

## Board Meeting Agenda

24 July 2019

9.15 am to 4.45pm

XRB Offices, Level 7, 50 Manners Street, Wellington

Est. Time	Item	Topic	Objective		Page
<b>A: NON-PUBLIC SESSION</b>					
10.30 am	<i>Morning tea</i>				
<b>B: PUBLIC SESSION</b>					
10.45 am	<b>3</b>	<b><u>IAASB's LCE Discussion Paper</u></b>			
	3.1	Board meeting summary paper	Note	Paper	
	3.2	Outreach plan	Consider	Paper	
	3.3	Discussion of issues	Consider	Paper	
	3.4	IAASB LCE discussion paper	Consider	Paper	
11.45 am	<b>4</b>	<b><u>Impact of mandate on NZAuASB standards</u></b>			
	4.1	Board meeting summary paper	Note	Paper	
	4.2	Project plan	Consider	Paper	
12.15 pm	<i>Lunch</i>				
<b>C: NON-PUBLIC SESSION</b>					
<b>D : PUBLIC SESSION</b>					
1.30 pm	<b>6</b>	<b><u>New Zealand Quality Management EDs</u></b>			
	6.1	Board meeting summary paper	Note	Paper	
	6.2	Issues paper	Consider	Paper	
	6.3	NZ changes to ISQM1	Consider	Paper	
2.15 pm	<b>7</b>	<b><u>Modified audit reports</u></b>			
	7.1	Board meeting summary paper	Note	Paper	
	7.2	Summary of modifications	Note	Paper	
2.30 pm	<b>8</b>	<b><u>NZ ED: Conforming amendments for Code</u></b>			
	8.1	Board meeting summary paper	Note	Late	
	8.2	Draft NZ conforming amendments	Consider	Late	
	8.3	Exposure Draft	Consider	Late	
3:00 pm	<i>Afternoon tea</i>				
3:15 pm	<b>9</b>	<b><u>NZASB Update</u></b>			
	9.1	Update from Anthony Heffernan on NZASB reporting framework post implementation review (PIR)	Note	Verbal	
3:45 pm	<b>10</b>	<b><u>FMA subsequent events follow up query</u></b>			
	10.1	Board meeting summary paper	Note	Paper	

Est. Time	Item	Topic	Objective		Page
	10.2	Issues paper	Consider	Paper	
4.15 pm	<b>11</b>	<b><u>Environmental Scanning</u></b>			
	11.1	International monitoring update	Note	Paper	
	11.2	Domestic monitoring update	Note	Paper	
<b>E: NON-PUBLIC SESSION</b>					

Next meeting: 4 September 2019, Auckland

## NZAuASB Board Meeting Summary Paper

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<b>AGENDA ITEM NO.</b>	3.1
<b>Meeting date:</b>	24 July 2019
<b>Subject:</b>	The IAASB LCE discussion paper
<b>Date:</b>	12 July 2019
<b>Prepared by:</b>	Peyman Momenan

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### Objectives

1. The objective of this agenda item is for the Board to CONSIDER and provide FEEDBACK on:
  - The outreach plan to receive feedback from the stakeholders on the IAASB discussion paper: *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*.
  - Preliminary draft responses and suggested discussion points in relation to the questions included in the discussion paper.

### Background

2. In April 2019 the IAASB released the discussion paper. The purpose of this consultation is to obtain input on the challenges and to help the IAASB determine its actions in relation to audits of LCEs. The deadline for submission on the discussion paper is 12 September 2019.
3. To assist with the NZAuASB's consideration of the discussion paper, we have prepared:
  - An outreach plan (agenda item 3.2).
  - Preliminary draft responses and comments to help with the discussion, and to assist in developing a draft submission for the Board's consideration in September (agenda item 3.3)

### Actions Required

4. For the Board to:

- provide feedback on the proposed outreach plan; and discuss and provide preliminary comments on the questions raised in the LCE discussion paper;

**Material Presented**

3.1	Board meeting summary paper
3.2	The LCE Audit Outreach Plan
3.3	Preliminary draft responses and some suggested discussion points in relation to the discussion paper.
3.4	The IAASB discussion paper: <i>Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs.</i>

### **Who are we going to try to engage with?**

- The audit quality monitoring organisations
- Auditors (with focus on auditors from non-big4 practices)
- Professional accounting bodies (the CA ANZ and CPA Australia)

→ Should we engage with any other stakeholders (e.g. Institute of directors)?

### **How are we planning to reach out to them?**

- One on one interviews
- Online survey
- Webinar
- Submissions received from NZ stakeholders

### **Which specific challenges are we planning to address?**

The discussion paper identifies the following challenges within the scope of the IAASB's project:

- Language and Basic Approach to the Standards
- Length of the Standards
- Documentation
- Lack of Clarity as to What Needs to be Done or Why
- Not Enough Guidance Within / Outside of the ISAs
- ISAs Noted as Particularly Problematic

From the above, we are planning to focus on ISAs noted as particularly problematic. We believe that the nature of the other identified challenges makes it unlikely to elicit specific feedback from the stakeholders beyond confirming that they are challenges that need to be addressed. However, in trying to understand what standards are problematic from the perspective of scalability, we are likely to also receive feedback and insight on the other challenges (for e.g. in investigating why ISA 315 (Revised) may not be scalable, we may identify instances of unclear requirements, or challenging documentation matters).

### **The interviews**

Our plan is to interview appropriate individuals from the following groups/organisations:

- NZ audit quality monitoring groups including:
  - The FMA audit monitoring team
  - The CA ANZ audit monitoring team
  - The OAG audit quality control team
- A small number of (between 5-10) licenced and qualified auditors from non-big4 practices and the big four.

The interviews will be conducted via telephone, videocalls or in person as appropriate. We plan to conduct the interviews before the end of July.

The interviews will focus on the interviewee's experience, views and feedback on what specific standards (and requirements) are problematic in practice from a scalability perspective (e.g. if there

are any standards or requirements that more frequently come up in file reviews of LCE entities? What the interviewees believe are the underlying reasons? How this could improve etc.)

### **The online survey**

We plan to survey the audit practitioners for their feedback and views on the questions included in the discussion paper. The IAASB<sup>1</sup> and the AUASB<sup>2</sup> have already published their surveys on these questions. We will use these surveys as the basis for our survey and may add some specific questions based on the results of our interviews. The online survey will be short enough for participants to complete in 5 minutes. The existing surveys address overall questions and is likely to be specifically useful in receiving feedback on challenges that the IAASB has considered outside the scope of the project. The survey is also likely to provide a good overview of which of the proposed solutions is more popular with the NZ practitioners.

We expect to issue our survey on 5<sup>th</sup> of August.

### **The Webinar**

Our plan includes hosting a webinar on the topic for New Zealand auditors. In addition to providing an overview of the discussion paper we intend the webinar to be interactive (i.e. asking for participants to complete polls during the webinar, answer questions, etc) to enable us to receive useful feedback. We will also promote our survey during the webinar. We will also encourage them to submit their views on the discussion paper and will show them how to do it on our website.

We expect to host the webinar on 9<sup>th</sup> of August.

### **Submissions from stakeholders**

The discussion paper is already promoted on our website and users are referred to the IAASB's website for more details. We have requested submissions by 22 August 2019. To date of this agenda item, we have received no responses. We will analyse any feedback received and present the results to the board in its September meeting.

The deadline for submissions is 22 August 2019.

### **Working with the AUASB and the Canadian Auditing and Assurance Standards Board (CAASB)**

We have already engaged with the AUASB and the CAASB staff to accommodate collaboration on this project. We will compare notes and ideas, share survey questions and other material to the benefit of all three boards.

### **The NZAuASB submission to the IAASB**

We will present the draft submission to the board for its consideration, feedback and approval in the board's meeting on 5<sup>th</sup> of September. The board papers for that meeting will be sent to board members by 23<sup>rd</sup> of August 2019. The submission is due by 12<sup>th</sup> of September.

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<sup>1</sup> The IAASB survey can be viewed here: <https://bit.ly/2XEdRht>

<sup>2</sup> The AUASB survey can be viewed here: <https://www.surveymonkey.com/r/QNWTWX9>

**Timetable for actions**

The summary timetable for the NZAuASB submission on the discussion paper is included below:

Action	Completed by
Interviews	31 July 2019
Survey	5 August 2019
Webinar	9 August 2019
Analysing submissions received	23 August 2019
Draft submission sent to board	23 August 2019
Board feedback and approval of the submission	5 September 2019
Approval by circular resolution if necessary based on feedback from Sept meeting	10 September 2019
Submissions sent to the IAASB	12 September 2019

Does the Board have any feedback or comments on our proposed outreach plan?

Question 1. We are looking for views about how LCEs could be described (see page 4). In your view, is the description appropriate for the types of entities that would be the focus of our work in relation to audits of LCEs, and are there any other characteristics that should be included?

Suggested response for discussion:

*a) Should the focus be on Less Complex Entities or Less Complex Audits?*

While it may be reasonable to assume that there is a strong overlap between the two, they are not the same. In fact, some of the qualitative characteristics that are included in the LCE discussion paper (and in fact in the ISAs) for a less complex entity may in fact increase the complexity of undertaking an audit in accordance with the ISAs. This is because these features may adversely affect auditors' ability to conduct an effective and efficient audit (e.g. obtaining reliable evidence may be more difficult because the underlying source of evidence has never been designed and operated in a manner that yields itself for auditing and verification).

It may be more appropriate to address what makes an audit engagement more complex. Answering the following questions may be helpful.

- 1) How difficult/easy is it to identify risks of material misstatement?
- 2) How difficult/easy is it to support and document the risk identification and assessment procedures performed by the auditor?
- 3) How sophisticated/straightforward are audit procedures to address these risks?
- 4) How well/poorly designed and operated is the accounting information system underlying the financial statements and its associated risks?
- 5) The degree of persuasiveness of available evidence and how easy/difficult is it to obtain it?

*b) Are the qualitative characteristics (QCs) of LCEs appropriate?*

The discussion paper uses the QCs of a small entity included in IAS 200 as its foundation to define LCEs. However, it may be debateable how some of these characteristics may affect complexity. Executing a task includes both the task itself and the tools available to execute it. Complexity of a task can significantly change in response to what tools are available to execute it. It is therefore important to consider not only the QCs of the entity, but how the QCs are likely to affect what tools are at the disposal of the auditors to achieve their objectives.

For example, the discussion paper notes that concentration of ownership and management in a small number of individuals (often a single individual –either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics) is an LCE characteristic. It is reasonable to assume that this simpler corporate structure makes an entity less complicated. However, as it is noted in the ISAs, lack of a complicated corporate structure may result in:

- more informal and often undocumented business processes and financial management practices and procedures;
- less incentive to invest in professionally developed information systems and specially in accounting information systems compared to other entities;
- lower likelihood of having staff specialised in matters directly related to the entity's information system design and operations;

- lower likelihood of employing highly skilled accounting professionals and a higher likelihood of lack of in-house expertise to deal with entity's financial reporting obligations effectively.

The above may mean that the auditor of such an entity have lots of blanks to fill in on their own (thus increasing the likelihood of error as well as finding it more difficult to verify what they have documented). This is unlikely to be a complexity reducing factor from an audit perspective. On the contrary, with the ISAs requirements regarding understanding the information systems of the entity (and controls relevant to audit) this characteristic is likely to increase complexity.

Similar considerations apply to the following QCs of a smaller entity and how these may in fact increase the difficulty of an audit:

- Few internal controls
- Few levels of management with responsibility for a broad range of controls
- Few personnel, many having a wide range of duties.

*c) Are there any other important QCs that can be included in defining an LCE?*

For example, the entity's capability to produce "auditable" financial statements is a matter that can be included.

It is evident that a reliable and complete accounting information system is an essential pre-requisite to an audit engagement that is expected to be conducted in accordance with the ISAs. To be able to rely on information/evidence obtained from these systems auditors have to evaluate the integrity of the systems. However, the following characteristics may adversely impact the auditor's ability to undertake such an evaluation.

- The entity's capability of producing an "auditable" set of financial statements is low. This is due to limited investment in the accounting and financial reporting capabilities of the entity. Especially where the entity needs to prepare financial statements in accordance with a demanding financial reporting framework (e.g. IFRS). Also, as the underlying accounting systems have never been designed to address management assertions (i.e. Occurrence, Completeness, Accuracy, Cut-off, Classification and Presentation) the auditors may find it more difficult to obtain reliable evidence to support their conclusion.
- The entity may have few complicated financial reporting matters (e.g. very few complex transactions), but lack of resources and the nature of available evidence may result in a disproportional increase in difficulty to obtain appropriate and adequate audit evidence to form a conclusion. For example, a very small listed entity may use share-based payments to remunerate its executive directors. This payment needs to be accounted for under IFRS 2 *Share-based Payment*. Amongst other things this would require determining the fair value of the entity's shares. While this is rather a straightforward matter for a listed company with an active share market, a small entity without an active market for its shares may find it very difficult to determine the fair value of its shares. The entity has no in-house expertise to deal with this matter and engaging an external expert to undertake the valuation is very expensive. In this situation, the auditor of an LCE is in a more difficult situation. Another example is a small forestry with very limited financial resources VS a large forestry. Both will require to measure their forestry asset at fair value. However, the smaller forestry will find it much more difficult (and relatively more costly) to produce a valuation that meets the requirements of IAS 41, *Biological Assets*.

Question 2. Section II describes challenges related to audits of LCEs, including those challenges that are within the scope of our work in relation to audits of LCEs. In relation to the challenges that we are looking to address:

- a. What are the particular aspects of the ISAs that are difficult to apply? It would be most helpful if your answer includes references to the specific ISAs and the particular requirements in these ISAs that are most problematic in an audit of an LCE.
- b. In relation to 2a above, what, in your view, is the underlying cause(s) of these challenges and how have you managed or addressed these challenges? Are there any other broad challenges that have not been identified that should be considered as we progress our work on audits of LCEs?

a) *What are the particular aspects of the ISAs that are difficult to apply?*

Draft response for discussion

It may be helpful to consider such difficulties from various perspectives, for example:

- Challenges caused by the characteristics of the audit firm (e.g. limited number of partners and how it may make it more challenging to comply with engagement quality control)
- Challenges caused by the characteristics of the entity (e.g. how risk assessment may be more challenging for entities that do not have any formal risk management function).
- Challenges caused by the characteristics of required evidence
- Challenges caused by the audit environment (e.g. fee pressure, difficulty to attract talent etc).
- Challenges caused by the relationships between various stakeholders in audits, including expectations (e.g. monitoring bodies and auditors).
- Challenges due to the requirements of the ISAs (e.g. the requirements are vague, or impractical).

The discussion paper notes the following standards as particularly challenging:

- ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
- ISA 240 (Revised), The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- ISA 540 (Revised), Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

We believe that it may also be relevant to consider the following three standards (not specifically referred to in the discussion paper):

- ISA 520, Analytical Procedures
- ISA (Revised) 570, Going Concern
- ISA 620, Using the Work of an Auditor's Expert

b) *What are root causes?*

Possible response is for E.g.

- It is impractical to document a smaller audit in a manner to satisfy a monitoring body review (e.g. client characteristics, engagement characteristics etc)

- Business risk approach may not be an efficient way to conduct an LCE audit. The entity structure, management practices and systems are not a good match for a business risk approach. The auditor may need to increase their effort to somehow fit the entity into the business risk framework underlying the ISA 315 (Revised).

c) *how to address the root causes?*

*Possible response is for E.g.:*

- Allow more flexibility for selecting a risk identification approach.

d) *Are there any other broad challenges that have not been identified that should be considered as we progress our work on audits of LCEs?*

- Audit of micro entities in accordance with the ISAs may be particularly problematic.

Question 3: With regard to the factors driving challenges that are not within our control, or have been scoped out of our exploratory information gathering activities (as set out in Section II), if the IAASB were to focus on encouraging others to act, where should this focus be, and why?

Possible response

While commercial viability of audit as a service is not a standard setting matter, it nevertheless underpins why the standards are needed in first place. If the market is unwilling to pay the fees needed to conduct an audit in full compliance with the ISAs, this may be a strong indication that the market considers that value delivered by an audit does not exceed its costs. It is essential to understand what value is sought from an audit by smaller entities and why the existing arrangement is not addressing their needs. It is therefore important to engage with intended potential and existing users of audits of LCEs to evaluate how better to address their needs. Without such an engagement, auditing standards may stop to be relevant to a very important segment of the world economy.

To be able to develop an appropriate way forward, it is important that we understand our stakeholders' views about each of the possible actions. In relation to the potential possible actions that may be undertaken as set out in Section III:

a. For each of the possible actions (either individually or in combination):

- i. Would the possible action appropriately address the challenges that have been identified?
- ii. What could the implications or consequences be if the possible action(s) is undertaken? This may include if, in your view, it would not be appropriate to pursue a particular possible action, and why.

Possible response

Possible actions	Pros	Cons
Revising the ISAs	Less confusion for the market. The public interest is likely to be best served if audit is undertaken to the highest standard possible	Unlikely to be able to meaningfully address the identified challenges. Would take time.

Developing a Separate Auditing Standard for Audits of LCEs	Have the potential to address the identified challenges	Can confuse the market. May increase expectation gap. Is the quality of an engagement in accordance with a separate standard comparable to an audit in accordance with ISAs.
Developing Guidance for Auditors of LCEs or Other Related Actions	Would be quicker to do.	There is already an abundance of guidance available. It is unlikely that additional guidance on its own may be helpful

Are there any other possible actions that have not been identified that should be considered as we progress our work on audits of LCEs?

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In your view, what possible actions should be pursued by us as a priority, and why? This may include one or more of the possible actions, or aspects of those actions, set out in Section III, or noted in response to 4b above.

Possible response

The most promising option seems to be a separate standard(s) for LCE audits. If this separate standard is developed specifically to be responsive to characteristics of LCE audits, it may be a success. An effort to develop such a standard is very likely to become very useful even if it is ultimately determined that a separate standard is not a viable option. In that event, the prepared material for a separate standard may be useful for revising the ISAs in a way that is more helpful for audits of LCEs.

A separate standard has also a greater potential for innovation as it is not restricted to stay in line with the existing ISAs in their current form and shape.

DISCUSSION PAPER  
COMMENTS DUE: SEPTEMBER 12, 2019



**Audits of Less Complex Entities:  
Exploring Possible Options to Address  
the Challenges in Applying the ISAs**

**IAASB**

International Auditing  
and Assurance  
Standards Board



The International Auditing and Assurance Standards Board is a global independent standard-setting body that serves the public interest by setting high-quality international standards which are generally accepted worldwide.

The IAASB follows a rigorous process in developing its standards, involving multi-stakeholder input, including from the IAASB's Consultative Advisory Group, the International Federation of Accountants' (IFAC) relevant committees and professional accountancy organizations, regulatory and oversight bodies, firms, national standard setters (NSS), governmental agencies, investors, preparers and the general public.

For copyright, trademark, and permissions information, please see page 21.

## Request for Input

This Discussion Paper was developed by the International Auditing and Assurance Standards Board® (IAASB®).

Comments are requested by **September 12, 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: <http://www.iaasb.org>.

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# CONTENTS

Chairman’s Foreword .....	2
The Purpose of this Discussion Paper .....	3
What is a Less Complex Entity? .....	4
SECTION I - Background.....	5
SECTION II - Challenges Related to Applying the ISAs in Audits of LCEs .....	10
SECTION III - Possible Actions to be Explored.....	14
Questions for Respondents.....	18
Appendix - Standards, Guidance and Tools (Recent Literature) and Articles and Thought Leadership (Recent Publications) .....	19

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## CHAIRMAN'S FOREWORD



Smaller entities make a critical contribution to the world economy, and quantitatively the majority of audits globally are audits of smaller entities. The ongoing challenges relating to the complexity and difficulties in applying the International Standards on Auditing (ISAs) faced by those auditing smaller entities is an area that is of particular importance to the Board, and to me personally. The strides that we have made since our Small- and Medium-Sized Practices (SMP) Working Conference held in Paris in 2017 in moving forward and building on what we already know about these challenges have culminated in this Discussion Paper (DP).

We hear the urgency for action, and recognize that we need to think more, and with an open mind, about actions that will result in solutions that will help not only those auditing smaller entities, but also those auditing entities where their nature and circumstances is less complex (hereafter referred to as less complex entities (LCEs)). We acknowledge the efforts of others in their activities to support auditors of LCEs and have heeded the call for global action.

