

New Zealand Institute of Chartered Accountants<sup>1</sup>

PROFESSIONAL STANDARD 1

2006

**QUALITY CONTROL*****Issued by the Council of the  
New Zealand Institute of Chartered Accountants*****CONTENTS**

|  | <i>paragraph</i> |
|--|------------------|
| Introduction.....  | 1                |
| Purpose .....  | 4                |
| Applicability .....  | 10               |
| Effective Date .....   | 12               |
| Definitions .....  | 13               |
| Background.....  | 14               |
| Quality of Work Performed by Members and Firms.....                                  | 14               |
| Benefits of Quality Control.....   | 15               |
| Establishment of a System of Quality Control .....                                   | 16               |
| Firm Level Systems of Quality Control .....  | 21               |
| Leadership Responsibilities for Quality within the Firm .....                        | 22               |
| Ethical and Professional Requirements.....   | 27               |
| Acceptance and Continuance of Client Relationships<br>and Specific Engagements ..... | 46               |
| Human Resources .....  | 55               |
| Engagement Performance .....   | 65               |
| Monitoring .....   | 107              |
| Documentation.....   | 128              |
| Quality Control Procedures for Individual Engagements .....                          | 132              |
| Leadership Responsibilities for Quality on Engagements.....                          | 136              |
| Ethical Requirements .....   | 138              |
| Acceptance and Continuance of Client Relationships<br>and Specific Engagements ..... | 143              |
| Assignment of Engagement Teams.....  | 148              |
| Engagement Performance .....   | 152              |
| Monitoring .....   | 170              |
| Comparison of PS-1 with International and<br>Australian Standards .....              | Appendix         |

<sup>1</sup> The New Zealand Institute of Chartered Accountants is the operating name of the Institute of Chartered Accountants of New Zealand, a body established under the Institute of Chartered Accountants of New Zealand Act 1996. All references to the New Zealand Institute of Chartered Accountants or to the Institute in this document mean the Institute of Chartered Accountants of New Zealand.

## PS-1

### INTRODUCTION

1 This Standard is issued by the Council of the New Zealand Institute of Chartered Accountants. The New Zealand Institute of Chartered Accountants is the operating name of the Institute of Chartered Accountants of New Zealand, the legal body established under the Institute of Chartered Accountants of New Zealand Act 1996. All references to the New Zealand Institute of Chartered Accountants or to the Institute in this document mean the Institute of Chartered Accountants of New Zealand.

2 This Standard is to be read in conjunction with the *Code of Ethics* and the *Code of Ethics: Independence in Assurance Engagements* (the *Code of Ethics*). Compliance with this Standard is mandatory in terms of Rule 11 (paragraph 97) of the *Code of Ethics*.

3 Mandatory provisions are paragraphs in bold type-face in this Standard. Where appropriate, interpretative guidance or commentary paragraphs in plain type-face follow mandatory provisions.

#### Purpose

4 The purpose of this Standard is to establish standards and provide guidance on the responsibilities of firms regarding a system of quality control in respect of:

- (a) work generally undertaken by the firm; and
- (b) work delegated to persons in the engagement team on individual engagements.

**5 The firm must establish a system of quality control designed to provide reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.**

6 The delivery of quality professional services to a client is a prime objective for members and firms. The establishment of a system designed to provide reasonable assurance regarding the quality of engagements is a logical extension of that objective.

7 A system of quality control consists of policies designed to achieve the objectives set out in paragraph 5 and the procedures necessary to implement and monitor compliance with those policies.

8 Policies and procedures established by a firm to meet these objectives and to comply with the requirements of this Standard should be designed in response to the types of activities the firm undertakes. The design of those policies and procedures will vary with factors such as the size and nature of the firm or practice, its operating characteristics including whether it is part of a network of firms, its geographic dispersion, and appropriate cost/benefit considerations. Accordingly, the policies and procedures individual firms adopt will vary, as will the extent of

their documentation and the manner and extent of their communication to the engagement team and personnel of the firm.

9 Small and medium-sized firms must comply with the requirements of this Standard to the extent that they apply to the types of activities those firms undertake. This Standard describes responsibilities for several different roles and functions within the firm, including overall leadership responsibility and monitoring. In the case of small firms it may be necessary for one person to perform more than one of these roles and functions. In some cases, such as when an engagement quality control review is required (for compliance with this Standard those reviews are required only for financial statement audits of entities that are issuers), it may be necessary or appropriate to use the services of a suitably qualified external person.

#### **Applicability**

**10 This Professional Standard applies to firms and to individual engagements undertaken by firms.**

11 Standards and guidance on the responsibilities of firm personnel regarding quality control procedures for individual engagements (other than audits of historical financial information) are set out in paragraphs 132 to 172 of this Standard. Standards and guidance on the responsibilities of firm personnel regarding quality control procedures for audits of historical financial information are contained in Auditing Standard AS-220: *Quality Control for Audits of Historical Financial Information*.

#### **Effective Date**

12 Firms are required to establish systems of quality control in compliance with this Standard by the following dates:

- 1 April 2007 for firms that undertake assurance engagements; and
- 1 January 2008 for firms that do not undertake assurance engagements.

Firms that undertake both assurance engagements and non-assurance engagements are required to apply this Standard from 1 April 2007 for the firm as a whole.

This Standard is effective for individual engagements (other than audits of historical financial information) as follows:

- for assurance engagements beginning on or after 1 April 2007; and
- for engagements other than assurance engagements beginning on or after 1 January 2008.

#### **DEFINITIONS**

13 For the purpose of this Professional Standard the following terms have the meanings specified below.

## PS-1

- (a) *Assurance engagement* means an engagement in which a member expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

This would include an engagement in accordance with the standards issued by the New Zealand Institute of Chartered Accountants such as the Codified Auditing Standards and Statement of Review Engagement Standards No. 1 (RS-1).

- (b) *Engagement documentation* means the record of work performed, results obtained and conclusions the member reached (terms such as working papers or work papers are sometimes used). The documentation for a specific engagement is assembled in an engagement file.
- (c) *Engagement partner* means the person in the firm who is responsible for an engagement and its performance, and for any report 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, a Chartered Accountant, or other suitably qualified person (appointed auditor) to perform audits or other assurance services on that officer's behalf, for the purposes of this 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.

- (d) *Engagement quality control review* means, in respect of an engagement for which a report is required, a process designed to provide an objective evaluation, before the report is issued, of the significant judgements the engagement team made and the conclusions they reached in formulating the report.
- (e) *Engagement quality control reviewer* means, in respect of an engagement for which a report is required, a person in the firm, a suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgements the engagement team made and the conclusions they reached in formulating the report.
- (f) *Engagement team* means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
- (g) *Firm* means a sole practitioner, partnership, corporate practice or other form of entity through which a member undertakes engagements.

*Considerations Specific to the Public Sector*

Where a statutory officer (such as the Auditor-General) appoints an employee, a Chartered Accountant, or other suitably qualified person (appointed auditor) to perform audits or other assurance services on that officer's behalf, for the purposes of this 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.

