

**EXPOSURE DRAFT NZAUASB 2021-2
QUALITY MANAGEMENT**

Invitation to Comment

February 2021

© Crown Copyright 2021
External Reporting Board
PO Box 11250
Manners St Central, Wellington 6142
New Zealand
<http://www.xrb.govt.nz>

Permission to reproduce: The copyright owner authorises reproduction of this work, in whole or in part, so long as no charge is made for the supply of copies, and the integrity and attribution of the work as a publication of the External Reporting Board is not interfered with in any way.

Disclaimer: Readers are advised to seek specific advice from an appropriately qualified professional before undertaking any action relying on the contents of this exposure draft. The External Reporting Board does not accept any responsibility whether in contract, tort, equity or otherwise for any action taken, or reliance placed on, any part, or all, of the information in this document, or for any error or omission from this document.

Table of Contents

	Page
Information for respondents	4
List of abbreviations	5
Questions for respondents	5
1. Introduction	6
1.1 Purpose of this Invitation to Comment	6
1.2 Background	6
1.3 Timeline and next steps	7
2. Overview of proposed amendments	7
2.1 Quality Management and Scalability.....	7
2.2 New Zealand Specific Content	8
2.3 Extant NZ Public Sector Paragraphs	9
2.4 Effective Date	10
Appendix: Extant NZ public sector paragraphs in PES 3 (Amended)	11

Information for respondents

Invitation to Comment

The New Zealand Auditing and Assurance Standards Board (NZAuASB)¹ is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all responses before finalising the Quality Management standards.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions, or issues, that are relevant to you.

Comments should be submitted electronically using our 'Open for Comment' page at <https://www.xrb.govt.nz/assurance-standards/standards-in-development/open-for-comment/nzauasb-ed-2021-2>

The closing date for submissions is 30 April 2021.

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz) unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or full. The Privacy Act 1993 also applies.

If you have any objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g., that it would be likely to unfairly prejudice the commercial position of the person providing the information).

¹ The NZAuASB is a sub-Board of the External Reporting Board (XRB Board) and is responsible for setting auditing and assurance standards.

List of abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure Draft
IAASB	International Auditing and Assurance Standards Board
ISA (NZ)	International Standard on Auditing (New Zealand)
ISQM	International Standard on Quality Management
ITC	Invitation to comment
NZAuASB	New Zealand Auditing and Assurance Standards Board
PES	Professional and Ethical Standard
XRB	External Reporting Board

Questions for respondents

The NZAuASB intends to adopt the new suite of quality management standards in New Zealand, and is interested in hearing from constituents as to whether they agree with the proposed New Zealand amendments to the international standards. Respondents are asked to consider the following specific questions and to respond to the NZAuASB by 30 April 2021:

1. Do you agree with the addition of the New Zealand paragraphs in the proposed standards, labelled as NZ paragraphs, which differ from the international standards? If not, please provide details of the specific provisions and reasons why you disagree with the addition.
2. Are you aware of any regulatory or other issues in the New Zealand environment that may affect the implementation of the proposals? If so, please provide details.
3. Do you consider there are any weaknesses or gaps in the proposals for which there is a compelling reason to be addressed in the New Zealand context?
4. Is it clear from the requirement in paragraph NZ34(f) that an engagement quality review is a specified response for audits of financial statements of all FMC reporting entities? If not, please explain why not and provide suggestions on how the NZAuASB could make this clearer.
5. The NZAuASB is seeking feedback both on the application material on scalability in the proposed PES 3 and on the types of implementation material that would assist firms in developing the necessary systems to apply the standard. Please let us know what implementation support you would find most helpful.

1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this Invitation to Comment (ITC) is to seek feedback from stakeholders on Exposure Draft (ED) NZAuASB 2021-2. This ED includes the following proposed standards:
 - Professional and Ethical Standard 3 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*;
 - Professional and Ethical Standard 4 *Engagement Quality Reviews*;
 - ISA (NZ) 220 (Revised) *Quality Management for an Audit of Financial Statements*; and
 - *Conforming Amendments to ISAs (NZ) and Related Material Arising from the Quality Management Project*.
2. When the IAASB released its exposure drafts for comment in early 2019, they were exposed simultaneously in New Zealand, by inviting stakeholders to provide comments on the international exposure drafts to assist the NZAuASB with its submission to the IAASB. Accordingly, in this consultation, the NZAuASB is seeking comment on the New Zealand specific changes that have been made to the international standards (identified with the prefix NZ).
3. The NZAuASB does not propose any additional NZ paragraphs on scalability, but is interested to receive comment on the scalability material and on the focus of any implementation guidance that would help firms to apply the standards.