However, before committing to further actions, we need to make sure that we have a thorough understanding about the challenges faced by auditors of LCEs, including the underlying causes of those challenges, in the many jurisdictions impacted by our activities. We need to work out what actions are for us, and what actions may be for others, and we will encourage others, as needed, to take action, recognizing that the best way forward may involve a combination of approaches. Therefore, we need to hear from all our stakeholders about the different possible actions we outline in this paper, including whether there are other actions that we have not identified, to enable us to determine what is most appropriate and what will be most effective.

We must also maintain the fine balance between competing needs and being mindful that any changes do not reduce the robustness of the existing auditing standards thereby affecting audit quality (i.e., have unintended consequences on audits other than those that are audits of LCEs). There is no easy 'fix,' and it will take time to progress global actions, but we are very aware that more must be done to keep the ISAs relevant to those auditing LCEs.

We remain committed to actively further exploring and progressing our thinking in relation to audits of LCEs. I wish to emphasize the importance of hearing from those most affected by these challenges to be able to progress this topic and look forward to hearing from all of our stakeholders about the matters set out in this DP. A feedback statement will be published to share what we have heard from the input received, and we will then deliberate about how to best move forward.

**Prof. Arnold Schilder**  
*IAASB Chairman*

## THE PURPOSE OF THIS DISCUSSION PAPER

In order to achieve its objective of enhancing the quality and consistency of audit practice throughout the world, and strengthening public confidence in the global auditing and assurance profession, the IAASB develops and maintains one set of auditing standards. These are applied to a wide variety of entities with differing circumstances.

Recognizing the challenges faced by practitioners in applying the ISAs, in particular for engagements where the entity being audited is less complex, this DP focuses on audits of LCEs using the ISAs, and sets out:

- Challenges that have been identified to date.
- A number of possible actions that could be undertaken to address the identified challenges.

The purpose of this consultation is to obtain input on the challenges and to help us determine our actions in relation to audits of LCEs. Accordingly, we are looking for input from all stakeholders, but in particular practitioners auditing LCEs on the matters set out in this DP, as well as any other challenges or possible actions we have not yet thought about.

# WHAT IS A LESS COMPLEX ENTITY?

## *What do we mean by a “less complex entity” (LCE) and why do we use this term rather than “small- and medium-sized entity” (SME)?*

Although the discussion about the challenges of applying the ISAs has historically been around the difficulties experienced in audits of smaller entities as outlined in the Chairman’s Foreword, we are of the view that it is appropriate to focus on the complexity of the entity rather than its size. This is because in today’s environment it is not only about size—there may be entities that are smaller but may be considered complex, and there may be other entities that would not be considered smaller, but would be considered less complex.

As we move forward, further consideration will be given to how we describe LCEs for the purpose of our work. How this description may be applied in individual jurisdictions will depend on the nature of the outputs arising from this consultation process and how each jurisdiction adopts any possible future pronouncements, and the legal or regulatory requirements and other relevant circumstances of the jurisdiction (it is possible that this may encompass a broad range of entities including such entities as those in the public sector and not-for-profit sectors). However, as a starting point, we have looked to our current definition of a “smaller entity,” which sets out many of the qualitative characteristics that could be attributable to an LCE:

*“An entity which typically possesses qualitative characteristics such as:*

- a. Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and*
- b. One or more of the following:*
  - i. Straightforward or uncomplicated transactions;*
  - ii. Simple record-keeping;*
  - iii. Few lines of business and few products within business lines;*
  - iv. Few internal controls;*
  - v. Few levels of management with responsibility for a broad range of controls; or*
  - vi. Few personnel, many having a wide range of duties.*

*These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.”<sup>1</sup>*

We are seeking views of respondents about how best to describe LCEs (refer to Question 1).

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<sup>1</sup> IAASB’s Glossary of Terms

# I. BACKGROUND



At present, 129 jurisdictions use, or are committed to using, the ISAs (up from some 90 countries in the mid-2000's) demonstrating the increasing importance the global community attaches to the ISAs. This widespread and continually growing international use of the ISAs, in both well-developed as well as developing economies, underscores the importance of the IAASB continuing to focus its efforts on maintaining the quality and scalability<sup>2</sup> of these standards for entities of all sizes, and to meeting the expectations that stakeholders have regarding their application.

## The Evolving World and the Effect on the ISAs

There are a number of influences driving changes to the environment in which auditors operate. These influences are described in the section that follows, and although these influences may impact audits of all entities, the intention is to consider these influences in the context of LCEs as background to the identified challenges and future possible actions:

<b>The Evolving Business Environment</b>	<ul style="list-style-type: none"><li>• The <i>evolving business environment</i>—which is driving increasingly complex structures and transactions.</li><li>• <i>Technology</i>—is advancing at a rapid pace, affecting how transactions are undertaken and how records are kept.</li><li>• <i>Audit regulators and oversight bodies have become more coordinated and are committed to driving audit quality</i>—primarily through their audit inspection processes, including focusing on remedial action plans to address the root causes of deficiencies identified. This increased robustness in inspections has resulted, for example, in calls for more specificity in the requirements in the ISAs against which the audits can be inspected.</li><li>• <i>Changing public expectations</i>—audits are under increasing scrutiny, with continued discussion of the need to better address the gap between what the auditor is required to do and what some stakeholders expect the auditor to do.</li></ul>
<b>Changing Financial and Non-Financial Reporting</b>	<ul style="list-style-type: none"><li>• <i>Law and regulation</i>—is changing, with enhanced and evolving reporting requirements, including in relation to non-financial reporting, which are driving different business and reporting decisions.</li><li>• <i>Financial reporting standards</i> are continually evolving to address changes in the business environment, public expectations, and other influences, and are also becoming more complex, lengthy and require more interpretation and judgment.</li><li>• <i>Assurance needs related to non-financial reporting</i> continue to evolve.</li><li>• <i>Increasing requirements for estimates</i> using forward-looking information, which requires practitioners to apply heightened professional judgment and professional skepticism.</li></ul>

<sup>2</sup> The ability to apply the ISAs to a wide range of entities with varying complexity is referred to as 'scalability.'

The evolving influences outlined above are taken into account when updating the ISAs. However, these may also be creating new challenges which in turn are perceived to be impacting the way that audits of LCEs are undertaken. Specifically, increases in the length and detail of the ISAs can:

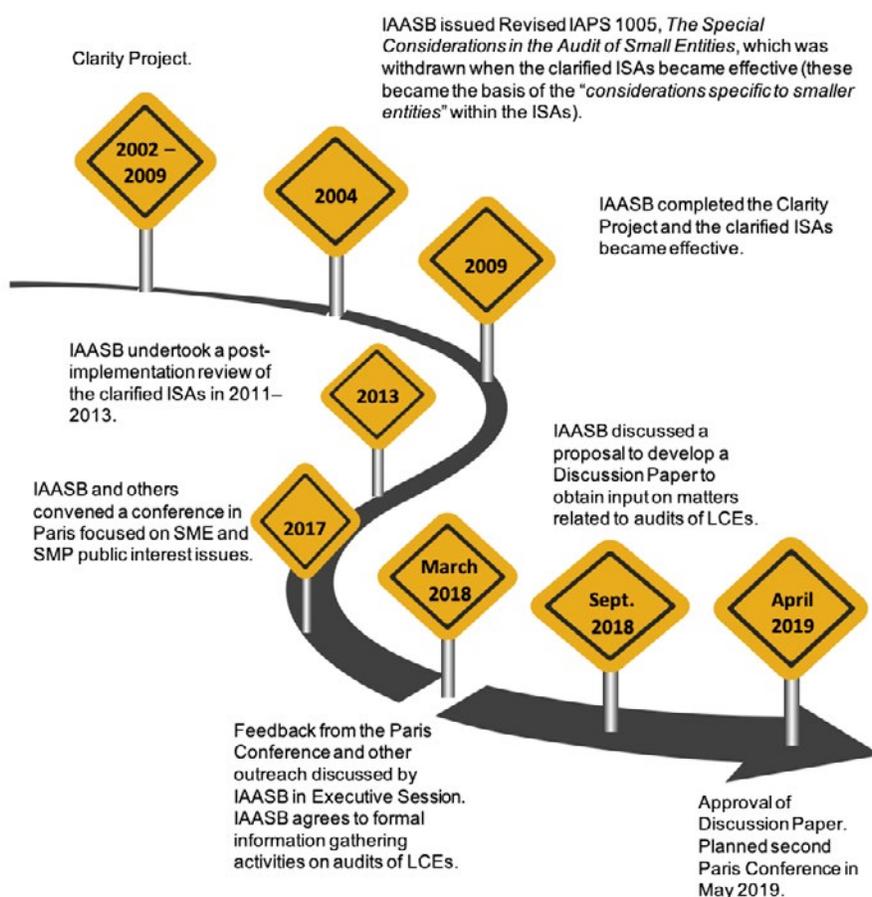
- Act as a barrier to auditors reading and understanding the ISAs, particularly for those auditors in situations where there is a gap in available guidance for applying the ISAs.
- Result in a perceived ‘checklist-approach,’ with a greater focus on compliance rather than using professional judgment.
- Lead to increased documentation in audit files, with no perceived commensurate benefit.

All of these can potentially lead to a reduction in audit quality as they could affect how the auditor applies the standards.

## The IAASB’s Journey...

The IAASB has always been mindful of the need for the ISAs to be applicable to all entities,<sup>3</sup> ranging from those whose nature and circumstances are simpler and more straightforward (i.e., LCEs), to those entities where the nature and circumstances are more complex (for example, more complex structures or more complex transactions). Furthermore, the environment is continually evolving, which is driving changes to the ISAs, and may be making them more challenging to apply to audits of LCEs.

Since 2002 when our Clarity Project commenced, we have been making concerted efforts to keep the revised or developed standards operational and scalable, but there continues to be concern about the increasing complexity and usability of the ISAs, in particular for LCEs. There have also been questions raised as to whether the ISAs remain fit-for-purpose for audits of LCEs. In 2017, as explained further below, we convened a working conference in Paris that included consideration of the issues related to audits of SMEs, thereby providing the impetus for further IAASB action. The diagram above sets out our ‘journey’.



<sup>3</sup> IFAC has a [policy position \(no. 2\)](#) that notes that the ISAs are designed for audits of entities of all sizes, and that their design enables them to be applied in a manner that is proportionate to the size and complexity of an entity, and therefore that it is in the public interest to have audits of SMEs performed using the same standards (i.e., as some would say “an audit is an audit”).

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## Others Have Reacted to the Evolving Environment and Growing Complexity of the ISAs

Others too have recognized that there are challenges with applying the ISAs for audits of LCEs:

- At a global level, IFAC has developed a Guide to Using ISAs in the Audits of SMEs,<sup>4</sup> to assist with the application of the ISAs, and the Guide to Using ISAs in the Audits of SMEs is now in its Fourth Edition.
- National Standard Setters (NSS) and others have also sought to develop solutions to help practitioners when undertaking audits in circumstances where the entity is less complex, including national guidance for audits of SMEs, information technology (IT) tools (such as electronic methodologies) and ISA manuals.
- Jurisdictions have been changing their statutory thresholds for when an audit is required.
- Regional bodies, such as Accountancy Europe, have engaged stakeholders on matters relating to simplifying auditing standards for small or non-complex entities through publications and events.

The **Appendix** sets out examples of tools and resources developed by various jurisdictions.

More recently, there have also been various jurisdictional or regional initiatives specifically targeted at audits of less complex (or smaller) entities, including:

- In June 2015, a consultation on a "[Nordic Standard for Audits of Small Entities](#)" was published. The draft standard was developed by the Nordic Federation of Public Accountants for consultation in Sweden, Denmark, Finland, Iceland and Norway. Responses were received from all around the world, not only from the intended targeted countries. Respondents echoed the call for something to be done, but had mixed views about what this should be. One of the major messages from the responses was that, in order for this initiative to be successful, an international rather than a regional response was required. In light of this, the Nordic Federation of Public Accountants has continued to encourage the IAASB to focus efforts in this area.
- In 2018, Sri Lanka issued "[The Sri Lanka Auditing Standard for the Audits of Non-Specified Business Enterprises](#)" (SLAuS). The SLAuS was developed at the Institute of Chartered Accountants of Sri Lanka with the draft Nordic Standard being used in its development.
- In considering the introduction of a minimum threshold for mandatory audits in France, consideration is being given to a new 'pronouncement' for audits that would fall below the statutory threshold but where the entity may voluntarily seek an audit (this pronouncement may possibly be a simplified audit standard).
- In March 2019, Belgium published a statutory standard for auditing SMEs and small not-for-profit entities. This standard on contractual audits of SMEs, can be performed by both the registered auditors and the external accountants. It does not apply to statutory audits (for which only the ISAs apply) and includes the possibility to apply the ISAs if agreed between the relevant parties. The definition of an SME is linked to the threshold for mandatory audits. However, when the SME is considered to be complex, the registered auditors will have to apply the ISAs.

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4 IFAC's [Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities](#) (hereafter referred to as The Guide to Using ISAs in Audits of SMEs).

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The concerns being expressed and the initiatives being undertaken in different jurisdictions around the world signal that additional support is likely needed in the application of the ISAs for LCEs, as well as further consideration about the standards themselves. Notwithstanding that guidance and other support is being developed at a jurisdictional or regional level, pressure is increasing for a global solution, with similar challenges being identified in many jurisdictions regardless of the size or complexity of the local business environment. In light of these jurisdictional and regional developments, we remain mindful of the relevance of our standards in relation to audits of LCEs.

## The Paris SMP / SME Conference

Shaping the way forward...

In early 2017, we (together with the Compagnie Nationale des Commissaires aux Comptes (CNCC) / the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC)) convened a conference in Paris, France, to further discuss the needs of SMPs and SMEs and help shape a way forward. The two-day conference was attended by over 100 stakeholders from all over the world, including many practitioners representing SMPs, with a focus on both audits of SMEs and also other services performed by practitioners for SMEs. Broadly, the discussions related to audit can be summarized as follows:



- A strong need was expressed for better support for audits of smaller entities and LCEs.
- After a presentation on the draft Nordic Standard, mixed views were expressed about the need for a new separate standard.
- More needs to be done to understand the root causes of the issues that have been identified relating to audits of smaller entities, for example, further considering whether there is a deficiency in the standards or whether it is more an issue in the execution when applying the standards.
- Some stakeholders encouraged the IAASB to “think simpler first” in the revisions that were underway at the time.
- There is a growing perception in some jurisdictions that the increasing length and complexity of standards may lead to overly costly audits in the LCE sector of their economy.
- It was emphasized that more thought was needed about how to utilize the advances in technology (by the IAASB and others).
- Further consideration was needed:
  - To bridge the ‘expectations gap’ between different stakeholders.
  - About how to better promote the value of an audit.

Attendees recognized that it was not only the IAASB that needed to action some of these matters.

After this conference, we started to more intently explore what actions may be required to address the concerns and issues that had been discussed at the conference. The timeline on page 6 illustrates our related activities in this area before and since this conference.

## Our Ongoing Efforts Regarding Scalability and Proportionality in our Current Projects

We have also increased our focus on scalability and proportionality to explore what more can be done, for example, in our recent projects on ISA 540 (Revised)<sup>5</sup> and ISA 315 (Revised).<sup>6</sup>

With regard to ISA 540 (Revised), the standard now recognizes explicitly that scalability of the risk assessment and further procedures inherently varies with the complexity of the estimate, which may be particularly relevant for LCEs, i.e., where the processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.

The exposure draft of ISA 315 (Revised) (ED-315)<sup>7</sup> has also taken a similar approach, with further support provided in new introductory paragraphs explaining the various aspects of the standard in 'simpler' language, as well as enhanced examples in the application material to illustrate how the requirements can be applied in varying circumstances. Many of these changes have been supported by respondents to the exposure draft. However, significant concerns were still expressed with regard to the length and scalability of the proposed revised standard. We will continue our efforts to address the concerns of our stakeholders as we finalize the revised standard, while remaining mindful of retaining the robustness of our standards.

## Next Steps

We are seeking feedback about whether the challenges relating to audits of LCEs have been correctly identified (refer to Section II), to be able to consider how the underlying reasons for these challenges can be best addressed. The information collected through the responses to this DP will help us make an informed decision on possible further actions in relation to audits of LCEs. The possible actions that could be explored by the IAASB (and on which we are seeking views of respondents) are set out in Section III.

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<sup>5</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>6</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>7</sup> ED-315, *Identifying and Assessing the Risks of Material Misstatement*

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## II. CHALLENGES RELATED TO APPLYING THE ISAs IN AUDITS OF LCEs

As set out in Section I, there is a broad range of influences on the audit environment, and therefore, there is not necessarily a one-size-fits-all solution. Furthermore, solutions may not lie with the IAASB alone, there will likely be action required by others too.

Not all of the influences leading to challenges when using the ISAs for audits of LCEs are under the control of the IAASB, or may form part of our considerations related to this initiative. We are, however, of the view that it is important to set out all the relevant considerations as we explore and gain feedback on the challenges related to auditing LCEs.

We are aware of various challenges that have been identified facing auditors of LCEs, and would like to further understand the underlying reasons for, or root causes of, the identified challenges. In addition, we would like to know whether there is anything else that should be considered as we progress our thinking in relation to audits of LCEs.

This section first sets out those identified challenges that are not within the boundaries of our work relating to audits of LCEs, and then, as context for the possible actions that follow in Section III, describes those identified challenges that are within the boundaries of our work related to audits of LCEs. We recognize the important role we play in relation to setting the standards and the influence we have, and are therefore committed to exploring what further can be done while being mindful of our stakeholders' expectations about what can be done.

Challenges in applying the ISAs differ, depending on a variety of factors. For example, additional support may be needed when the ISAs are first adopted within a particular jurisdiction, or may vary based on the size of the audit practice,<sup>8</sup> the level of resources, the number of audit engagements undertaken by an auditor, and the nature and complexity of the firm's audit clients.

The support available for applying the ISAs also varies between:

- Jurisdictions—for example, some jurisdictions have very active professional accountancy organizations providing substantial support, guidance and other related resources; and
- Firms—for example, some SMPs have less access to ongoing technical resources and other appropriate support compared to those belonging to large international networks.



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<sup>8</sup> For example, a report from the UK's Financial Reporting Council, *Key Facts and Trends in the Accountancy Profession*, notes that 5,351 out of 5,660 (95%) registered audit firms have 6 or less principals per firm, indicating that a large majority of firms in the UK are smaller.

## Setting Boundaries for Our Work

### Challenges Not within Our Control or Within the Scope of the IAASB's Work on Audits of LCEs

The following sets out the factors driving the challenges noted by our stakeholders, and other relevant matters, that may impact the audit environment for LCEs, but that do not fall within our remit as an international standard-setter, or which we do not intend to consider as part of this project because it is related to other assurance engagements that are not audits and is therefore 'not in scope' when considering audits of LCEs. Notwithstanding that we do not intend to directly address these as part of our work in relation to audits of LCEs, we may be in a position to further consider how we may best influence and encourage actions by others.

Factors Driving Challenges that are Not Within the Control of the IAASB	
<b>Legal and Other Requirements for an Audit</b>	<p>The IAASB does not set the requirements for which entities require an audit as this is prescribed by each jurisdiction's laws and regulations (some jurisdictions have audit exemption thresholds above which an audit is mandatory) or influence in any way where an entity voluntarily elects to have an audit undertaken. We do not, and cannot be expected to be, involved in such jurisdictional or entity level determinations.</p> <p><i>To illustrate the variation in practice of different jurisdictions using audit exemption thresholds, countries within the European Union continue to change their thresholds, with some member states (Cyprus, Estonia, Italy and Romania) having lowered their thresholds in the last two years, while two member states (Denmark and Ireland) have increased their thresholds in the last two years.<sup>9</sup> Italy has recently introduced mandatory audits for very small companies, which is effective at the end of 2019. Other jurisdictions in Europe, such as France, have recently introduced audit thresholds as a way of reducing the burden on smaller entities. To further illustrate the point of jurisdictional mandate, an independent body of the Swedish parliament evaluated the impact of Sweden's 2010 reform that raised audit thresholds, and concluded that the costs to society outweighed the benefits, in particular that small companies' competitiveness and growth were not enhanced by abolishing audits. Accordingly, in 2018 Sweden did not further raise its audit threshold. It is not only in Europe that audit thresholds are changing, for example, Malaysia introduced audit thresholds, which were effective in 2018, and Australia has current proposals to double the current audit threshold (see Appendix).</i></p>
<b>Commercial Considerations Relating to an Audit</b>	<ul style="list-style-type: none"> <li>• Audit fee pressure,<sup>10</sup> often driven by market forces and other environmental influences, may lead to questions about the cost-benefit of performing the required audit procedures.</li> <li>• The auditing standards do not address fees, rather the Ethics Code sets out considerations relating to fees (including independence and objectivity).<sup>11</sup></li> </ul>
<b>Technology / Methodology</b>	<ul style="list-style-type: none"> <li>• Access to technology tools / methodologies that may help with the application of the ISAs in an audit of an LCE may be limited.</li> <li>• Although a helpful global solution, developing or promoting such technology tools or methodologies is not part of the remit of the IAASB as a standard-setter.</li> </ul>
<b>Education and People</b>	<ul style="list-style-type: none"> <li>• The ISAs set out the principles to be complied with in an audit, but do not prescribe how auditors are trained. The auditor's knowledge of the ISAs contributes to the effective execution of an audit. Therefore, a lack of understanding of existing, new or revised ISAs may negatively impact the way that the ISAs are applied.</li> <li>• Attracting and retaining talented people has been identified as a challenge, but is outside of the scope of the IAASB.</li> </ul>

9 Source: Accountancy Europe's "Audit Exemption Thresholds in Europe – 2019 Update."

10 *IFAC's 2018 Global SMP Survey* found that pressure to lower fees is the top challenge facing SMPs.