- (h) *Inspection* means, in relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.
- (i) *Issuer* means an entity referred to under section 4 of the Financial Reporting Act 1993 and includes an entity whose shares, stock or debt are quoted or listed on a recognised stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body.
- (j) *Member* means a member of the New Zealand Institute of Chartered Accountants.
- (k) *Monitoring* means a process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.
- (l) *Network firm* means an entity under a member's common control or under common control, ownership or management with the firm or any entity that a reasonable and informed third party, having knowledge of all relevant information, would reasonably conclude as being part of the firm nationally or internationally.
- (m) *Partner* means any individual with authority to bind the firm with respect to the performance of an engagement.
- (n) *Personnel* means all partners and staff.
- (o) *Professional Standards* means the Professional Standards and Engagement Standards issued by the Council of the Institute, and relevant ethical requirements contained in the Institute's *Code of Ethics* and *Code of Ethics: Independence in Assurance Engagements* (the *Code of Ethics*).
- (p) *Public* entity has the meaning as defined in section 5 (1) of the Public Audit Act 2001.
- (q) *Reasonable assurance* means, in the context of this Standard, a high, but not absolute, level of assurance.
- (r) *Staff* means professionals, other than partners, including any experts the firm employs.
- (s) *Suitably qualified external person* means an individual outside the firm with the capabilities and competence to act as an engagement partner, for example

## PS-1

a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform engagements or of an organisation that provides relevant quality control services.

### BACKGROUND

#### Quality of Work Performed by Members and Firms

14 Increasing attention is being given to work performed by members in the context of ethical and professional standards and accepted industry practice. Members are expected to provide quality services in a manner that demonstrates a high level of professionalism consistent with the fundamental principles of ethical conduct expected of professional accountants.

#### Benefits of Quality Control

15 A well-designed and effective system of quality control should not only ensure compliance with professional standards and regulatory and legal requirements, but also provide a framework for firms when considering issues related to quality, and enhance the reliability and overall quality of work performed. The major benefits of an effective system of quality control are as follows.

- (a) Benefits to clients and the public:
  - (i) higher quality service; and
  - (ii) increased reliability of the final product.
- (b) Benefits to the accounting profession:
  - (i) assists in distinguishing the work of members from that of other providers of accounting services;
  - (ii) in strengthening the quality controls within firms themselves, the quality assurance processes of the profession overall are significantly strengthened; and
  - (iii) maintaining public confidence in the quality of work undertaken by the members of the profession as represented by members of the Institute.
- (c) Benefits to the firm:
  - (i) improved internal communication;
  - (ii) reduction in lost time due to re-work or ineffective and/or inefficient practices;
  - (iii) early identification of problems;
  - (iv) reduced risk of litigation;
  - (v) client retention; and
  - (vi) increased confidence that controls are in place and that the risk of error is reduced.

**ESTABLISHMENT OF A SYSTEM OF QUALITY CONTROL**

**16** Quality control policies and procedures must be established and implemented at both the level of the firm and on individual engagements.

**17** The firm must establish a system of quality control designed to provide reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.

**18** The engagement team must implement quality control procedures which, in the context of the policies and procedures of the firm, are appropriate to individual engagements.

**19** The quality control policies and procedures must be documented and communicated to the firm's personnel, and to the engagement team for individual engagements. They must be communicated in a manner that provides reasonable assurance that the policies and procedures are understood and implemented.

**20** The communication should describe the quality control policies and procedures and the objectives they are designed to achieve, and should include the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. The form and content of communication should be explicit to provide personnel with a ready source of information concerning those policies and procedures applicable to them. In addition, the firm should recognise the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm should encourage its personnel to communicate their views or concerns on quality control matters.

**FIRM LEVEL SYSTEMS OF QUALITY CONTROL**

**21** The firm's system of quality control must include policies and procedures addressing each of the following elements:

- (a) leadership responsibilities for quality within the firm;
- (b) ethical and professional requirements;
- (c) acceptance and continuance of client relationships and specific engagements;
- (d) human resources;
- (e) engagement performance; and
- (f) monitoring.

**Leadership Responsibilities for Quality within the Firm**

**22** The firm must establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures must require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board

## PS-1

**of partners (or equivalent), to assume ultimate responsibility for the firm's system of quality control.**

23 The firm's leadership and the example it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management emphasising the firm's quality control policies and procedures, and the requirement to:

- (a) perform work that complies with professional standards and regulatory and legal requirements; and
- (b) issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognises and rewards high-quality work. They may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They are incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

24 Of particular importance is the need for the firm's leadership to recognise that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Accordingly, the firm should:

- (a) assign its management responsibilities so that commercial considerations do not override the quality of work performed;
- (b) design policies and procedures addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, so as to demonstrate the firm's overriding commitment to quality; and
- (c) devote sufficient resources for the development, documentation and support of its quality control policies and procedures.

**25 Any person or persons assigned operational responsibility for the firm's quality control system by the firm's chief executive officer or managing board of partners must have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.**

26 Sufficient and appropriate experience and ability enable the responsible person or persons to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

### **Ethical and Professional Requirements**

**27 The firm must establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with:**

- (a) the relevant ethical requirements as set out in the *Code of Ethics* issued by the Institute; and
- (b) the Institute's Rules.

**28 The firm must ensure the policies and procedures established for the firm and its personnel are in compliance with the *Code of Ethics* and are likely to continue to be so.**

29 Quality is maintained through, among other things, compliance with the *Code of Ethics* and Professional Standards. Paragraph 5 of the *Code of Ethics* states that compliance with the *Code of Ethics* is mandatory for all members, and that members must be able to demonstrate at all times that their actions, behaviour and conduct comply with the *Code of Ethics*.

30 Ethical Rule 13 of the *Code of Ethics* establishes the professional duty for members to report unethical behaviour of another member to the Chief Executive of the Institute, on a confidential basis, where the member has reasonable grounds to suspect that another member has engaged in unethical behaviour. Further guidance on this duty is contained in the *Code of Ethics*. Members who encounter situations which possibly indicate involvement of other members in unethical behaviour, particularly likely breaches of the *Code of Ethics*, should consider whether they have a professional duty to report such behaviour to the Chief Executive of the Institute. If necessary, members should consider obtaining legal advice to assist them to decide whether this professional duty exists in the particular circumstances.

***Code of Ethics: Fundamental Principles***

31 Many of the components of quality control are embodied in the Fundamental Principles contained in the *Code of Ethics* and throughout the Professional Standards. Commitment by members to the Fundamental Principles allows the Institute and its members to be distinguished from other persons who hold themselves out as providing accounting and other professional services.

**32 The firm and its personnel must adhere to the Fundamental Principles set out in the *Code of Ethics* when performing engagements.**

33 The Fundamental Principles guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional behaviour. These principles are:

- (a) Integrity;
- (b) Objectivity and Independence;
- (c) Competence;
- (d) Quality Performance; and
- (e) Professional Behaviour.