1.2 Background

4. In December 2020, the IAASB released its suite of quality management standards. The suite includes:
 - (i) 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*;
 - (ii) International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*;
 - (iii) International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*; and
 - (iv) *Conforming Amendments to ISAs (NZ) and Related Material Arising from the Quality Management Project*.
5. ISQM 1 deals with the firm's responsibility to establish policies or procedures addressing quality management at the firm level, including policies and procedures addressing engagements that are required to be subject to engagement quality reviews. ISQM 2

deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.

6. ISA 220 (Revised) deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibility of the engagement partner.
7. A key strategic objective set by the XRB Board for the NZAuASB is to adopt international auditing and assurance standards, including the professional and ethical standards, in New Zealand. Modifications for application in New Zealand may be acceptable where there is a compelling reason, provided such modifications consider the public interest and do not conflict with or result in lesser requirements than the international standards.
8. The NZAuASB has identified modifications to the international standards. These are described in section 2.2.

1.3 Timeline and next steps

9. Submissions on ED NZAuASB 2021-2 are due by 30 April 2021. Information on how to make a submission is provided on page 4 of this ITC.
10. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the New Zealand quality management standards following the NZAuASB's September 2021 meeting.

2. Overview of ED NZAuASB 2021-2

2.1 Quality management and scalability

11. Among the public interest issues identified by the IAASB at the outset of the quality management project were the need for proactive management of quality and keeping the standard fit for purpose. The IAASB also identified scalability as a key issue, so that the standard can be applied by a variety of firms of different size and complexity. To address these issues, the IAASB proposed that the standard adopt a new approach to managing quality, termed "quality management", focused on proactively identifying and responding to risks to quality.
12. The new focus on quality management encapsulates an integrated approach to quality management that reflects upon the system of quality management as a whole, focuses on risk, and requires a firm to customise the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm and the engagements it performs.
13. Key concerns for stakeholders, including New Zealand stakeholders and the NZAuASB in response to the IAASB's exposure draft of ISQM 1, included the scalability of the proposals, the prescriptive approach to setting the quality objectives, and the need for implementation support. The identification of quality risks was identified as

challenging, resource intensive and costly, especially for small to medium-sized practices and sole practitioners (SMPs).

14. The IAASB has taken a number of actions to address the key concerns, as outlined in the [IAASB's basis for conclusions](#). In an effort to help users understand and implement the standard, as well as to reduce its length and complexity, the IAASB has placed examples in the application material in separate boxes, clearly signposting examples that demonstrate scalability.
15. The NZAuASB considers that the application material on scalability is likely to assist firms, including SMPs, in applying the standard in New Zealand. It is therefore of the view that it is in the public interest to adopt the standards in New Zealand without amendment in this respect.
16. The IAASB has committed to perform activities to support awareness, understanding and effective implementation of ISQM 1, including a "First Time Implementation Guide" which is expected to be available in the first half of 2021. Despite this, implementing the new requirements is likely to be challenging, from both a scalability and a cost and time perspective, especially to SMPs in New Zealand.
17. The NZAuASB is therefore seeking feedback both on the application material on scalability and on the types of implementation material that would assist firms in developing the necessary systems to apply the standard.

2.2 New Zealand Specific Content

2.2.1 Scope and Application

18. ISQM 1 deals with the 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. Related services under the IAASB framework includes compilation engagements.
19. During 2019, the XRB's statutory mandate was extended to include related services. However, the statutory definition of related services does not include compilation engagements. Rather it refers only to agreed-upon procedures engagements and other non-assurance work that may ordinarily be carried out by an audit or assurance practitioner. This definition is also reflected in XRB Au1. Accordingly, there remains a compelling reason to amend the scope of the proposed PES 3 to limit application in line with the XRB's statutory mandate, albeit with a broader application than extant PES 3 (Amended).
20. The scope of the proposed PES 3 therefore includes related services engagements, as defined in XRB Au1. This is a narrower scope than ISQM 1.
21. To clarify the scope of application of the proposed PES 3, the following definition of related services has been included:

NZ 16.1 Related services – services to perform agreed-upon procedures or other non-assurance work that may ordinarily be carried out by an audit or assurance practitioner.