11 The International Ethics Standards Board for Accountants (IESBA) issued a publication, *Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure*, to highlight auditor's ethical obligations under the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code).

## Scoped Out of Exploratory Activities Related to Audits of LCEs

<b>Engagements Other than Audit</b>	<ul style="list-style-type: none"><li>• Although our other standards (i.e., review, assurance and related services standards) may be appropriate alternatives in cases where an audit is not required or needed, the scope of the IAASB's work on audits of LCEs addressed in this DP excludes further consideration of engagements that are not audits.</li><li>• Other engagements not specifically addressed by our International Standards, such as direct engagements.</li></ul>
<b>Enhanced Accessibility of the ISAs</b>	<ul style="list-style-type: none"><li>• Although we recognize the importance of converting the IAASB's Handbook to an electronic format to make it easier to use through better navigation and improved signposting, these efforts are outside of the project on audits of LCEs.<sup>12</sup></li></ul>
<b>Value of an Audit</b>	<ul style="list-style-type: none"><li>• Questions have been raised about the value of having an audit, including:<ul style="list-style-type: none"><li>– Trust in the audit process;</li><li>– Appropriate communication of information to support investment or funding decisions;</li><li>– Relevance of the information being reported on (e.g., backward-looking versus forward-looking); and</li><li>– Using technology to execute better audits.</li></ul></li></ul> <p>Although the changes to the standards may impact the matters influencing the value of an audit, and may influence the value of the audit for LCEs, the objective of the work on audits of LCEs addressed in this DP is not about directly exploring the value of an audit.</p>
<b>Public Expectations</b>	<ul style="list-style-type: none"><li>• Notwithstanding our recent efforts requiring the auditor to provide more transparency in relation to their work,<sup>13</sup> the gap in expectations between what the auditor does and what the auditor is expected to do still exists.</li><li>• The scope of this work is not intended to directly address this gap, but improving the application of ISAs to LCEs may close aspects of this gap and indirectly help users of financial statements better understand the procedures undertaken in an audit.</li></ul>

### Challenges within the Scope of the IAASB's Work on Audits of LCEs

The objectives of our Clarity Project<sup>14</sup> was to write the standards in a clear and concise way, with the requirements set out as principles, and application material that sets out further explanation about the requirements and guidance about how to carry them out. In our view, a principles-based approach to the standards enables the application of the ISAs to entities with a wide variety of nature and circumstances.

The influences set out in Section I, and our journey in thinking more about what can be done to improve the application of the ISAs for LCEs, have already driven changes in our current work practices. For example, we have revised, or are in the process of revising, some of our core ISAs, including considering focusing on scalability as part of the revisions. However, ongoing concern and challenges with applying the ISAs (or proposals) is continually being highlighted by our stakeholders, in particular in relation to our recent exposure drafts (for example, in the responses to ED-315 as well as the responses that were received to the proposals to revise ISA 540 (Revised)).

The more significant, recurring comments regarding the ISAs set out below are presented in the context of what we have heard in relation to challenges when auditing LCEs, for the purpose of determining where the focus of our work should be. In addition, although some of these may be conflicting (for example, there have been criticisms regarding the increasing length of the standards, while there have also been calls for more guidance within the standards) we need to understand all of the challenges and their root causes to be able to determine an appropriate way forward.

<sup>12</sup> In 2019, working with IFAC, work effort will commence relating to converting the IAASB's Handbook to an electronic format.

<sup>13</sup> For example, through reporting on Key Audit Matters in the auditor's report and proposed new requirements for communication with external parties under the proposed 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*.

<sup>14</sup> In March 2009, we completed our Clarity Project, which had involved a comprehensive review of all ISAs to improve their clarity and thereby facilitate their consistent application. Approximately half of the clarified ISAs included substantive changes aimed at improving practice in a variety of respects.

<b>Language and Basic Approach to the Standards</b>	<ul style="list-style-type: none"> <li>• Some of the ‘clarity’ principles have diminished, with the language becoming more complex and therefore more difficult to comprehend. This may also impact the translation of the standards.</li> <li>• The standards are now being drafted to include the “how” in requirements i.e., the process to undertake the procedure, which is resulting in more detailed requirements, which is sometimes seen as a move away from principle-based requirements.</li> <li>• The detail in the standards is driving auditors towards more of a ‘compliance with the standards’ approach rather than an approach that encourages the use of professional judgment in determining the most appropriate audit procedures for the specific circumstances.</li> <li>• The standards can be difficult to navigate as they break up a continuous audit process into discrete elements, and are written in a linear way, but the audit process is iterative in nature. In addition, they are not electronic, so navigating is done manually.</li> </ul>
<b>Length of the Standards</b>	<ul style="list-style-type: none"> <li>• ISAs are voluminous, which can make them difficult to read and determine what needs to be done, and which has the potential to discourage some auditors from reading all of the relevant and necessary material.</li> <li>• Significant material is being added through recent revision processes of the core ISAs, in particular, to add application material as the ISAs become more complex; however, this material is needed to support the application of the standards. Paradoxically, some of this additional length is to aid scalability of the ISAs.</li> </ul>
<b>Documentation</b>	<ul style="list-style-type: none"> <li>• Documentation requirements throughout the ISAs are extensive, and becoming more onerous.</li> <li>• In many cases, there is a lack of clarity as to what needs to be documented, and the extent thereof, in particular, when auditing LCEs. This lack of clarity has sometimes resulted in: <ul style="list-style-type: none"> <li>– Different interpretations about how certain matters need to be documented.</li> <li>– Over documentation (for example, auditors of LCEs may include extensive documentation to justify what has not been done, which is seen as additional work that does not provide additional assurance or a measurable increase in audit quality).</li> </ul> </li> </ul>
<b>Lack of Clarity as to What Needs to be Done or Why</b>	<ul style="list-style-type: none"> <li>• In some cases, unnecessary procedures are being performed because when an auditor is faced with a specific set of circumstances, the standards are not clear about the nature and extent of the work required. In other circumstances, necessary procedures are not being performed because the application of the requirements to the circumstances are not clear.</li> </ul>
<b>Not Enough Guidance Within / Outside of the ISAs</b>	<ul style="list-style-type: none"> <li>• Paragraphs detailing <i>considerations specific to smaller entities</i>, where they are presented within the ISAs, are not helpful in all cases to understand scalability and proportionality of the requirements.</li> <li>• There is insufficient supporting material to aid effective application of the ISAs.<sup>15</sup></li> </ul>
<b>ISAs Noted as Particularly Problematic</b>	<ul style="list-style-type: none"> <li>• Risk identification and assessment—some stakeholders have noted that the proposals in ED-315 may lead to an over-engineered risk assessment for entities in a non-complex environment. The changes proposed in ED-315 have also been seen by some to add unnecessary complexity, in particular, in relation to obtaining an understanding of the system of internal control (which is also a noted issue in extant ISA 315 (Revised)).</li> <li>• The auditor’s considerations in relation to fraud—the focus of the work to comply with the requirements of ISA 240<sup>16</sup> when auditing an LCE is considered by some to be more onerous than what would be appropriate in the circumstances.</li> <li>• Auditing accounting estimates—some audit procedures required under ISA 540 (Revised) have been noted by some as unnecessary, especially where the estimates do not involve complex fair values or significant forward-looking information.</li> <li>• In addition to the ISAs noted above, there may be other aspects of the ISAs where the standards are not seen to be robust with regard to scalability and proportionality – the IAASB is looking for further feedback on these (refer to Question 2).</li> </ul>

15 However, the IAASB’s proposed [Strategy for 2020–2023](#) has indicated a future focus on implementation activities, and we have been increasing our activities relating to the initial implementation of new and revised standards through webinars, supporting guidance, etc.

16 ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

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### III. POSSIBLE ACTIONS TO BE EXPLORED

The IAASB and others have recognized the need for global solutions to address the challenges in relation to audits of LCEs.

In light of the challenges within the scope of our work on audits of LCEs as set out in Section II, we have reflected on potential possible actions that could be undertaken.

The most appropriate way forward may be one, or a combination of the possible actions, or only some aspects of the possible actions, set out hereafter, and may also include other actions identified by respondents. Some of the possible actions will be quicker to progress (for example, developing non-authoritative guidance), while others will take longer (for example, standard-setting activities). In addition, consideration will be given to the impact on **all** stakeholders using the ISAs (positively or negatively), not only those interested in audits of LCEs.

In our efforts to date, we have recognized that there is no simple solution—the ISAs are intended for audits of a wide variety of entities, ranging from large, complex public interest entities to entities that are considerably less complex; therefore, there are competing interests. We have not yet decided on a future course of action and remain open minded as to what are the most appropriate future possible actions. Accordingly, responses to the challenges outlined in this DP are needed to better understand whether:

- Such possible actions may be appropriate for all stakeholders;
- There is anything else that we need to know in our considerations of these actions; or
- Further research and information gathering is needed.

The input will help us develop a clear direction for our future work in this area and to appropriately scope any future projects related to these matters. There will likely be mixed views on some of these possible actions,<sup>17</sup> and it is therefore essential that we are informed as to the views of **all** our stakeholders, including understanding the rationale underpinning those views. The potential possible actions that we have identified that are described further in this document include:



- A. Revising the ISAs.
- B. Developing a Separate Auditing Standard for Audits of LCEs.
- C. Developing Guidance for Auditors of LCEs or Other Related Actions.

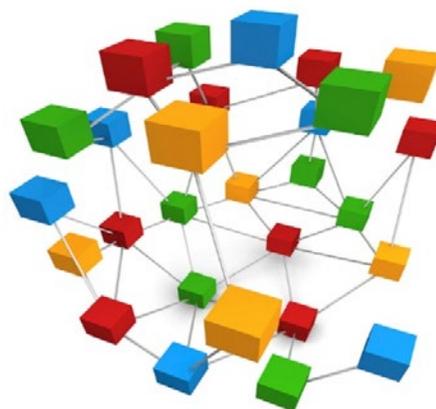
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<sup>17</sup> The Accountancy Europe publication, [Simplifying Auditing Standards for Small or Non-Complex Entities](#), sets out Pros and Cons of various possible actions that have been explored in its publication.

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## A. Revising the ISAs

The ISAs could be revised to make the auditor’s work effort clearer, in particular to benefit audits where the circumstances of the entity are less complex. We continue to place great emphasis on addressing complexity and scalability of the ISAs in our projects, as have been described in Sections I and II. In order to address the identified challenges in applying ISAs in audits of LCEs, we are keen to get views on what further can be done, while always remaining mindful of the need to retain the robustness and quality of our standards.



Broadly, this may involve one or more of the following:

- Greater focus on more clearly setting out what the auditor needs to do (i.e., focusing on the way the requirements have been articulated using clearer and understandable language), with appropriate application material to support applying the requirements effectively and efficiently.
- Adopting an approach of revising the standards by setting out the basic requirements for all audits, then expanding as needed to address more complex circumstances (the so-called “building-blocks approach”).
- Considering how the application material could feature more scalability and proportionality considerations, e.g., providing examples of both simple and complex circumstances in order to contrast the differences.
- Better signposting within the application material about how to apply the requirements that are relevant to audits of LCEs. This could be done, for example, by enhancing the considerations specific to audits of LCEs (previously included in the standards as considerations specific to smaller entities) in a separate section within each ISA.

There are various ways that such a revision of the ISAs could be undertaken:

- Revising all of the ISAs as part of one substantial project.
- Revising the ISAs on a rolling or phased basis (for example, selecting a group of ISAs for updating, and once completed select other ISAs, or selecting certain standards to be revised first, possibly those where the most challenges for audits of LCEs have been identified).
- Making targeted changes when an ISA is being revised—we are currently exploring this approach on projects currently underway. For example, we are focusing on the complexity, and scalability and proportionality, of our proposals relating to the revision of ISA 315 (Revised).<sup>18</sup>

The exact approach how best to revise the standards would still need to be determined, and further exploratory work may be needed to determine our specific activities.

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<sup>18</sup> Our Consultation Paper on our [proposed Strategy for 2020–2023 and Work Plan for 2020–2021](#) has highlighted the importance of developing ways to address complexity, while maintaining scalability and proportionality, as a strategic focus in our future strategy period.

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## B. Developing a Separate Auditing Standard for Audits of LCEs

The development of a separate standard specifically for audits of smaller entities has been the subject of discussion internationally, with a number of jurisdictions having developed, or in the process of developing, drafts or pronouncements. However, from previous outreach (including the 2017 Paris Conference), we have heard concerns from some stakeholders about the development of a separate standard for auditing LCEs. Nevertheless, in light of developments in the environment where others are actively pursuing an alternative for audits of LCEs, and our commitment to exploring a global approach, we have the view that this is included as a possible option to gather input from our stakeholders.

From outreach undertaken to date, it is clear that the level of assurance for the audit opinion issued in accordance with any standard should be the same as the ISAs (i.e., reasonable assurance). However, what reasonable assurance means in the circumstances may vary by context, which may need to be explored further. It has also been highlighted that any separate standard developed should retain a similar robustness as the ISAs.

We have not specifically discussed the content of such a standard but recognize the importance of outlining the key features of such a standard to provide a basis for respondents to form their views. The following has been developed based on work done by others in this area. More would need to be done to determine whether this is a feasible option.

A separate standard may include a description of the types of entities for which it would be appropriate to use or not (for example, it may not be appropriate to use such a standard for audits of publicly listed entities). As with the ISAs, local laws and regulations would then prescribe when such a standard could be used in a particular jurisdiction.

### *Separate Auditing Standard Based on the Existing ISAs*

A separate auditing standard could be based on the existing ISAs with the aim of achieving the same objective and encompassing all the relevant requirements for an audit of an LCE, including compliance with ISQC 1 (or the IAASB's new proposed quality management standards) and relevant ethical requirements.

Other possible features include:

- Mirroring the risk-based approach of the ISAs but be presented in a way that follows the work flow of an audit.
- Quality management principles at the engagement level, setting out, for example, a focus on the broad quality management principles such as the engagement partner's responsibilities.
- Retaining principle-based requirements appropriate for audits of LCEs that allow the auditor to use their professional judgment to focus on the objectives to be achieved by the auditor (i.e., more appropriately focused on being outcomes-based in the circumstances of LCEs and refraining from including specific procedures and processes); developed based on the existing ISAs where relevant for LCEs.
- Aligning any documentation requirements with the principles of ISA 230,<sup>19</sup> with consideration given to whether more specific documentation requirements may be needed in areas that would be applicable to LCEs.

As the standard would be based on the ISAs, it may not have a complete set of specific application material developed; rather the development of supporting guidance and application material could be left to others (such as NSS) to develop, or if based on the same principles and structure as the ISAs, may reference the applicable parts of the ISAs (in a similar way that International Financial Reporting Standards (IFRSs) are referenced in the *IFRS for SMEs Standard*).

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<sup>19</sup> ISA 230, *Audit Documentation*

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### **Separate Auditing Standard Developed Based on a Different Framework**

The approach for the development of a separate standard described above focuses on the ISAs as a starting point. An alternative is to explore the option of developing a standalone standard taking a different approach from the risk-based approach in the current ISAs. Such an approach would likely require the development of a supporting framework including relevant criteria, with the objective that the engagement would result in the same assurance as an audit opinion. Such an approach could, for example, be more substantive in nature.

The development of a separate standard of this nature would require substantial research and information gathering activities to be undertaken in order to determine viability and, therefore, would likely have a substantially longer timeframe than some of the other options that have been identified.

### **C. Developing Guidance for Auditors of LCEs or Other Related Actions**

There have been ongoing calls for more guidance for applying the ISAs in audits of LCEs, notwithstanding our current, and future proposed, efforts in relation to the development of guidance and support materials. In particular, there are calls for a practical “how to” guide when approaching an audit of an LCE, as well as for specific areas within the ISAs specific to auditing LCEs.

This section addresses guidance and other support material developed specifically for audits of LCEs that is outside of the ISAs (i.e., not application or other explanatory material within the ISAs), so the nature of such material would be non-authoritative. Options for guidance, in addition to current and planned future efforts relating to implementation guidance, may include:

- a. *A comprehensive guide about how to apply the ISAs in circumstances where the nature and circumstances of the entity being audited are less complex.* A guide along these lines has already been developed by IFAC (the Guide to Using ISAs in Audits of SMEs, see footnote 4, hereafter referred to as “The Guide”), which is intended to provide practical support when applying the ISAs in audits of SMEs. The Guide is currently set out in two volumes, with Volume 1 covering the fundamental concepts of a risk-based approach, and Volume 2 setting out practical examples including illustrative case studies. The Guide has been translated into over 20 languages, and the latest version has been downloaded in more than 140 countries. However, notwithstanding the broad demand for The Guide, it is voluminous and there are many stakeholders still calling for more. Instead of developing our own guide, we could also consider how we could collaborate with IFAC in enhancing The Guide, as appropriate.
- b. *An International Auditing Practice Note (IAPN) for Audits of LCEs*—IAPNs do not impose additional requirements on auditors beyond those required by the ISAs, nor do they change the auditor’s responsibility to comply with all of the ISAs relevant to the audit being undertaken. They are intended to provide practical assistance to auditors. Such an IAPN would likely only cover specific areas where additional guidance is needed.
- c. *Guidance for the application of specific areas within the ISAs, or particular ISAs<sup>15</sup> specifically for challenges identified related to audits of LCEs*—for example, a guide specifically targeted at risk identification and assessment.
- d. *Focused “implementation packs” for new and revised ISAs specifically for audits of LCEs*—including slide presentations, webinars and focused guidance about how to implement the revised or new ISA, to educate and assist once new or revised standards are published.

# QUESTIONS FOR RESPONDENTS

Your feedback will be helpful to us in determining an appropriate way forward in relation to audits of LCEs. In answering the following questions, providing detail and reasons for your answers will assist us in understanding the views of our stakeholders.

*Stakeholders may choose to answer all, or only some, of the questions below—all input is helpful to our future considerations.*

1. We are looking for views about how LCEs could be described (see page 4). In your view, is the description appropriate for the types of entities that would be the focus of our work in relation to audits of LCEs, and are there any other characteristics that should be included?
2. Section II describes challenges related to audits of LCEs, including those challenges that are within the scope of our work in relation to audits of LCEs. In relation to the challenges that we are looking to address:
  - a. What are the particular aspects of the ISAs that are difficult to apply? It would be most helpful if your answer includes references to the specific ISAs and the particular requirements in these ISAs that are most problematic in an audit of an LCE.
  - b. In relation to 2a above, what, in your view, is the underlying cause(s) of these challenges and how have you managed or addressed these challenges? Are there any other broad challenges that have not been identified that should be considered as we progress our work on audits of LCEs?
3. With regard to the factors driving challenges that are not within our control, or have been scoped out of our exploratory information gathering activities (as set out in Section II), if the IAASB were to focus on encouraging others to act, where should this focus be, and why?
4. To be able to develop an appropriate way forward, it is important that we understand our stakeholders' views about each of the possible actions. In relation to the potential possible actions that may be undertaken as set out in Section III:
  - a. For each of the possible actions (either individually or in combination):
    - i. Would the possible action appropriately address the challenges that have been identified?
    - ii. What could the implications or consequences be if the possible action(s) is undertaken? This may include if, in your view, it would not be appropriate to pursue a particular possible action, and why.
  - b. Are there any other possible actions that have not been identified that should be considered as we progress our work on audits of LCEs?
  - c. In your view, what possible actions should be pursued by us as a priority, and why? This may include one or more of the possible actions, or aspects of those actions, set out in Section III, or noted in response to 4b above.
5. Are there any other matters that should be considered by us as we deliberate on the way forward in relation to audits of LCEs?

