

AG PES 3

Quality Management for Firms that Perform Audits or Other Engagements on Behalf of the Auditor-General

Contents

	Page
Introduction	2
Scope of this Statement	2
Application	2
Effective date	2
Background	3
Definitions	3
Requirements	4
Compliance obligations on firms	4
Acceptance and continuance procedures	4
Determining whether other engagements should be carried out	4
Engagement performance	5
Information and communication	5
Results of monitoring and remediation	5
Assurance engagements for which an engagement quality review is required	6
Responsibility for the system of quality management	7
Provision of information to the Office of the Auditor-General about a firm's system of quality management	8
Application and other explanatory material	8
Acceptance and continuance procedures	8
Results of monitoring and remediation - identified deficiencies	9

Introduction

Scope of this Statement

1. This Auditor-General's Auditing Statement (referred to hereafter as Statement):
 - (a) establishes the Auditor-General's requirements in relation to Professional and Ethical Standard 3: *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (PES 3) that apply to annual audits and other engagements carried out by firms on behalf of the Auditor-General; and
 - (b) provides additional guidance to reflect the public sector perspective.

Application

2. Compliance with this Statement is mandatory for firms that carry out annual audits and other engagements on behalf of the Auditor-General.
3. For the purpose of this Statement "firm" means Audit New Zealand, and private sector audit service providers that carry out annual audits and other engagements on behalf of the Auditor-General.
4. This Statement requires compliance with all of the requirements of PES 3 and the additional requirements included in this Statement for the purpose of managing the quality of annual audits and other engagements carried out by firms on behalf of the Auditor-General.
5. A firm carrying out audits and other engagements on behalf of the Auditor-General must comply with this Statement at the same time as it complies with PES 3.

Effective date

6. This Statement applies from 1 April 2023.

Background

Objective of PES 3 on the firm

7. An objective of PES 3 is to require the firm to manage the quality of its engagements. To do so it requires the firm to design, implement and operate a system of quality management. Completing engagements that meet appropriate standards of quality is fundamental to the reputation and credibility of the Auditor-General and ultimately to the Auditor-General's ability to fulfil their mandate.

Objective of the system of quality management

8. The objective of the system of quality management is to provide the firm with reasonable assurance that:
 - (a) The firm and its personnel fulfil their responsibilities in accordance with professional standards, which include the Auditor-General's Auditing Standards, and applicable legal and regulatory requirements, and carry out engagements in accordance with such standards and requirements; and
 - (b) Engagement reports issued by the Appointed Auditor on behalf of the Auditor-General are appropriate in the circumstances.

Definitions

9. For the purpose of this Auditor-General's Auditing Statement, the defined terms listed below have the following meanings:

Appointed Auditor	means the person or persons appointed by the Auditor-General to carry out the annual audit or other engagement on behalf of the Auditor-General, and who are supported by other members of the audit team. Where an Auditor-General's Statement or Standard expressly intends that a requirement be fulfilled by the Appointed Auditor personally, the requirement will indicate that the Appointed Auditor shall personally satisfy the requirement.
Firm	means Audit New Zealand and private sector audit service providers contracted to carry out annual audits and other engagements on behalf of the Auditor-General.
Office of the Auditor-General	means the Auditor-General, the Deputy Auditor-General, and all employees other than Audit New Zealand employees.

Other engagement	means engagements where the Auditor-General has a statutory requirement to report (other than an annual audit), other engagements carried out on behalf of the Auditor-General, and other auditing services (under section 17 of the Public Audit Act 2001).
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Requirements

Compliance obligations on firms

10. All firms that the Auditor-General appoints to carry out annual audits and other engagements on their behalf are required to comply with Professional and Ethical Standard 3: *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* issued by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board and the requirements in this Statement.