## PS-1

The *Code of Ethics* explains members' obligation to act in the public interest and requires members to comply with the Fundamental Principles. It states that this involves identification of compliance threats, and application of appropriate safeguards to mitigate or eliminate those threats.

34 The *Code of Ethics* includes a conceptual approach to independence for assurance engagements that takes into account threats to independence and application of appropriate safeguards responsive to those threats. It contains comprehensive guidance on the application of the conceptual approach to specific situations in the context of maintaining independence for assurance engagements.

35 The firm's policies and procedures should emphasise the Fundamental Principles, which are reinforced in particular by:

- (a) the leadership of the firm;
- (b) education and training;
- (c) monitoring; and
- (d) a process for dealing with non-compliance.

Independence in engagements for which independence is required, including independence in assurance engagements, is addressed separately in paragraphs 36 – 44.1 below. These paragraphs need to be read in conjunction with the *Code of Ethics*.

### *Firms Performing Engagements for which Independence is Required*

**36 The firm must establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the *Code of Ethics*. Such policies and procedures must enable the firm to:**

- (a) communicate its independence requirements to its personnel and, where applicable, others subject to them; and**
- (b) identify and evaluate circumstances and relationships that create threats to independence, and take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, by withdrawing from the engagement.**

**37 Such policies and procedures must require:**

- (a) engagement partners to provide the firm with relevant information about engagements undertaken for clients, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;**
- (b) personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and**

- (c) **the accumulation and communication of relevant information to appropriate personnel so that:**
  - (i) **the firm and its personnel can readily determine whether they satisfy independence requirements;**
  - (ii) **the firm can maintain and update its records relating to independence; and**
  - (iii) **the firm can take appropriate action regarding identified threats to independence.**

**38 The firm must establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures must include requirements for:**

- (a) **all who are subject to independence requirements to promptly notify the firm of independence breaches of which they become aware;**
- (b) **the firm to promptly communicate identified breaches of these policies and procedures to:**
  - (i) **the engagement partner who, with the firm, needs to address the breach; and**
  - (ii) **other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action; and**
- (c) **prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b) (ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action.**

39 A firm receiving notice of a breach of independence policies and procedures should promptly communicate relevant information to engagement partners, others in the firm as appropriate and, where applicable, experts contracted by the firm and network firm personnel, for appropriate action. Appropriate action by the firm and the relevant engagement partner should include applying appropriate safeguards to eliminate the threats to independence or to reduce them to an acceptable level, or withdrawing from the engagement. In addition, the firm should provide independence education to personnel who are required to be independent.

*39.1 Considerations Specific to the Public Sector*

In the case of a statutory officer (such as the Auditor-General) who is bound by this Standard in their professional capacity as a member, 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 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

## PS-1

- (b) disclose the threat to independence to those responsible for governance of the entity and publicly disclose the matter in any report that is issued.

**40. At least annually, the firm must obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel and, where applicable, others required to be independent by the *Code of Ethics* (including experts contracted by the firm and network firm personnel).**

41 Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the firm demonstrates the importance that it attaches to independence and makes the issue current for, and visible to, its personnel.

**42 The firm must establish policies and procedures:**

- (a) **setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement or other engagement where independence is required, over a long period of time; and**
- (b) **for all audits of financial statements of issuers, requiring the rotation of the engagement partner after a specified period in compliance with the *Code of Ethics* and any other regulatory requirements that apply.**

43 The *Code of Ethics* discusses the familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such a threat. Using the same senior personnel on assurance engagements over a prolonged period may create a familiarity threat or otherwise impair the quality of performance of the engagement. Therefore, the firm should establish criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm should consider such matters as:

- (a) the nature of the engagement, including the extent to which it involves a matter of public interest; and
- (b) the length of service of the senior personnel on the engagement.

Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.

44 The *Code of Ethics* recognises that the familiarity threat is particularly relevant in the context of financial statement audits of issuers. For these audits, the *Code of Ethics* requires the rotation of the engagement partner after a pre-defined period, normally no more than seven years, and provides related standards and guidance. 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.

#### 44.1 *Considerations Specific to the Public Sector*

In the case of a statutory officer (such as the Auditor-General) who is bound by this Standard in their professional capacity as a member, if the officer is unable because of the statutory nature of their appointment to comply with any rotation requirements specified in the *Code of Ethics*, or other regulatory requirements for rotation periods of less than seven years, it will be sufficient compliance with this Standard for the statutory officer to ensure that any person or firm whom he or she appoints to perform audits of issuer public entities on their behalf complies with any rotation requirements specified in the *Code of Ethics* or other regulatory requirements.

There may be audits of particularly significant public entities (other than issuer public entities) where the Auditor-General should consider rotating the engagement partner. 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.

#### ***Professional Requirements: Practice Review***

45 The Institute's Rules establish Practice Review as a function the Institute performs to regulate its members' practices to ensure that professional standards are being maintained. As part of that function, the Practice Review Board of the Institute may, among other things:

- (a) require a member to produce documents or other material in the member's possession or power which may be required for a practice review; and/or
- (b) examine any document or other material or undertake any other form of enquiry which may be required for a practice review.

These powers extend to undertaking enquiries, and requiring production of or examination of documents or other material, for the purpose of ascertaining a member's compliance with the requirements of this Standard. Members have a professional duty to disclose information required by the Practice Review Board. In accordance with the *Code of Ethics* this duty extends to information acquired in the course of members' professional work that is otherwise subject to the professional duty of confidentiality (*Ethical Rule 12* and paragraph 124).

#### **Acceptance and Continuance of Client Relationships and Specific Engagements**

**46 The firm must establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it:**

## PS-1

- (a) **has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;**
- (b) **is competent to perform the engagement and has the capabilities, time and resources to do so; and**
- (c) **can comply with ethical requirements.**

**The firm must obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it must document how the issues were resolved.**

47 Subject to situations where a firm has no choice in accepting or retaining a client, for example a statutory mandate, an evaluation of prospective clients and a review of existing clients should be conducted to ensure that the firm is able to meet its professional obligations while serving the clients' needs. The evaluation of existing and prospective clients should be performed by personnel who have the appropriate professional skills and competence required in the circumstances.

48 With regard to the integrity of a client, matters that the firm should consider include, for example:

- (a) the identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- (b) the nature of the client's operations, including its business practices.
- (c) 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.
- (d) whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- (e) indications of an inappropriate limitation in the scope of work.
- (f) indications that the client might be involved in money laundering or other criminal activities.
- (g) the reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

49 Information on such matters that the firm obtains may come from, for example:

## PS-1

- (a) communications with existing or previous providers of professional services to the client in accordance with the *Code of Ethics*, and discussions with other third parties.
- (b) inquiry of other firm personnel or third parties such as bankers, legal counsel and industry peers.
- (c) background searches of relevant databases.

