on larger, or more complex, audit engagements, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, for a smaller ET with fewer ET members, project management may be achieved through less formal means.	• Engagement Resources – Paragraph A63–A64.
• Explicit acknowledgement of a tailored approach to quality management at the engagement level that is responsive to the nature and circumstances of the audit engagement.	• Scope of this ISA – Paragraph A2. • The Firm's System of Quality Management and Role of Engagement Teams – Paragraphs 4(b), 7, A5, A9, and A14. • Relevant Ethical Requirements, Including Independence Requirements – Paragraphs 14–15, 18, and A32–A33. • Acceptance and Continuance of Client Relationships and Audit Engagements – Paragraph A49. • Leadership Responsibilities for Managing and Achieving Quality on Audits – Paragraphs 11, A23–A24, and A66. • Engagement Resources – Paragraphs 23, 25, A52, A60, and A11D. • Direction, Supervision and Review – Paragraphs 27(b), A69, A81, and A84. • Monitoring and Remediation – Paragraph A97. • Taking Overall Responsibility for Managing and Achieving Quality – Paragraph 37.

PROPOSED INTERNATIONAL STANDARD ON AUDITING 220 (REVISED) QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS

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Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner. This ISA is to be read in conjunction with relevant ethical requirements. (Ref: Para. A1–A2)

The Firm's System of Quality Management and Role of Engagement Teams

2. The firm is responsible for the system of quality management. Under proposed ISQM 1, the objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements performed by the firm, that provides the firm with reasonable assurance that:

   (a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and

   (b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.[10] (Ref: Para. A3, A14–A15)

3. This ISA is premised on the basis that the firm is subject to the ISQMs or to national requirements that are at least as demanding. (Ref: Para. A4)

4. The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this ISA, for:

   (a) Implementing the firm's responses to quality risks (i.e., the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm; (Ref: Para. A5–A8)

   (b) Given the nature and circumstances of the audit engagement, determining whether to design and implement responses beyond those set forth in the firm's policies or procedures; and (Ref: Para. A9–A10)

   (c) Providing the firm with information from the audit engagement to support the design, implementation, and operation of the firm's system of quality management that is required to be communicated in accordance with the firm's policies or procedures. (Ref: Para. A11)

5. Complying with the requirements in other ISAs may provide information that is relevant to quality management at the engagement level. (Ref: Para. A12)

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[10] Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* paragraph 21

6. The public interest is served by the consistent performance of quality audit engagements. Quality audit engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and exercising professional skepticism. (Ref: Para. A13)

7. In accordance with ISA 200,[11] the engagement partner and other members of the engagement team are required to plan and perform an audit with professional skepticism and to exercise professional judgment. In doing so, the engagement partner and engagement team exercise professional judgment and professional skepticism in meeting the objective and requirements of this ISA. Professional judgment is applied in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement partner and other members of the engagement team. Such actions and communications may include specific steps to deal with impediments that may impair the appropriate exercise of professional skepticism, such as unconscious bias or resource constraints. (Ref: Para. A27–A29)

Effective Date

8. This ISA is effective for audits of financial statements for periods beginning on or after [Date].

Objective

9. The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that:

   (a) The auditor has fulfilled the auditor's responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements; and

   (b) The auditor's report issued is appropriate in the circumstances.

Definitions

10. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Engagement partner[12] – The partner, or other individual appointed by the firm, who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

   (b) Engagement quality review – An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon that is completed on or before the date of the engagement report.

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[11] ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of An Audit In Accordance with International Standards on Auditing*, paragraphs 15–16

[12] "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

(c) Engagement quality reviewer – A suitably qualified partner or other individual appointed by the firm to be responsible for the performance of the engagement quality review.

(d) Engagement team – All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an auditor's external expert engaged by the firm or a network firm,[13] and also excludes individuals within the client's internal audit function who provide direct assistance on an engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).[14] (Ref: Para. A16–A19)

(e) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants, or public sector equivalent. (Ref: Para. A20)

(f) Network firm – A firm or entity that belongs to a network. (Ref: Para. A21)

(g) Network – A larger structure: (Ref: Para. A21)

  (i) That is aimed at cooperation, and

  (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality management policies or procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(h) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(i) Personnel – Partners and staff.

(j) Professional standards – International Standards on Auditing (ISAs) and relevant ethical requirements.

(k) Relevant ethical requirements – Principles of professional ethics and ethical requirements that are applicable to professional accountants when undertaking the audit engagement. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to audits of financial statements, together with national requirements that are more restrictive.

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

  (i) Policies are statements of what should, or should not, be done to address a quality risk. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.

  (ii) Procedures are actions to implement policies.

(m) Staff – Professionals, other than partners, including any experts the firm employs.

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[13] ISA 620, *Using the Work of an Auditor's Expert*, paragraph 6(a), defines the term "auditor's expert."

[14] ISA 610 (Revised 2013), *Using the Work of Internal Auditors,* establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

Requirements

Leadership Responsibilities for Managing and Achieving Quality on Audits

11. The engagement partner shall take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the engagement such that the engagement partner has the basis for determining whether the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. (Ref: Para. A22–A29)

12. In creating the environment described in paragraph 11, the engagement partner, and others to whom supervisory roles are assigned, shall take clear, consistent and effective actions that reflect the firm's commitment to quality and establish and communicate the expected behavior of engagement team members, including:

    (a) Emphasizing that all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;

    (b) Reinforcing the importance of professional ethics, values, and attitudes to the members of the engagement team;

    (d) Encouraging open and robust communication within the engagement team, and supporting the ability of engagement team members to raise concerns without fear of reprisal; and

    (e) Emphasizing the importance of each engagement team member exercising professional skepticism throughout the audit engagement.

13. If the engagement partner assigns procedures, tasks or actions to other members of the engagement team to assist the engagement partner in complying with the requirements of this ISA, the engagement partner shall continue to take overall responsibility for managing and achieving quality on the audit engagement. When assigning procedures, tasks or actions to other members of the engagement team, the engagement partner shall: (Ref: Para. A30)

    (a) Appropriately inform assignees about the nature of their responsibilities and authority, the scope of the work being assigned, the objectives thereof and any other necessary instructions and relevant information; and

    (b) Monitor the performance of the work of assignees and review selected related documentation in order to evaluate the conclusions reached.

Relevant Ethical Requirements, Including Those Related to Independence

14. The engagement partner shall have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: Para. A31–A35, A41)

15. The engagement partner shall determine that other members of the engagement team have been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that deal with: (Ref: Para. A33–A35)

(a) Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence;

(b) Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and their responsibilities when they become aware of actual or suspected breaches; and

(c) Their responsibilities when they become aware of an instance of actual or suspected non-compliance with laws and regulations.[15]

16. If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner shall evaluate such threats through complying with the firm's policies or procedures, using relevant information from the firm, the engagement team, or other sources and take appropriate action. (Ref: Para. A36–A37)

17. The engagement partner shall remain alert throughout the audit engagement, through observation and making inquiries as necessary, for actual or suspected breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: Para. A38)

18. If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the audit engagement have not been fulfilled, the engagement partner, in consultation with others in the firm, shall take appropriate action. (Ref: Para. A39)

19. Prior to dating the auditor's report, the engagement partner shall determine whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: Para. A40)

Acceptance and Continuance of Client Relationships and Audit Engagements

20. The engagement partner shall be satisfied that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A42–A45, A51)

21. The engagement partner shall take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with the ISAs and complying with the requirements of this ISA. (Ref: Para. A46–A49)

22. If the engagement partner obtains information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: Para. A50)

Engagement Resources

23. The engagement partner shall determine that, given the nature and circumstances of the audit engagement (and any changes that may arise during its course), sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team by the firm on a timely basis. (Ref: Para. A52–A61, A63–A64, A67)

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[15] ISA 250 (Revised), *Considerations of Laws and Regulations in an Audit of Financial Statements*

24. The engagement partner shall determine that members of the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: Para. A62–A64)

25. If, as a result of complying with the requirement in paragraphs 23 and 24, the engagement partner determines that resources assigned or made available by the firm are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner shall take appropriate action, including communicating with appropriate personnel in the firm about the need to allocate or assign additional or alternative resources to the engagement. (Ref: Para. A65–A66)

26. The engagement partner shall take responsibility for using the resources assigned or made available to the engagement team a4ppropriately, given the nature and circumstances of the audit engagement. (Ref: Para. A58)

Engagement Performance

Direction, Supervision and Review

27. The engagement partner shall take responsibility for the nature, timing and extent of direction and supervision of the members of the engagement team and the review of the work performed, and determine that such direction, supervision and review is: (Ref: Para A68–A76, A81–A83)

    (a) Planned and performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements;

    (b) Responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement; and

    (c) Planned and performed on the basis that the work performed by less experienced team members is directed, supervised, and reviewed by more experienced engagement team members.

28. On or before the date of the auditor's report, the engagement partner shall, through review of audit documentation and discussion with the engagement team, determine that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A77–A80)

29. In complying with the requirements of paragraph 28, the engagement partner shall review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to: (Ref: Para. A77–A80)

    (a) Significant matters;[16]

    (b) Other areas involving significant judgments, especially those relating to difficult or contentious matters identified during the course of the engagement, and the conclusions reached; and

    (c) Other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

30. Prior to dating the auditor's report, and in order to determine that the report to be issued will be appropriate in the circumstances, the engagement partner shall review the financial statements and

[16] ISA 230, *Audit Documentation*, paragraph 8

the auditor's report, including, if applicable, the description of the key audit matters[17] and related audit documentation.

31. The engagement partner shall review, prior to their issuance, any formal written communications to management, those charged with governance, or regulatory authorities.

Consultation

32. The engagement partner shall: (Ref: Para. A84–A87)

    (a) Take responsibility for the engagement team undertaking consultation on:

        (i) Matters where the firm's policies or procedures require consultation, including on difficult or contentious matters; and

        (ii) Other matters that in the engagement partner's professional judgment, require consultation;

    (b) Determine that members of the engagement team have undertaken appropriate consultation during the course of the audit engagement, both within the engagement team, and between the engagement team and others at the appropriate level within or outside the firm;

    (c) Determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and

    (d) Determine that conclusions resulting from such consultations have been implemented.

Engagement Quality Review

33. For audit engagements for which an engagement quality review is required, the engagement partner shall: (Ref: Para. A88)

    (a) Be satisfied that an engagement quality reviewer has been appointed;

    (b) Cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so;

    (c) Discuss significant matters arising during the engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and

    (d) Not date the auditor's report until the completion of the engagement quality review. (Ref: Para. A89–A92)

Differences of Opinion

34. If differences of opinion arise, within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation, the engagement team shall follow the firm's policies or procedures for dealing with and resolving them. (Ref: Para. A93–A94)

35. The engagement partner shall:

    (a) Take responsibility for differences of opinion being dealt with and resolved in accordance with the firm's policies or procedures;

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[17] ISA 701, *Communicating Key Audit Matters in the Auditor's Report*

(b) Determine that conclusions reached are documented and implemented; and

(c) Not date the auditor's report until any differences of opinion are resolved.

Monitoring and Remediation

36. The engagement partner shall: (Ref: Para. A97–A98)

(a) Be satisfied that the engagement team has been made aware of results of the firm's monitoring and remediation process, as communicated by the firm including, as applicable, the results of the monitoring and remediation process of the network or network firms;

(b) Determine the relevance and effect on the audit engagement of the information referred to in paragraph 36(a) and take appropriate action; and

(c) Remain alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicate such information to those responsible for the process.