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# APPENDIX

## Standards, Guidance and Tools (Recent Literature)

1. [\*Belgian Standard on Contractual Audits of Small and Medium Entities.\*](#)
2. [\*Chartered Professional Accountants Canada, 2011. Anatomy of a 12-hour audit for micro-entities.\*](#)
3. [\*Conseil Supérieur de l'Ordre des Experts-Comptables, 2017. Professional Standard for the Audit Mission of Financial Statements in a Small Entity \(NP 2910\).\*](#)
4. [\*CPA Australia, 2017. Small Entities Audit Manual \(SEAM\).\*](#)
5. [\*Hong Kong Institute of Certified Public Accountants, 2016. Audit and Practice Manual.\*](#)
6. [\*IFAC, 2018. Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities \(4th Edition\).\*](#)
7. [\*Institut Österreichischer Wirtschaftsprüfer, 2017. Quality Assurance Handbook – Guidance No 27.\*](#)
8. [\*Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises, 2018. Pack Petites Entités - Small Entities \(PE-KE\) version 4.0 and Case Study.<sup>21</sup>\*](#)
9. [\*Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises, 2017. Technical note: Summary of the audit approach in non-complex entities.\*](#)
10. [\*Nordic Federation of Public Accountants, 2015. Consultation - Nordic Standard for Audits of Small Entities.\*](#)
11. [\*The Institute of Chartered Accountants of Sri Lanka, 2018. Sri Lanka Auditing Standard \(SLAuS\) for the Audits of Non-Specified Business Enterprises \(Non-SBEs\).\*](#)

## Articles and Thought Leadership (Recent Publications)<sup>22</sup>

1. [\*Accountancy Europe, 2018. Rediscovering the Value of SME Audit.\*](#)
2. [\*Accountancy Europe, 2018. Simplifying Auditing Standards for Small or Non-Complex Entities.\*](#)
3. [\*Accountancy Europe, 2019. Audit exemption thresholds in Europe.\*](#)
4. [\*Association of Chartered Certified Accountants, 2018. Thinking Small First. Towards better auditing standards for the audits of less complex entities.\*](#)
5. [\*Centre for Financial Reporting Reform – World Bank Group, 2017. Small and Medium Practices: The Trusted Advisors of SMEs.\*](#)
6. [\*Centre for Financial Reporting Reform – World Bank Group, 2016. Smaller audits: Challenges and Insights.\*](#)

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21 This tool was originally developed by CNCC and is used in France and many other countries.

22 IFAC Knowledge Gateway Audit & Assurance Section, which includes just under 100 articles and videos. Available at: <http://www.ifac.org/global-knowledge-gateway/audit-assurance>.

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7. [Chartered Accountants Australia and New Zealand, 2016. Perspective: How audits can work for small entities.](#)
  8. [Chartered Accountants Australia and New Zealand, 2017. Perspective: Are International Auditing Standards suitable for small audits?](#)
  9. [Edinburgh Group, 2019. The SMP of the future in a changing world.](#)
  10. [European Federation of Accountants and Auditors for SMEs, 2018. To audit or not to audit: Debunking the myths about audit for SMEs.](#)
  11. [Evidence on the Value of an Audit for SMEs in Europe, 2019](#)
  12. [IFAC, 2016. Choosing the Right Service: Comparing Audit, Review, Compilation, and Agreed-Upon Procedure Services.](#)
  13. [IFAC, 2016. The Role of SMPs in Providing Business Support to SMEs: New Evidence – Key Findings.](#)
  14. [IFAC, 2017. 2016 IFAC Global SMP Survey Report & Summary.](#)
  15. [IAASB, 2017. SMP / SME Audits Presentation](#)
  16. [IFAC 2018. IFAC Global SMP Survey: 2018 Summary.](#)
  17. [Swedish National Audit Office, 2017. Abolition of audit obligation for small limited companies.](#)
  18. [Treasury Australia, 2018. Reducing the financial reporting burden by increasing the thresholds for large proprietary companies.](#)

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ISBN: 978-1-60815-405-0



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## NZAuASB Board Meeting Summary Paper

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**AGENDA ITEM NO.** 4.1  
**Meeting date:** 24 July 2019  
**Subject:** Possible XRB mandate change and the impact on the standards  
**Date:** 10 July 2019  
**Prepared By:** Misha Pieters

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

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### Agenda Item Objectives

#### **For the Board to:**

- APPROVE a project plan to consider the broader implications of a probable mandate change on the existing standards issued by the NZAuASB.

### Background

1. In June, the Board noted recent communication on the Regulatory Systems (Economic Development) Amendment (No 2) Bill. The Bill has not yet been passed however as a change in mandate seems more likely, and with questions arising as to how the XRB can adopt ED ISQM 1, it is appropriate to reflect on the broader implications of a possible mandate change on the standards issued by the NZAuASB in order to prepare for any such change.

### Matters to Consider

2. A proposed project plan has been developed at agenda item 4.2.

### Recommendations

We recommend that the Board APPROVE a project to consider the implications of a probable mandate change on the existing standards issued by the NZAuASB.

### Material Presented

Agenda item 4.1 Board Meeting Summary Paper  
Agenda item 4.2 Proposed project plan

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# Project Plan

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<b>Project Title:</b>	Implications of XRB mandate change on existing standards issued by the NZAuASB
<b>Project Objective(s):</b>	Address issues arising if the mandate of the NZAuASB is extended to include related services
<b>Priority:</b>	High
<b>Issue/Reason:</b>	Has implications for the adoption of the quality management standards in New Zealand
<b>Date Prepared:</b>	10 July 2019
<b>Date Approved:</b>	
<b>Date Updated: (if applicable)</b>	

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## Project Objectives

1. To identify and consider the broader implications to existing NZAuASB standards if the XRB mandate is extended to cover related services.

## Background

2. The XRB has requested an amendment to the Financial Reporting Act to enable the Board to issue a standard on agreed upon procedures and other related services.
3. The mandate of the XRB is currently:
  - b) to prepare and, if it thinks fit, issue auditing and assurance standards for—
    - (i) the purposes of the Auditor Regulation Act 2011 or any other enactment that requires a person to comply with those standards; or
    - (ii) the purposes of any rules or codes of ethics of an association of accountants where those rules or codes require the association's members to comply with those standards; or
    - (iii) any other purpose approved by the Minister by notice in writing to the Board:

20 Auditing and assurance standards

(1) Auditing and assurance standards may—

(a) have general or specific application:

(b) differ according to differences in time or circumstance.

(2) Auditing and assurance standards may (without limitation) include professional and ethical standards that govern the professional conduct of persons who are appointed or engaged to carry out audits or other assurance engagements.

4. There is still uncertainty as to if, when and how exactly the mandate of the XRB may change going forward to enable the Board to issue an agreed upon procedures standard and other related services. If the mandate is changed it is possible it will be amended as follows:

20 (2) Auditing and assurance standards may (without limitation) include—

- (a) professional and ethical standards that govern the professional conduct of persons who are appointed or engaged to carry out audits or other assurance engagements or engagements referred to in paragraph (b) audit or assurance practitioners;
- (b) standards for agreed-upon procedures engagements related services.
- (3) In this section,—
- audit or assurance practitioner means a person who is appointed or engaged to carry out audits or other assurance engagements
- related services means services to perform—
- (a) agreed-upon procedures; or
- (b) other non-assurance work that may ordinarily be carried out by an audit or assurance practitioner.
5. While this change may enable the board to issue new standards, it will also be necessary to consider the impact of the change of the standards it has already issued.
6. Possible issues arising:
- 6.1. A clear understanding of the types of services to be covered under the new mandate and who will be performing such engagements will be needed for the drafting of the standards going forward. For example:
- 6.1.1. What other related services are envisaged (e.g. compilation type work for smaller charities?)
- 6.1.2. Who will be performing these engagements (e.g., the IAASB's exposure draft of agreed upon procedures refers to practitioner rather than an "assurance practitioner")
- 6.2. Any change to the mandate may impact on the way in which the NZAuASB has adopted the restructured Code of Ethics.
- 6.3. The extension of the scope to include related services will impact the scope of PES 3 (ISQM 1 applies to assurance and related services engagements). We note that related services may be defined differently in the IAASB standards than the way it may be defined in the legislation.
- 6.4. There may be additional references throughout the ISAs (NZ) that will need to reflect the decisions made in this project.

#### **PES 1 Code of Ethics**

7. Related services cover both agreed upon procedures and compilation engagements.
8. The NZAuASB is also currently investigating another type of engagement that may be more relevant for smaller charities where no legislative requirement for assurance exists. Such an engagement may not be an "assurance engagement" as defined under the international assurance framework. It is not yet clear how this engagement will fit within the current framework or how it will be described. While such an engagement may not be subject to the independence requirements of Part 4A or 4B (the independence sections of the Code that apply to assurance engagements), there may be additional ethical obligations to consider, as applicable for these engagements.
9. As part of the restructure of the IESBA Code, the applicability of the section for Professional Accountants in Business was clarified and enhanced. While the title of Part 2 remains Professional Accountants in Business, it still applies to professional accountants in public practice (PAPPs).
10. The IESBA agreed that matters relating to a PAPP's client engagement and employment relationship in a firm are often interrelated. However, the IESBA believes that the proposed paragraphs in the Applicability ED sufficiently cover this point and that further clarification is not warranted.
11. The following is an extract from the IESBA's Basis for Conclusions on the Applicability project. The underlined text is added for emphasis as this may be applicable to assurance practitioners which is or may be within the mandate of the XRB:

“After extensive deliberations, the IESBA determined that the provisions in Part 2 of the restructured Code may be applicable to circumstances where PAPPs perform professional services for clients and to their client relationships. The IESBA determined that these circumstances should not be excluded from the scope of the applicability paragraphs. The IESBA noted that, although the provisions in Part 2 of the restructured Code deal primarily with matters that are relevant to professional activities that occur internally within the employing organization, there are situations where those provisions will also be relevant to a PAPP when the PAPP performs professional services for clients or to the PAPP’s client relationships. For example, the IESBA believes that the provisions in Part 2 of the restructured Code relating to preparing and presenting information (Section 220) and pressure to breach the fundamental principles (section 270), which are not dealt with in the other parts of the Code (i.e., Parts 1, 3, 4A and 4B) should be relevant to all professional activities that PAPPs perform irrespective of whether they are internal to their firm or relate to professional services provided to their clients.”

12. When adopting the restructured Code, the Board determined to remove Part 2. Specific references to the applicability of section 270 Pressure to Breach the Fundamental Principles to an audit engagement have been deleted. Rather generic references to “other relevant ethical requirements” have been included within PES 1.
13. The inclusion of related services within the XRB mandate may require the inclusion of sections such as preparing and presenting information (Section 220) and pressure to breach the fundamental principles (section 270), which are not dealt with in the other parts of the Code in PES 1.
14. This increased emphasis on the applicability of Part 2 to PAPPs (including when performing professional services to clients) again raises the question as to whether an assurance practitioner can assert compliance with the ethical requirements (such as PES 1) that are at least as stringent as the IESBA Code, if PES 1 does not incorporate these provisions.
15. In an ideal world, it would be clearer for all (standard setters, CAANZ and practitioners and even regulators) if the entire contents of the Code was in one place. However, this may not be possible, even under a broader XRB mandate.

#### **Quality management standards**

16. The Board has previously considered possible options to amend the references to Part 2 of the IESBA Code of Ethics in proposed ISQM 1 and wished to consult further with CAANZ and CPA Australia.
17. An example of a reference in the IESBA Code where there is an issue, of how to reflect the requirement to comply with a section in Part 2 of the Code in the XRB standards, is as follows:

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).

18. Additional possible references are identified in agenda item 6.3.
19. There is an increasing emphasis in both the IESBA and IAASB standards on the integrated nature of the Code of Ethics (i.e. the need to apply the whole Code).

#### **Conforming amendments to other ISAs (NZ)**

20. We are exploring the possible impact of the changes to the IESBA Code on the ISAs (NZ). For example, the references to the ethical requirements in the auditor’s report. Any changes that are identified by the Board as a result of a

probable mandate change, may also impact on the way that these references are made in the ISAs (NZ). Again this reflects the increasing emphasis in the IAASB standards on the integrated nature of the Code of Ethics.

### Risks/Issues

Issues which may impact the project include the following:

21. The mandate may not be amended as expected or may take a long time before it is actioned. This poses a risk in how the NZAuASB plans to adopt ED ISQM 1 as the mandate directly impacts any compelling reason amendments for adoption in New Zealand.

### Action Plan

22. The project will involve the following key steps:
  1. Considering the need for a sub-committee of the Board to work through the issues.
  2. Continue to monitor developments of the Bill.
  3. Liaise with the CAANZ and CPA Australia and other relevant stakeholders to get their views on the implications of the changes.
  4. Identify all possible implications of a possible mandate change, given the information we have available.
  5. Consider if amendments will be needed to PES 1, the quality management exposure drafts (and any other possible implications identified for example in the ISAs (NZ)) if the mandate is amended that will best future proof these standards given the Board's other key projects on its strategic action plan.
  6. Develop any necessary exposure drafts, including the exposure drafts of ISQM 1 for New Zealand.
  7. Obtain and collate comments, and obtain the Board's approval of amendments to address comments.
  8. Final approval obtained from the Board to issue any changes to existing standards.
  9. Quality assurance to be conducted prior to issuing.
  10. Release amendments with Communique alert and any other explanatory statements as required.
  11. Consider the need for further education sessions once any changes are released.

### Timetable

23. The timetable will ultimately be determined by whether and when the mandate of the XRB is amended. The idea is to work through the issues to enable a position to be built into the development of the NZ ISQM exposure drafts, which we plan to approve at the April 2020 meeting of the Board. Any delay in the mandate will impact upon that project.

Description	Proposed Date
NZAuASB approves project plan at Board meeting	24 July 2019
Establishment of a sub-committee of the NZAuASB to assist in developing ideas and recommendations	(if needed)
NZAuASB to consider initial issues to explore paper.	September 2019

NZAuASB to consider key issues and draft documents	October 2019
Approval of exposure drafts (with approval of NZ ED ISQM 1)	April 2020
Exposure draft open for comment	April – June 2020
Consideration of submissions	June 2020
Read and Approval of final standards	July 2020

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## NZAuASB Board Meeting Summary Paper

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<b>AGENDA ITEM NO.</b>	6.1
<b>Meeting date:</b>	24 July 2019
<b>Subject:</b>	Quality management possible New Zealand changes
<b>Date:</b>	10 July 2019
<b>Prepared By:</b>	Misha Pieters



Action Required



For Information Purposes Only

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### Agenda Item Objectives

#### For the Board to:

- CONSIDER possible compelling reason amendments for the quality management exposure drafts in New Zealand

### Background

1. The NZAuASB submissions on the quality management standards have been submitted to the IAASB. The NZAuASB considered possible compelling reason amendments at the April meeting. The issues paper at agenda item 6.2 further evaluates the possible issues in order to develop a New Zealand exposure draft and possible compelling reason changes. Agenda item 6.3 demonstrates possible wording for a New Zealand exposure draft in context, and indicates staff recommendations as to whether extant material should be included within the new standard.

### Matters to Consider

2. The matters we seek feedback on are outlined in the issues paper at agenda item 6.2.

We seek feedback on the following questions:

- a. Does the NZAuASB agree with the proposed timing i.e. to defer the development of a New Zealand exposure draft until the finalisation of the IAASB standards?
  - b. Does the NZAuASB agree with the proposed titles for the New Zealand standards? (i.e., PES 3 and PES 4)
  - c. Does the NZAuASB support the definition outlined in the issues paper for listed issuer if the need to define this term arises?
3. In developing a New Zealand exposure draft for ED ISQM 1:
    - a. Does the NZAuASB agree with the proposed compelling reason amendments to describe the scope of engagements subject to an engagement quality review?

- b. *References to Part 2 of the IESBA Code and the scope of ISQM 1:* Does the NZAuASB agree to first evaluate the impact of the mandate change on the XRB standards prior to the development of the New Zealand exposure draft? This impacts references to related services and the IESBA Code.
  - c. Does the NZAuASB agree that there is no longer a compelling reason to include a New Zealand addition with reference to:
    - i. Sufficient time?
    - ii. Documentation of reasons alternative courses of actions were undertaken?
  - d. What is the NZAuASB's view on whether there is a compelling reason to add additional material in New Zealand to address public sector considerations?
4. In developing a New Zealand exposure draft for ED ISQM 2, does the NZAuASB consider there is a need for the EQR to consider the teams evaluation of the firm's independence?

### **Recommendations**

We recommend that the Board consider the issues paper and provide feedback on the matters identified.

### **Material Presented**

Agenda item 6.1	Board Meeting Summary Paper
Agenda item 6.2	Issues Paper
Agenda item 6.3	NZ paragraphs in the context of ED ISQM 1 (for reference purposes)

## Agenda 6.2

### Issues Paper

1. At the February meeting of the NZAuASB, the Board DISCUSSED preliminary views on possible compelling reason amendments to the IAASB's quality management exposure drafts. These included:
  1. Proposed scope of engagements subject to an engagement quality review (EQR)
  2. How to refer to PART 2 of IESBA Code of Ethics<sup>1</sup>
  3. Scope of the standard given that the NZAuASB mandate is currently limited to assurance engagements and excludes related services (which are scoped into the IAASB's proposals).
2. The Board asked staff to reflect on any further possible changes and determine the most appropriate time to develop a New Zealand exposure draft. Agenda item 6.3 considers possible amendments in the context of ED ISQM 1, but has not made all necessary spelling and reference amendments given our recommendation to defer the development of a New Zealand exposure draft as outlined below.

### Timing

3. Staff recommend that we wait for the final standard to be approved by the IAASB before exposing a New Zealand exposure draft for the following reasons:
  - a. The mandate of the NZAuASB may be updated prior to the finalization of the international standards to include Related Services, given that the Bill is currently under consideration. If the XRB's mandate is expanded, there may not be a need to amend the scope of the IAASB standard. This may be clearer by the time the standard is finalized (expected March 2020). For this reason we recommend that the Board undertake a project to explore the implications of a change in the mandate on the existing standards in issue. (Refer to agenda item 4)
  - b. If the IAASB does not address the need for additional support for the smaller firms to implement the proposals, it may be appropriate for the NZAuASB to consider the compelling reason test, to develop a "thinking checklist" possibly in collaboration with other NSS. We are unable to assess whether compelling reasons are met until the IAASB has considered the submissions on the exposure draft.
4. We have already conducted extensive outreach on the IAASB's proposals and the window for seeking feedback on both the international and any New Zealand compelling reason changes at the same time has already closed. I.e. a separate timeframe for New Zealand changes must be developed.
5. Our due process encourages the Board to develop any compelling reason changes as soon as practicable. We consider that while some of the changes may be discussed now, it is not practicable to resolve all of the compelling reason changes (i.e. whether there is an ongoing need to change the IAASB scope, given possible changes to the NZAuASB mandate and the weight of concerns expressed on the IAASB's proposals for smaller practices.)

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<sup>1</sup> Part 2 of the IESBA Code of Ethics deals with Professional Accountants in Business

6. The risk of delaying the development of a New Zealand exposure draft is that it is expected there will be a relatively short transition period (18 months) between the issue of the standards and their effective dates.

To address this risk, we propose to develop our rationale for the compelling reason changes that are practicable at this stage, and continue to monitor the discussions by the IAASB in finalizing the standard so that we will be in a position to approve and issue a New Zealand exposure draft in April 2020. (Based on the version approved by the IAASB at its March meeting but pre-approval by the PIOB). The IAASB standard is expected to be issued in June. We recommend approving the New Zealand exposure draft at the April meeting of the Board. This may still enable us to issue the final New Zealand standard shortly after the IAASB issues the final international standards.

<b>7. Question 1: Does the NZAuASB agree with the proposed timing i.e. to defer the development of a New Zealand exposure draft?</b>
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#### **Issue 1: Titles**

8. The IAASB is proposing to rename ISQC 1 as ISQM 1 and also introduce a new standard ISQM 2.
9. In New Zealand, ISQC 1 was adopted as PES 3. The Professional and Ethical standards form a part of the assurance standards as defined in law.
10. We recommend retaining the proposals as part of the professional and ethical standards. These could be titled
  - a. PES 3 *Quality Management for Firms that Perform Audits or Reviews of Financial statements, or Other Assurance (or Related Services) Engagements*. (The wording in brackets would be subject to the mandate of the XRB being widened to include related services.
  - b. and a new standard created: PES 4 *Engagement Quality Reviews*.