50 In considering whether the firm has the capabilities, competence, time and resources to undertake a new engagement for a new or an existing client, the firm should review the specific requirements of the engagement and existing partner and staff profiles at all relevant levels. Matters the firm should consider include whether:

- (a) firm personnel have knowledge of relevant industries or subject matters;
- (b) firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- (c) the firm has sufficient personnel with the necessary capabilities and competence;
- (d) experts are available, if needed;
- (e) individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- (f) the firm is able to complete the engagement within the reporting deadline.

51 The firm should also consider whether accepting an engagement from a new or an existing client may give rise to an actual or perceived conflict of interest. Where a potential conflict is identified, the firm should consider whether it is appropriate to accept the engagement.

52 Deciding whether to continue a client relationship should include consideration of significant matters that have arisen during the current or previous engagements, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary knowledge or expertise.

**53 Where the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on the continuance of the engagement and the client relationship must include consideration of:**

- (a) **the professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and**
- (b) **the possibility of withdrawing from the engagement or from both the engagement and the client relationship.**

## PS-1

54 Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship should address issues that include the following:

- (a) discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances.
- (b) if the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
- (c) considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or 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.
- (d) documenting significant issues, consultations, conclusions and the basis for the conclusions.

### 54.1 *Considerations Specific to the Public Sector*

In the case of a statutory officer (such as the Auditor-General) who is bound by this Standard in their professional capacity as a member but does not have the ability to withdraw from or to decline to accept an engagement, if the officer, having taken account of the requirements and guidance set out in paragraphs 46 to 54, would normally be required to withdraw from or decline to accept an engagement for reasons described in those paragraphs, it will be sufficient compliance with this Standard for the statutory officer to take appropriate action to mitigate any risks in the engagement - including, if necessary, public reporting of any issues.

### **Human Resources**

**55 The firm must establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.**

56 Such policies and procedures should address the following personnel issues:

- (a) recruitment;
- (b) performance evaluation;
- (c) capabilities;
- (d) competence;
- (e) career development;
- (f) promotion;

- (g) compensation; and
- (h) the estimation of personnel needs.

Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes should include procedures that help the firm select individuals of integrity with the capacity to develop the capabilities and competence necessary to perform the firm's work.

57 Capabilities and competence are developed through a variety of methods, including the following:

- (a) professional education.
- (b) continuing professional development, including training.
- (c) work experience.
- (d) coaching by more experienced staff, for example, other members of the engagement team.

58 The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. The firm should therefore emphasise in its policies and procedures the need for continuing training for all levels of firm personnel, and should provide the necessary training resources and assistance to enable personnel to develop and maintain the required capabilities and competence. Where internal technical and training resources are unavailable, or for any other reason, the firm may use a suitably qualified external person for that purpose.

59 The firm's performance evaluation, compensation and promotion procedures should give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. In particular, the firm should:

- (a) make personnel aware of the firm's expectations regarding performance and ethical principles;
- (b) provide personnel with evaluation of, and counselling on, performance, progress and career development; and
- (c) help personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.

60 The size and circumstances of the firm will influence the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

## PS-1

### *Assignment of Engagement Teams*

**61 The firm must assign responsibility for each engagement to an engagement partner. The firm must establish policies and procedures requiring that:**

- (a) **the identity and role of the engagement partner are communicated to key members of client management and those charged with governance;**
- (b) **the engagement partner has the appropriate capabilities, competence, authority and time to perform the role; and**
- (c) **the responsibilities of the engagement partner are clearly defined and communicated to that partner.**

62 Policies and procedures should include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

**63 The firm must also assign appropriate staff with the necessary capabilities, competence and time to perform engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.**

64 The firm should establish procedures to assess its staff's capabilities and competence. The capabilities and competence considered when assigning engagement teams, and in determining the level of supervision required, should include the following:

- (a) an understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- (b) an understanding of professional standards and regulatory and legal requirements.
- (c) appropriate technical knowledge, including knowledge of relevant information technology.
- (d) knowledge of relevant industries in which the clients operate.
- (e) ability to apply professional judgement.
- (f) an understanding of the firm's quality control policies and procedures.

#### *64.1 Considerations Specific to the Public Sector*

Additional capabilities may be required in engagements performed in public sector contexts. Such additional capabilities may include an understanding of the applicable reporting arrangements, including reporting to a representative body, for example, Parliament or a local authority. The wider scope of a public sector engagement may include, for example, some aspects of performance auditing or a comprehensive assessment of the arrangements for ensuring legality and preventing and detecting fraud and corruption.

**Engagement Performance**

**65 The firm must establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.**

66 Through its policies and procedures, the firm should seek to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardised documentation, and industry or subject matter-specific guidance materials. Matters addressed should include the following:

- (a) how engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- (b) processes for complying with applicable professional standards.
- (c) processes of engagement supervision, staff training and coaching.
- (d) methods of reviewing the work performed, the significant judgements made and the form of report being issued.
- (e) appropriate documentation of the work performed and of the timing and extent of the review.
- (f) processes to keep all policies and procedures current.

67 It is important that all members of the engagement team understand the objectives of the work they are to perform. Appropriate team-working and training are necessary to assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

68 Supervision should include the following:

- (a) tracking the progress of the engagement.
- (b) considering the capabilities and competence 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.
- (c) addressing significant issues arising during the engagement, considering their significance and modifying the planned approach appropriately.
- (d) identifying matters for consultation or consideration by more experienced engagement team members during the engagement.

69 Review responsibilities should be determined on the basis that more experienced engagement team members, including the engagement partner, should review work performed by less experienced team members. Reviewers should consider whether:

- (a) the work has been performed in accordance with professional standards and regulatory and legal requirements;

## PS-1

- (b) significant matters have been raised for further consideration;
- (c) appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- (d) there is a need to revise the nature, timing and extent of work performed;
- (e) the work performed supports the conclusions reached and is appropriately documented;
- (f) the evidence obtained is sufficient and appropriate to support any engagement report to be issued; and
- (g) the objectives of the engagement procedures have been achieved.

### *Consultation*

**70 The firm must establish policies and procedures designed to provide it with reasonable assurance that:**

- (a) appropriate consultation takes place on difficult or contentious matters;**
- (b) sufficient resources are available to enable appropriate consultation to take place;**
- (c) the nature and scope of such consultations are documented; and**
- (d) conclusions resulting from consultations are documented and implemented.**

71 The acceptance of an engagement implies that the engagement partner and the engagement team have the necessary competence to carry out the engagement. A firm should not undertake or continue an engagement that the firm is not competent to carry out. Where the engagement partner or other members of the engagement team are unable to carry out a particular aspect of an engagement, the firm should obtain advice and assistance from those who have the appropriate expertise, competence, judgement and authority to enable the firm to complete the engagement in accordance with professional standards and regulatory and legal requirements.

72 Consultation should include discussion, at the appropriate professional level, with individuals within or outside the firm who have specialised expertise, to resolve a difficult or contentious matter.

73 Consultation should use appropriate research resources as well as the collective experience and technical expertise of the firm. Consultation helps to promote quality and improves the application of professional judgement. The firm should seek to establish a culture in which consultation is recognised as a strength and encourages personnel to consult on difficult or contentious matters.