Taking Overall Responsibility for Managing and Achieving Quality

37. Prior to dating the auditor's report, the engagement partner shall determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner shall determine that: (Ref: Para. A99–A101)

(a) The engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and

(b) The nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures, have been taken into account in complying with the requirements of this ISA.

Documentation

38. The auditor shall include in the audit documentation:[18] (Ref: Para. A102–A104)

(a) Matters identified, relevant discussions with firm personnel, and conclusions reached with respect to:

(i) Fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence.

(ii) The acceptance and continuance of the client relationship and audit engagement.

(b) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement and how such conclusions were implemented.

(c) If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed on or before the date of the auditor's report.

[18] ISA 230, paragraphs 8-11 and A6

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Application and Other Explanatory Material

Scope of this ISA (Ref: Para. 1)

A1. This ISA applies to all audits of financial statements, including audits of group financial statements. ISA 600,[19] deals with special considerations that apply to group audits, in particular those that involve component auditors.

A2. ISA 200 requires the auditor to comply with relevant ethical requirements, including those related to independence, relating to financial statement audit engagements.[20] Paragraphs 14–19 and A31–A41 of this ISA include requirements and guidance that deal with complying with relevant ethical requirements that are applicable given the nature and circumstances of the engagement, including those related to independence.

The Firm's System of Quality Management and Role of Engagement Teams (Ref: Para. 2 – 5)

A3. Proposed ISQM 1 deals with a firm's responsibilities for its system of quality management. A system of quality management is designed, implemented and operated by a firm in accordance with proposed ISQM 1 and is organized into the following eight components:

- Governance and leadership;
- The firm's risk assessment process;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Engagement performance;
- Resources;
- Information and communication; and
- The monitoring and remediation process.

A4. Firms or national requirements may use different terminology or frameworks to describe components of a system of quality management. National requirements that deal with the firm's responsibilities to design, implement, and operate a system of quality management are at least as demanding as proposed ISQM 1 when they deal with all the components referred to in paragraph A3 and impose obligations on the firm to achieve the objective set out in proposed ISQM 1.

Implementing the Firm's Responses to Quality Risks That Are Applicable to the Audit Engagement (Ref: Para. 4(a))

A5. Quality management at the engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with proposed ISQM 1, the firm is responsible for communicating to relevant personnel, including the engagement team, about their responsibilities for implementing the firm's responses that are applicable at the engagement level. For example, such firm level responses may include policies or

[19] ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

[20] ISA 200, paragraph 14.

procedures to undertake consultations with designated personnel in certain situations involving complex technical or ethical matters, or to involve firm-designated experts in specific engagements to deal with particular matters (e.g., the firm may specify that firm-designated credit experts are to be involved in auditing credit loss allowances in all audits of financial institutions).

A6. Firm level responses may include policies or procedures established by a network, or by another firm or group of firms within the same network (network requirements or network services are described further in proposed ISQM 1 within the "Network Requirements or Network Services" section). The requirements of this ISA are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network resources or services or the work of network resources or services on the audit engagement.

Other Firm Level Responses That May be Relevant to the Engagement Team (Ref: Para. 4(a))

A7. Some firm level responses to quality risks are not performed at the engagement level but are nevertheless relevant when complying with the requirements of this ISA. For example, when determining whether the members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement, the engagement partner may be able to depend on the firm's policies or procedures dealing with personnel recruitment and professional training. Other examples of firm level responses that the engagement partner may be able to depend on when complying with the requirements of this ISA include:

- Information systems that monitor independence;
- Information systems that deal with acceptance and continuance of client relationships and audit engagements; and
- Audit methodologies and related implementation tools and guidance.

A8. Matters that the engagement partner may take into account when determining whether, and if so, the degree to which, the engagement partner may depend on the firm's policies or procedures in complying with the requirements of this ISA include:

- The engagement partner's knowledge or understanding of, or practical experience with, such policies or procedures.
- Information obtained from the firm, engagement team, or other parties, about the effectiveness of such policies or procedures (e.g., information provided by the firm's monitoring and remediation processes that indicate that the firm's policies or procedures are operating effectively or that do not provide any indications of deficiencies).

Designing and Implementing Responses at the Engagement Level (Ref: Para. 4(b))

A9. Due to the specific nature and circumstances of each audit engagement and changes that may occur during the engagement, a firm cannot identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement partner exercises professional judgment in determining whether to design and implement responses, beyond those set forth in the firm's policies or procedures, at the engagement level in order to meet the objective of this ISA.[21] The engagement partner's determination of whether such engagement level responses are required (and if so, what those responses are) is influenced by the requirements of this ISA, and the engagement partner's understanding of the nature and circumstances of the engagement and any changes thereto. For example,

[21] ISA 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.

unanticipated circumstances may arise during the course of the engagement that may cause the engagement partner to request the involvement of appropriately experienced personnel in addition to those initially assigned or made available by the firm.

A10. The relative balance of the engagement partner's efforts to comply with the requirements of this ISA (i.e., between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (e.g., an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement partner's actions in complying with the engagement performance requirements of this ISA may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (e.g., planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

Providing the Firm with Information from the Audit Engagement (Ref: Para. 4(c))

A11. The firm's policies or procedures may require the engagement team to provide the firm with specific information from the audit engagement that is relevant to the design, implementation, and operation of the firm's system of quality management. During the engagement, the engagement partner may become aware (including through being informed by other members of the engagement team) that the firm's responses to quality risks are deficient in the context of the specific engagement. Providing such information to the firm may be relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit program provided by the firm does not deal with new or revised regulation, timely communication of such information to the appropriate individuals within the firm enables the firm to take steps to update and reissue the audit program to deal with such regulation.

Information Relevant to Quality Management at the Engagement Level (Ref: Para. 5)

A12. Complying with the requirements in other ISAs may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its environment required to be obtained under ISA 315 (Revised)[22] provides information that may be relevant to complying with the requirements of this ISA. Such information may be relevant to the determination of:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas, or the involvement of experts to deal with complex matters;
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations;
- The nature, timing and extent of review of the work performed by members of the team based on the number and significance of the assessed risks of material misstatement; or

[22] ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

- The allocation of the budgeted audit hours, including allocating more time, and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher.

Public Interest (Ref: Para. 6)

A13. Relevant ethical requirements contain requirements and application material for professional accountants that enable professional accountants to meet their responsibility to act in the public interest. In the context of engagement performance, the consistent performance of quality engagements forms part of the professional accountant's responsibility to act in the public interest.

Considerations Specific to Smaller Firms (Ref: Para. 2–4)

A14. In a smaller firm, the design and implementation of many responses to the firm's quality risks, may be most effectively dealt with by the engagement partner at the engagement level (i.e., given the nature and circumstances of the firm and the engagements it performs, there may be less need for firm level responses to many of the firm's quality risks). Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence, and rather, independence will be monitored at the individual engagement level by the engagement partner.

A15. If an audit is carried out entirely by the engagement partner, some requirements in this ISA are not relevant because they are conditional on the involvement of other members of the engagement team. For example, the requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

Definitions

Engagement Team (Ref: Para. 10(d))

A16. Engagement teams may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations, and may be organized in groups by activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures[23] on the audit engagement is considered to be a member of the engagement team. External experts and internal auditors providing direct assistance are not members of the engagement team. ISA 620[24] and ISA 610[25] include requirements for the auditor to comply with when using the work of an external expert or when using the work of internal auditors in a direct assistance capacity. The auditor performs audit procedures to comply with these requirements and these procedures form the basis for the auditor's determination as to whether work performed by external experts or internal auditors providing direct assistance can be used as audit evidence.

A17. Engagement teams may include individuals from service delivery centers who perform audit procedures. For example, the firm may determine that specific tasks that are repetitive or specialized

[23] ISA 500, *Audit Evidence*, paragraph A10

[24] See ISA 620, paragraph 12–13

[25] See ISA 610 (Revised 2013), paragraphs 21–25

in nature can be performed by a group of appropriately skilled personnel and the engagement team may therefore include such individuals. Service delivery centers may be established at the firm level, at the network level, or by another firm or group of firms from within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.

A18. Engagement teams may include individuals from network firms or other firms to perform audit procedures, for example, procedures such as attending a physical inventory count or inspecting physical fixed assets at a remote location.

A19. If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and individuals who assist the engagement quality reviewer in performing the engagement quality review, are not members of the engagement team.

Firm (Ref: Para. 10(e))

A20. The definition of "firm" in relevant ethical requirements may differ from the definition set out in this ISA. For example, the IESBA Code defines the "firm" as:

(a) A sole practitioner, partnership or corporation of professional accountants;

(b) An entity that controls such parties through ownership, management or other means; and

(c) An entity controlled by such parties through ownership, management or other means.

In complying with the requirements in this ISA, the definitions used in the relevant ethical requirements apply in so far as is necessary to interpret those ethical requirements.

"Network" and "Network Firm" (Ref: Para. 10(f)–10(g))

A21. The definitions of "network" or "network firm" in relevant ethical requirements may differ from those set out in this ISA. The IESBA Code also provides guidance in relation to the terms "network" and "network firm." Networks and the firms within the network may be structured in a variety of ways, and are in all cases external to the firm. The provisions in this ISA in relation to networks apply to any structures or organizations that do not form part of the firm, but that exist within the network.

Leadership Responsibilities for Managing and Achieving Quality on Audits (Ref: Para. 11–13)

Taking Overall Responsibility for Managing and Achieving Quality

A22. The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that promotes the conduct of quality audit engagements. In addressing the requirements in paragraphs 11 and 12, the engagement partner may communicate directly and reinforce this communication through personal conduct and actions (e.g., leading by example). A commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement.

A23. The nature and extent of the actions of the engagement partner to reflect the firm's commitment to quality may depend on a variety factors including the size, structure, geographical dispersion and complexity of the firm, and the nature and circumstances of the audit engagement. With a smaller engagement team, with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary.

Sufficient and Appropriate Involvement

A24. Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including:

- Taking responsibility for the nature, timing and extent of the direction and supervision of members of the engagement team, and the review of the work performed in complying with the requirements of this ISA;
- Varying the nature, timing and extent of such direction, supervision, and review, in the context of the nature and circumstances of the engagement.

Communication

A25. Communication is the means through which the engagement partner and the members of the engagement team share relevant information on a timely basis in order to comply with the requirements of this ISA, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team, or with:

(a) The firm, such as with personnel performing activities within the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management;

(b) Others involved in the audit (e.g., an auditor's external expert or component auditor); and

(c) Parties that are external to the firm (e.g., management, those charged with governance, or regulatory authorities).

A26. The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the most appropriate means of effective communication with the engagement team members. For example, in-person and more frequent interactions are likely to be a more effective way to direct and supervise less experienced team members.

Professional Skepticism

A27. As explained in paragraph 7, professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, the overall effectiveness of the engagement team in achieving quality at the engagement level. In some circumstances the engagement partner may need to deal with impediments to the exercise of professional skepticism at the engagement level such as:

- Tight deadlines or budget constraints may negatively affect the behavior of those who perform the work as well as those who direct, supervise and review it;
- Lack of cooperation or undue pressures imposed by management may negatively affect the engagement team's ability to resolve complex or contentious issues;
- Insufficient emphasis on the importance of quality may undermine the exercise of professional skepticism by the engagement team;
- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions;

- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible; and
- Overreliance on tools and templates may undermine the exercise of professional skepticism by the engagement team.