<b>11. Question 2: Does the NZAuASB agree with the proposed titles for the New Zealand standards?</b>
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#### **Issue 2: Terminology**

12. In extant PES 3, all references to listed entities have been amended to FMC reporting entities considered to have a higher level of public accountability. This can continue to be amended in this way.
13. The only difference may lie in ED ISQM 2, where reference to listed entity is made relating to a cooling off period where the engagement partner becomes the engagement quality reviewer. The NZAuASB was strongly opposed to the IAASB's approach to interpreting the threats to independence in a different way to the IESBA Code of Ethics. At the February meeting the possibility of retaining the term listed entity was tentatively agreed to, subject to further debate when the proposals are finalized.
14. In ISA (NZ) 700 (Revised), the NZAuASB included a definition of listed issuer for the reporting of key audit matters. This is a definition that could be reused for this reference to listed entity.

"For the purposes of this transitional provision, a listed issuer is defined as a person that is party to a listing agreement with a licensed market operator in relation to a licensed market (and

includes a licensed market operator that has financial products quoted on its own licensed market) (as defined in the Financial Markets Conduct Act 2013 section 6(1)).”

15. In some instances, references to listed entity is included only as an example so the Board may wish to reconsider whether these examples are amended to listed issuer if this term is introduced.

**16. Question 3: Does the NZAuASB support the above definition for listed issuer if the need to define this term arises?**

## **ED ISQM 1**

### **Issue 1: Proposed scope of engagements subject to an EQR**

17. At the April meeting, the Board tentatively agreed to amend the requirement for an engagement quality review (EQR) from “listed entity” to “FMC reporting entity considered to have a higher level of public accountability” and leave it up to the firms to determine other entities of significant public interest. The definition of an FMC reporting entity considered to have a higher level of public accountability currently included in extant PES 3 will therefore need to be retained.
18. The Board also discussed that requiring an EQR for all public interest entities as defined in PES 1 would be extending the requirements beyond what was intended by the IAASB’s proposals. The Board REQUESTED that staff develop additional New Zealand application material to clarify this in the New Zealand context. (refer to para A101)
19. This has been marked up in agenda item 6.3 to illustrate suggested amendments.

**20. Question 4: Does the NZAuASB agree with the proposed compelling reason amendments to describe the scope of engagements subject to an EQR?**

### **Issue 2: References to Part 2 of the IESBA Code**

21. ED ISQM 1 makes references to the IESBA Code and includes an explicit reference to section 260 of Part 2 of the IESBA Code. “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).”
22. PES 1 does not include Part 2 of the IESBA Code.
23. ED ISQM 1 refers to professional accountants in the context of the IESBA Code. PES 1 currently refers to assurance practitioners. If the XRB mandate is changed, we will need to consider what “name” will be given to those performing the engagement, and how PES 1 will be worded to capture the ethical requirements for those performing agreed upon procedures and other related services engagements.
24. We consider that the change in the mandate of the XRB may require a re-evaluation of the exclusion of some sections of Part 2 and that this project to commence as soon as possible in order to determine the best way to make these cross references in the New Zealand standards.
25. Other options include:
- a. Retaining the reference as is, i.e. to Part 2 of the IESBA Code
  - b. Amending the reference to Part 2 of the Code of Ethics issued by the New Zealand Institute of Chartered Accountants, applicable in New Zealand

- c. Deleting the underlined text in paragraph 21 above, but retaining the reference to relevant ethical requirements.

**26. Question 5: Does the NZAuASB agree to evaluate the impact of the mandate change on the XRB standards prior to the development of the New Zealand exposure draft?**

**Issue 3: Scope of ISQM 1**

27. Extant PES 3 differs in scope from extant ISQC 1 as it does not apply to related services. We recommend monitoring the developments of potential changes to the XRB's mandate prior to developing any changes to the proposed ISQM 1.
28. If the XRB's mandate is amended, it is likely that the definition of "related services" will differ between the mandate and the way in which the term is used by the IAASB. Therefore it is likely that some compelling reason changes will be needed, but the changes will depend on if and how the mandate is changed before the standard is finalized. We recommend that this is considered as part of a project to consider the impact of a change in mandate on the standards issued by the NZAuASB.
29. Extant PES 3 includes additional paragraphs on scope and additional definitions given that it is restricted to assurance engagements and refers to assurance practitioners. The ongoing need for these definitions and how these terms may be defined going forward may be affected by the how and when the mandate changes are made.

**30. Question 6: Does the NZAuASB agree to evaluate the impact of the mandate change on the XRB standards prior to the development of the New Zealand exposure draft?**

**Issue 5: Sufficient time**

31. PES 3 includes additional emphasis on having appropriate time available as a consideration in assigning the engagement team (NZ 31.1)
32. The IAASB has addressed this emphasis. In the proposed requirements on resources, proposed paragraph 38 requires that
- "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:...
- (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)

33. We do not consider that this additional requirement will be needed going forward.

**34. Question 7: Does the NZAuASB agree that there is no longer a compelling reason to include a New Zealand addition with reference to sufficient time?**

#### **Issue 6: Documentation**

35. PES 3 currently includes an additional requirement to document the reasons alternative courses of action from consultation were undertaken (NZ34.1)

36. Historically this had been added to the Australian standard on quality control. This was added in New Zealand to align more closely with ASQC 1.

37. ED ISQM 1 does not explicitly address scenarios where alternative action is taken but could be covered by the firms' policies and procedures that cover differences in opinion, which explicitly extend to those who provide consultation, but are not explicit on documentation. (Refer to para 37(d) of ED ISQM 1)

"The policies or procedures addressing the review of the work of engagement teams may address matters such as the reviewer's consideration of whether:

- d. The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- e. Significant matters have been raised for further consideration;
- f. Appropriate consultations have been undertaken and the resulting conclusions have been documented and implemented, or the reasons alternative courses of actions were undertaken are documented;

38. We do not consider that there is a compelling reason to add this additional requirement in New Zealand. However, if the Board wishes to retain this addition, we consider that it is better positioned in application material and could be added as indicated in the underlined text above.

**39. Question 8: Does the NZAuASB agree there is no longer a need to add this additional New Zealand requirement?**

#### **Issue 7: Public sector application material**

40. Additional definitions and application material were added to extant PES 3. Of the additional application material added, the one that still appears to have the most relevance is:

[NZA67.1] In the public sector, the Office of the Auditor-General performs quality reviews on appointed auditors on a cyclical basis. A quality review by the Office of the Auditor-General would contribute towards the firm's compliance with the monitoring requirements.

41. This was raised during the quality management workshops by the sole practitioners and SMPs. Consider there remains a compelling reason to address this in New Zealand. Refer to para A171 in agenda item 6.3.

42. Additional definitions and additional paragraphs that provide additional application material is documented in agenda item 6.3 for context, but staff query whether there remains a compelling reason to add these definitions and paragraphs. If this is needed in the public sector, it could be added to the standards issued by the Office of the Auditor General.

**43. Question 9: What is the NZAuASB's view on whether there is a compelling reason to add additional material in New Zealand to address public sector considerations?**

**ED ISQM 2**

44. Extant ISA (NZ) 220 has the following additional requirements related to the engagement quality control review:

the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

- The engagement team's evaluation of the firm's independence in relation to the audit engagement;

[This matter is not dealt with explicitly in ED ISQM 2. Discussions with the FMA signaled they would be supportive of retaining this requirement in New Zealand].

- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

[This is explicitly required by ED ISQM 2 para 22(e). Recommend there is no need to retain going forward].

- Whether audit documentation selected for review reflects the work performed in relation to the significant judgements made and supports the conclusions reached. (Ref: Para. NZ 21.1)

[ED ISQM 2 has a focus on the engagement quality review (EQR) role in reviewing engagement documentation that supports the significant judgements made by the engagement team and the conclusions reached (Para 22(d) of ED ISQM 2).]

45. We consider that if the Board wishes to retain the requirement for the EQR to consider the engagement teams evaluation of independence, this will need to be reflected as a NZ paragraph. We recommend that this would be best positioned within the equivalent of ED ISQM 2 in New Zealand.

**46. Question 10: Does the NZAuASB consider there is a need for the EQR to consider the teams evaluation of the firm's independence?**

**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)

**CONTENTS**

	Paragraph
<b>Introduction</b>	
Scope of this ISQMPES .....	1–6
The Firm's System of Quality Management .....	7–15
Authority of this ISQMPES .....	16
Effective Date .....	17
<b>Objective</b> .....	18
<b>Definitions</b> .....	19
<b>Requirements</b>	
Applying, and Complying with, Relevant Requirements .....	20–21
System of Quality Management .....	22
Governance and Leadership .....	23–25
The Firm's Risk Assessment Process .....	26–31
Relevant Ethical Requirements .....	32–33
Acceptance and Continuance of Client Relationships and Specific Engagements .....	34–35
Engagement Performance .....	36–37
Resources .....	38–39
Information and Communication .....	40–41
Monitoring and Remediation Process .....	42–57
Network Requirements or Network Services .....	58–63
Service Providers .....	64–65
Documentation .....	66–69
<b>Application and Other Explanatory Material</b>	
Scope of this ISQMPES .....	A1
The Firm's System of Quality Management .....	A2–A5
Authority of this ISQMPES .....	A6–A9

**Commented [MP1]:** This mark up is prepared for reference purposes only. It has been prepared to illustrate existing paragraphs added in extant PES 3 for context. This is not a complete mark up of a New Zealand exposure draft

**Commented [MP2]:** Text in red is wording that may have to be amended for the XRB mandate or New Zealand context

Definitions .....	A10–A18
Applying, and Complying with, Relevant Requirements.....	A19–A20
System of Quality Management.....	A21–A24
Governance and Leadership .....	A25–A47
The Firm’s Risk Assessment Process.....	A48–A66
Relevant Ethical Requirements.....	A67–A75
Acceptance and Continuance of Client Relationships and Specific Engagements .....	A76–A90
Engagement Performance.....	A91–A112
Resources.....	A113–A134
Information and Communication .....	A135–A153
Monitoring and Remediation Process .....	A154–A191
Network Requirements or Network Services.....	A192–A204
Service Providers .....	A205–A210
Documentation.....	A211–A214

Appendix 1: The Components of a System of Quality Management

Proposed ~~International Standard on Quality Management~~ Professional and Ethical Standard (ISQM/PES) 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 ISQMPES

1. This International Standard on Quality Management Professional and Ethical Standard (ISQMPES) 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**. ISQMPES 24<sup>1</sup> deals with the responsibility of the firm and engagement quality reviewers relating to engagement quality reviews. This ISQMPES is to be read in conjunction with relevant ethical requirements. Text is red to be agreed pending discussion on mandate
2. Other pronouncements of the International New Zealand Auditing and Assurance Standards Board (IAASB/NZAuASB) include requirements for engagement partners and other personnel regarding quality management at the engagement level. ISA (NZ) 220 (Revised),<sup>2</sup> 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 ISQMPES.

No longer a need to include an additional NZ para "This standard is not intended to detract from responsibilities which may be imposed by law or regulation"

4. This ISQMPES 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 ISQMPES applies). any amendment to be agreed pending discussion on mandate. Note that the IAASB has clarified that the standard applied if the firm performs these engagements irrespective. If the XRB mandate is extended to include "related services", all that may be needed is a NZ definition of related services to match how the legislation defines this term for the XRB mandate. We will need to liaise with CAANZ to determine if they will still need to issue a quality management standard if the mandate is amended.

### Scalability

5. This ISQMPES 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

**Commented [MP3]:** References to related services – consider with respect to possible mandate changes.

**Commented [MP4]:** References to listed entities – consider if need to amend all to FMC reporting entities considered to have a higher level of public accountability.

<sup>1</sup> Proposed ISQMPES 42, *Engagement Quality Reviews*

<sup>2</sup> Proposed International Standard on Auditing (New Zealand) (ISA (NZ)) 220 (Revised), *Quality Management for an Audit of Financial Statements*

performs only reviews of financial statements or compilation engagements. To agree if there is actually a need to amend this reference, given it is only an example, or should it be listed issuer or FMC reporting entity considered to have a higher level of public accountability

6. The nature and circumstances of the firm and its engagements may change over time. This ~~ISQM~~ PES 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 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~~ judgement and, when applicable to the type of engagement, exercising professional skepticism. (Ref: Para. A2–A4)
8. This ~~ISQM~~ PES requires professional judgement 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~~ PES, 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-PES~~ and additional quality objectives beyond those required by this ~~ISQMPES~~, when those objectives are necessary to achieve the objective of this ~~ISQMPES~~.

- (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 ~~ISQMPES~~, which are organized by component, in its responses to its assessed quality risks. The responses required by this ~~ISQM-PES~~ are relevant to every firm's system of quality management, and are therefore applicable to all firms. However, the responses required by this ~~ISQM-PES~~ 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 ~~ISQMPES~~.

11. This ~~ISQM-PES~~ 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-PES~~ 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 ~~ISQMPES~~. Accordingly, other pronouncements of the ~~IAASB/NZASB~~, such as ISA (NZ) 220 (Revised),<sup>3</sup> are premised on the basis that the firm is subject to the ~~ISQMs-PESs~~ or to national requirements that are at least as demanding.

#### Networks

<sup>3</sup> Proposed ISA 220 (Revised), paragraph 3

14. In some circumstances, the firm may belong to a network. This ~~ISQM-PES~~ 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-PES~~. 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.

#### *Service Providers*

15. This ~~ISQM-PES~~ 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-PES~~**

16. This ~~ISQM-PES~~ contains the objective of the firm in following this ~~ISQM-PES~~, 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-PES~~, and definitions. (Ref: Para. A6–A9)

~~[This Professional and Ethical Standard applies to all firms of assurance practitioners in respect of audits and reviews of financial statements, and other assurance engagements. The nature and extent of the policies and procedures developed by an individual firm to comply with this Professional and Ethical Standard will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.]~~

**Commented [MP5]:** Consider need for such a paragraph pending discussion on XRB mandate

#### **Effective Date**

17. Systems of quality management in compliance with this ~~ISQM-PES~~ 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—the~~ standards issued by the New Zealand Auditing and Assurance Standards Board 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-PES, the following terms have the meanings attributed below:

Consider the need for a definition of an assurance engagement, assurance practitioner and related services engagement pending discussion on mandate

- (a) Deficiency in the firm's system of quality management (referred to as "deficiency" in this ISQM-PES) – This exists when:
  - (i) A quality objective required to achieve the objective of this ISQM-PES 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<sup>4</sup> – 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.

### Considerations Specific to the Public Sector

Where a statutory officer (such as the Auditor-General) appoints an employee or other suitably qualified person (appointed auditor) to perform audits or other assurance services on that officer's behalf, for the purposes of this Professional and Ethical Standard it is the appointed auditor who effectively discharges the obligations of the engagement partner. Any reference to the engagement partner should be interpreted accordingly.

Commented [MP6]:

- (d) Engagement quality review – An objective evaluation of the significant ~~judgment~~ judgements 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. [No reference to scope so no need to amend definition in New Zealand]
- (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

<sup>4</sup> "Engagement partner" and "partner" should be read as referring to their public sector equivalents where relevant.

provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).<sup>5</sup>

- (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)

Reconsider need for public sector guidance. This is not included in the other NZAuASB standards.

#### [NZ] Considerations Specific to the Public Sector

Where a statutory officer (such as the Auditor-General) appoints an employee or other suitably qualified person (appointed auditor) to perform audits or other assurance services on that officer’s behalf, for the purposes of this Professional and Ethical Standard the term “firm” refers to the combination of the statutory officer, the appointed auditor, and, if applicable, the firm of which the appointed auditor is a partner, member or employee

- (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.

Retain definition of FMC reporting entity and possibly include a definition of listed issuer.

- (j) Network firm – A firm or entity that belongs to a network.
- (k) Network<sup>6</sup> – 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.

<sup>5</sup> 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.

<sup>6</sup> As defined in the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

- (o) Professional standards – IASB–NZAuASB Engagement Standards, as defined in the IASB's XRB Au1, *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).

[To consider if definition of Public entity, public sector auditor are needed]

[To consider if definition of public interest entity is needed. The IAASB use the term in a different way than that used in PES 1. and do not define it.]

- (r) Reasonable assurance – In the context of the ISQMs/PESs, 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/PES 1 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) [to determine if a reference to Part 2 of IESBA code is needed]
- (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/PES relevant to their responsibilities, including the application and other explanatory

material, to understand the objective of this ISQM-PES and to apply its requirements properly. (Ref: Para. A19)

21. The firm shall comply with each requirement of this ISQM-PES 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-PES. The requirements are designed to enable the firm to achieve the objective stated in this ISQM-PES. The proper application of the requirements in this ISQM-PES is expected to provide a sufficient basis for the achievement of the objective of this standard. In applying the requirements of this ISQM-PES, the firm shall exercise professional judgement, taking into account the nature and circumstances of the firm and its engagements, such that the objective of this ISQM-PES 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 ISQMPES. The firm shall also establish additional quality objectives beyond those required by this ISQMPES, when those objectives are necessary to achieve the objective of this ISQMPES. (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

**Commented [MP7]:** NZAuASB wanted the objectives to be less granular.

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~~**PES**. 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)

**Commented [MP8]:** Consider whether there is a need to develop a thinking list of risks depending on implementation support developed by the IAASB to assist sole practitioners and SMPs.

**Commented [MP9]:** NZAuASB submission noted that this order may be problematic

#### *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)

**Commented [MP10]:** Definition of relevant ethical requirements may need to reference to Part 2 of the IESBA Code. Consider in conjunction with XRB mandate discussion.

**Commented [MP11]:** If mandate extends to related services, the onus is on the firm to determine which part of the code applies.

- (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 ~~judgment~~judgements about whether to accept or continue a client relationship or specific engagement. (Ref: Para. A77–A82)
  - (b) The firm makes appropriate ~~judgment~~judgements 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 ~~judgment~~judgements 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~~judgement~~ 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)

**Commented [MP12]:** Consider definition change or change to XRB standards.

[PES 3 currently includes an additional requirement to document the reasons alternative courses of action from consultation were undertaken (NZ34.1)]

Historically this had been added to the Australian standard on quality control. This was added in New Zealand to align more closely with ASQC 1. ED ISQM 1 does not explicitly address scenarios where alternative action is taken but could be covered by the firms policies and procedures that cover differences in opinion, which explicitly extend to those who provide consultation, but are not explicit on documentation] Consider amendment to application material if the NZAuASB wishes to retain this additional emphasis.

- (e) Establishing policies or procedures addressing engagement quality reviews in accordance with ISQM-2PES 4, and that require an engagement quality review for: (Ref: Para. A101–A107)

[NZ](i) Audits of financial statements of listed entities FMC reporting entities considered to have a higher level of public accountability ;

- (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)

**Commented [MP13]:** NZAuASB comment to IAASB sought additional clarification as to how this differs from a public interest entity.

#### 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)  
No longer consider that an additional paragraph is needed to place emphasis on sufficient time as this has been added by the IAASB
  - (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 behaviours, 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)

Consider ongoing need for additional NZ para related to making the form and content of communication explicit to provide firm personnel with a ready source of information concerning those policies and procedures. The new section on communication added by the IAASB covers both internal and external communication.

- (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)

**Commented [MP14]:** Consider ongoing need for guidance in the public sector – given the footnote inclusion may not be needed? Staff no longer consider there is a compelling reason to add material on the form and content of communication given the new section added by the IAASB.

- (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

**Commented [MP15]:** The NZAUASB submission sought additional clarification as to when a root cause analysis would be required.

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 judgment/judgements 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/PES. (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-PES (Ref: Para. 2)

A1. Other pronouncements of the IAASB/NZAuASB, including ISRE (NZ) 2400 (Revised)<sup>7</sup> and ISAE (NZ) 3000 (Revised),<sup>8</sup> 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 PES 1 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-PES, 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 of a firm's system of quality management. Such limitations include reality that human judgment/judgement 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/judgement, 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-PES 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.

<sup>7</sup> International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*

<sup>8</sup> International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

**Commented [MP16]:** Name given to those performing professional services may need to be reconsidered under the mandate project.

**Authority of this ISQM-PES** (Ref: Para. 16)

- A6. The objective of this ISQM-PES provides the context in which the requirements of this ISQM-PES are set, establishes the desired outcome of this ISQM-PES 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-PES 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-PES. 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-PES. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this ISQM-PES.

- A9. This ISQM-PES includes, under the heading “Definitions,” a description of the meanings attributed to certain terms for purposes of this ISQM-PES. These definitions are provided to assist in the consistent application and interpretation of this ISQM-PES, 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 NZAuASB 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-PES. The Glossary of Terms also includes descriptions of other terms found in the ISQMs-PESs to assist in common and consistent interpretation and translation.