74 Effective consultation with other professionals should require that those consulted be given all the relevant facts that will enable them to provide informed advice on technical, ethical or other matters. Consultation procedures should require consultation with those having appropriate knowledge, seniority and experience within the firm (or, where applicable, outside the firm) on significant technical,

ethical and other matters, and appropriate documentation and implementation of conclusions resulting from consultations.

75 A firm needing to consult externally, for example a firm without appropriate internal resources, may take advantage of advisory services provided by other firms, professional and regulatory bodies or commercial organisations that provide relevant quality control services.

Before contracting for such services, the firm should consider whether the external provider is suitably qualified for that purpose.

76 The documentation of consultations with other professionals that involve difficult or contentious matters should be agreed by both the individual seeking consultation and the individual consulted. The documentation should be sufficiently complete and detailed to enable an understanding of:

- (a) the issue on which consultation was sought; and
- (b) the results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

#### *Differences of Opinion*

**77 The firm must establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer. Conclusions reached must be documented and implemented.**

**78 Where an engagement report is to be issued, the report must not be issued until the matter that is subject to a difference of opinion is resolved.**

79 The procedures to deal with and resolve differences of opinion should encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

80 A firm using a suitably qualified external person to conduct an engagement quality control review should recognise that differences of opinion can occur and establish procedures to resolve such differences, for example, by consulting with another practitioner or firm, or a professional or regulatory body.

#### *Engagement Quality Control Review*

**81 The firm must establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgements made by the engagement team and the conclusions reached in formulating any report that is to be issued for the engagement. Such policies and procedures must:**

## PS-1

- (a) require an engagement quality control review for all audits of financial statements of issuers;
- (b) set out criteria against which all other audits and reviews of historical financial information, and other engagements should be evaluated to determine whether an engagement quality control review should be performed; and
- (c) require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).

**82 The firm's policies and procedures must require the completion of the engagement quality control review before any report is issued.**

83 Criteria that a firm should consider when determining which engagements, other than audits of financial statements of issuers, are to be subject to an engagement quality control review include the following:

- (a) the nature of the engagement, including the extent to which it involves a matter of public interest.
- (b) the identification of unusual circumstances or risks in an engagement or class of engagements.
- (c) whether laws or regulations require an engagement quality control review.

### 83.1 *Considerations Specific to the Public Sector*

There may also be audits in respect of significant public entities (other than issuer public entities) where the Auditor-General should consider applying engagement quality control review. 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.

### *Nature, Timing and Extent of an Engagement Quality Control Review*

**84 The firm must establish policies and procedures setting out:**

- (a) the nature, timing and extent of an engagement quality control review;
- (b) criteria for the eligibility of engagement quality control reviewers; and
- (c) documentation requirements for an engagement quality control review.

85 An engagement quality control review should ordinarily involve discussion with the engagement partner, a review of the financial statements or other subject matter information and any engagement report that is to be issued, and, in particular, consideration of whether the report is appropriate. It should also involve a review of selected working papers relating to the significant judgements the engagement team made and the conclusions they reached. The extent of the review should depend on the complexity of the engagement and the risk that the

report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.

86 An engagement quality control review for audits of financial statements of issuers should include considering the following:

- (a) the engagement team's evaluation of the firm's independence in relation to the specific engagement.
- (b) significant risks identified during the engagement and the responses to those risks.
- (c) judgements made, particularly with respect to materiality and significant risks.
- (d) 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.
- (e) the significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- (f) the matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- (g) whether working papers selected for review reflect the work performed in relation to the significant judgements and support the conclusions reached.
- (h) the appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of issuers may, depending on the circumstances, include some or all of these considerations.

87 The engagement quality control reviewer should conduct the review in a timely manner at appropriate stages during the engagement so that significant matters may be promptly resolved to the reviewer's satisfaction before any report is issued.

88 Where the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, any report that is to be issued should not be issued until the matter is resolved by following the firm's procedures for dealing with differences of opinion.

*Criteria for the Eligibility of Engagement Quality Control Reviewers*

**89 The firm's policies and procedures must address the appointment of engagement quality control reviewers and establish their eligibility through:**

- (a) **the technical qualifications required to perform the role, including the necessary experience and authority; and**

## PS-1

- (b) **the degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.**

90 The firm's policies and procedures on the technical qualifications of engagement quality control reviewers should address the technical expertise, experience and authority necessary to perform the role. What constitutes sufficient and appropriate technical expertise, experience and authority will depend on the circumstances of the engagement. In addition, the engagement quality control reviewer for an audit of the financial statements of an issuer should be an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of issuers.

91 The firm's policies and procedures should be designed to maintain the objectivity of the engagement quality control reviewer. For example, the engagement quality control reviewer should not:

- (a) be selected by the engagement partner;
- (b) otherwise participate in the engagement during the period of review;
- (c) make decisions for the engagement team; and
- (d) be subject to other considerations that would threaten the reviewer's objectivity.

92 The engagement partner may consult the engagement quality control reviewer during the engagement. Such consultation need not compromise the engagement quality control reviewer's eligibility to perform the role. Where the nature and extent of the consultations become significant, however, care should be taken by both the engagement team and the reviewer to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person should be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement. The firm's policies should provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired.

93 Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Where the firm contracts suitably qualified external persons, the firm should follow the requirements and guidance in paragraphs 89-92.

### 93.1 *Considerations Specific to the Public Sector*

Paragraph 91 requires the engagement quality control reviewer to be objective (for example, not to be selected by the engagement partner). In the case of a statutory officer (such as the Auditor-General) who is bound by this Standard in their professional capacity as a member, it will be sufficient compliance with this Standard for the engagement quality control reviewer to be selected having regard

to the need for independence and objectivity and, for audits of public entities that are issuers for the appointment of an engagement quality control reviewer to be in accordance with paragraphs 89-93.

*Documentation Requirements for an Engagement Quality Control Review*

**94 Policies and procedures on documentation of the engagement quality control review must require documentation that:**

- (a) **the procedures required by the firm's policies on engagement quality control review have been performed;**
- (b) **the engagement quality control review has been completed before any report is issued; and**
- (c) **the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgements the engagement team made and the conclusions they reached were not appropriate.**

*Engagement Documentation*

*Completion of the Assembly of Final Engagement Files*

**95 The firm must establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalised.**

96 Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement should be completed. Where no such time limits are prescribed in law or regulation, the firm should establish time limits appropriate to the nature of the engagements that reflect the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit should ordinarily be not more than 60 days after the date of the auditor's report.

97 Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files should address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

*Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation*

**98. The firm must establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.**

## PS-1

99 Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

100. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, the firm should design and implement appropriate controls for engagement documentation to:

- (a) enable the determination of when and by whom engagement documentation was created, changed or reviewed;
- (b) protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via the Internet;
- (c) prevent unauthorised changes to the engagement documentation; and
- (d) allow access to the engagement documentation by the engagement team and other authorised parties as necessary to properly discharge their responsibilities.