A28. Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including for example, the selection of an audit approach, performance of audit procedures, or evaluation of audit evidence. Examples of unconscious auditor biases that may affect the exercise of professional skepticism, and therefore the reasonableness of the professional judgments made by the engagement partner in complying with the requirements of this ISA, include:

- Availability bias, which involves considering information that is easily retrievable from memory as being more likely, more relevant, and more important for a judgment.
- Confirmation bias, which involves seeking, and treating as more persuasive, information that is consistent with initial beliefs or preferences.
- Overconfidence bias, which involves overestimating one's own abilities to perform tasks or to make accurate assessments of risk or other judgments and decisions.
- Anchoring bias, which involves making assessments by starting from an initial numerical value and then adjusting insufficiently away from that initial value in forming a final judgment.

A29. Possible actions that the engagement partner may take to deal with impediments to the exercise of professional skepticism at the engagement level include:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement, and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement;
- Explicitly alerting the engagement team to instances or situations when vulnerability to unconscious or conscious auditor biases may be greater (e.g., areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures (see paragraph A28);
- Changing the composition of the engagement team assigned, for example, involving more experienced staff in order to obtain greater skills or knowledge or specific expertise;
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with;
- Involving members of the engagement team with specialized skills and knowledge, or an auditor's expert to deal with complex or subjective areas of the audit;
- Modifying the nature, timing and extent of direction and supervision of engagement team members, and review of their work, for complex or subjective areas of the audit, including involving more experienced members of the team, more in-person oversight on a more frequent basis and more in-depth reviews of certain working papers;
- Setting expectations for:

  - Less experienced members of the engagement team to seek advice frequently and on a timely basis from more experienced team members or the engagement partner;
  - More experienced team members to be available to less experienced members of the engagement team throughout the audit and to respond positively and on a timely basis to their insights, requests for advice, or assistance; and
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought.

Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team (Ref: Para. 13)

A30. The engagement partner is ultimately responsible and therefore accountable for managing and achieving quality on the audit engagement. However, it will generally not be possible or practical for all of the requirements in this ISA to be dealt with solely by the engagement partner (e.g., due to the nature and size of the entity, or the complexity of the audit and the need for specialized skills or expertise). In managing quality at the engagement level, the engagement partner may therefore assign responsibility for procedures, tasks, or other actions to appropriately skilled or suitably experienced members of the engagement team who assist the engagement partner in complying with the requirements of this ISA. For example, engagement team members other than the engagement partner may be assigned supervisory roles.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: Para. 14–19)

Relevant Ethical Requirements

A31. ISA 200[26] requires that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, there may be requirements related to independence that are applicable only when performing audits of listed entities.

A32. Based on the nature and circumstances of the audit engagement, certain relevant ethical requirements, or aspects of law or regulation, may be of significance to the engagement, for example law or regulation dealing with money laundering, corruption, or bribery.

Firms Policies or Procedures to Deal With Relevant Ethical Requirements

A33. Information and communication, and resources provided by the firm may assist the engagement partner and other members of the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement in accordance with paragraphs 14–19. For example:

- Communicating the independence requirements to all personnel and others subject to independence requirements, as applicable.
- Providing training for personnel on relevant ethical requirements.

[26] ISA 200, paragraphs 14 and A16-A19

- Establishing manuals and guides (i.e., intellectual resources), containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.
- Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements (e.g., ISQM 1 requires that the firm obtain, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or to provide consultation on matters related to relevant ethical requirements.
- Establishing policies or procedures for personnel to communicate relevant information to appropriate parties within the firm or to the engagement partner, such as requirements for engagement teams or personnel to:
    - Communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.
    - Communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and if it is not, address the threat by eliminating it or reducing it to an acceptable level.
    - Promptly communicate any breaches of the relevant ethical requirements, including those related to independence.
- Establishing an information system, including through IT applications (i.e., technological resources), to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

A34. The engagement partner may take into account the information, communication and resources described in paragraph A33 when determining whether, and if so, the degree to which, the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements. For example, the engagement partner may be able to depend on information systems that monitor independence. See paragraphs A7–A8.

A35. Open and robust communication between the engagement partner and the members of the engagement team about relevant ethical requirements may also assist in:

- Drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement; and
- Keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

Identifying and Evaluating Threats to Compliance with Relevant Ethical Requirements (Ref: Para. 15–16)

A36. In accordance with proposed ISQM 1, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence, include policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed.

A37. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be dealt with. For example, the IESBA Code explains that a self-interest threat to compliance with the fundamental principle of professional competence and due care may arise if the fee quoted for an audit engagement is so low that it might be difficult to perform the engagement in accordance with professional standards.

Actual or Suspected Breaches of Relevant Ethical Requirements (Ref: Para. 17)

A38. In accordance with proposed ISQM 1, the firm is required to establish policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches.

Taking Appropriate Action (Ref: Para. 18)

A39. Appropriate actions may include, for example:

- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate personnel within the firm so that appropriate action can be taken, including as applicable, disciplinary action(s);
- Communicating with those charged with governance;
- Communicating with regulatory authorities. In some circumstances, communication with regulatory authorities may be required by law or regulation;
- Seeking legal advice; or
- Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Prior to Dating the Auditor's Report (Ref: Para. 19)

A40. ISA 700 (Revised) requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.[27] Performing the procedures required by paragraphs 14–19 of this ISA provides the basis for these statements in the auditor's report.

Considerations Specific to Public Sector Entities

A41. Statutory measures may provide safeguards for the independence of public sector auditors. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 14. This may include, where the public sector auditor's mandate does not permit withdrawal from the audit engagement, disclosure through a public report of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

[27] ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 28(c)

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 20–22)

A42. Proposed ISQM 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements that are appropriate in the circumstances.

A43. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity and ethical values of the principal owners, key management and those charged with governance of the entity;
- Whether there are sufficient and appropriate resources to perform the engagement;
- Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement;
- Whether the engagement team has the competence and capabilities, including sufficient time to perform the engagement;
- Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement.

A44. Under proposed ISQM 1, for acceptance and continuance decisions, the firm is required to make appropriate judgments about whether it will have access to information to perform the engagement, or to the persons who provide such information. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process.

A45. If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained, or used by the firm, in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner being satisfied that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.

A46. Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this ISA and making informed decisions about appropriate courses of action. For example:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework;
- The entity's timetable for reporting, such as at interim and final stages;
- In relation to group audits, the nature of the control relationships between the parent and its components; and
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement which may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed.

A47. Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other ISAs, as well as this ISA, for example with respect to:

- Establishing an understanding of the terms of the audit engagement, as required by ISA 210;[3]
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with ISA 315 (Revised) and ISA 240;[28]
- Understanding the group, its components, and their environments, in the case of an audit of group financial statements in accordance with ISA 600, and directing, supervising and reviewing the work of component auditors;
- Determining whether, and how, to involve an auditor's expert in accordance with ISA 620; and
- The entity's governance structure in accordance with ISA 260[29] and ISA 265.[30]

A48. Law, regulation, or relevant ethical requirements may require the auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected non-compliance with laws and regulations to the proposed successor auditor. For example, if the predecessor auditor has withdrawn from the engagement as a result of identified or suspected non-compliance with laws and regulations, the IESBA Code requires that the predecessor auditor, on request by a proposed successor auditor, provide all such facts and other information concerning such non-compliance that, in the predecessor auditor's opinion, the proposed successor auditor needs to be aware of before deciding whether to accept the audit appointment.

A49. In circumstances when the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement in complying with the requirement in paragraph 21.

A50. In deciding on the necessary action in accordance with paragraph 22, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement, and if so, what additional steps are necessary at the engagement level (e.g., the assignment of more staff, or staff with particular expertise). If the engagement partner has further concerns and is not satisfied that the matter has been appropriately dealt with, the firm's policies or procedures for resolving differences of opinion may be applicable.

Considerations Specific to Public Sector Entities (Ref: Para. 20–22)

A51. In the public sector, auditors may be appointed in accordance with statutory procedures and the public sector auditor may not need to establish all policies or procedures regarding the acceptance and continuance of audit engagements. Nevertheless the requirements and considerations for the acceptance and continuance of client relationships and engagements as set out in paragraphs 20–22 and A42–A47 may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

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[28] ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

[29] ISA 260 (Revised), *Communication with Those Charged with Governance*

[30] ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

Engagement Resources (Ref: Para. 23–26)

A52. Under proposed ISQM 1, the resources assigned, allocated, or made available by the firm to support the performance of audit engagements include:

- Human resources;
- Technological resources; and
- Intellectual resources.

Under proposed ISQM 1, the firm's quality objectives are required to address appropriately obtaining, developing, using, maintaining, allocating and assigning such resources in a timely manner to enable the design, implementation and operation of the system of quality management. Based on the nature and circumstances of the engagement the engagement partner may be able to depend on the firm's policies or procedures that address the quality risks related to such quality objectives when complying with the requirements in paragraphs 23–26 of this ISA (see also paragraphs A7–A8).

A53. A relevant consideration for the engagement partner, in complying with the requirements in paragraph 23 and 24, is whether the resources assigned or made available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles, such as professional competence and due care.

Human Resources

A54. Human resources assigned or made available by the firm include members of the engagement team and, where applicable, external experts. In addition, as provided for by ISA 610 (Revised 2013) individuals from within the entity's internal audit function may provide direct assistance.

A55. An engagement team includes any individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes, information technology, or in using automated tools to analyze complex data or to perform statistical analysis.

Technological Resources

A56. The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technology may allow the auditor to more effectively and efficiently manage the audit. Technology may also allow the auditor to evaluate large amounts of data more easily in order to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Inappropriate use of such technological resources may however increase the risk of overreliance on the information produced for decision purposes, or may create threats to complying with relevant ethical requirements, for example, those requirements related to confidentiality.

A57. The firm's policies or procedures may set forth required considerations or responsibilities for the engagement team when using firm approved technology to perform audit procedures and may require the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output.

A58. The firm's policies or procedures may specifically prohibit the use of certain technological resources (e.g., software that has not yet been specifically approved for use by the firm) or may include

requirements to seek approval to use a new technological resource. In some circumstances the firm's policies or procedures may not specifically deal with the use of a specific technological resource (e.g., a spreadsheet developed by the engagement team or obtained from outside the engagement team or the firm). In these circumstances, the engagement partner may apply professional judgment in considering whether the use of the resource on the audit engagement is appropriate in the context of the engagement, and if so, how the technological resource is to be used.

Intellectual Resources

A59. Intellectual resources include, for example, firm, network firm, or network audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms.

A60. The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, laws and regulations, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, industry-specific methodology or related guides and performance aids.

Sufficient and Appropriate Resources to Perform the Engagement (Ref: Para. 23)

A61. In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team by the firm, the engagement partner may be able to depend on the firm's related policies or procedures as described in paragraph A7. Matters that the engagement partner may take into account when making such a determination are described in paragraph A8. For example, the engagement partner may be able to depend on the firm's technological development and maintenance programs when using firm approved technology to perform audit procedures based on information communicated by the firm.

Competence and Capabilities of the Engagement Team (Ref: Para. 24)

A62. When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's:

- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and applicable legal and regulatory requirements.
- Expertise in specialized areas of accounting or auditing.
- Expertise in information technology used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- Knowledge of relevant industries in which the entity being audited operates.
- Ability to exercise professional skepticism and apply professional judgment.
- Understanding of the firm's policies or procedures.

