

## **REVISIONS TO PROFESSIONAL AND ETHICAL STANDARD 1: ADDRESSING THE OBJECTIVITY OF AN ENGAGEMENT QUALITY REVIEWER AND OTHER APPROPRIATE REVIEWERS**

This Standard was issued on 8 July 2021 by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 5 August 2021.

The amendments in this Standard are effective:

- For Part 4A: audits and reviews of financial statements for periods beginning on or after 15 December 2022.
- For Part 4B: assurance engagements beginning on or after 15 December 2022.
- For all other engagements within the scope of Part 3: engagements beginning on or after 15 December 2022.

Early adoption is permitted.

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

This Standard has been issued as a result of changes to the *International Code of Ethics for Professional Accountants (including International Independence Standards)*.

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# REVISIONS TO PROFESSIONAL AND ETHICAL STANDARD 1 ADDRESSING THE OBJECTIVITY OF AN ENGAGEMENT QUALITY REVIEWER AND OTHER APPROPRIATE REVIEWERS

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## SECTION 300

### Requirements and Application Material

#### Identifying Threats

300.6 A1 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. The categories of threats are described in paragraph 120.6 A3. The following are examples of facts and circumstances within each of those categories of threats that might create threats for an assurance practitioner when undertaking a professional service:

(a) Self-interest Threats

- An assurance practitioner having a direct financial interest in a client.
- An assurance practitioner quoting a low fee to obtain a new engagement and the fee is so low that it might be difficult to perform the professional service in accordance with standards issued by the External Reporting Board, the New Zealand Auditing and Assurance Standards Board and the New Zealand Accounting Standards Board for that price.
- An assurance practitioner having a close business relationship with a client.
- An assurance practitioner having access to confidential information that might be used for personal gain.
- An assurance practitioner discovering a significant error when evaluating the results of a previous assurance service performed by a member of the assurance practitioner's firm.

(b) Self-review Threats

- An assurance practitioner issuing an assurance report on the effectiveness of the operation of financial systems after implementing the systems.
- An assurance practitioner having prepared the original data used to generate records that are the subject matter of the assurance engagement.

(c) Advocacy Threats

- An assurance practitioner promoting the interests of, or shares in, a client.
- An assurance practitioner acting as an advocate on behalf of a client in litigation or disputes with third parties.
- An assurance practitioner lobbying in favour of legislation on behalf of a client.

(d) Familiarity Threats

- An assurance practitioner having a close or immediate family member who is a director or officer of the client.
- A director or officer of the client, or an employee in a position to exert significant influence over the subject matter of the engagement, having recently served as the engagement partner.

- An audit team member having a long association with the audit client.
- An individual who is being considered to serve as an appropriate reviewer, as a safeguard to address a threat, having a close relationship with an individual who performed the work.

(e) Intimidation Threats

- An assurance practitioner being threatened with dismissal from a client engagement or the firm because of a disagreement about a professional matter.
- An assurance practitioner feeling pressured to agree with the judgement of a client because the client has more expertise on the matter in question.
- An assurance practitioner being informed that a planned promotion will not occur unless the assurance practitioner agrees with an inappropriate accounting treatment.
- An assurance practitioner having accepted a significant gift from a client and being threatened that acceptance of this gift will be made public.

### Evaluating Threats

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### Addressing Threats

300.8 A1 Paragraphs R120.10 to 120.10 A2 set out requirements and application material for addressing threats that are not at an acceptable level.

#### *Examples of Safeguards*

300.8 A2 Safeguards vary depending on the facts and circumstances. Examples of actions that in certain circumstances might be safeguards to address threats include:

- Assigning additional time and qualified personnel to required tasks when an engagement has been accepted might address a self-interest threat.
- Having an appropriate reviewer who was not a member of the team review the work performed, or advise as necessary might address a self-review threat.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats.
- Disclosing to clients any referral fees or commission arrangements received for recommending services or products might address a self-interest threat.
- Separating teams when dealing with matters of a confidential nature might address a self-interest threat.

300.8 A3 The remaining sections of Part 3 and *International Independence Standards (New Zealand)* describe certain threats that might arise during the course of performing professional services and include examples of actions that might address threats.

Appropriate Reviewer

300.8 A4 An appropriate reviewer is a professional with the necessary knowledge, skills, experience and authority to review, in an objective manner, the relevant work performed or service provided. Such an individual might be an assurance practitioner.

## **SECTION 325**

### **OBJECTIVITY OF AN ENGAGEMENT QUALITY REVIEWER AND OTHER APPROPRIATE REVIEWERS**

#### **Introduction**

- 325.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.
- 325.2 Appointing an engagement quality reviewer who has involvement in the work being reviewed or close relationships with those responsible for performing that work might create threats to compliance with the principle of objectivity.
- 325.3 This section sets out specific application material relevant to applying the conceptual framework in relation to the objectivity of an engagement quality reviewer.
- 325.4 An engagement quality reviewer is also an example of an appropriate reviewer as described in paragraph 300.8 A4. Therefore, the application material in this section might apply in circumstances where an assurance practitioner appoints an appropriate reviewer to review work performed as a safeguard to address identified threats.