101 Controls that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation should include, for example:

- (a) the use of a password among engagement team members to restrict access to electronic engagement documentation to authorised users.
- (b) appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- (c) procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement.
- (d) procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

102 For practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm should implement appropriate procedures requiring engagement teams to:

- (a) generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;
- (b) integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and
- (c) enable the scanned copies to be retrieved and printed as necessary.

The firm should consider whether to retain original paper documentation that has been scanned for legal, regulatory or other reasons.

*Retention of Engagement Documentation*

**103 The firm must establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.**

104 The needs of the firm for retention of engagement documentation, and the period of such retention, will vary with the nature of the engagement 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. The retention period may also depend on other factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements. In the specific case of audit engagements, the retention period should ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report.

105 Procedures that the firm adopts for retention of engagement documentation should include those that:

- (a) enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation since the underlying technology may be upgraded or changed over time.
- (b) provide, where necessary, a record of changes made to engagement documentation after the engagement files have been completed.
- (c) enable authorised external parties to access and review specific engagement documentation for quality control or other purposes.

*Ownership of Engagement Documentation*

106 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.

**Monitoring**

**107 The firm must establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures must include an ongoing consideration and evaluation of the firm's system of quality**

## PS-1

**control, including a periodic inspection of a selection of completed assurance engagements.**

108 The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- (a) adherence to professional standards and regulatory and legal requirements;
- (b) whether the quality control system has been appropriately designed and effectively implemented; and
- (c) whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

109 The firm should entrust responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility. Monitoring of the firm's system of quality control should be performed by competent individuals and covers both the appropriateness of the design and the effectiveness of the operation of the system of quality control.

110 Ongoing consideration and evaluation of the system of quality control should include matters such as the following:

- (a) analysis of:
  - (i) new developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm's policies and procedures where appropriate;
  - (ii) written confirmation of compliance with policies and procedures on independence;
  - (iii) continuing professional development, including training; and
- (iv) decisions related to acceptance and continuance of client relationships and specific engagements.
- (b) determination of corrective actions to be taken and improvements to be made in the system, including the provision of feedback into the firm's policies and procedures relating to education and training.
- (c) communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with it.
- (d) follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

111 The inspection of a selection of completed assurance engagements should ordinarily be performed on a cyclical basis. Engagements selected for inspection should include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years. The manner in which the inspection cycle is organised, including the timing of selection of individual engagements, depends on many factors, including the following:

- (a) the size of the firm.
- (b) the number and geographical location of offices.
- (c) the results of previous monitoring procedures.
- (d) the degree of authority both personnel and offices have (for example, whether individual offices are authorised to conduct their own inspections or whether only the head office may conduct them).
- (e) the nature and complexity of the firm's practice and organisation.
- (f) the risks associated with the firm's clients and specific engagements.

112 The inspection process should include the selection of individual assurance engagements, some of which may be selected without prior notification to the engagement team. Those inspecting the engagements should not be involved in performing the engagement or the engagement quality control review. In determining the scope of the inspections, the firm may take into account the scope or conclusions of an independent external inspection programme. However, an independent external inspection programme should not act as a substitute for the firm's own internal monitoring programme.

113 Small firms and sole practitioners may wish to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, they may wish to establish arrangements to share resources with other appropriate organisations to facilitate monitoring activities.

**114 The firm must evaluate the effect of deficiencies noted as a result of the monitoring process and must determine whether they are either:**

- (a) instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and regulatory and legal requirements, and that any reports issued by the firm or engagement partners are appropriate in the circumstances; or
- (b) systemic, repetitive or other significant deficiencies that require prompt corrective action.

**115 The firm must communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.**

**116 The firm's evaluation of each type of deficiency must result in recommendations for one or more of the following:**

- (a) taking appropriate remedial action in relation to an individual engagement or member of personnel;
- (b) the communication of the findings to those responsible for training and professional development;
- (c) changes to the quality control policies and procedures; and

## **PS-1**

- (d) disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.**

**117 Where the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm must determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. The firm must also consider obtaining legal advice.**

**118 At least annually, the firm must communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm, including the firm's chief executive officer or, if appropriate, its managing board of partners. Such communication must enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities. Information communicated must include the following:**

- (a) a description of the monitoring procedures performed;**
- (b) the conclusions drawn from the monitoring procedures; and**
- (c) where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.**

119 The reporting of identified deficiencies to individuals other than the relevant engagement partners ordinarily should not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

120 Some firms operate as part of a network and, for consistency, may implement some or all of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies and procedures designed to comply with this Standard, and these firms place reliance on such a monitoring system:

- (a) at least annually, the network should communicate the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms;
- (b) the network should communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken; and
- (c) engagement partners in the network firms should be entitled to rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

121 Appropriate documentation relating to monitoring should:

- (a) set out monitoring procedures, including the procedure for selecting completed engagements to be inspected;

- (b) record the evaluation of:
  - (i) adherence to professional standards and regulatory and legal requirements;
  - (ii) whether the quality control system has been appropriately designed and effectively implemented; and
  - (iii) whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
- (c) identify the deficiencies noted, evaluate their effect, and set out the basis for determining whether and what further action is necessary.

*Complaints and Allegations*

**122 The firm must establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:**

- (a) **complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and**
- (b) **allegations of non-compliance with the firm's system of quality control.**

123 Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel. They may also be received from the Institute under the Institute's complaints process.

124. As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

125 The firm should investigate such complaints and allegations in accordance with established policies and procedures. The investigation should be supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and should include involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them should be documented.

**126 Where a complaint is received from the Institute under the Institute's complaints process the firm must give the Institute its full assistance with the investigation and resolution of the complaint.**

127 Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm should take appropriate action as discussed in paragraph 116.

## PS-1

### Documentation

**128 The firm must establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.**

129 How such matters are documented should be the firm's decision. For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections. Smaller firms may use more informal methods such as manual notes, checklists and forms.

130 Factors to consider when determining the form and content of documentation evidencing the operation of each of the elements of the system of quality control should include the following:

- (a) the size of the firm and the number of offices.
- (b) the degree of authority both personnel and offices have.
- (c) the nature and complexity of the firm's practice and organisation.

131 The firm should retain this documentation for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

### **QUALITY CONTROL PROCEDURES FOR INDIVIDUAL ENGAGEMENTS**

132 The engagement team should:

- (a) implement quality control procedures that are applicable to the engagement;
- (b) provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to ethical requirements, including independence where applicable; and
- (c) be entitled to rely on the firm's systems (for example in relation to capabilities and competence of personnel through their recruitment and formal training; independence through the accumulation and communication of relevant independence information; maintenance of client relationships through acceptance and continuance systems; and adherence to regulatory and legal requirements through the monitoring process), unless information provided by the firm or other parties suggests otherwise.