**Commented [MP17]:** Do we need to name these public entities?

**Commented [MP18]:** Does the NZAuASB wish to retain a reference to 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~~PES.

*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~~PES, 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~~PES 1 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~~PES 1 addresses circumstances when law or regulation precludes the professional accountant from complying with certain parts of ~~the IESBA Code~~PES 1. 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~~PES 1 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.

**Commented [MP19]:** This paragraph has not been included in PES 1. Consider removing or how else to reflect this here?

### 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-PES 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.

**Commented [MP20]:** Consider whether compilation will or may fall within the mandate?

- External factors, such as relevant **professional standards** and law or regulation.

A24. The quality of professional ~~judgment~~judgements exercised by the firm is enhanced when personnel making such ~~judgment~~judgements 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~~ISQMPE. 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 behaviours 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 behaviour 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.

**Commented [MP21]:** Is there any relevant law to reference or consider here?

*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 PES. 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).

**INZA70.11** Complaints and allegations may also be received from relevant professional bodies.

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 **ESBA 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

**Commented [MP22]:** To consider whether still needed given enhanced emphasis in the proposals on all relevant sources

**Commented [MP23]:** PES 1 does not include section 260

- 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-PES 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 ISQMPES, when those objectives are necessary to achieve the objective of this ISQMPES.
- May decide that more granular quality objectives than those set out in this ISQM-PES 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-PES 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 ISQMPES, 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-PES 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-PES, 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-PES 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-PES 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 PES. 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 PES 1 sets out the fundamental principles of ethics that establish the standard of behaviour 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 behaviour. The IESBA Code PES 1 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. [To consider mandate]

[NZA14.1] PES 1 recognises that the familiarity threat is particularly relevant in the context of financial statement audits of public interest entities. For these audits, PES 1 requires the rotation of the key audit partner<sup>9</sup> after a pre-defined period, normally no more than seven years, and provides related standards and guidance<sup>10</sup>. [to consider if still required]

<sup>9</sup> Professional and Ethical Standard 1 (Revised), Definitions.

<sup>10</sup> Paragraph 290.151 of Professional and Ethical Standard 1 (Revised).

**[NZA14.2]** Shorter rotation requirements may be established for particular audit engagements or classes of audit engagement, for example for audits of entities whose securities are quoted or listed on a recognised stock exchange. [to consider if still required]

**Commented [MP24]:** Unclear why this is needed in PES 3?

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.

**Commented [MP25]:** If mandate include related services this is appropriate.

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).

**Commented [MP26]:** Need to reference – pending outcome of mandate discussion. One option to explore is whether there is a need to include Part 2 in PES 1. An alternative option is to retain references to the IESBA Code.

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~~ PES 1 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~~ PES 1 sets out requirements for the firm in the event of a breach of PES 1 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.

[NZA16.1] There may be other public entities that are not defined as a public interest entity, that are significant due to size, complexity, commercial risk, parliamentary or media interest or public interest aspects, and which consequently have a wide range of stakeholders. There are no fixed objective criteria on which this determination of significance should be based. Such a determination should encompass an evaluation of all factors relevant to the public entity. Therefore, there may be instances

**Commented [MP27]:** Recommend no longer needed.

when a firm determines, based on its quality control policies and procedures, that a public entity is significant for the purposes of expanded quality control procedures. [this was amended IAASB text, this text is no longer carried forward so no longer a need to amend]

[NZA17.1] In the public sector, legislation may establish the appointments and terms of office of the auditor with engagement partner responsibility. Nonetheless, for public entities considered significant, as noted in paragraph A16, it may be in the public interest for public sector auditors to establish policies and procedures to promote compliance with the spirit of rotation of engagement partner responsibility. [amended IAASB text from extant ISQC 1 but not retained in ED ISQM 1 so no longer a need to amend]

**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 ~~judgment~~ **judgements** 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.

**Commented [MP28]:** Consider in relation to new mandate.

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 (NZ) 220 (Revised)<sup>11</sup> 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 (NZ) and complying with the requirements of ISA (NZ) 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 engagement. For example, when there has been a change of auditors, ISA (NZ) 300<sup>12</sup> requires the auditor, prior to starting an initial audit, to communicate with the predecessor auditor in compliance with relevant ethical requirements. The IESBA Code PES 1 also includes requirements for the consideration of conflicts of interests in accepting or continuing a client relationship or specific

<sup>11</sup> Proposed ISA 220 (Revised), paragraph 21

<sup>12</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraph 13(b)

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 ~~judgment~~judgements 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~~PES 4, 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~~PES 1 addresses fees and other types of remuneration, including 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 (NZ) 220 (Revised)<sup>13</sup> 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).

*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

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<sup>13</sup> Proposed ISA 220 (Revised), paragraph 22

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.

Consider if still needed given additional material added in A89 and A90. Recommend no need to add going forward]

[NZA10.1] In the case of a statutory officer (such as the Auditor-General) who is bound by this Professional and Ethical Standard in their professional capacity as an assurance practitioner, if the officer does not have the ability to withdraw from, or to decline to accept, an engagement to eliminate a threat to independence of a professional nature, it will be sufficient compliance with this Professional and Ethical Standard for the statutory officer to:

(a) Introduce safeguards to reduce the threat to independence to the extent that is reasonably possible in the circumstances; and

(b) Disclose the threat to independence to those responsible for governance of the entity and publicly disclose the matter where a report is required.

**Commented [MP29]:** This is covered in section 220 on Preparation an presentation of information not included in PES 1. This may have relevance for other related services engagements. Consider with the mandate of the XRB project.

#### **Engagement Performance** (Ref: Para. 36–37)

A91. ISA (NZ) 220 (Revised)<sup>14</sup> 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;

<sup>14</sup> Proposed ISA 220 (Revised), paragraph 11

- 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:

- 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 or the reasons alternative courses of actions were undertaken are documented;
- 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.

**Commented [MP30]:** [To consider if there remains a compelling reason for this additional emphasis. Has been added in the requirements of extant PES 3].

*Judgment Judgements 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~~judgement and, when applicable to the type of engagement, professional ~~sk~~cepticism.

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~~judgement and, when applicable to the type of engagement, professional ~~sk~~cepticism 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 ~~sk~~cepticism supports the quality of ~~judgment~~judgements made on the engagement and, through these ~~judgment~~judgements, the overall effectiveness of the engagement team in performing the engagement. Other pronouncements of the ~~IAASB-NZA~~ASB may address the exercise of professional ~~judgment~~judgement or professional ~~sk~~cepticism at the engagement level. For example,

ISA (NZ) 220 (Revised)<sup>15</sup> 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).<sup>16</sup> [Will need to determine whether compilation will be covered by XRB mandate going forward]

*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.

NZA101. In New Zealand, engagement quality reviews are required by law or regulation to be performed for all FMC reporting entities. XRB A1 provides guidance on which entities are deemed to have public accountability. [Consider need to clarify legal position and where guidance on public accountability is positioned.]

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

**Commented [MP31]:** Consider whether to leave as listed entity, listed issuer or FMC reporting entity considered to have higher level of public accountability?

**Commented [MP32]:** Compelling reason – there is a legislative reason to include all FMC reporting entities as these are required by the FMA by law in New Zealand. Currently PES 3 is silent in this regard and has been raised as a matter that may create confusion or uncertainty given the FMA's requirements.

<sup>15</sup> Proposed ISA 220 (Revised), paragraphs A27–A29

<sup>16</sup> International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, paragraphs 34–36

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).

**Commented [MP33]:** NZAuASB asked the IAASB to clarify how this differs from the application material in the Code.

**Commented [MP34]:** Note that the IAASB does not define this term

**Commented [MP35]:** Leave as listed entity, listed issuer or FMC reporting entity considered to have a higher level of public accountability. Given all within scope may no longer be a compelling reason to amend.

#### 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.

**Commented [MP36]:** Consider ongoing need to amend to "public entities"

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).

NZA46.2 There are no fixed objective criteria on which this determination of significance should be based. However, such a determination should encompass an evaluation of all factors relevant to the public entity. Such factors include size, complexity, commercial risk, parliamentary or media interest and the number and range of stakeholders affected

**Commented [MP37]:** Consider no longer needed given changes made by IAASB

#### *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 PES.

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)–(d), 41(a)–(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~~judgement 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,

**Commented [MP38]:** Consider amending to FMC reporting entities considered to have a higher level of public accountability.

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 ~~judgment~~ judgements 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~~judgement 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 PES 1, 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.

[NZA67.1] In the public sector, the Office of the Auditor-General performs quality reviews on appointed auditors on a cyclical basis. A quality review by the Office of the Auditor-General would contribute towards the firm's compliance with the monitoring requirements [still applicable. This was raised during the quality management workshops by the sole practitioners and SMPs. Consider there remains a compelling reason to address this in New Zealand.]

#### 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-PES~~ 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-PES~~, 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 (NZ) 220 (Revised)<sup>17</sup> 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 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.

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<sup>17</sup> Proposed ISA (NZ) 220 (Revised), paragraph 36(b)

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-NZA~~ASB 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~~PES.<sup>18</sup>
- 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 (NZ) 610 (Revised 2013).<sup>19</sup>

<sup>18</sup> See, for example, ISA (NZ) 620, *Using the Work of an Auditor's Expert*.

<sup>19</sup> ISA (NZ) 610 (Revised 2013), *Using the Work of Internal Auditors*

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~~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 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 PES, 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 judgement 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 judgment judgements 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.

**[NZA75.1] The policies are often simply embedded in the firm's engagements templates in the form of standard communications, questionnaires, checklists, memoranda, and forms. [still applicable]**

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-PES 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-PES and additional quality objectives beyond those required by this ISQM-PES, when those objectives are necessary to achieve the objective of this ISQM-PES.
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-PES~~, which are organized by component; and
- (b) Additional responses determined by the firm.

The responses required by this ~~ISQM-PES~~ 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-PES~~.

7. The responses designed and implemented by the firm, including the responses required by this ~~ISQM-PES~~, 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

judgment, ~~judgements~~ 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~~ judgement and, when applicable to the nature and circumstances of the engagement, exercising professional ~~s~~kepticism. 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-PES 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 PES.
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.

## NZAuASB Board Meeting Summary Paper

**AGENDA ITEM NO.** 7.1

**Meeting date:** 24 July 2019

**Subject:** Modified audit reports

**Date:** 12 July 2019

**Prepared by:** Peyman Momenan

Action Required

For Information Purposes Only

### Objective

For the Board to note the summary of modified auditor reports received by the XRB between 24 November 2018 and 30 June 2019.

### Introduction

1. In September 2016, the XRB approved a policy for dealing with modified audit reports received under the Companies Act 1993 and the Financial Markets Conduct Act 2013. The policy requires the NZAuASB to consider implications for the relevant standards by ensuring that the modified audit opinions do not raise any issue about the appropriateness, applicability, clarity and/or completeness of the relevant standards.
2. In December 2016, the policy was supplemented by an operating procedure (OP) document including specific actions that the XRB and its boards (including the NZAuASB) need to take to operationalise the policy. The OP requires the NZAuASB staff to review the received modified audit reports to:
  - Identify categories of modified audit opinions that affect auditing & assurance standards
  - Identify trends, if any
  - Refer any strategy-related issues to the XRB Board staff team, as appropriate
  - Make appropriate recommendation to the NZAuASB, as necessary
3. The OP requires staff to report to the NZAuASB at least every 6 months on matters including:
  - the number of audit reports received
  - the types of modified audit opinions
  - the nature/subject matter of the modified opinions
  - whether the modified audit opinions have implications for any XRB standards and/or XRB strategy/standards frameworks
  - any emerging trends.

4. The Board had previously seen the summary of modified audit reports up to end of November 2018 at the December 2018 meeting. The next report will be presented at the Board's December 2019 meeting.

#### **Matters to consider**

5. We have prepared a summary of the reasons for the qualifications by modification type to consider if there are any implications for the XRB standards. A summary of the reasons for the modified audit reports received from 24 November 2018 to 30 June 2019 is attached at agenda item 7.2.
6. We have not identified any implications for the auditing and assurance standards and have no recommendations for further action required by the NZAuASB. It is worth mentioning that the accounting staff have also not identified any implications for the accounting standards when they presented their analysis to the NZASB in June 2019.

#### **Recommendations**

7. It is recommended that the Board **NOTE** the contents of this report.

#### **Material Presented**

Agenda item 7.1	Board Meeting Summary Paper
Agenda item 7.2	Summary of modifications

**Modified Auditor Reports received by the XRB between 24/11/2018 and 30/06/2019****A) Modified Auditor Reports**

Modification in relation to	Adverse Opinion	Disclaimer of Opinion	Qualified Opinion		Grand Total	
	Financial statements are materially misstated	Unable to obtain sufficient appropriate audit evidence	Financial statements are materially misstated	Unable to obtain sufficient appropriate audit evidence	Financial statements are materially misstated	Unable to obtain sufficient appropriate audit evidence
Appropriateness of using the Going Concern assumption		2		2		4
Audit Procedures		1		1		2
Deferred Tax			1		1	
Impairment of intangible assets			1		1	
Impairment test of PPE			3		3	
Inventories				1		1
Presentation of financial instruments				1		1
Related party transactions				1		1
Valuation of Investment in associated entities				1		1
<b>Total</b>	<b>0</b>	<b>3</b>	<b>5</b>	<b>7</b>	<b>5</b>	<b>10</b>

## Modified Auditor Reports received by the XRB between 24/11/2018 and 30/06/2019

ID number <sup>1</sup> Nature of industry Balance date Audit report date	Type of modified audit opinion	Accounting standard(s) affected	Proposed action
170 Software and app developer 30 Sep 2018 30 Nov 2018	Disclaimer of opinion Unable to obtain sufficient appropriate audit evidence to support the going concern assumption.	NZ IAS 1 <i>Presentation of Financial Statements</i>	Nil. We did not identify any issues with the underlying auditing standard.
171 Building society 31 Mar 2018 28 Nov 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the going concern assumption.	NZ IAS 1 <i>Presentation of Financial Statements</i>	Nil. We did not identify any issues with the underlying auditing standard.
172 Non-bank deposit taker 30 Sep 2019 15 Feb 2019	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the completeness of related party transactions and the resulting impact, if any, on both the recorded total portfolio income and operating and other expenses in the statement of profit or loss.	NZ IFRS 15 <i>Revenue from Contracts with Customers</i> NZ IAS 24 <i>Related Party Disclosures</i>	Nil. We did not identify any issues with the underlying auditing standard.
173 Plastic container manufacturer 31 Dec 2017 12 Feb 2019	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the carrying value of inventories because the auditor was unable to observe the counting of the inventories. Unable to obtain sufficient appropriate audit evidence to support the goodwill arising from an acquisition.	NZ IFRS 3 <i>Business Combinations</i> NZ IAS 2 <i>Inventories</i> NZ IAS 38 <i>Intangible Assets</i>	Nil. We did not identify any issues with the underlying auditing standard.

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<sup>1</sup> From internal database.

## Modified Auditor Reports received by the XRB between 24/11/2018 and 30/06/2019

ID number <sup>1</sup> Nature of industry Balance date Audit report date	Type of modified audit opinion	Accounting standard(s) affected	Proposed action
174 Meat processing and exporting 31 Mar 2018 28 Feb 2019	Disclaimer of opinion Unable to obtain sufficient appropriate audit evidence to support the nature, terms and recoverability of a loan receivable and the recoverability of another loan receivable. Unable to obtain sufficient appropriate audit evidence to support the existence or valuation of inventory.	NZ IAS 2 <i>Inventory</i> NZ IAS 39 <i>Financial Instruments: Recognition and Measurement</i>	Nil. We did not identify any issues with the underlying auditing standard.
175 Coffee and other coffee related products and services 31 Mar 2017 5 Feb 2019	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the going concern assumption.	NZ IAS 1 <i>Presentation of Financial Statements</i>	Nil. We did not identify any issues with the underlying auditing standard.
176 Therapeutic natural products 31 Dec 2018 29 Mar 2019	Disclaimer of opinion Unable to obtain sufficient appropriate audit evidence to support the going concern assumption.	NZ IAS 1 <i>Presentation of Financial Statements</i>	Nil. We did not identify any issues with the underlying auditing standard.
177 Poultry products 31 Dec 2018 2 May 2019	Qualified opinion The prior year's audit opinion was qualified because the entity did not recognise the impairment loss on goodwill. The entity has recognised the prior year's impairment loss on goodwill in the current period's financial statements. In the auditor's opinion the impairment loss should have been recognised in the prior period.	NZ IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> NZ IAS 36 <i>Impairment of Assets</i>	Nil. We did not identify any issues with the underlying auditing standard.
178 Supplier of healthcare linen 30 Jun 2018 27 Nov 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support textile and linen stock because controls over the identification and existence of the asset was limited.	NZ IAS 2 <i>Inventories</i> NZ IAS 16 <i>Property, Plant and Equipment</i>	Nil. We did not identify any issues with the underlying auditing standard.

## Modified Auditor Reports received by the XRB between 24/11/2018 and 30/06/2019

ID number <sup>1</sup> Nature of industry Balance date Audit report date	Type of modified audit opinion	Accounting standard(s) affected	Proposed action
179 Airport and management of assets 30 Jun 2018 2 Nov 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the carrying amount of airport related assets because the entity has not determined the recoverable amount.	NZ IAS 16 <i>Property, Plant and Equipment</i> NZ IAS 36 <i>Impairment of Assets</i>	Nil. We did not identify any issues with the underlying auditing standard.
180 Investment holding company 30 Jun 2018 1 Oct 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the carrying value of a subsidiary's stadium asset. The entity had acquired a subsidiary, a PBE. The PBE had recognised its assets using non-commercial valuation approaches. The entity had carried forward this valuation in the consolidated financial statements and not carried out an assessment of the value of the subsidiary's asset on a commercial basis.	NZ IFRS 10 <i>Consolidated Financial Statements</i> NZ IFRS 13 <i>Fair Value Measurement</i> NZ IAS 16 <i>Property, Plant and Equipment</i> NZ IAS 36 <i>Impairment of Assets</i>	Nil. We did not identify any issues with the underlying auditing standard.
181 Investment company 30 Jun 2018 30 Sep 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the carrying value of the current and prior period's tax balance for the water storage scheme and the prior period's carrying value of the water storage scheme.	NZ IAS 12 <i>Income Taxes</i> NZ IAS 16 <i>Property, Plant and Equipment</i>	Nil. We did not identify any issues with the underlying auditing standard.
182 Forestry 30 Jun 2018 26 Sep 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support all the values relating to the investment in associate as the auditor could not access the financial information of the associate.	NZ IAS 28 <i>Investments in Associates and Joint Ventures</i>	Nil. We did not identify any issues with the underlying auditing standard.
183 Trading arm of a council controlled organisation 30 June 2018 20 Nov 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support the carrying amount of airport related assets because the entity has not determined the recoverable amount.	NZ IAS 16 <i>Property, Plant and Equipment</i> NZ IAS 36 <i>Impairment of Assets</i>	Nil. We did not identify any issues with the underlying auditing standard.
184 Council 30 Jun 2018 27 Sep 2018	Qualified opinion Unable to obtain sufficient appropriate audit evidence to support certain performance measures because of the extent	PBE IPSAS 1 <i>Presentation of Financial Statements</i>	Nil. We did not identify any issues with the underlying auditing standard.

## Modified Auditor Reports received by the XRB between 24/11/2018 and 30/06/2019

ID number <sup>1</sup> Nature of industry Balance date Audit report date	Type of modified audit opinion	Accounting standard(s) affected	Proposed action
	of inaccuracies identified from the sample tested by the auditor.		

## NZAuASB Board Meeting Summary Paper

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**AGENDA ITEM NO.** 10  
**Meeting date:** 24 July 2019  
**Subject:** FMA query on subsequent events standard  
**Date:** 10 July 2019  
**Prepared By:** Sylvia van Dyk

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**Action Required**

**For Information Purposes Only**

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### **Agenda Item Objectives**

For the Board to consider:

- issues raised by the FMA about subsequent events impacting on the auditor's opinion; and
- our response and recommendations to the FMA's request to consider amending the relevant standard ISA (NZ) 560 *Subsequent Events*

### **Background**

1. Jacco Moisson from the FMA contacted the XRB in September 2018 about discussions they have had with auditors on issues experienced subsequent to issuing their audit opinions, where the audit opinion was either incorrect or the evidence no longer supported their opinion.
2. The Board requested further information about the matters, which were subsequently provided in an email from Jacco and included in the correspondence at the October 2018 meeting. The Board then requested us to prepare an issues paper for discussion at a future Board meeting.