Acceptance and continuance procedures

11. Appointed Auditors shall contact the Assistant Auditor-General – Audit Quality if:
 - (a) the acceptance and continuance procedures indicate that there are significant risks in carrying out the annual audit or other engagement that ordinarily would have led to the engagement being declined;
 - (b) the annual audit or other engagement may pose significant risks to the Auditor-General;
 - (c) information becomes available after accepting or continuing an entity relationship or engagement that would have led to the relationship with the entity or the engagement being declined; or
 - (d) they are no longer able to carry out the engagement in accordance with professional standards and applicable legal and regulatory requirements (Ref: Paras. A1-A4).

Determining whether other engagements should be carried out

12. A firm, in conjunction with the Office of the Auditor-General (where appropriate), shall determine whether an engagement, other than an annual audit or an engagement where the Auditor-General has a statutory requirement to report (other than an annual audit), should be carried out by having regard to the *Auditor-General's Code of Ethics*.

Engagement performance

13. Appointed Auditors shall comply with the Opinion Review process set out in AG ISA (NZ) 700 (Revised) *Forming an Opinion and Reporting on Financial and Performance Information* for annual audits.

Information and communication

14. For the purpose of PES 3 the Office of the Auditor-General's primary information and communication system is the Auditors' Homepage. Appointed Auditors shall comply with the requirements contained in the Auditors' Homepage (as applicable) when carrying out engagements on behalf of the Auditor-General and activities within the system of quality management.

Results of monitoring and remediation

Engagement level

15. Engagements carried out on behalf of the Auditor-General shall be subject to the firm's monitoring activities.
16. When findings indicate that procedures were omitted during an engagement carried out on behalf of the Auditor-General, resulting in inappropriate and/or insufficient evidence to support the conclusion the auditor reached, or the report issued may be inappropriate, the firm shall consult the Assistant Auditor-General – Audit Quality about the planned response before advising the entity to which the engagement relates.

System level

17. Where the firm's monitoring and remediation process has assessed a deficiency as severe, and this could affect or has affected audits or other engagements carried out on behalf of the Auditor-General, the firm shall advise the Assistant Auditor-General – Audit Quality:
- (a) information about the identified deficiency, including the severity and pervasiveness of such deficiency; and
 - (b) the remedial action to address the identified deficiency. (Ref: Paras. A5-A7)
18. The advice required by paragraph 17 shall be timely, once the individual assigned ultimate responsibility for the system of quality management for the firm has been informed of the identified deficiency.

Assurance engagements for which an engagement quality review is required

19. An engagement quality review shall be performed for the following engagements carried out on behalf of the Auditor-General:
- (a) FMC reporting entity annual audits and other engagements;
 - (b) long-term plan audits¹ and
 - (c) annual audits assessed as high-risk audits (Ref: Para. 20 below for further guidance on assessing high risk audits).
20. Subject to the provisions in paragraph 19 above, Appointed Auditors shall perform their own risk assessments of annual audits to determine whether the annual audit should be subject to engagement quality review. The risk assessments shall be performed annually. The individual with delegated responsibility for overseeing compliance with AG PES 3 shall confirm the risk assessments. The following are relevant factors to consider when assessing risk:
- (a) entities that are likely to be privatised, either wholly or in part;
 - (b) entities where there is significant media or political interest;
 - (c) entities that engage in large and complex financial transactions;
 - (d) entities where there are complex revenue recognition and measurement risks, or high-risk contracts;
 - (e) entities with a history of aggressive accounting treatments;
 - (f) entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g. certain financial institutions and entities with non-routine material actuarial estimates)²
 - (g) entities with engagements that involve regulatory reporting on financial or non-financial information with a high degree of judgement;

¹ An engagement quality control review may not be required for the audit of an amendment to a long-term plan (LTP amendment). This is because an LTP amendment may be different in nature, risk and complexity to an LTP. Appointed Auditors shall perform their own assessment to determine if an LTP amendment audit should be subject to engagement quality control review. In making their assessment the Appointed Auditor shall consider if:

- (a) the LTP amendment is of significant media or political interest;
- (b) the LTP amendment is large and complex;
- (c) the LTP opinion was modified and the LTP amendment relates to why it was modified; and
- (d) the audit of the LTP amendment involves a high degree of judgement.