22. The NZ definitions of “assurance engagement”, “assurance practitioner” and “engagement” in extant PES 3 (Amended) are no longer considered necessary, given the extension to the XRB’s mandate.

2.2.2 References to Listed Entities

23. The NZAuASB does not refer to “listed entities” in its standards because it considers that term is not applicable to the New Zealand regulatory environment.
24. The NZAuASB considered the scope of the engagement quality control review standard in 2014 having regard to the Financial Reporting Act 2013. It decided to use the term *FMC reporting entity considered to have a higher level of public accountability* (as opposed to FMC reporting entity) in PES 3. This took account of the layers within the ethical and auditing standards, which also included public interest entities and all tier 1 entities under the XRB’s financial reporting framework.
25. The NZAuASB considers the same considerations apply to the new suite of quality management standards. Accordingly, in proposed PES 3 and proposed PES 4 references to “listed entities” are amended to “FMC reporting entities considered to have a higher level of public accountability”.

2.2.3 Entities subject to Engagement Quality Review

26. The requirement for an engagement quality review in paragraph 34(f)(i) of ISQM 1 refers to “listed entities”. In New Zealand, the FMA requires an engagement quality control review to be performed for all FMC audits.
27. Paragraph NZ34(f)(i) of proposed PES 3 will therefore require an engagement quality review for:
 - (i) audits of financial statements of FMC reporting entities considered to have a higher level of public accountability;
 - (ii) audits of other engagements for which an engagement quality review is required by law or regulation; and
 - (iii) audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risks.
28. The FMA requirement for those entities that are not considered to have a higher level of public accountability is captured by paragraph NZ34(f)(ii).
29. Is it clear from the requirement in paragraph NZ34(f) that an engagement quality review is a specified response for audits of financial statements of all FMC reporting entities? If not, please explain why not and provide suggestions on how this could be clearer.

2.3 Extant NZ Public Sector Paragraphs

30. Extant PES 3 (Amended) includes several paragraphs that provide guidance on how to apply PES 3 in the public sector. These paragraphs have not been included in the proposed PES 3. Appendix 1 to this ITC includes the NZ public sector paragraphs.

31. The new international standards contain enhanced application guidance for audits of public sector entities.
32. The staff of the XRB will work with the Office of the Auditor-General to determine the appropriate public sector paragraphs to carry forward.

2.4 Effective Date

33. The proposed effective date for the three standards and the conforming amendments is 15 December 2022. The proposed wording of the effective date paragraphs is included in each of the proposed standards. This will allow for an implementation period of approximately 15 months from the expected approval date of the finalised standards by the NZAuASB and will align with the effective date of the international standards. This date was agreed by the IAASB during 2020, as an extension to the originally proposed date, in response to the COVID-19 situation and after consultation with national standard setters.
34. Early adoption is permitted; however, all three standards would need to be early adopted as a package due to the linkages between them and the incompatibility with extant standards that would result from selective early adoption of only one or two of the new standards.

Appendix

This appendix is included for information purposes.

Extant NZ paragraphs in PES 3 (Amended) specific to the Public Sector:

[NZ12.3] (c) Engagement partner² – The partner or other person in the firm who is responsible for the assurance 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.

[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 it is the appointed auditor who effectively discharges the obligations of the engagement partner. Any reference to the engagement partner should be interpreted accordingly.

12(g) Firm – A sole practitioner, partnership or corporation or other entity undertaking assurance engagements.

[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.

[NZ12.8] Public sector auditor – The Auditor-General or an auditor appointed by the Auditor-General to perform audits or other assurance services for public entities.

[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.

² "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

Considerations Specific to the Public Sector

A15. Statutory measures may provide safeguards for the independence of a statutory officer (for example, the Auditor-General). However, threats to independence may still exist regardless of any statutory measures designed to protect it. Therefore, in establishing the policies and procedures required by paragraphs 20-25, the public sector auditor may have regard to the public sector mandate and address any threats to independence in that context.

A16. [Amended by the NZAuASB. Refer to NZA16.1].

[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 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.

A17. [Amended by the NZAuASB. Refer to NZA17.1].

[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.

Considerations Specific to the Public Sector

A46. [Amended by the NZAuASB].

NZA46.1 Although not referred to as FMC reporting entities considered to have a higher level of public accountability, as described in paragraph A16, certain public entities may be of sufficient significance to warrant performance of an engagement quality control review.

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.

[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 of this standard.