Project Management

A63. In situations where there are many engagement team members, for example on larger, or more complex, audit engagements, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, for a smaller engagement team with fewer engagement team members, project management may be achieved through less formal means.

A64. Project management techniques and tools may support the engagement partner and the other members of the engagement team in managing the quality of the audit engagement by, for example:

- Increasing the engagement team's ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism;
- Facilitating timely performance of audit work to more effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise;
- Monitoring the progress of the audit against the audit plan,[31] including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources;
- Assisting the engagement partner in taking responsibility for the direction and supervision of engagement team members and the review of their work (see paragraph 27); or
- Coordinating arrangements with component auditors and auditor's experts.

Insufficient or Inappropriate Resources (Ref: Para. 25)

A65. Proposed ISQM 1 requires that the firm's quality objectives include that the firm's strategic decisions and actions, including financial and operational priorities, reflect the firm's commitment to quality and do not undermine the firm's role in serving the public interest by consistently performing quality engagements. However, in certain circumstances the firm's financial and operational priorities may place constraints on the resources assigned or made available to the engagement team.[32] In such circumstances, these constraints do not override the engagement partner's responsibility for achieving quality at the engagement level, including for becoming satisfied that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement.

A66. The engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this ISA and the nature and circumstances of the audit engagement. If the engagement partner determines that the resources assigned or made available by the firm are insufficient or inappropriate in the circumstances of the engagement and additional or alternative resources have not been made available, the engagement partner is required to take appropriate action. In such cases, appropriate actions may include:

- If possible, discussing an extension to the reporting deadlines with management or those charged with governance.

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[31] ISA 300, paragraph 9

[32] See also paragraph A37.

- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement.
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Considerations Specific to Public Sector Entities (Ref: Para. 23–26)

A67. In the public sector, specialized skills may be necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such skills may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing.

Engagement Performance

Direction, Supervision and Review (Ref: Para. 27)

A68. Under proposed ISQM 1, the firm is required to establish polices or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including that such direction, supervision and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised and reviewed by more experienced engagement team members.

A69. Direction and supervision of the engagement team and the review of the work of the engagement team are firm level responses that are implemented at the engagement level of which the nature, timing and extent may be further tailored by the engagement partner in managing quality of the audit engagement. Accordingly, the approach to direction, supervision and review will take into account the nature and circumstances of the engagement and will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses. The approach will vary from one engagement to the next.

A70. The approach to the direction and supervision of the members of the engagement team and the review of the work performed provides support for the engagement partner in addressing the requirements in this ISA, as well as the conclusion that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph 37.

A71. Ongoing discussion and communication among members of the engagement team allows less experienced team members to raise questions with more experienced team members (including the engagement partner) on a timely basis and enables effective direction, supervision and review in accordance with paragraph 27(c).

Direction

A72. Direction of the engagement team may involve informing the members of the engagement team of matters such as:

- The responsibility for all engagement team members for contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions.

- The importance of maintaining a questioning mind and being aware of unconscious or conscious auditor biases in exercising professional skepticism in gathering and evaluating audit evidence (see paragraph A29).
- Their responsibilities to fulfill relevant ethical requirements.
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- Respective roles and responsibilities of the engagement team members in performing audit procedures and the roles of more experienced team members in directing, supervising and reviewing the work of less experienced team members.
- The objectives of the work to be performed and detailed instructions regarding the nature, timing and extent of planned audit procedures as set forth in the overall audit strategy and audit plan.
- Threats to the achievement of quality, and the engagement team's expected response in this regard. For example, budget constraints or resource constraints should not result in the engagement team members modifying planned audit procedures or failing to perform planned audit procedures.

Supervision

A73. Supervision includes matters such as:

- Tracking the progress of the audit engagement, which includes:
  - Monitoring the progress against the audit plan;
  - Monitoring whether the objective of work performed has been achieved;
  - Monitoring the ongoing adequacy of assigned resources.
- Taking appropriate action to address issues arising during the engagement, including for example, reassigning planned audit procedures to more experienced members of the engagement team when issues are more complex than initially anticipated.
- Addressing matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.
- Providing coaching and on-the-job training to help engagement team members develop skills or competencies.
- Creating an environment where engagement team members raise concerns without fear of reprisals.

Review

A74. Review of work performed provides support for the conclusion that the requirements of this ISA have been addressed.

A75. Review of work performed consists of consideration of whether, for example:

- The work has been performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the audit procedures have been achieved.

A76. The firm's policies or procedures may contain specific requirements regarding:

- The nature, timing and extent of review of audit documentation;
- Different types of review that may be appropriate in different situations (e.g., detailed review of each individual working paper or a high-level review of selected working papers); and
- Which members of the engagement team are required to perform the different types of review.

The Engagement Partner's Review of Work Performed (Ref: Para. 28–31)

A77. The firm's policies or procedures may specify the nature, timing and extent of the engagement partner's review. As required by ISA 230, the partner documents the extent and timing of the review.[33]

A78. Timely review by the engagement partner at appropriate stages during the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation but may do so.

A79. The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement and the overall conclusions reached by the engagement team, for example:

- Matters related to planning the engagement such as matters related to determining materiality;
- The composition of the engagement team, including:
  - Personnel using expertise in a specialized area of accounting or auditing;
  - The use of personnel from service delivery centers;
- The decision to involve an auditor's expert, including the decision to involve an external expert;
- The engagement team's consideration of risks identified through the acceptance and continuance process and proposed responses to those risks;
- The engagement team's risk assessment process, including situations where consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team;

[33] ISA 230, paragraph 9(c)

- The engagement team's consideration of related party relationships and transactions and disclosures;
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions in respect of certain estimates, accounting policies, or going concern considerations;
- The engagement team's evaluation of the work performed by experts and conclusions drawn therefrom;
- In group audit situations:
  - The proposed overall group audit strategy and group audit plan, including the identification of significant components;
  - Decisions about the involvement of component auditors, including how to direct and supervise their work. For example, if a component auditor is located in a jurisdiction or a firm with significant audit inspection findings, then judgments about their involvement in the engagement and the direction, supervision and review of their work are likely to be more significant; and
  - The evaluation of work performed by component auditors and the conclusions drawn therefrom.
- How matters affecting the overall audit strategy and audit plan have been addressed;
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement; or
- The engagement team's proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.

A80. The engagement partner uses professional judgment in determining other matters to review, for example based on:

- The nature and circumstances of the audit engagement.
- Which engagement team member performed the work.
- Matters relating to recent inspection findings.
- The requirements of the firm's policies or procedures.

Nature, Timing and Extent (Ref: Para. 27)

A81. In accordance with paragraph 27(a), the nature, timing and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm's policies or procedures. For example, the firm may require that work planned to be performed at an interim date be directed, supervised, and reviewed at the same time as the performance of the procedures rather than at the end of the period so that any necessary corrective action can be taken on a timely basis.

A82. In accordance with paragraph 27, the engagement partner is responsible for the nature, timing and extent of direction and supervision of the engagement team and the review of the work performed. The engagement partner may tailor the approach to direction, supervision and review depending on, for example:

- The engagement team member's previous experience with the entity and the area to be audited. For example, if the work related to the entity's information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and frequency of the direction and supervision of the engagement team member may be less and the review of the related working papers may be less detailed.
- The complexity of the entity, including whether there are significant events that have occurred at the entity or in the industry in which the entity operates since the previous audit engagement or during the current engagement.
- The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of direction and supervision of engagement team members, and a more detailed review of their work.
- The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced team members may require more detailed instructions and more frequent, or in person, interactions as the work is performed.
- The manner in which the engagement partner and manager reviews of work performed are expected to take place. For example, in some circumstances remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
- The structure of the engagement team, and location of engagement team members, including where service delivery centers are used. For example, direction and supervision of individuals located at remote service delivery centers and the review of their work may need to be more formalized and structured than when members of the engagement team are all situated in the same location.

A83. In accordance with paragraph 27(b), the engagement partner is required to determine that the approach to direction, supervision and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced member of the engagement team becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members.

Consultation (Ref: Para. 32)

A84. Proposed ISQM 1 requires the firm to establish policies or procedures addressing consultation on difficult or contentious matters, including the engagement team's responsibilities for consultation, the matters on which to consult, and how the conclusions should be agreed and implemented. Consultation may be appropriate or required, for example for:

- Issues that are complex or unfamiliar (e.g., issues related to an accounting estimate with a high degree of estimation uncertainty);
- Significant risks;
- Significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual;
- Limitations imposed by management; and

- Non-compliance with law or regulation.

A85. Effective consultation on significant technical, ethical and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

A86. It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

A87. The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.[34]

Engagement Quality Review (*Ref: Para. 33*)

A88. Proposed ISQM 1 requires that the firm establish policies or procedures that require an engagement quality review for certain types of engagements.[35] Proposed ISQM 2[36] deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review. National requirements that deal with the appointment and eligibility of an engagement quality reviewer and the responsibilities of the engagement quality reviewer are at least as demanding as proposed ISQM 2 when they address all of the requirements in proposed ISQM 2.

Completion of the Engagement Quality Review before Dating of the Auditor's Report (Ref: Para. 33(d))

A89. ISA 700 (Revised) requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements.[37] If applicable to the audit engagement, proposed ISQM 2 requires that the engagement quality review be completed on or before the date of the auditor's report.

A90. The auditor's report cannot be dated until the completion of the engagement quality review. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate then the engagement quality review is not complete.[38]

A91. An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report.

A92. Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the

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[34] ISA 701, paragraphs 9 and A15

[35] Proposed ISQM 1, paragraph 40(e)

[36] Proposed ISQM 2, *Engagement Quality Reviews*

[37] ISA 700 (Revised), paragraph 49

[38] Proposed ISQM 2, paragraph 21(b)

engagement partner may assign responsibility for coordinating requests from the engagement quality reviewer to another member of the engagement team.

Differences of Opinion (Ref: Para. 34)

A93. Proposed ISQM 1 sets out requirements for the firm to establish policies or procedures to address differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality reviewer or personnel performing activities within the firm's system of quality management, including those who provide consultation.

A94. In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example:

- Seeking legal advice; or
- Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Monitoring and Remediation (Ref: Para. 36)

A95. Under proposed ISQM 1, the firm is required to establish quality objectives and responses that address the firm's monitoring and remediation process that enable the evaluation of the design, implementation and operation of the components of the system of quality management and whether the quality objectives have been achieved. In addition, the firm is required to communicate to personnel information about the firm's monitoring and remediation process to the extent that it is relevant to their responsibilities and to enable the personnel to take prompt and appropriate action in accordance with their responsibilities. The results of the firm's monitoring and remediation activities are based on an evaluation of findings from the firm's monitoring activities, the results of external inspections and other relevant information that the firm obtains or of which the firm becomes aware.

A96. Information provided by the firm may be relevant to the audit engagement when, for example, it deals with findings identified on another engagement done by the engagement partner or engagement team, findings from the local firm office or previous inspection results of this particular engagement.

A97. In considering relevant information communicated by the firm and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to deal with identified deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that:

- An auditor's expert should be used;
- The nature, timing and extent of direction, supervision, and review needs to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (e.g., if it relates to a technological resource that the engagement team did not use) then no further action may be needed.

A98. A deficiency in the firm's system of quality management does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the auditor's report was not appropriate.