**133 All quality control policies and procedures implemented in the performance of individual engagements must be adequately documented in accordance with paragraph 19, and with the requirements and guidance on engagement documentation in paragraphs 95-106.**

**134 The engagement partner must ensure that quality control policies and procedures relevant to the individual engagement are communicated to the engagement team, in accordance with paragraphs 19 and 20.**

**135 Quality control policies and procedures for individual engagements must address each of the following elements:**

- (a) leadership responsibilities for quality on engagements;
- (b) ethical requirements;
- (c) acceptance and continuance of client relationships and specific engagements;
- (d) assignment of engagement teams;
- (e) engagement performance; and
- (f) monitoring.

#### **Leadership Responsibilities for Quality on Engagements**

**136 The engagement partner must take responsibility for the overall quality on each engagement to which that partner is assigned.**

137 The engagement partner should set an example regarding engagement quality to the other members of the engagement team through all stages of the engagement. Ordinarily, this example is provided through the actions of the engagement partner and through appropriate messages to the engagement team. Such actions and messages should emphasise:

- (a) the importance of:
  - (i) performing work that complies with professional standards and regulatory and legal requirements;
  - (ii) complying with the firm's quality control policies and procedures as applicable; and
  - (iii) issuing engagement reports that are appropriate in the circumstances; and
- (b) the fact that quality is essential in performing engagements.

#### **Ethical Requirements**

**138 The engagement partner must consider whether members of the engagement team have complied with ethical requirements, and apply the requirements and guidance set out in paragraphs 27-35 as they relate to individual engagements.**

139 The engagement partner should remain alert for evidence of non-compliance with ethical requirements. Inquiry and observation regarding ethical matters amongst the engagement partner and other members of the engagement team should occur as necessary throughout the engagement. If matters come to the engagement partner's attention through the firm's systems or otherwise that indicate that members of the engagement team have not complied with ethical

## PS-1

requirements, the partner, in consultation with others in the firm, should determine the appropriate action.

140 The engagement partner and, where appropriate, other members of the engagement team, should document issues identified and how they were resolved.

### *Independence in Engagements for which Independence is Required*

**141 The engagement partner for an engagement for which independence is required must form a conclusion on compliance with independence requirements that apply to the engagement. In doing so, the engagement partner must:**

- (a) **obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;**
- (b) **evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the engagement;**
- (c) **take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards. The engagement partner must promptly report to the firm any failure to resolve the matter for appropriate action; and**
- (d) **document conclusions on independence and any relevant discussions with the firm that support these conclusions.**

142 The engagement partner may identify a threat to independence regarding the engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, the engagement partner should consult within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the engagement. Such discussion and conclusions should be documented.

#### *142.1 Considerations Specific to the Public Sector*

In the case of a statutory officer (such as the Auditor-General) who is bound by this Standard in their professional capacity as a member but 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 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 public entity, and publicly disclose the matter in any report that is issued.

**Acceptance and Continuance of Client Relationships and Specific Engagements**

**143 The engagement partner must be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and specific engagements have been followed and that conclusions reached in this regard are appropriate and have been documented.**

144 The engagement partner may or may not initiate the decision-making process for acceptance or continuance regarding the engagement. Regardless of whether the engagement partner initiated that process, the partner should determine whether the most recent decision remains appropriate.

145 Acceptance and continuance of client relationships and specific engagements should include considering:

- (a) the integrity of the principal owners, key management and those charged with governance of the entity;
- (b) whether the engagement team is competent to perform the engagement and has the necessary time and resources; and
- (c) whether the firm and the engagement team can comply with ethical requirements.

Where issues arise out of any of these considerations, the engagement team should conduct the appropriate consultations set out in paragraphs 161-162, and should document how issues were resolved.

146 Deciding whether to continue a client relationship should include consideration of significant matters that have arisen during the current or previous engagement, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary knowledge or expertise.

**147 Where the engagement partner obtains information that would have caused the firm to decline the engagement if that information had been available earlier, the engagement partner must communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.**

*147.1 Considerations Specific to the Public Sector*

In the case of a statutory officer (such as the Auditor-General) who is bound by this Standard in their professional capacity as a member but does not have the ability to withdraw from or to decline to accept an engagement, if the officer, having taken account of the requirements and guidance set out in paragraphs 143 – 147, would normally be required to withdraw from or decline to accept an engagement for reasons described in those paragraphs, it will be sufficient compliance with this Standard for the statutory officer to take appropriate action to mitigate any risks in the engagement – including, if necessary, public reporting of any issues.

## PS-1

### Assignment of Engagement Teams

**148 The engagement partner must be satisfied that the engagement team collectively has the appropriate capabilities, competence and time to perform the engagement in accordance with professional standards and regulatory and legal requirements, and to enable any engagement report that is appropriate in the circumstances to be issued.**

149 The appropriate capabilities and competence expected of the engagement team as a whole are set out in paragraph 64.

### *Delegation*

150 Before delegating any work to the engagement team the engagement partner should consider the skills and professional competence of the members of the engagement team to decide the extent of direction, supervision and review required.

151 Where work is to be delegated within the engagement team, the delegation should be done in a manner that provides reasonable assurance that such work will be performed by persons who have the skills and competence required in the circumstances.

### Engagement Performance

**152 The engagement partner must take responsibility for the direction, supervision and performance of the engagement in compliance with professional standards and regulatory and legal requirements, and for any engagement report that is issued to be appropriate in the circumstances.**

153 The engagement partner should direct the engagement by informing the members of the engagement team of:

- (a) their responsibilities;
- (b) the nature of the entity's business;
- (c) risk-related issues;
- (d) problems that may arise; and
- (e) the detailed approach to the performance of the engagement.

The engagement team's responsibilities should include maintaining an objective state of mind and an appropriate level of professional scepticism, and performing the work delegated to them in accordance with the ethical principle of quality performance. Members of the engagement team should be encouraged to raise questions with more experienced team members. Appropriate communication should occur within the engagement team.

154 It is important that all members of the engagement team should understand the objectives of the work they are to perform. Appropriate team-working and

training are necessary to assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

155 Supervision procedures for engagements are set out in paragraph 68.

156 Review responsibilities should be determined on the basis that more experienced team members, including the engagement partner, should review work performed by less experienced team members. Review procedures that reviewers should consider are set out in paragraph 69.

**157 Before an engagement report is issued, the engagement partner, through review of the engagement documentation and discussion with the engagement team, must be satisfied that there is a sufficient appropriate basis to support the conclusions reached and for the engagement report to be issued.**

158 The engagement partner should conduct timely reviews at appropriate stages during the engagement. This should allow significant matters to be resolved on a timely basis to the engagement partner's satisfaction before the engagement report is issued. The reviews should cover critical areas of judgement, especially those relating to difficult or contentious matters identified during the course of the engagement, significant risks, and other areas the engagement partner considers important. The engagement partner need not review all engagement documentation. However, the partner should document the extent and timing of the reviews. Issues arising from the reviews should be resolved to the satisfaction of the engagement partner.