### **Matters to Consider**

3. The issues paper at agenda 10.2 outlines the matters for consideration, as well as our recommendations.

### **Recommendations**

We recommend that the Board consider the matters raised and our recommendations.

### **Material Presented**

Agenda item 10.1 Board Meeting Summary Paper  
Agenda item 10.2 Issues paper

## ISA (NZ) 560, Subsequent Events

1. Jacco Moisson from the FMA contacted the XRB about discussions they have had with auditors on issues experienced subsequent to issuing their audit opinions, where the audit opinion was either incorrect or the evidence no longer supported their opinion.
2. The FMA's main concern is how to ensure that investors and other stakeholders are informed in a timely manner that they cannot rely on the audit opinion. This is important for all stakeholders in the reporting financial chain.
3. Another issue the FMA has raised is the practical difficulties the auditors face about how to inform users of the financial statements that they cannot rely on the audit opinion attached to the financial statements. Auditors are finding it difficult to deal with these issues, and the FMA wants to explore ways to provide more clarity to auditors under those circumstances. In addition to consider amending the relevant auditing standard, this may need to include discussions with other stakeholders such as the NZX and the Companies Office.
4. ISA (NZ) 560 deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Paragraphs 14-16 deals with the circumstances if a fact becomes known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
5. The relevant requirements for the auditor in ISA (NZ) 560 are:

### Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

14. After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, if, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall: **(Ref: Para. A18)**
  - (a) Discuss the matter with management and, where appropriate, those charged with governance;
  - (a) Determine whether the financial statements need amendment; and, if so,
  - (b) Enquire how management intends to address the matter in the financial statements.
15. If management amends the financial statements, the auditor shall: **(Ref: Para. A19)**
  - (a) Carry out the audit procedures necessary in the circumstances on the amendment.
  - (b) Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.
  - (c) Unless the circumstances in paragraph 12 apply:

- (i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor's report and date the new auditor's report no earlier than the date of approval of the amended financial statements; and
  - (ii) Provide a new auditor's report on the amended financial statements.
  - (d) When the circumstances in paragraph 12 apply, amend the auditor's report or provide a new auditor's report as required by paragraph 12.
16. The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.
17. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity<sup>1</sup>, those charged with governance that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report. **(Ref: Para. A20)**

#### Issue 1

- 6. The FMA considers that it is in the public interest for the market (in the case of listed entities) and investors or other stakeholders (for non-listed entities) to be informed as soon as possible when an audit opinion is found to be incorrect. The auditor should inform management immediately or at least as soon as possible, and management should report this to the market mostly within a day.
- 7. The FMA notes the requirements in paragraphs 14-17 of the standard does not include timeframes and has asked whether the NZAuASB would consider amending the standard to clarify when the auditor should discuss the matter with management (i.e. immediately or at least as soon as possible).

#### Our response:

- 8. We do not consider there is a compelling reason to amend the standard to include timeframes in paragraphs 14-17. In our view the requirement is clear what the auditor needs to do and adding as 'soon as possible' or 'immediate' may have unintended consequences. For example, it may not be practical for the auditor to immediately discuss the matter with management. Also, the term 'as soon as possible' may be interpreted differently by auditors and may result in the auditor delaying acting.
- 9. We agree that it is in the public interest to ensure that investors and other stakeholders are informed in a timely manner that they cannot rely on the audit opinion. However, we do not consider amending the standard will address that matter, but rather that it is a corporate governance issue to address.
- 10. We recommend not amending the standard to include timeframes in paragraphs 14-17.

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<sup>1</sup> ISA 260, "Communication with Those Charged with Governance," paragraph 13.

Q1. Does the Board agree with our recommendation?

11. Other areas the FMA has asked us to consider are:

- a. To include a requirement for the auditor to report to the FMA as soon as possible if the audit firm becomes aware of issues with their current audit opinion. Listed entities have a requirement to disclose these matters under the continuing disclosure requirement. The FMA can help to facilitate this disclosure if they become aware of the issue.
- b. Include examples of other steps auditors can take to ensure stakeholders are informed. For example, reporting matters directly to the stock exchange after management or TCWG did not report these matters on a timely basis or contacting the Companies Office that users of financial statements can no longer rely on the audit opinion included in the financial statements.

Our response:

12. Paragraph 17 of the standard deals with the auditor's responsibilities when management or TCWG do not amend the financial statements and do not take appropriate steps to inform those in receipt of the previously issued financial statements of the situation. Guidance on appropriate action to take is included in A20;

A20 Where the auditor believes that management, or those charged with governance, have failed to take the necessary steps to prevent reliance on the auditor's report on financial statements previously issued by the entity despite the auditor's prior notification that the auditor will take action to seek to prevent such reliance, the auditor's course of action depends on the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

13. We do not consider it would be appropriate to include a requirement for the auditor to report to the FMA as soon as possible if the audit firm becomes aware of issues with their current audit opinion. The standard notes that the auditor's action depends on the auditor's legal rights and obligations and including such a reporting requirement may have unintended consequences. Our recommendation is therefore not to include it as a requirement in the standard.

14. However, it may be helpful to include some more guidance about possible steps the auditor could take to prevent reliance on the auditor's report. Possible guidance<sup>2</sup> to include could be, for example:

Unless the legal advice obtained recommends a different course of action, possible actions the auditor may consider include:

- a. Notifying management and TCWG that the auditor's report must no longer be associated with the financial statements
- b. Notifying the regulatory agencies having jurisdiction over the entity that the auditor's report should no longer be relied upon, and requesting the regulatory

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<sup>2</sup> Based on requirements in the equivalent PCAOB standard AS 2905: *Subsequent discovery of facts existing at the date of the Auditor's Report*.

agency to take whatever steps it may deem appropriate to provide appropriate disclosure.

- c. If practicable, notifying each person known to the auditor to be relying on the financial statements that the auditor's report should no longer be relied upon.

Q2. Does the Board agree with our recommendation not to include a requirement in the standard for the auditor to report to the FMA as soon as possible if the firm becomes aware of issues with their current audit opinion?

Q3. What is the Board's view about adding guidance as proposed in the application material or maybe in FAQs?

Q4. Does the Board have any other suggestions to address the concerns raised by the FMA?



NZ AUDITING  
AND ASSURANCE  
STANDARDS BOARD

**DATE:** 12 July 2019

**TO:** Members of the New Zealand Auditing and Assurance Standards Board

**FROM:** Peyman Momenan

**SUBJECT:** **International Update**

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### **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 June and July 2019.

### **International Federation of Accountants (IFAC)**

1. IFAC SMP Committee issued the following comment letters to the IAASB:
  - [IFAC SMP Committee Comment Letter on the IAASB's Exposure Draft on Quality Management at the Firm and Engagement Level](#): The SMPC is concerned that the QM standards' complexity may eventually drive a compliance mindset, especially amongst smaller firms who become subject to proportionately greater documentation burdens to "explain/prove" their compliance. Therefore, it is important for the IAASB to ensure that the final suite of QM standards address this issue to foster an effective focus on the quality of the engagement each individual firm delivers, as opposed to compliance with complex standards. In any case, the SMPC believes that the implementation period should not be less than 24 months after the approval of the standards by the PIOB.
  - [IFAC SMP Committee Comment Letter on the IAASB Exposure Draft for Proposed International Standard on Quality Management 1](#): The SMPC generally supports the new quality management approach using a risk management lens. However, the Committee also believes that the IAASB needs to consider the cost/benefit of the proposed changes in terms of anticipated quality increase from International Standard on Quality Management 1 (ISQM 1). The SMPC believes that making the standard less complex to apply would go a long way in addressing the practical issues many SMPs would otherwise face and, simultaneously, resolve many of the scalability issues. Specifically, by:
    - a) determining a more appropriate (i.e., higher) threshold for risk identification and assessment (instead of "more than remote likelihood of occurrence") – preferably one that takes both the likelihood of occurrence and likely magnitude of impact into account, and
    - b) setting far fewer and less granular objectives – in other words, setting a more appropriate objective for the standard as a whole, aligning quality to the firm's individual strategy with just a single objective, preferably for each relevant area that drives quality (i.e., personnel, IT applications etc.).

It is also likely that many smaller firms will benefit from assistance from their PAOs and other third parties for QM system support and methodologies. The SMPC is available to support implementation initiatives and IFAC will coordinate with the IAASB when revising the previous QC Guide as the standard progresses to its approval stage.

- [IFAC SMP Committee Comment Letter on the IAASB Exposure Draft for Proposed International Standard on Quality Management 2](#) : Based on how the standard is currently being drafted, the proposed International Standard on Quality Management 2 (ISQM 2) is unique as it combines firm wide requirements for policies and procedures and engagement level requirements relating to EQR with the objective of the firm being framed, in part, as the responsibility of the EQ reviewer. Although the IAASB is confident that such an approach is not an issue (since the standard is intended to be outcome-oriented), the SMPC has some concerns over the approach. The lack of clear demarcation of responsibilities between the firm, the engagement partner and the EQR may lead to confusion as to who is ultimately responsible, particularly in the case of breaches and where the remedial action should be taken. The risks associated with this might be reduced if the standard was restructured to deal with firm wide policies and procedures and engagement level procedures separately. In addition, smaller firms often have relatively small pool of individuals with both the seniority and experience to act as engagement partners and engagement quality reviewers. For this reason, the practicalities associated with internal rotation generally poses specific challenges to such firms. We would also caution that the use of any external third party adds significant costs that will disadvantage SMPs and/or the SMEs they serve.
  - [IFAC SMP Committee Comment Letter on the IAASB Exposure Draft for Proposed ISA 220](#): The SMPC noted that the responsibilities of the engagement partner now exceed those of extant ISA 220. Under extant ISA 220, the engagement team can rely on the firm's quality control unless there are indications to the contrary. In the Committee's view, this remains a pragmatic approach. We believe it is appropriate for the engagement partner and the engagement team to be required to go through an exercise of evaluation on a case-by-case basis as to whether the firm has implemented sufficient QM responses to quality risks and, if so, whether additional measures need to be taken to address any 'gaps' so identified. This should be confined to certain areas only at the engagement level. The IAASB has also proposed a change to the definition of engagement team from "all partners and staff performing the audit engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement" in extant ISA 220 to "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 network firm". We do not believe this proposed change is appropriate. Our concerns were further described in the said letter of comment.
2. On 7<sup>th</sup> of June 2019, IFAC [issued its response to Brydon Review](#).

### **International Auditing and Assurance Standards Board (IAASB)**

1. The IAASB Ongoing projects (refer to appendix 1)
2. Chairs of the International Auditing & Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA) [respond to](#) the UK's Brydon review. In addition to responding to the Brydon review's proposals, this letter highlights how both Boards act in the public interest to support public confidence in audits of financial statements and other assurance engagements, and also serve to reinforce the important ethical responsibilities of professional accountants in business (PAIBs) in the external reporting ecosystem.
3. Mr. Thomas R. Seidenstein will become the new chair of the International Auditing and Assurance Standards Board (IAASB) for a three-year term commencing July 1, 2019. He succeeds Prof. Arnold Schilder, who has led the IAASB since 2009. Mr. Seidenstein's career spans both international standard setting and the private sector. He is currently senior vice president for Strategy, Innovation and Capital Management at Fannie Mae, a leading source of US housing market liquidity.

### **International Ethics Standards Board for Accountants (IESBA)**

1. The IESBA on 26<sup>th</sup> of June 2019 launched the eCode – a web-based tool that delivers the International Code of Ethics for Professional Accountants (including International Independence

Standards) (the Code) on a digital platform. In addition to “app-like” features and functionalities, this new platform better demonstrates the Code’s “building blocks” architecture and scalability.

#### **Accountancy Europe (AE) (former FEE)**

1. AE published the following submission to the IAASB in response to the IAASB’s current invitation to comment projects:
  - [IAASB’s consultation on Extended External Reporting \(EER\) assurance](#)
  - [proposed International Standard on Quality Management 1](#)
  - [proposed International Standard on Quality Management 2](#)
  - [proposed International Standard on Auditing 220 \(ED-220\)](#)
  - [Quality Management for Firms and Engagements](#)
2. AE also published [its response](#) to Sir Donald Brydon’s Independent Review into the Quality and Effectiveness of Audit on 10 July 2019.

#### **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. The world’s leading financial and non-financial corporate reporting frameworks have the same common foundations, based on the key objectives of transparency and accountability, according to a position paper [published by the framework providers on 2 July 2019](#). The position paper sets out the seven key principles report preparers should follow for achieving such transparency and accountability.
2. On 20 June 2019, IIRC announced that its Chief Executive Officer Richard Howitt is stepping down with effect from 21 June 2019 after nearly three years’ service. His replacement is yet to be announced.

#### **Global Reporting Initiative (GRI)**

1. There have been no significant developments related to audit and assurance to report in the period.

#### **International Forum of Independent Audit Regulators (IFIAR)**

1. IFIAR has published [its comment letter](#) on the IAASB’s Exposure Drafts for ISQM 1, ISQM 2 and ISA 220 on 1 July 2019.

#### **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. There have been no significant developments related to audit and assurance to report in the period.

## **Australia**

#### **The Australian Auditing and Assurance Standards Board (AUASB)**

1. The AUASB were informed about and discussed the key matters on the IAASB’s June 2019 Agenda, with the two main topics being:
  - An update on the progress of the proposed ISA 315 Identifying and Assessing the Risks of Material Misstatement. The agenda item was attended by Fiona Campbell, Deputy

Chair of the IAASB and Chair of the IAASB's ISA 315 Task Force. The AUASB provided feedback that they are supportive of the proposed changes to ISA 315 and agreed with the new approach which restructures the requirements and application material, and the use of extended definitions, to address the complexity, scalability and proportionally issues raised in many responses the IAASB received on ED 315. The AUASB generally considered that the significant concerns they raised in the AUASB submission on ED 315 have been addressed, and provided other specific feedback on the proposed changes to ISA 315.

- An update on the progress of the ISA 600 Group Audits project. The update focussed on confirming that the key public interest issues that the IAASB plan to address are aligned to feedback that the AUASB had provided in response to the IAASB Discussion Paper on this topic. The AUASB discussed the proposed new approach to scoping a group audit and how it aligns ISA 600 with the principles of revised ISA 315.

The other IAASB June 2019 topics discussed by the AUASB were Audit Evidence, Auditor Reporting Implementation and Phase 2 of the Guidance on Emerging Forms of External Reporting.

2. The AUASB Technical Group (ATG) provided the AUASB with a summary of the feedback received on the suite of Quality Management Exposure Drafts (EDs). The AUASB discussed what should be included in the AUASB's submission to the IAASB on the EDs, taking into account matters raised during the AUASB's review of the IAASB papers, recent outreach conducted by the ATG and comments received from stakeholders. A draft submission will be circulated to the AUASB for consideration and approval at its 26 June 2019 AUASB teleconference, ahead of submission to the IAASB on 1 July 2019.
3. The AUASB received an update on the revision to GS 005 Using the Work of a Management's Expert. A draft revision will be brought to the September 2019 AUASB meeting for consideration.
4. The ATG provided the AUASB with an analysis of the suite of current AUASB Guidance Statements (GSs), identifying whether relevant legislation / regulation or relevant standards had changed and therefore which GSs required update or withdrawal. The AUASB determined that additional feedback from stakeholders is required to determine the currency and priority associated with each GS.  
The ATG also provided the AUASB with a project plan to update GS 008 The Auditor's Report on a Remuneration Report Under Section 300A of the Corporations Act 2001. A draft revision will be brought to the September 2019 AUASB meeting for consideration.
5. The AUASB meeting welcome the Chair of the Financial Reporting Council, Bill Edge, for a discussion on recent Audit Quality developments in the Australian and Global Auditing and Assurance Industry. The discussion highlighted a commitment for the AUASB to collaborate with the FRC, ASIC and all key stakeholders in the profession to broaden the debate around how audit quality is measured and addressed.
6. The AUASB reviewed a draft submission on the EER Assurance – Phase 1 EER Consultation Paper due to the IAASB by 21 June 2019. AUASB members express support for the concepts the Consultation Paper is seeking to address, but have suggested a number of changes and fed back that the guidance should be redeveloped to be made more accessible for the different stakeholders who will rely on this pronouncement.
7. The AUASB discussed the implications for stakeholders of the AASB's project on removing special purpose financial statements. Whilst the impact on AUASB standards is likely to be limited to updating references, the AUASB viewed that this change was a good opportunity to remind auditors of their responsibilities related to the financial reporting framework under the AUASB standards. To communicate this to stakeholders the ATG will develop and issue an AUASB Bulletin addressing the underlying audit issues associated with this topic, likely by early July 2019 so this guidance is available for upcoming June reporting season.
8. The PAG Chair provided an update to the AUASB on the progress made in addressing Public Sector specific auditing issues raised for consideration by ACAG. The work completed so far has involved scoping the challenges for the public sector with Terms of Engagement, Engagement Leader responsibilities and Going Concern, as well as outlining the range of AUASB pronouncements to respond to these challenges. The next PAG meeting will involve a detailed analysis of each AuditorGeneral's office's challenges for each topic area.
9. The AUASB held a joint session with the AASB to review the current AASB and AUASB Strategic Objectives and also identify projects on which the two boards should collaborate on for the 2019-

20 reporting period.

## United Kingdom

### FRC

1. FRC issued its [latest audit inspection](#) results on 10 July 2019. Summary of findings are as follows:
  - 75% of FTSE 350 audits assessed as good or requiring limited improvements. The FRC's target is 90%. Overall there has been no improvement on last year
  - 25% of assessed audits are below an acceptable standard. Grant Thornton placed under increased scrutiny due to sustained poor results

The latest audit inspections for 2018/19, which relate principally to audits of companies' December 2017 year-ends, found 75% of FTSE 350 audits reviewed were good or required no more than limited improvements, compared to 73% in 2017/18. No firms achieved the FRC's audit quality target for 90% of FTSE 350 audits to meet this standard. Looking across all audit reviews completed at the largest seven firms, the outcome was 75% compared to 74% in 2017/18. In the reports published today, each firm has committed to specific actions to enhance audit quality including, for the worst performers, detailed audit quality improvement plans. The FRC will assess the success of these initiatives and secure further action if necessary.

The FRC found cases in all seven firms where auditors had failed to challenge management sufficiently on judgemental issues. This has been a recurring finding over a number of years and it can have many contributory factors. These include the mindset of audit teams, especially an absence of professional scepticism in evaluating evidence presented by company management, tight reporting deadlines and the complexity of the judgements involved. Familiarity is also a factor arising from long-standing audit relationships, particularly if the company comes to be considered as "the client" for the auditor, rather than the shareholder or investor. The audit firms need to work harder to solve this problem. The FRC is undertaking detailed work to assess how the audit firms are responding to this.

2. On 2 July 2019, the FRC issued a revision of [Practice Note 19: The audit of banks and building societies in the United Kingdom](#). Practice Notes are intended to assist practitioners to comply with the requirements of UK auditing standards, by providing additional contextual material on the application of those standards in particular circumstances or in specialised sectors.

The revisions to Practice Note 19 reflect:

- revisions to UK auditing standards (ISAs (UK)), in particular ISA (UK) 540 (Revised December 2018), Auditing Accounting Estimates and Related Disclosures, which is effective for audits of financial statements for periods beginning on or after 15 December 2019 (early adoption is permitted);
- guidance relevant to the audit of estimates for expected credit losses (ECL). Auditors may find this guidance helpful for the audits of periods ending before 15 December 2019 even if they have not early adopted ISA (UK) 540 (Revised December 2018);
- changes in relevant legislation and regulation (at the time of publication, there are EU regulations, including binding technical standards, that apply directly to UK banks and building societies. References to these are made in this revised PN. When the UK ceases to be a member of the EU these references will be updated accordingly); and
- the establishment of the of the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) in place of the Financial Services Authority (FSA).

The Practice Note has been developed with input from an expert working group including representation from audit firms with bank audit expertise, the banking industry, and the banking regulators. The revisions that the FRC has made will support the delivery of high quality audit, and responds to findings from the FRC's audit inspection work covering bank audits, which were covered extensively in public reports in June 2018. The final revised Practice Note reflects the actions that the FRC determined should be taken, having considered the responses received

## **Institute of Chartered Accountants in England and Wales**

1. [The ICAEW response](#) to Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit was issued on 3 July 2019.
2. Back in February, a group of audit firms met at Chartered Accountants' Hall. Their agenda was to discuss how technology – particularly data – could be harnessed to improve market collaboration, and ultimately improve the quality of audit and the efficiency with which it is delivered. The use of data in audit has increased dramatically in recent years, but gathering and analysing it is becoming ever-more complex.