Taking Overall Responsibility for Managing and Achieving Quality (Ref: Para. 37)

A99. Under proposed ISQM 1, the firm is required to establish objectives relating to the engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement.

A100. Relevant considerations in addressing the requirement in paragraph 37 include determining how the engagement partner has complied with the requirements of this ISA, given the nature and circumstances of the audit engagement, and how the audit documentation evidences the engagement partner's involvement in the engagement.

A101. If the engagement's partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph 37. In addition to taking account of firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example:

- Reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner; or
- Consulting with firm personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

Documentation (Ref: Para. 38)

A102. In accordance with ISA 230,[39] audit documentation provides evidence that the audit complies with the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. Documentation of the performance of the requirements of this ISA, including evidencing the involvement of the engagement partner, may be accomplished in different ways. For example:

- Direction of the engagement team can be documented through signoffs of the audit plan and project management activities;
- Minutes from meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions in respect of culture and expected behaviors that reflect the firm's commitment to quality;
- Agendas from discussions between the engagement partner and engagement team members, and where applicable the engagement quality reviewer, and related time records, may provide evidence of the engagement partner's involvement throughout the audit; and
- Signoffs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

A103. When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to

[39] ISA 230, paragraph A7

decline the engagement (see paragraph 22), the documentation may include explanations of how the engagement team dealt with the circumstance.

A104. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The nature and scope of the issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

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NZ AUDITING AND ASSURANCE STANDARDS BOARD

DATE: 1 February 2019

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: **International Update**

Introduction

1. This Update summarises the significant news of the IAASB, other national auditing standards-setting bodies and professional organisations for the Board's information, for December 2018 and January 2019.

International Federation of Accountants (IFAC)

1. The newly published sequel to the 2017 G20 public trust in tax report from ACCA (the Association of Chartered Certified Accountants), CA ANZ and IFAC reveals a high level of distrust among the public in politicians and non-government organisations (NGOs) when it comes to tax systems.

   The new report also shows that public trust in professionals, such as accountants and lawyers, remains high by comparison.

   When it comes to evaluating their tax systems, respondents across G20 nations are most concerned about transparency, complexity, inequality and corruption in tax systems.

   Respondents' concerns about inequality stem from the perception in English-speaking countries that high income earners and multinationals are treated better by tax systems than average or low income earners. Respondents in China, Indonesia and India had high levels of trust in tax authorities, politicians and accountants, reported efficient tax filing, and supported tax competition to attract multinational business.

   G20 public trust in tax report is based on an online survey of more than 8,400 members of the general public across G20 countries and New Zealand.

International Auditing and Assurance Standards Board (IAASB)

1. The IAASB Ongoing projects (refer to appendix 1)

2. A 10 minute video presentation by Rich Sharko, IAASB Board member and the Chair of the ISA 540 (Revised) *Implementation Working Group*, as he explains the public interest issues addressed by International Standard on Auditing 540 (Revised), *Auditing Accounting Estimates and Related Disclosures.* This presentation also contains useful information to help stakeholders understand the changes to the standard and the planned activities of the ISA 540 (Revised) Implementation Working Group.

International Ethics Standards Board for Accountants (IESBA)

1. There have been no significant developments related to audit and assurance to report in the period.

Accountancy Europe (AE) (former FEE)

2. About two years after the implementation deadline, AE presented an updated state of play of this process in 30 European countries, including 28 EU Member States in January 2019. The report further analysed Member States' decisions and visualised the outcomes for the key options regarding:

   - providing non-audit services
   - mandatory audit firm rotation
   - organising public oversight

   To provide a better overview and make information easier to understand, information on non-audit services, mandatory audit firm rotation and public oversight is displayed in a more detailed way.

Public Interest Oversight Board of IFAC (IPIOB)

1. There have been no significant developments related to audit and assurance to report in the period.

International Integrated Reporting Council (IIRC)

1. There have been no significant developments related to audit and assurance to report in the period.

Global Reporting Initiative (GRI)

1. Nearing the end of the 20th Century, the United Nations assembled experts to develop the eight Millennium Goals (MDGs), to serve as blueprints and guides for public, private and social sector actions during the period 2000-2015 (the "new millennium").

   For "post-2015", the more ambitious Sustainable Development Goals (SDGs) were launched with 17 goals and 169 targets – these are calls to action for rich and poor and middle-income nations out to the year 2030. These ambitious efforts are focused on such societal issues as improving education, health, social protection, providing job opportunities, and encouraging greater environmental protection (global climate change clearly in focus!).

2. Governance & Accountability Institute today announces the release of its year-long, comprehensive "Sector Study on Sustainability Materiality of the SDG Targets & GRI Indicators." This research project was designed to examine sector trends in the ESG materiality decisions of 1,387 GRI reporters across 40 sectors on each of the 91 GRI G4 Specific Standard Disclosure Indicators. Download the research here: https://www.ga-institute.com/SDGsWhatMatters2018

International Forum of Independent Audit Regulators (IFIAR)

1. IFIAR has released a Report on its Survey of Audit Regulators' Enforcement Regimes. The Report underscores the extent to which IFIAR members have the authority to respond to auditor misconduct and enforce compliance with the rules, laws, and standards that govern the audit profession in different parts of the globe. The results recognize the unique and critical role that enforcement plays in audit oversight.

   Please click here for the Press Release and here to access the Report.

International Organization of Supreme Audit Institutions (INTOSAI)

1. There have been no significant developments related to audit and assurance to report in the period.

International Organization of Securities Commissions (IOSCO)

1. IOSCO issued good practices to assist audit committees in supporting audit quality on 17th January 2019.

Australia

The Australian Auditing and Assurance Standards Board (AUASB)

1. No update for the period.

United Kingdom

FRC

1. In view of the significant public interest in this matter, the Financial Reporting Council (FRC) is providing a further update on its investigations in relation to Carillion. However, in order to protect the integrity of the investigations it would not be appropriate at this time to comment beyond the contents of the update below.

   The FRC is investigating KPMG's audits of Carillion (2014-2017) and the conduct of two former finance directors, Richard Adam and Zafar Khan.

   Additionally, in November 2018, the FRC opened a further investigation relating to the provision of materials to the FRC by KPMG in connection with the FRC's Audit Quality Review into aspects of the audit of Carillion for the year end 2016. The decision to open this investigation followed matters self reported by KPMG.

   The FRC continues to progress its original investigations in relation to the collapse of Carillion in conjunction with other regulators. A key area of focus has been the financial performance of Carillion's major contracts in both the construction and services divisions, and whether Carillion management and its auditors ensured that this was appropriately reported in its financial statements. The investigations are also considering conduct relating to pension liabilities, goodwill, cash disclosures and going concern.

   The FRC has obtained and is analysing very significant quantities of documents relating to these areas. Detailed interviews have been conducted with audit team members and Carillion senior executives and further interviews are planned for early 2019.

2. The Financial Reporting Lab (The Lab) has published the latest in its series of reports looking at how technology might impact the production, distribution and consumption of corporate reporting. The report, ***"Artificial Intelligence – How does it measure up?"***, explains what artificial intelligence is, where its use might make sense in corporate reporting, and explores some of the possible and current use cases for the technology.

   The report considers a range of uses of the technology, from AI tools in the finance function, to investors' use of AI to find investment relevant information. It also highlights some of the key decisions and considerations that boards and others need to think about when using AI.

3. FRC issued an International Standard on ***Auditing Accounting Estimates and Related Disclosures***, covering the audit of expected credit losses in banks and which reflects the increased importance and complexity of estimates in financial statements. The FRC strongly supported the development on this standard.

The FRC is also consulting on updates to its Practice Note on ***The Audit of Banks and Building Societies*** in the United Kingdom, an area where the FRC has called for improved quality. The consultation reflects findings from the FRC's audit inspection work covering bank audits, which were covered extensively in public reports in June 2018.

4. Auditors' work on the information in the front end of company reports outside of the financial statements does not meet the requirements of Auditing Standards consistently, according to a **new report from the Financial Reporting Council (FRC)**. Inconsistency in the extent and quality of the work in part reflects the non-prescriptive requirements in the Audit Standards. Firms' own guidance to their auditors also lacks prescription, which has led to varying approaches being taken to this work, even by different audit teams within the same firm.

   While the FRC identified instances of good practice in the audits that it reviewed, there were too many instances where insufficient work was performed to support the statements made by auditors in respect of the Other Information (OI) in their audit reports.

   Investors place a great deal of focus on the OI in Annual Reports, often referred to as the "front end", to guide their decisions, because it is helpful to assessing a company's future prospects. The amount of information included in the front end has grown significantly over time and in most cases is now larger than the financial statements themselves.

Institute of Chartered Accountants in England and Wales

1. Cloud computing is transforming business IT services, increasing its operational efficiencies and reducing its costs. But the use of cloud computing services also poses significant risks that need to be planned for by audit committees, boards and management if they are to be handled effectively.

   Relevant key issues include cloud security, customer services, supplier management and legal and regulatory compliance.

   ICAEW publication How to audit the cloud provides internal audit functions with important guidance on the work they should carry out.

The Charity Commission

1. Charities are not doing enough to demonstrate their public benefit, or explain how they spend their money, according to reviews of charity accounts, published today by the Charity Commission.

   Charity trustees are under an important legal duty to publish a trustees' annual report and accounts, by which they are accountable to the Commission and the public. The regulator has therefore carried out proactive scrutiny of charity accounts and trustees' annual reports*, and assessed these against public expectations and public benefit reporting requirements.

   Just 70% of trustees' annual reports and accounts in the 'Public reporting review' met the Commission's basic benchmark of user requirements, compared with last year's 74%. The quality benchmark was based on recent research into trust in charities which found that 'ensuring a reasonable proportion of donations make it to the end cause' and 'making a positive difference to the cause they work for' were the most important factors driving public trust and confidence in charities.

2. Auditors (and independent examiners) of UK charities have a long-standing duty to report any matters of material significance that they identify in the course of their work to their respective charity regulator, as soon as they become aware of it. These reports provide valuable information to the UK regulators, informing our regulation of the charity sector and enabling us to engage more promptly with charities in difficulty.

   With effect from 1 May 2017, the list of reportable matters includes where an auditor intends to give a modified audit opinion and/or an audit opinion that includes paragraphs about an emphasis of matter or a material uncertainty regarding going concern. The reporting requirements are explained in the UK regulators' guidance Matters of Material Significance reportable to UK charity regulators.

   In February 2018, we published the results of our research on auditors' compliance with this new aspect of their reporting duty in England and Wales during the first six months since the updated list of reportable matters came into force. The CC found that we had received only 28 reports from auditors, compared with the 114 audit opinions containing information that auditors were required to report to the Commission as a matter of material significance. You can find the full report at Charity Commission accounts monitoring reviews..

Association of Chartered Certified Accountants (ACCA)

1. ACCA published its report "thinking small first". This report responds to concerns that International Standards on Auditing (ISAs) can be burdensome when applied to the audits of some smaller and less complex entities. The report proposes that ISAs could be drafted using simpler language and a simpler structure that starts with the most basic requirements and builds up. The report identifies that this approach would benefit regulators and the general public as well as auditors.