² Revaluations of property, plant and equipment would typically be excluded unless a consideration of (e) and (i) apply.

- (h) entities where there may be significant doubt about the validity of the going concern basis of accounting;
 - (i) entities where issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremedied significant deficiencies in internal control, or a material restatement of comparative information in the financial statements;
 - (j) entities assessed as having a weak control environment, such as weak or poor governance, or a dominant CEO or dysfunctional senior management team that is not being effectively countered by strong governance;
 - (k) entities where an actual or suspected fraud has been identified that exceeds performance materiality or where the fraud is large enough to attract national media attention;
 - (l) entities assessed as high “integrity” risk as a result of continuance and acceptance procedures; and
 - (m) entities with other risk(s) or condition(s) that would require an engagement quality review under the audit service provider’s policies.
21. Where provision for an engagement quality review is included in a proposal to carry out an annual audit on behalf of the Auditor-General and cited in the audit engagement agreement, the terms of the audit engagement agreement take precedence over the provisions in paragraphs 19 and 20 above, and the involvement of an engagement quality reviewer will be required in those annual audits.
22. Appointed Auditors shall apply the Auditor-General’s policies and procedures for engagement quality control reviews for annual audits set out in AG PES 4.

Responsibility for the system of quality management

23. The individual assigned ultimate responsibility and accountability for the firm’s system of quality management is normally the Chief Executive (or equivalent). If ultimate responsibility and accountability is assigned to an individual below the Chief Executive, the firm shall advise the Assistant Auditor-General – Audit Quality, of the name of the individual and explain the reasons for delegating that individual this responsibility.
24. The evaluation conclusion required by paragraph 54 of PES 3 shall be provided to the Office of the Auditor-General annually.

Provision of information to the Office of the Auditor-General about a firm's system of quality management

25. The Office of the Auditor-General may request information about a firm's system of quality management and may review the support for any compliance statement made about the firm so far as it relates to the work performed on behalf of the Auditor-General. The firm shall provide such information to the Office of the Auditor-General on request.

Application and other explanatory material

Acceptance and continuance procedures (Ref: Para. 11)

- A1. It is important that the Office of the Auditor-General is made aware of significant acceptance and continuance risks because the Auditor-General cannot decline an annual audit, and it is often inappropriate to decline other engagements because of public interest considerations. As a result, the Office of the Auditor-General, in conjunction with the Appointed Auditor, needs to actively manage the risks to the Auditor-General.
- A2. Significant acceptance and continuance risks are those risks that would have resulted in your firm not accepting the engagement and/or continuing the relationship with the entity.
- A3. The firm's ability to carry out the engagement in accordance with professional standards and applicable legal and regulatory requirements may be affected by:
- the availability of appropriate resources to carry out the engagement;
 - not having access to information to carry out the engagement, or to the persons who provide such information; or
 - whether the firm and the engagement team are able to fulfil their responsibilities in relation to the relevant ethical requirements.
- A4. Firms are expected to make an initial assessment of their ability to carry out an annual audit before the balance date the audit relates to and advise the Office of the Auditor-General (AuditorAppointments@oag.parliament.nz) where the firm has assessed that it does not have the ability to carry out the audit.

Results of monitoring and remediation - identified deficiencies (Ref: Para. 17)

- A5. The Office of the Auditor-General should be made aware of deficiencies in the firm's system of quality management which are severe and had affected or could affect engagements carried out on behalf of the Auditor-General.
- A6. Determining a severe deficiency requires evaluating the magnitude of the identified deficiency, and the duration of time that it existed and had an effect on the system of quality management.
- A7. We have not prescribed factors to use to assess the severity of identified deficiencies. Deficiencies requiring advice to the Office of the Auditor-General are those:
- a) assessed and reported as severe to the individual assigned ultimate responsibility and accountability for the firm's system of quality management; and
 - b) that could affect engagements carried out on behalf of the Auditor-General.