Discussions and workshops have continued over the past few months, around a new concept called 'Engine B'. The underlying premise is that a set of Common Data Models (CDMs) be used across the industry, consisting of a standard dictionary of common terms for business data that everyone can use. CDMs will cover structured data – such as that held in the general ledger – and unstructured data – such as PDFs, e-mails and texts. These CDMs will be open-source and available to anyone. The name 'Engine B' originated within KPMG – where the project started – but it is fast-becoming a standalone entity, supported by the largest firms. IBM and Microsoft have also been involved and are keen to continue, and others are interested in joining.

## **The Charity Commission**

1. There have been no significant developments related to audit and assurance to report in the period.

## **Association of Chartered Certified Accountants (ACCA)**

1. [A survey of ACCA](#) members and affiliates about their understanding of terms such as artificial intelligence (AI), machine learning (ML), natural language processing (NLP), data analytics and robotic process automation (RPA), revealed technology's ability to renew processes that improve audit quality and increase efficiency.

The report reveals how technology is also a catalyst that will help shift the focus of the audit process from a retrospective view to one which is prospective. It also assesses the technologies having most impact on the audit profession as we know it today.

Drawing on existing research and exploring the views of leading practitioners, it provides an understanding of how the changing business environment is shaping technological change in auditing – summarising how different technologies could be expected to impact its future and what this means for auditors as people.

Key findings in the report also revealed:

- Among the available technologies, data analytics is currently the most mature and is currently used by most firms
- The audit profession is still at a very early stage with AI and has not embedded it as deeply as it could
- The human relationship between client and auditor remains important: not everything can be replaced by technology
- Auditors will need to be more adaptable to change in future

# 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. There have been no significant developments related to audit and assurance to report in the period.

# Canada

## **Canadian Auditing and Assurance Standards Board (AASB)**

1. The AASB decided to form an advisory group to provide input to the Board on issues as the International Auditing and Assurance Standards Board (IAASB) audit evidence project progresses. The Board discussed the size of the advisory group and relevant experience that members should have. The Board will issue a public call to identify and engage potential members.
2. The AASB discussed key issues stakeholders raised on the Exposure Draft, "Communication of Key Audit Matters in the Auditor's Report," including:
  - the unique regulatory environment of entities that comply with National Instrument 81-106, Investment Fund Continuous Disclosure;
  - the benefits and challenges of key audit matter (KAM) reporting for other listed entities and investment funds; and
  - the proposed effective date.The AASB also discussed academic research that was conducted during the exposure period to identify whether there are benefits to KAM reporting for users of TSX-V financial statements. The Board expects to approve final Handbook material at its September 2019 meeting.
3. The AASB discussed issues related to developing an auditor's report that complies with the requirements of both Public Company Accounting Oversight Board (PCAOB) standards and CASs. Key issues discussed include the differences between the PCAOB standards and CASs for:
  - the descriptions of auditor responsibilities and other information; and
  - critical audit matters versus KAMs.The AASB concluded not to continue work on developing such a report due to the significant differences between the standards and the challenges in developing a report that would be understood. However, the Board agreed on future steps to address public interest issues that arise when there are separate PCAOB and CAS auditor's reports on one set of financial statements.
4. The AASB discussed the status of matters that gave rise to the deferral of paragraph 46 of CAS 700, Forming an Opinion and Reporting on Financial Statements, relating to disclosure of the engagement partner name in certain audit reports. The Board concluded that extension of the one-year deferral is not required. However, it will continue to monitor any issues related to inclusion of the engagement partner name in CAS auditor reports filed with the U.S. Securities and Exchange Commission.
5. The AASB discussed the proposed plan to collect stakeholders' feedback to inform its response to the IAASB'S Discussion Paper, "Audits of Less Complex Entities: Exploring Possible Options to

Address the Challenges in Applying the ISAs.”The Board will continue to discuss this project at future meetings.

6. The AASB provided input to the IAASB members from Canada about the IAASB’s project to revise ISA 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. The Board discussed:
  - public interest issues;
  - use of the risk-based approach for planning and performing an audit of group financial statements;
  - proposed definitions of component, group financial statements and consolidation;
  - proposed structure and scope of revised ISA 600; and
  - proposed changes to the engagement acceptance and continuance and planning considerations.The Board will continue to discuss this project at future meetings.
7. The AASB provided input to the IAASB members from Canada on issues related to proposed ISA 315 (Revised), *Identifying and Assessing the Risk of Material Misstatement*. The Board discussed the IAASB’s:
  - proposed approach to presenting the requirements and application material;
  - proposed changes to the requirements, application material, and appendices; and
  - proposed consequential amendments to ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.The Board will continue to discuss this project at future meetings.
8. The AASB discussed its draft responses to the IAASB’s Exposure Draft for *“Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews”* which includes:
  - proposed 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*;
  - proposed ISQM 2, *Engagement Quality Reviews*; and
  - proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*.The AASB will review draft response letters at its conference call on June 25, 2019. The Chair and Director will review the final responses before submission.
9. The AASB discussed issues related to the IAASB’s project to revise International Standard on Related Services (ISRS) 4400 (Revised), *Agreed-Upon Procedures Engagements*. The Board noted that the issues raised in its response letter to the Exposure Draft of ISRS 4400 (Revised) are largely consistent with those raised by global stakeholders and are recognized by the IAASB Task Force as key issues to be addressed.  
The Board will continue to discuss this project at future meetings.
10. The AASB discussed key issues stakeholders raised on the Exposure Draft, “*Compilation Engagements*,” including:
  - the wording and format of the compilation engagement report;
  - the stand back requirement; and
  - the description of the basis of accounting.At a future meeting, the Board will consider the effective date of the new standard and, if appropriate, approve the final standard

## **CPA Canada**

1. CPA Canada and the Canadian Auditing and Assurance Standards Board (AASB) have collaborated with regulators, auditors and individuals in the crypto-asset industry to explore auditing approaches to respond to the risks in this evolving industry. [This article](#) provides update on the progress on the project.

Project	Overview of the project and its current status
<p><b>Quality Control</b></p> <p><b>No Update for the period</b></p>	<p><b>Objective of the Project:</b> 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</p> <p><b>Background and current status:</b> The proposed changes to QC were 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 <a href="#">project proposals for quality control</a> that were presented at the September 2016 IAASB meeting.</p> <p>The IAASB considered the Quality Control Other Working Group's (QCOWG) <a href="#">proposals</a> in respect of:</p> <ul style="list-style-type: none"> <li>• Setting the objective of an engagement quality control (EQC) Revising the definition of an EQC review;</li> <li>• Determining the scope of the engagements subject to an EQC review; and</li> <li>• The execution of an EQC review.</li> </ul> <p>At its March 2017 meeting, the IAASB discussed matters to do with the <a href="#">eligibility</a> of the engagement quality control reviewer.</p> <p><b>QC-Firm Level</b></p> <p>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.</p> <p>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:</p> <ul style="list-style-type: none"> <li>• 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</li> </ul>

- 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

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

	<p>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.</p> <p>The Board supported the Quality Control Task Force’s recommendations regarding matters to be addressed in the Explanatory Memorandum, including the proposed questions.</p> <p><b>Quality Control – Engagement Level</b></p> <p>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.</p> <p>The Board discussed a draft ED of proposed ISA 220 (Revised)<sup>2</sup> 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.</p> <p>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.</p> <p>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.</p>
<p><b>Group Audits– ISA 600</b></p> <p>Has update for the period</p>	<p><b>Objective of the project:</b> 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 from audit regulators, discussion with NSS and responses to the IAASB’s Work Plan consultation (i.e., whether standard-setting activities are appropriate to</p>

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)<sup>3</sup> TF, to help ensure that the requirements in those standards provide appropriate connection points between those projects and ISA 600.<sup>4</sup> 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.

In March 2019, the Board was updated on the work performed by the Group Audit Task Force since the start of the project to revise ISA 600<sup>1</sup> and was asked for its views on issues related to scoping a group audit, the definitions, and the linkages with other ISAs. The Board continued to support developing a risk-based approach for scoping a group audit and generally supported the Group Audit Task Force's approach on the definitions and the issues that were presented in relation to the responsibilities of the group engagement partner, acceptance and continuance, understanding the group and its components, understanding the component auditor, identifying and assessing the risks of material misstatement and responding to assessed risks, the consolidation process, communication between the group auditor and component auditors, and evaluating the audit evidence obtained. These and other issues need to be further developed in the context of the risk-based approach and changes made to other of the IAASB's International Standards. The Group Audit Task Force will continue to work on the issues related to scoping a group audit, the definitions and other issues identified in the [Invitation to Comment](#), and will present it for further discussion at the June 2019 IAASB meeting.

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<sup>1</sup> International Standard on Auditing (ISA) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

	<p><b>Update for the period</b></p> <p>In June 2019, the Board was updated on the ISA 6003 Task Force’s progress since the March 2019 meeting and discussed the public interest issues that the ISA 600 Task Force identified, the ISA 600 Task Force’s proposals with respect to the risk-based approach to scoping a group audit, and the special considerations related to auditing a group. The Board also discussed indicative drafting related to the risk-based approach to scoping a group audit and the special considerations related to proposed ISA 220 (Revised).<sup>4</sup> Generally, the Board was supportive of the approach taken but had suggestions on the way forward and the indicative drafting. The ISA 600 Task Force will take these comments into account and will present further drafting at the September 2019 meeting. The ISA 600 Task Force will also continue its outreach to key stakeholders and coordinate with IESBA and other IAASB Task Forces as needed.</p>
<p><b>Professional Scepticism</b></p> <p><b>No Update for the period</b></p>	<p><b>Objective of the project:</b> To make recommendations on how to more effectively respond to issues related to professional scepticism.</p> <p><b>Background and current status:</b> 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.</p> <p>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.</p> <p>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, <a href="#">presented the results</a> to IAASB at the September 2016 IAASB meeting.</p> <p>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 <a href="#">here</a>.</p> <p>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</p>

	<p>recommendations of the Professional Skepticism IAASB Subgroup not to introduce the concept into the ISAs.</p> <p>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.</p> <p>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.</p>
<p><b>Accounting Estimates (ISA 540) and Special Audit Considerations Relevant to Financial Institutions (No Update for the period)</b></p>	<p><b>Objective of the project:</b> The objective of the financial institutions project is to:</p> <ul style="list-style-type: none"> <li>A. Clarify and enhance the relationship between the banking supervisors and the bank’s external auditors;</li> <li>B. Consider and address issues of particular significance in audits of financial institutions; and</li> <li>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</li> </ul> <p><b>Background and current status:</b> 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.</p> <p>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. <a href="#">The board reviewed the draft in its June 2016 meeting.</a></p> <p>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.</p>

	<p>The IAASB has released the ED ISA 540 for comment in May 2017.</p> <p>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).</p> <p>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)<sup>1</sup> in March 2018, ahead of a targeted approval in June 2018.</p> <p>The ISA (540) was approved in IAASB's June 2018 meeting.</p>
<p><b>Data Analytics</b></p> <p><b>No Update for the period</b></p>	<p><b>Objective of the project:</b> The objective of the Data Analytics Working Group (WG) is to:</p> <p>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.</p> <p><b>Background and current status:</b> 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.</p> <p>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.</p> <p>The Chair of the DAWG provides an <a href="#">update</a> on the project in February 2017 on the IFAC website.</p> <p>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</p>

	encouraged continued active participation of the Data Analytics Working Group in other current standard-setting projects of the IAASB underway.
<p><b>Emerging External Reporting</b> <span style="color: blue;">Has update for the period</span></p>	<p><b>Objective of the project:</b> The objective of the Integrated Reporting Working Group (IRWG) is to:</p> <ul style="list-style-type: none"> <li>A) Explore emerging developments in integrated reporting and other emerging developments in external reporting;</li> <li>B) Gather further information on the demand for assurance, the scope of the assurance engagement and the key assurance issues; and</li> <li>C) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe.</li> </ul> <p><b>Background and current status:</b> 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 <a href="#">Supporting Credibility and Trust in Emerging Forms of External Reporting</a> in its June 2016.</p> <p>The Discussion Paper was issued in August 2016.</p> <p>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.</p> <p>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).</p> <p>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.</p>

	<p>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.</p> <p>In March 2019, the Board approved for public comment Phase 1 of the draft guidance in January 2019. At its March 2019 meeting, the Board discussed several challenges related to Phase 2 of the guidance. The challenges include: determining the scope of an EER assurance engagement; communicating effectively in the assurance report; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and obtaining evidence in respect of narrative and future-oriented information. The Board's deliberations of the challenges concerned were facilitated through breakout sessions, after which each breakout group reported back to the Board in a plenary session. The EER Task Force will consider the inputs that were received in progressing the development of Phase 2 of the guidance for further discussion at the June 2019 IAASB meeting.</p> <p><b>Update for the period:</b></p> <p>In June 2019, the Board was updated on the work of the EER Task Force on the challenges allocated to Phase 2 of the project. These challenges include: determining the scope of an EER assurance engagement; obtaining evidence in respect of narrative and future-oriented information; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and communicating effectively in the assurance report. The Board discussed views on the EER Task Force's initial proposals to address each of these challenges in the Phase 2 guidance. The EER Task Force will consider the inputs received from the Board, together with responses to the Phase 1 EER Consultation Paper in so far as they impact the Phase 2 guidance, in developing the draft Phase 2 guidance, which will be presented for discussion at the September 2019 IAASB meeting.</p>
<p><b>Agreed-Upon Procedures</b></p> <p><b>has update for the period</b></p>	<p><b>The objective of the project is to:</b></p> <p>A) Revise International Standard on Related Services (ISRS) 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information in the Clarity format; and</p> <p>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.</p>

	<p><b>Background and current status:</b> 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.</p> <p>The Agreed-Upon Procedures (AUP) Working Group presented a first draft of its Discussion Paper, <a href="#"><i>Exploring the Growing Demand for Agreed-Upon Procedures Engagements and Other Services and the Implications for the IAASB’s Standards</i></a>, 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.</p> <p>In its September 2017 meeting, the Board discussed the feedback received on the Discussion Paper and <b>approved</b> 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.</p> <p>In its September 2018 meeting, The Board approved the ED of ISRS 4400 (Revised)<sup>3</sup> 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.</p> <p><b>Update for the period</b></p> <p>In June 2019 the Board received an overview of the responses to proposed ISRS 4400 (Revised)<sup>2</sup> (ED–4400). The Board discussed, among other matters, respondents’ comments on the application of professional judgment when performing procedures, the independence disclosure requirements, and the effective date.</p> <p>The Board also acknowledged areas of broad support, including not including a precondition for the practitioner to be independent, using the term “findings” and requiring an explanation of this term in the engagement letter and the AUP report, not requiring or prohibiting a reference to the practitioner’s expert in the AUP report, and not requiring a restriction on use or distribution of the AUP report. The AUP Task Force will deliberate the Board’s input and will present the first read of the post-exposure ISRS 4400 (Revised) to the Board in the second half of 2019.</p>
<p><b>ISA 315 (Revised) has update for the period</b></p>	<p><b>The tentative objectives of the projects at this stage are:</b></p> <p>A) to address the issues that have been identified by the ISA Implementation Monitoring project.</p>

- 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)<sup>2</sup>. 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.

In March 2019 The Board discussed the ISA 315 Task Force's initial proposals to address specific responses to the proposed ISA 315 (Revised)<sup>2</sup> (ED-315), in particular, the broad concerns in relation to the length and complexity of the standard. In doing so, the Board considered alternative approaches about how to present the requirements for the auditor's understanding of the entity's system of internal control.

The Board agreed to move forward by presenting the requirements at a broader, higher level (i.e., in a more direct way in terms of focusing on the 'what' that is required from the auditor), while maintaining the robustness of the current standard. Accordingly, all of the requirements will be reconsidered, the criteria or matters that are definitional will be relocated to definitions, and the 'why' and 'how' will be further explicitly considered as to where it is appropriate to be moved to. The Board acknowledged that scalability was likely best addressed in the application material.

The Board's discussions also focused on proposed changes to address specific issues within the section on understanding the entity's system of internal control, in particular, in relation to clarifications on controls relevant to the audit, the information system and control activities components, and the various evaluations required within this section of the standard.

Aspects of ED-315 and related feedback that have not been addressed during this meeting will be presented at the June 2019 IAASB meeting. The ISA 315 Task Force will continue to progress the proposed changes to ED-315 with a targeted approval of the final standard at the September 2019 IAASB meeting.

#### Update for the period

In June 2019, the Board discussed a full version of the standard reflecting the new drafting approach that was broadly supported with the Board at its March 2019 meeting. The Board broadly supported specific aspects of this approach, in particular the enhanced flow and understandability of the requirements, as well as the separate presentation or signposting of examples and scalability paragraphs in the application material.

Notwithstanding broad support for the overall approach, concern was expressed about the change to move certain material (primarily criteria or terms previously included in requirements relating to the understanding of the system of internal control) to definitions. It was also highlighted that this could cause challenges in navigating the standard. The Board was presented with a revised approach to drafting the requirements for the understanding of the system of internal control, which reconnected the definitions, and the Board broadly supported moving forward.

Specific other areas discussed and agreed include revisions to the definitions of significant risk and the inherent risk factors, specifically in relation to how fraud is presented within the inherent risk factors. Conforming amendments arising from the proposed changes to the standard will be discussed at an IAASB teleconference in August 2019 and a final draft of the proposed

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<sup>2</sup> Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

	<p>standard will be presented to the IAASB for approval at its September 2019 meeting.</p>
<p><b>Less Complex Entities</b></p> <p><b>Has update for the period</b></p>	<p>In March 2019 the Board discussed a proposed Discussion Paper (DP), <i>Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Implementing the ISAs</i>. The discussion highlighted the shift in focus on complexity of the entity rather than its size in driving the ongoing discussions and activities to address issues and challenges in audits of less complex entities (LCEs). The Board was supportive of the DP's overall direction, noting the importance of the project and the need for action by the IAASB and others.</p> <p>The Board liked the simple, clear way the DP had been presented and noted it was appropriate for its key target audience (i.e., auditors of LCEs). The Board made suggestions for improvements, particularly with respect to the issues and challenges, the possible actions presented within the DP and the questions to be posed to respondents in order to obtain relevant and useful feedback. Proposed changes to the DP will be presented in a Board call on April 10<sup>th</sup>, with the final DP targeted to be published for public consultation before the end of April 2019.</p> <p><b>Update for the period:</b></p>
<p><b>Audit Evidence</b></p> <p><b>Has update for the period</b></p>	<p><b>Update for the period:</b></p> <p>The Board discussed the analysis undertaken by the Audit Evidence Working Group of the issues across the ISAs related to audit evidence and the use of technology more broadly, and the possible actions to address the issues. The Board concurred that guidance should be developed on the effect of technology when applying certain aspects of the ISAs, and that this should be actioned expeditiously.</p> <p>The Board also indicated that more extensive information gathering and research need to be undertaken to understand the issues related to audit evidence, so that the Board is fully informed of the issues in determining the need for revisions to ISA 5005 and possibly other related standards.</p>

## Agenda Item 11.2



NZ AUDITING  
AND ASSURANCE  
STANDARDS BOARD

**DATE:** 12 July 2019

**TO:** Members of the New Zealand Auditing and Assurance Standards Board

**FROM:** Peyman Momenan

**SUBJECT:** Domestic Update

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### **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 June and July 2019.

### **Financial Markets Authority (FMA)**

1. The Financial Markets Authority (FMA) has published its [annual review](#) of whether NZX met its statutory obligations as a licensed market operator.

NZX plays a vital role in helping to achieve fair, orderly and transparent financial markets in New Zealand to promote confident and informed participation by investors.

NZX complied with its market operator obligations during the review period (calendar year 2018).

Last year, the FMA concluded that the NZX did not meet its obligation to have adequate arrangements to monitor the conduct of participants on, or in relation to its markets, due to a lack of market experience in its market surveillance function.

This year's review acknowledges the positive changes made by the Market Surveillance team during the review period and the FMA supports the NZX's approach to the continuous improvement of the team

2. FMA has an obligation to publish [an auditor regulation and oversight](#) plan by 30 June each year, for a three year period, setting out our intentions for the regulation and oversight of auditors under the Act. This plan will help licensed auditors, registered audit firms and accredited bodies to understand how FMA will approach auditor regulation. It may also be of interest to issuers, investors and their advisers.

### **The New Zealand Institute of Chartered Accountants**

1. There have been no significant developments relating to audit and assurance to report in the period.

### **CPA Australia**

1. There have been no significant developments relating to audit and assurance to report in the period

### **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.