United States of America

Public Company Accounting Oversight Board (PCAOB)

1. There have been no significant developments related to audit and assurance to report in the period.

American Institute of Certified Public Accountants (AICPA)

1. There have been no significant developments related to audit and assurance to report in the period.

Center for Audit Quality (CAQ) - (affiliated with AICPA)

1. *Emerging Technologies: An Oversight Tool for Audit Committees* provides a framework and questions that audit committees may ask management and auditors to help inform their oversight of financial reporting as emerging technologies take hold. Leveraging the work of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), the CAQ's framework has five key components. Under each component, the publication provides questions to spark dialogue among audit committees, auditors, management and others. Additionally, the tool highlights how two technologies—artificial intelligence and robotic process automation—are gaining significant traction in the financial reporting environment. An appendix points to helpful resources on emerging technologies from leading public company auditing firms and governance organizations.

Canada

Canadian Auditing and Assurance Standards Board (AASB)

1. The AASB unanimously approved an exposure draft, “Communication of Key Audit Matters in the Auditor’s Report.” The exposure draft is expected to be issued in January 2019 and will have 90-day comment period.

   The AASB is considering amending CAS 700, Forming an Opinion and Reporting on Financial Statements, to require auditors to disclose the engagement partner name when the auditor is also required to submit Form AP, Auditor Reporting of Certain Audit Participants, with the U.S. Public Company Accounting Oversight Board for that engagement. The Board plans to further discuss an amendment at a December 2018 conference call.

2. The AASB provided input to the CPA Canada nominee on the International Auditing and Assurance Standards Board (IAASB) about issues related to the IAASB’s project to adopt:
   - proposed International Standard on Quality Management (ISQM) (formerly International Standard on Quality Control) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements;*
   - proposed ISQM 2, *Engagement Quality Reviews;* and
   - proposed International Standard on Auditing (ISA) 220, *Quality Management for an Audit of Financial Statement*s.

   The IAASB is expected to approve the exposure drafts of ISQM 1, ISQM 2, and ISA 220 at its December 2018 meeting. The AASB reviewed a draft Canadian exposure draft that it expects to approve in January 2019.

CPA Canada

1. To stimulate the debate around the future of audit and assurance, Chartered Professional Accountants of Canada (CPA Canada) and the Institute of Chartered Accountants of Scotland (ICAS) convened an audit symposium in Toronto in November 2017 to bring together senior representatives from business, the profession and academia to discuss and explore possible solutions to some of the challenges that lie ahead.

   The symposium ignited engaging dialogue and a summary of what we learned is provided in the report.

Project	Overview of the project and its current status
Quality Control **Has update for the period**	**Objective of the Project:** Initial activities in scoping the project will focus on whether there is a need to revisit specific aspects of the quality control standards to enhance clarity and consistency of their application. This may include restructuring ISQC 1, additional requirements or guidance within the standard or additional guidance in support of the standard. Specific aspects within ISQC 1 and ISA 220 being explored include, governance, engagement partner responsibilities, engagement quality control reviews, monitoring, remediation, alternative audit delivery models and specific issues pertaining to small- and medium-sized practices **Background and current status:** The proposed changes to QC where included in the IAASB Audit Quality ITC. The ITC response period is closed now. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, and developed project proposals for quality control that were presented at the September 2016 IAASB meeting. The IAASB considered the Quality Control Other Working Group's (QCOWG) proposals in respect of: • Setting the objective of an engagement quality control (EQC Revising the definition of an EQC review; • Determining the scope of the engagements subject to an EQC review; and • The execution of an EQC review. At its March 2017 meeting, the IAASB discussed matters to do with the eligibility of the engagement quality control reviewer. **QC-Firm Level** In June 2017 the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC 1, a result of incorporating a quality management approach (QMA) into ISQC 1, that included a discussion of a working draft of ISQC 1 (Revised) and how the proposals are expected to change firm behaviors. The Board was supportive of the overall direction proposed by the QCTF and emphasized the importance of outreach with a variety of stakeholders to seek input on the practicality of the proposals. The Board also encouraged the QCTF to develop guidance and examples to accompany the revised standard in order to explain the implementation and application of the standard. In its September 2017, the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC1 in relation to documentation of the system of quality management. The Board was supportive of the QCTF's proposals and suggested various refinements. Some of the key proposals were as follow: • the proposal to retain the requirement for an EQC review for all audits of financial statements of listed entities, i.e., not only for general purpose financial statements

	• the proposals in relation to other engagements for which the firm determines that an EQC review is required (see here for details) • the objective of ISQC 2, including whether it is appropriate to locate the responsibilities of the EQC reviewer in ISQC 2, instead of ISA 220 • the IAASB supports the proposal to remove the reference to "team" from the definition of an EQC reviewer, and instead explain the use of a team in the application material supporting the appointment of the EQC reviewer • the proposed requirements and application material in relation to the eligibility of the EQC reviewer. The Board also discussed the QCTF's recommendations in relation to EQC reviews that would be incorporated in ISQC 1 and the proposed new standard, ISQC2. The Board confirmed that the purpose of the EQC review is to evaluate the significant judgments made by the engagement team. In addition to various recommendations to further enhance and clarify the various requirements and application material, the Board encouraged the QCTF to improve the robustness of the requirement relating to the scope of the engagements subject to EQC review. In December 2017, the Board discussed a first read of the proposed exposure draft of ISQC 1 (Revised) 5 and was broadly supportive of the direction of the standard. The Board focused on the scalability of the standard, clarifying the interrelationship of the components, and the appropriate placement of the governance and leadership component. As well as requesting the Task Force to clarify the meaning of deficiencies and major deficiencies, the Board asked that a framework be developed for assessing deficiencies in the system of quality management and requested clarification of how such deficiencies may impact the achievement of the overall objective of the standard. The Board also asked the Task Force to reconsider the threshold for the identification of quality risks and encouraged the Task Force to explore the development of appropriate guidance to accompany the proposed exposure draft that addresses the application of the standard to a spectrum of firms. The Board discussed the exposure draft (ED) of proposed ISQC 1 (Revised)1 and was supportive of the direction that the Quality Control Task Force was taking the standard, noting the improvement in the readability and understandability overall. The Board encouraged the Quality Control Task Force to consider whether there are further opportunities to address scalability, including further refinement and simplification of the standard, where possible. The Board also discussed changing the title of the standard **Update for the period:** In finalizing the ED in December 2018, the Board discussed the definition of deficiencies and bringing more emphasis to positive findings from the firm's monitoring activities and how they may be used in the system of quality management. The Board also discussed the requirement for the firm to establish additional quality objectives beyond those required by the standard and further clarifying the identification and assessment of quality risks. In addition, the Board suggested further simplification of the requirement addressing communication with external parties, although in general agreed

	to retain an explicit reference to transparency reports in the requirement. The Board also discussed network requirements or network services, and adjusted the requirement to clearly reflect the expectations of the firm regarding the effect of network requirements or network services on the firm's system of quality management. The Board supported the Quality Control Task Force's recommendations regarding matters to be addressed in the Explanatory Memorandum, including the proposed questions. **Quality Control – Engagement Level** In December 2017, The IAASB supported the direction of the proposed changes to ISA 220.4 In particular, the Board supported the proposed changes that emphasize that the engagement partner is responsible and accountable for audit quality. The Board encouraged the ISA 220 Task Force to consider, as it progresses revisions to ISA 220, how the proposed changes will strengthen the performance of quality audits. The Board discussed a draft ED of proposed ISA 220 (Revised)2 and was supportive of the proposed changes. The discussions focused on whether changes were needed to the objective of the standard and the wording of the requirement regarding the engagement partner being "sufficiently and appropriately involved." The Task Force plans on presenting the ED of proposed ISA 220 (Revised) for approval by the Board at the December 2018 meeting. **Update for the period** In December 2018 the Board supported the requirement for the firm to establish policies or procedures addressing limitations on the engagement partner moving into the role of engagement quality reviewer, including the reference to a cooling-off period in the application material. The Board agreed that stakeholder views were needed relating to the objectivity of the engagement quality reviewer and a cooling-off period and supported the ISQM 2 Task Force's recommendation for including specific questions in the Explanatory Memorandum on this matter to be developed in coordination with the IESBA. The Board also clarified the requirement for notifications by the engagement quality reviewer to the engagement partner and, when applicable, individual(s) within the firm, as well as the documentation requirements. The Board discussed the requirements that address firm policies or procedures, the role of the engagement partner vis-à-vis other members of the engagement team and the difference between the usages of the phrases "the auditor shall determine" and "the auditor shall be satisfied." The board also discussed how best to clarify the requirement addressing communications from the firm about the firm's monitoring and remediation process.
Group Audits– ISA 600	**Objective of the project:** Determining the nature of the IAASB's response to issues that have been identified, relating to Group Audits, from the ISA Implementation Monitoring project and outreach activities, inspection reports

No Update for the period	from audit regulators, discussion with NSS and responses to the IAASB's Work Plan consultation (i.e., whether standard-setting activities are appropriate to address the issues, and if so, whether specific enhancements within ISA 600 or a more holistic approach to the standard would be more appropriate). **Background and current status:** The IAASB commenced work on one aspect of this project relating to the responsibilities of the engagement partner in circumstances where the engagement partner is not located where the majority of the audit work is performed in December 2014. A Staff Audit Practice Alert on this aspect was published in August 2015. Information gathering on the broader aspects of group audits commenced in March 2015. The issues identified and discussed at the IAASB meetings form part of a combined Invitation to Comment on Enhancing Audit Quality in the public interest which was issued in December 2015 and is open for comments till May 16, 2016. The ITC is now closed. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting. In its June 2017 meeting, the IAASB received an update on the activities of the GATF. The IAASB supported the proposal of the GATF to engage more directly with the QCTF, ISA 220 TF and ISA 315 (Revised)3 TF, to help ensure that the requirements in those standards provide appropriate connection points between those projects and ISA 600.4 The IAASB also supported the proposal of the GATF to publish a short project update and asked the GATF to consider topics that are related to standards not under revision, for example, materiality and audit evidence. In December 2017, the Board received a presentation about the interconnections between ISA 600 and other ongoing projects, and how the Task Force is monitoring the activities of the other task forces, providing input and considering implications of changes in the other standards on ISA 600.
Professional Scepticism **No Update for the period**	**Objective of the project:** To make recommendations on how to more effectively respond to issues related to professional scepticism. **Background and current status:** The IAASB commenced its initial information gathering on the topic of professional scepticism in June 2015. The issues identified and discussed at the IAASB meetings are part of the Invitation to Comment on Enhancing Audit Quality in the Public Interest which was issued in December 2015 and is open for comments till May 16, 2016. The working group is comprised of representatives from the IAASB, the International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB) to explore the topic of professional scepticism, enabling the three independent standard-setting Boards to consider what actions may be appropriate within their collective Standards and other potential outputs to enhance professional scepticism. Together with the Quality Control and ISA 600-Group Audits project, this project is part of the Audit Quality Enhancements Coordination Group (AQECG). The AQECG intends to coordinate the various inputs to the invitation to comment

	developed at the individual working group level, and take a holistic approach as to how the matters are presented in one invitation to comment. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting. Subsequent to the December 2016 IAASB meeting, the joint PSWG held a teleconference to discuss matters related to potential changes to the concept/definition of professional scepticism in the ISAs. The March meeting papers are available here. In June 2017 meeting, the IAASB received an update on the activities of the Professional Skepticism Working Group (PSWG) and the Professional Skepticism IAASB Subgroup since the last Board meeting in March 2017. The Board supported the release of a communication to update stakeholders about the actions and current status of the PSWG's work. The Board also discussed the concept of "levels" of professional skepticism and supported the recommendations of the Professional Skepticism IAASB Subgroup not to introduce the concept into the ISAs. The IAASB discussed the Professional Skepticism Subgroup's analysis and related conclusions regarding different "mindset" concepts of professional skepticism and the use of the words in the ISAs in its December 2017. The Board supported the conclusions of the Subgroup, including that the current concept of the attitude of professional skepticism involving a "questioning mind" continues to be appropriate and should be retained within the ISAs. The IAASB Professional Skepticism Subgroup will liaise as needed with the Professional Skepticism Joint Working Group. In September 2018 meeting, The Board received an update on the activities of the IAASB's Professional Skepticism Subgroup (Subgroup) since March 2018. The Chair of the Subgroup also presented the Board with a draft publication that seeks to highlight the IAASB's efforts to appropriately reflect professional scepticism into the IAASB standards as well as other relevant news and information on professional skepticism, including collaboration with the International Ethics Standards Board for Accountants (IESBA) and International Accounting Education Standards Board (IAESB). The Board supported the issuance of the publication and future publications of this nature.
Accounting Estimates (ISA 540) and Special Audit Considerations Relevant to Financial Institutions (No Update for the period)	**Objective of the project**: The objective of the financial institutions project is to: A. Clarify and enhance the relationship between the banking supervisors and the bank's external auditors; B. Consider and address issues of particular significance in audits of financial institutions; and C. Consider as to whether the issues relating to ISA 540 that have been highlighted as particularly relevant to audits of banks and other financial institutions are more broadly applicable to other entities **Background and current status:** The ISA Implementation Monitoring project, specific requests from banking and insurance regulators and outreach activities by the ISA 540 Working Group, have identified issues with respect to auditing accounting estimates, in particular in relation to audits of financial institutions.