#### **Application Material**

##### **General**

- 325.5 A1 Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Professional and Ethical Standard 3<sup>1</sup> establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to address quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with Professional and Ethical Standard 4<sup>2</sup>.
- 325.5 A2 An engagement quality reviewer is a partner, other individual in the firm, or an external individual, appointed by the firm to perform the engagement quality review.

##### **Identifying Threats**

- 325.6 A1 The following are examples of circumstances where threats to the objectivity of an assurance practitioner appointed as an engagement quality reviewer might be created:
- (a) Self-interest threat
- Two engagement partners each serving as an engagement quality reviewer for the other's engagement.

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<sup>1</sup> Professional and Ethical Standard 3, *Quality Management for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance or Related Services Engagements*

<sup>2</sup> Professional and Ethical Standard 4, *Engagement Quality Reviews*

(b) Self-review threat

- An assurance practitioner serving as an engagement quality reviewer on an audit engagement after previously serving as the engagement partner.

(c) Familiarity threat

- An assurance practitioner as an engagement quality reviewer has a close relationship with or is an immediate family member of another individual who is involved in the engagement.

(d) Intimidation threat

- An assurance practitioner serving as an engagement quality reviewer for an engagement has a direct reporting line to the partner responsible for the engagement.

**Evaluating Threats**

325.7 A1 Factors that are relevant in evaluating the level of threats to the objectivity of an individual appointed as an engagement quality reviewer include:

- The role and seniority of the individual.
- The nature of the individual's relationship with others involved on the engagement.
- The length of time the individual was previously involved with the engagement and the individual's role.
- When the individual was last involved in the engagement prior to being appointed as engagement quality reviewer and any subsequent relevant changes to the circumstances of the engagement.
- The nature and complexity of issues that required significant judgement from the individual in any previous involvement in the engagement.

**Addressing Threats**

325.8 A1 An example of an action that might eliminate an intimidation threat is reassigning reporting responsibilities within the firm.

325.8 A2 An example of an action that might be a safeguard to address a self-review threat is implementing a period of sufficient duration (a cooling-off period) before the individual who was on the engagement is appointed as an engagement quality reviewer.

*Cooling-off Period*

325.8 A3 Professional and Ethical Standard 4 requires the firm to establish policies or procedures that specify, as a condition for eligibility, a cooling-off period of two years before the engagement partner can assume the role of engagement quality reviewer. This serves to enable compliance with the principle of objectivity and the consistent performance of quality engagements.

325.8 A4 The cooling-off period required by Professional and Ethical Standard 4 is distinct from, and



does not modify, the partner rotation requirements in Section 540, which are designed to address threats to independence created by long association with an audit client.

## Consequential Amendments to Section 540

### SECTION 540

#### LONG ASSOCIATION OF PERSONNEL (INCLUDING PARTNER ROTATION) WITH AN AUDIT CLIENT

*Audit Clients that are Public Interest Entities*

**R540.5** Subject to paragraphs R540.7 to R540.9, in respect of an audit or review of a public interest entity, an individual shall not act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years (the “time-on” period):

- (a) The engagement partner;
- (b) The individual appointed as responsible for performing the engagement quality ~~control~~ review; or
- (c) Any other key audit or key assurance partner role.

After the time-on period, the individual shall serve a “cooling-off” period in accordance with the provisions in paragraphs R540.11 to R540.19.

**R540.6** In calculating the time-on period, the count of years shall not be restarted unless the individual ceases to act in any one of the roles in paragraph R540.5(a) to (c) for a minimum period. This minimum period is a consecutive period equal to at least the cooling-off period determined in accordance with paragraphs R540.11 to R540.13 as applicable to the role in which the individual served in the year immediately before ceasing such involvement.

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Cooling-off Period

**R540.11** If the individual acted as the engagement partner for seven cumulative years, the cooling-off period shall be five consecutive years.

**R540.12** Where the individual has been appointed as responsible for the engagement quality ~~control~~ review and has acted in that capacity for seven cumulative years, the cooling-off period shall be three consecutive years.

**R540.13** If the individual has acted as a key audit partner other than in the capacities set out in paragraphs R540.11 and R540.12 for seven cumulative years, the cooling-off period shall be two consecutive years.

540.14 A1 The partner rotation requirements in this section are distinct from, and do not modify, the cooling-off period required by Professional and Ethical Standard 4 as a condition for eligibility before the engagement partner can assume the role of engagement quality reviewer (see paragraph 325.8 A4).

Service in a combination of key audit partner roles

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