	Also, inspection finding reports from audit regulatory bodies highlighted consistent issues with respect to the audit of accounting estimates, including in relation to audits of financial institutions. There are areas where there have been calls for clear er or additional requirements or guidance to enable auditors to appropriately deal with increasingly complex accounting estimates and related disclosures, including obtaining sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements as a whole. A draft exposure draft of revised ISA 540 has been developed and is to be deliberated by IAASB with an approved ED expected to be issued for comment in December 2016. The board reviewed the draft in its June 2016 meeting. IAASB expects to complete its deliberation of responses to the exposure draft and resulting proposed changes to ISA 540 (Revised) in 2017 with the revised standard expected to be issued in last quarter of 2017. The IAASB has released the ED ISA 540 for comment in May 2017. The Board received an overview of the comment letters received on proposed ISA 540 (Revised) in its September 2017 meeting. The Board discussed respondents' concerns about the complexity of the proposed ISA and potential difficulties in understanding and applying it in practice, and asked the ISA 540 Task Force to look at ways to restructure the proposed ISA to improve its clarity and readability. The Board also discussed the scalability of the ISA, how risk factors could be taken into account, and how best to structure the response to the assessed risks of material misstatement. The Board highlighted the importance of achieving the right balance between issuing a high-quality standard and the public interest in finalizing the ISA in a timely fashion. The IAASB is holding an additional meeting in October to progress proposed ISA 540 (Revised). The IAASB discussed key issues raised by respondents in relation to the Exposure Draft of ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures', including the scalability of the ISA, the use of the term "reasonable," the exercise of professional skepticism and the Task Force's approach to the application material. The IAASB also discussed the Task Force's revisions to requirements and application material based on comments received on the Exposure Draft. The IAASB asked the Task Force to focus on redrafting the application material according to the planned approach with a view to conducting a first read of ISA 540 (Revised)1 in March 2018, ahead of a targeted approval in June 2018. The ISA (540) was approved in IAASB's June 2018 meeting.
Data Analytics **No Update for the period**	**Objective of the project:** The objective of the Data Analytics Working Group (WG) is to: A) Explore emerging developments in audit data analytics; and B) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe.

	Background and current status: Information gathering on data analytics began in April 2015 and the Data Analytics Working Group will continue with its planned outreach activities in future. The DWAG published its first publication "The IAASB's Work to Explore the Growing Use of Technology in the Audit" in June 2016. At the March meeting, the IAASB received a video presentation of a panel discussion among members of the DAWG that was presented at the International Forum of Independent Audit Regulators Inspections Workshop. The Chair of the DAWG provides an update on the project in February 2017 on the IFAC website. In its June 2017 meeting, the IAASB received a presentation of high-level observations from respondents to the IAASB's Request for Input: Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics. It was noted that respondents supported the IAASB in undertaking this work and encouraged continued active participation of the Data Analytics Working Group in other current standard-setting projects of the IAASB underway.
Emerging External Reporting **Has update for the period**	**Objective of the project:** The objective of the Integrated Reporting Working Group (IRWG) is to: A) Explore emerging developments in integrated reporting and other emerging developments in external reporting; B) Gather further information on the demand for assurance, the scope of the assurance engagement and the key assurance issues; and C) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe. **Background and current status:** At its September 2014 meeting the Innovation WG proposed, and the IAASB agreed to establish a WG to specifically monitor the developing interest in integrated reporting and the demand for assurance on integrated reports. This includes initial thinking on the nature of such engagements, including the scope of the assurance engagement, the suitability of the criteria, and other matters related to assurance on integrated reports. The Board considered the draft working paper prepared by the IRWG *Supporting Credibility and Trust in Emerging Forms of External Reporting* in its June 2016. The Discussion Paper was issued in August 2016. In its June 2017 meeting, the IAASB received a presentation about the high-level observations from the comment letters received to the Discussion Paper, Supporting Credibility and Trust in Emerging Forms of External Reporting. It was noted that respondents generally supported the development of guidance on how to apply existing international assurance standards rather than developing new standards, and that the IAASB should continue to provide thought leadership on assurance issues and coordinate its work with other relevant organizations. The Board received an update on the project in December 2017. It was noted that the grant agreement with the World Business Council for Sustainable

	Development (WBCSD) was finalized for the funding of the project and that the Project Proposal and Feedback Statement has been finalized to be published on the IAASB's website. The board also received an update on the plan for developing the framework for the non-authoritative guidance for EER during the next year, including the required research to be gathered and the establishment of a Project Advisory Panel (PAP). In its September 2018 meeting, the EER Task Force presented the remaining Phase 1 'issues' that were not presented in June alongside a first draft of the Phase 1 guidance. The Board noted the need for the guidance to demonstrate its full alignment with the requirements of ISAE 3000 (Revised), 5 and for the EER Task Force to provide further explanations about any guidance that goes beyond the requirements and application material in ISAE 3000 (Revised). The EER Task Force expects to receive further input from stakeholders during its forthcoming series of discussion events and will present a revised draft of the guidance to the IAASB in December 2018. In December 2018 The EER Task Force presented an updated version of the Phase 1 draft guidance, which reflects changes to address feedback received from the IAASB at the September 2018 IAASB meeting, and from other stakeholders, including in relation to a 'materiality process' and assertions as they relate to the characteristics of suitable criteria. The Board noted that the draft guidance had significantly improved since discussions at the September 2018 meeting, but that further work on the drafting is enquired. The Board will discuss a further version on a teleconference in January 2019 before the draft guidance is published for public comment.
Agreed-Upon Procedures **No Update for the period**	**The objective of the project is to:** A) Revise International Standard on Related Services (ISRS) 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information in the Clarity format; and B) Consider whether standard-setting or other activities may be appropriate for engagements that use a combination of procedures derived from review, compilation and agreed-upon procedures engagements (also known as "hybrid engagements"), in light of the existing standards that may be applicable to these services in the IAASB's current suite of standards. **Background and current status:** During consultations on the IAASB's 2015-2019 Strategy and the related 2015-2016 Work Plan, many stakeholders expressed the need to revise ISRS 4400 to meet the growing demand for agreed-upon procedure engagements. In response to the stakeholders' comments, the IAASB established a working group to explore issues involving agreed-upon procedure engagements. The issues identified and discussed at the IAASB meetings will be used to revise ISRS 4400 and possibly develop new standard(s) or guidance that would address engagements where there is a combination of agreed-upon procedures and assurance. The Agreed-Upon Procedures (AUP) Working Group presented a first draft of its Discussion Paper, *Exploring the Growing Demand for Agreed-Upon Procedures Engagements and Other Services and the Implications for the IAASB's Standards*, to the Board in June 2016. The IAASB provided the AUP

	Working Group with input to enhance the Discussion Paper and suggested that the paper pose a question to explore whether the IAASB should develop guidance on multi-scope engagements. The AUP Working Group will present a revised draft of the Discussion Paper at the September 2016 IAASB meeting. In its September 2017 meeting, the Board discussed the feedback received on the Discussion Paper and **approved** a standard-setting project proposal to revise ISRS 4400, subject to clarifications around the use of judgment, independence, restriction of the report of factual findings and required documentation. In its September 2018 meeting, The Board approved the ED of ISRS 4400 (Revised)3 for public exposure. In finalizing the ED, the Board agreed that independence is not required for an AUP engagement and that the AUP report would include statements addressing circumstances when the practitioner is (or is not) required to be independent, and whether the practitioner is (or is not) independent. The ED will be issued in early November with a 120 day comment period
ISA 315 (Revised) **No Update for the period**	**The tentative objectives of the projects at this stage are:** A) to address the issues that have been identified by the ISA Implementation Monitoring project. B) Possible changes that may be necessary to ISA 315 (Revised) to enhance the requirements and guidance for evolving environmental influences (such as changing internal control frameworks and more advanced technology systems being utilized by both management and auditors). C) In its June 2016 meeting, the IAASB directed the ISA 315 (Revised) Working Group to present a project proposal for the IAASB's consideration at its September 2016 meeting to commence standard-setting activities. The project proposal was presented and approved in the IAASB's September 2016 meeting. Since the December 2016 IAASB meeting, the task force has had one physical meeting and two teleconferences to develop the March meeting papers. In September 2017, the ISA 315 Task Force presented proposed changes to the requirements in ISA 315 (Revised) to address identified issues relating to understanding the entity and its environment, including the applicable financial reporting framework, and internal control, including obtaining an understanding of the five components of internal control. The Board broadly supported the proposals, but asked for consideration about some of the proposed changes to the definitions, as well as the perceived focus on controls in obtaining the necessary understanding of the components of internal control. With regard to proposed changes to the identification and assessment of inherent and control risk, the Board supported a separate assessment of inherent and control risk, but asked that the ISA 315 Task Force further consider how this works practically and highlighted that further clarification is needed relating to the assessment of control risk. In December 2017, the Board discussed a first read of proposed changes to the requirements and application material of ISA 315 (Revised)2. The Board broadly supported the proposals, but asked for further consideration by the Task Force on various matters, including aspects of the definitions of

	‘controls’ and ‘relevant assertions,’ and regarding the introduction of the term ‘business model’ and its interactions with current requirements of the standard. The Board also questioned the use of ‘sufficient and appropriate’ as it relates to potential confusion with “sufficient appropriate audit evidence” and whether a change may have unintended consequences if this concept were to be introduced as proposed. The Board encouraged further consideration about how fraud can be included as a qualitative inherent risk factor, taking into account how this would link to the fraud risk factors in ISA 240.3 The Board continued to be supportive of the introduction of “spectrum of risk” but thought the spectrum of risk could be better emphasized and explained earlier in the standard. The Board recognized the need for further consideration about scalability, but agreed that scalability should be presented through the requirements and application material in context of the auditor’s consideration of risk thereby eliminating the need for “considerations for smaller entities.” The Task Force will continue to progress the proposed changes to the standard for a second read of an exposure draft in March 2018. The ED was issued in July 2018 for public consultation.

Agenda Item 9.2

DATE: **1 February 2019**

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: **Domestic Update**

Introduction

1. This Update summarises the significant news from Financial Market Authority, New Zealand Institute of Chartered Accountants and other organisations for the Board's information, for the period December 2018 and January 2019.

Financial Markets Authority (FMA)

1. The Financial Markets Authority (FMA) and Reserve Bank of New Zealand (RBNZ) have completed their joint review of 16 New Zealand life insurers. This review follows the regulators' bank review published in November 2018.

   Rob Everett, FMA Chief Executive said: "Overall the report shows the life insurance sector in a poor light. Life insurers have been complacent about considering conduct risk, too slow to make changes following previous FMA reviews and not sufficiently focused on developing a culture that balances the interests of shareholders with those of customers."

   The regulators found extensive weaknesses in life insurers' systems and controls, with weak governance and management of conduct risks across the sector and a lack of focus on good customer outcomes.

2. NZX and the Financial Markets Authority (FMA) have initiated an industry-led review of New Zealand's capital markets. Capital Markets 2029 is designed to deliver a ten-year vision and growth agenda for the sector.

   Capital Markets 2029 will consider the current framework and broader ecosystem of New Zealand's capital markets and outline recommendations for the creation of wider, more active participation and increased diversity of product.

   New Zealand's capital markets have performed well in a number of areas (such as KiwiSaver and debt issuance), however equity listings have remained subdued, and listed equity market is under developed relative to global peers.

3. The Financial Markets Authority (FMA) has today published the accredited body reports for the New Zealand Institute of Chartered Accountants (NZICA) and CPA Australia.

   The reports contain the findings of our monitoring assessments for the period 1 July 2017 to 30 June 2018. The Auditor Regulation Act 2011 requires us to monitor and

ensure the audit regulatory systems and processes used by accredited bodies are adequate and effective.

It is one of the FMA's strategic priorities to ensure that frontline regulators like the NZICA and CPA Australia are effective in their role.

The NZICA report can be found here
The CPA Australia report can be found here

The New Zealand Institute of Chartered Accountants

1. NZICA's New Zealand Regulatory Board (NZRB) is proposing to adopt a revised Code of Ethics based on the recently revised International Code of Ethics issued by the International Ethics Standards Board for Accountants (IESBA).

   This revised Code will be consistent with the New Zealand Auditing and Assurance Standards Board's (NZAuASB) recently approved *Professional and Ethical Standard 1*, *International Code of Ethics for Assurance Practitioners (Including International Independence Standards) (New Zealand)* issued by the External Reporting Board (XRB) in December 2018 (PES 1). PES 1 will be effective on, or for periods beginning on or after, 15 June 2019 (early adoption permitted).

2. The CAANZ published an article: Audit: What's Going on in the UK and What Does it Mean Here?

CPA Australia

1. In 2018, the Australian Securities and Investments Commission (ASIC) disqualified 10 self-managed superannuation fund (SMSF) auditors for breaching independence requirements.

   Since SMSF auditor registration commenced in 2013, up to 30 June 2018 ASIC has deregistered, suspended or imposed conditions on 101 SMSF auditors for various breaches, including issues relating to audit independence such as auditing their own fund, a family member's fund, or a business partner's fund or funds for which they also prepared accounts or financial statements.

   In other words, the auditors failed to remain independent from parties that might have a financial interest in what is being audited and allowed the bias, conflicts of interest or undue influence of others to adversely affect their judgement.

The Institute of Directors (IoD)

1. There have been no significant developments relating to audit and assurance to report in the period.

Sustainability Matters

1. There have been no significant developments relating to audit and assurance to report in the period.

Update on AUP engagements standards

1. The New Zealand Government introduced the *Regulatory Systems (Economic Development) Amendment Bill (No 2)* on 12 December 2018, which contains an amendment for the NZAuASB's mandate. Section 30 of the Bill, which seeks to amend section 20 of the *Financial Reporting Act 2013*, proposes to include the setting of standards for agreed-upon procedures engagements as part of the NZAuASB's work. The NZICA's New Zealand Regulatory Board currently sets these types of standards. This omnibus Bill will now work its way through the normal parliamentary process

Agenda 9.3

To: NZAuASB members
From: Dr Rowena Sinclair
Date: 31st January 2019
Re: Academic update 2019-1

This first update for 2019 initially reviews two research studies that considered the enhanced auditor reporting requirements. In New Zealand these impact auditor's reports of all FMC reporting entities considered to have a higher level of public accountability[1]. The next topic is on not-for-profit assurance in the New Zealand registered charities sector.

(1) AUDIT REPORTING REFORMS

Perceptions of Stakeholders

Prasad and Chand (2017, page 362) investigates the perceptions of stakeholders on the reporting reforms and "*evaluates the implications of the reforms on the informational value of the audit report, audit quality and audit costs*". Their study does this by analysing the 138 comment letters to the 2013 International Auditing and Assurance Standard Board's (IAASB) exposure draft on the audit reporting reforms. The analyses show that there are significant differences between stakeholder groups (refer *Table 1*). The authors conclude that "*the differences across stakeholder groups can be explained by their economic self-interest*" and that "*the implication of the reforms on audit quality- actual and perceived - is not clear*" (Prasad and Chand, 2017, pages 362 & 363).

	Communicating Key Audit Matter Information in the Audit Report				Enhanced Reporting on Going Concern and Material Uncertainty				Affirmative Statement on Auditor's Independence			
	Frequency (%) of Overall Position				Frequency (%) of Overall Position				Frequency (%) of Overall Position			
ED Respondent Groups	Support	Oppose	No Opinion	Total	Support	Oppose	No Opinion	Total	Support	Oppose	No Opinion	Total
Investors and analysts	11 (92)	1(8)	0(0)	12(9)	9(75)	1(8)	2(17)	12(9)	7(58)	2(17)	3(25)	12(9)
Those charged with governance	1(100)	0(0)	0(0)	1(1)	0(0)	1(100)	0(0)	1(1)	0(0)	0(0)	1(100)	1(1)
Regulators and audit oversight bodies	13(81)	2(13)	1(6)	16(12)	10(63)	5(31)	1(6)	16(12)	12(75)	0(0)	4(25)	16(12)
National standard setters	11(92)	0(0)	1(8)	12(9)	8(67)	4(33)	0(0)	12(9)	7(58)	4(33)	1(9)	12(9)
Accounting firms	13(81)	2(13)	1(6)	16(12)	11(69)	4(25)	1(6)	16(12)	13(81)	0(0)	3(19)	16(12)
Public sector auditors	9(64)	3(21)	2(15)	14(10)	5(36)	9(64)	0(0)	14(10)	7(50)	5(36)	2(14)	14(10)
Preparers	2(22)	7(78)	0(0)	9(6)	2(22)	5(56)	2(22)	9(6)	3(33)	2(22)	4(45)	9(6)
Member bodies and other professional organisations	37(88)	3(7)	2(5)	42(30)	29(69)	11(26)	2(5)	42(30)	31(74)	8(19)	3(7)	42(30)
Academics	7(78)	0(0)	2(22)	9(6)	5(56)	1(11)	3(33)	9(6)	3(33)	1(11)	5(56)	9(6)
Individuals and others	6(86)	1(14)	0(0)	7(5)	6(86)	0(0)	1(14)	7(5)	4(57)	1(14)	2(29)	7(5)
Total	**110(80)**	**19(14)**	**9(6)**	**138**	**85(62)**	**41(30)**	**12(8)**	**138**	**87(63)**	**23(17)**	**28(20)**	**138**

Table 1 Responses to the 2013 IAASB exposure draft (Prasad & Chand, 2017, Table 3, page 356)

Communicative Value of Key Audit Matters

Kohler, Ratzinger-Sakel & Theis' (2016) German study consider key audit matters (KAM) under the model of trust (refer *Figure 1*) with eight-nine investment professionals. They find that the "*specific informational content of the KAM section triggers different factors in the model to different degrees*" and that investment professionals positively value the disclosure of critical entity-related information (Kohler, et al. (2016, page 35).

[1] https://www.xrb.govt.nz/assurance-standards/new-auditors-report/auditor-reporting-faqs/

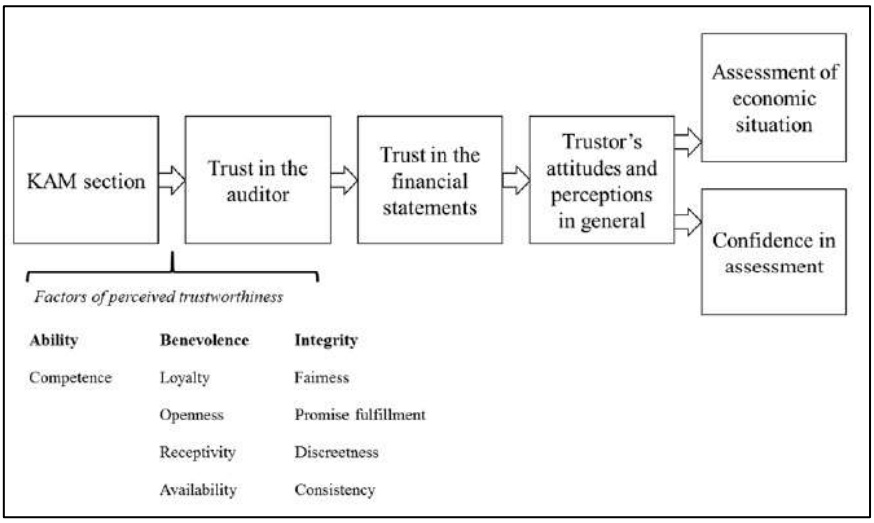

Figure 1: Model of trust (Kohler, et al., 2016, page 53)

(2) NOT FOR PROFITS

Peterson-Palmer & Malthus' (2017) Nelson case study of five charities considered their accounting and audit requirements. They highlight that "*obtaining an audit or a review of the financial report is a necessary cost that most charities incur to receive funding*" (Peterson-Palmer & Malthus, 2017, page 53).

This contrasts with the recent study (External Reporting Board, 2018) that identified that most charities have their financial statements audited or reviewed because of their founding documents. This supported Cordery's (2012, page 20) study of 837 New Zealand charities that "*ascertained compliance with those rules and the level of assurance obtained*". Cordery (2012) identified several charities whose rules required assurance but were not providing it (refer Table 2). She further identified that "*cost is a factor in whether or not charities secure assurance*" (Cordery, 2012, page 19).

Statement about not requiring an audit	<$40,000		>$40,000 - <$200,000		>$200,000 - <$300,000		>$300,000	
	% with rules	% gained assurance	% with rules	% gained assurance	% with rules	% gained assurance	% with rules	% gained assurance
No assurance required	70%	19%	65%	20%	43%	67%	88%	60%
Audit if demanded	27%	19%	32%	27%	57%	75%	6%	100%
Review if demanded	2%	25%	3%	100%	0%	0%	6%	100%
Total	100%		100%		100%		100%	

Table 2: Percentage of charities with rules not mandating an audit or review each year and those with assurance gained across four expenditure categories (Cordery, 2012, page 10).

One of the recommendations of the External Reporting Board's (2018) "*Small charities' assurance needs*[2]" was to explore the viability of the development of a new engagement standard and/or guidance for small entities as an alternative to an audit or review. Morgan (2011) provides a useful overview of an alternative assurance model - the independent examiners in the United Kingdom.

[2] https://www.xrb.govt.nz/information-hub/publications/

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