159 A new engagement partner taking over an engagement during the engagement should review the work performed to the date of the change. The review procedures should be sufficient to satisfy the new engagement partner that the work performed to the date of the review has been planned and performed in accordance with professional standards and regulatory and legal requirements.

160 Where more than one partner is involved in the conduct of an engagement, it is important that the responsibilities of the respective partners should be clearly defined and understood by the engagement team.

#### *Consultation*

**161 The engagement partner must:**

- (a) **be responsible for the engagement team undertaking appropriate consultation on difficult or contentious matters;**
- (b) **be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;**

## PS-1

- (c) **be satisfied that the nature and scope of, and conclusions resulting from, such consultations are documented and agreed with the party consulted; and**
- (d) **determine that conclusions resulting from consultations have been implemented.**

162 Considerations relevant for undertaking effective consultations and for the documentation of consultations undertaken are set out in paragraphs 71-76.

### *Differences of Opinion*

**163 Where differences of opinion arise within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team must follow the firm's policies and procedures for dealing with and resolving differences of opinion.**

164 As necessary, the engagement partner should inform members of the engagement team that they may bring matters involving differences of opinion to the attention of the engagement partner or others within the firm as appropriate without fear of reprisals.

### *Engagement Quality Control Review*

165 Where appropriate, the quality control for an individual engagement may include performing an engagement quality control review, for example on large or complex engagements.

166 Where an engagement quality control review is performed for an engagement, the engagement partner should:

- (a) determine that an engagement quality control reviewer has been appointed;
- (b) discuss significant matters arising during the engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- (c) not issue any engagement report until the completion of the engagement quality control review.

167 Where, at the start of the engagement, an engagement quality control review is not considered necessary, the engagement partner should be alert for changes in circumstances that would require such a review.

**168 An engagement quality control review must include an objective evaluation of:**

- (a) **the significant judgements made by the engagement team; and**
- (b) **the conclusions reached in formulating any engagement report issued.**

169 Considerations relevant to the nature, timing and extent of an engagement quality control review are set out in paragraph 85. The considerations relevant

to engagement quality control reviews for individual engagements should be determined with reference to the particular circumstances of the engagement and the professional judgement of the engagement quality control reviewer.

**Monitoring**

170 This Standard requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. The engagement partner should consider the results of the monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms. The engagement partner should consider:

- (a) whether deficiencies noted in that information may affect the engagement; and
- (b) whether the measures the firm took to rectify the situation are sufficient in the context of that engagement.

171 A deficiency in the firm's system of quality control does not indicate that a particular engagement was not performed in accordance with professional standards and regulatory and legal requirements, or that the engagement report was not appropriate.

**172 Members, including partners and engagement partners, must comply with any requirements of the Institute's Practice Review Board in relation to all engagements undertaken, or engagements with which they otherwise have an involvement, including any involvement for purposes of complying with this Standard.**

## PS-1

### APPENDIX

#### COMPARISON OF PS-1 QUALITY CONTROL WITH INTERNATIONAL AND AUSTRALIAN STANDARDS

This appendix reflects information as at 14 September 2006, and deals only with significant differences. It is produced for information purposes only and does not form part of the standards in PS-1.

##### A. Comparison of PS-1 with International Standards

PS-1 incorporates the requirements and guidance contained in International Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements* (ISQC 1) with the exception of one requirement in ISQC 1 in the area of monitoring that has been adopted in a narrower context in PS-1 as outlined below. The requirements and guidance of ISQC 1 incorporated into PS-1 carry the same intention (as to their meaning and effect) and authority as they do in ISQC 1.

The requirement in ISQC 1 (paragraph 74) for the firm to carry out periodic inspections of a sample of completed engagements, being engagements to perform audits and reviews of historical financial information and other assurance and related services, has been adopted differently in PS-1. Paragraph 107 of PS-1 requires that the firm must carry out periodic inspections of a sample of completed assurance engagements. This requirement is narrower than the requirement in ISQC 1 and does not require the firm to perform periodic inspections of completed non-assurance engagements, such as engagements undertaken to compile financial information.

Some wording of ISQC 1 as incorporated into PS-1 has been changed. These changes are:

- to accommodate the regulatory environment in New Zealand (for example references to “listed entities” in ISQC 1 are replaced by the word “issuer” (as defined)); and
- to achieve consistency with the structure of the Institute’s other pronouncements (the Code of Ethics); and
- to continue the existing drafting conventions used in the Institute’s Standards to convey:
  - the mandatory nature of requirements contained in the Standards. All bold-type requirements stated in ISQC 1 (which are expressed using the word “should”) are expressed using the word “must” in PS-1; and
  - the authority of non-mandatory guidance contained in the Standards, as guidance which the Institute recommends that its members follow. All

## PS-1

present-tense statements contained in the non bold-type content of ISQC 1 are rephrased using the word “should”.

Other than for the exception explained above regarding performance of inspections for completed engagements other than assurance engagements, the changes made in PS-1 do not affect the substance of the requirements in ISQC 1.

The Professional Practices Board of the Institute is of the view that, with the exception of paragraph 107 of PS-1, the Standard conforms to ISQC 1, and that the other changes outlined above accord with the IAASB’s Guide on Modifications to International Standards of the IAASB (IAASB Policy Position Paper, July 2006).

Also, PS-1:

- extends the requirements and guidance of ISQC 1 to apply across all types of engagements undertaken by firms where applicable as a general principle, subject to certain exceptions (see further detail provided under Section B below); and
- incorporates requirements and guidance addressing quality control at the level of individual engagements.

PS-1 incorporates public sector perspectives throughout the standards and guidance appropriate to the public sector audit environment in New Zealand. In ISQC 1 public sector perspectives are located at the end of the Standard.

### **B. Comparison of PS-1 with Australian Standards**

In Australia the Accounting Professional and Ethical Standards Board (APESB) issued APES 320 *Quality Control for Firms* in May 2006.

Areas of difference between APES 320 and PS-1 are explained below.

- PS-1 has wider scope and requirements and guidance in the Standard address quality control both at firm level and at the level of individual engagements.
- As a general principle PS-1 applies the requirements of the Standard in relation quality control at the firm level to all firms and across all types of engagements. The exceptions to this principle are:
  - paragraphs 36-44.1 addressing engagements for which independence is required, which apply only to those engagements;
  - paragraph 81(a) establishes the requirement to undertake engagement quality control reviews only in the case of audits of financial statements of issuers (supplemented by relevant guidance in paragraphs 86 and 90); and
  - paragraph 107 establishes the requirement to carry out periodic inspections only of completed assurance engagements (which requirement is supplemented by guidance contained in paragraphs 111 – 113).

## PS-1

APES 320 requires firms that have an assurance practice (as defined in that Standard) to apply the whole of APES 320 as applicable to their assurance practice or engagements. Firms that do not have an assurance practice, or the non-assurance parts of firms with an assurance practice, are required to apply all paragraphs of APES 320 where applicable other than those boxed and designated “Assurance Practices only”. Compilation engagements are included in the latter category.

Paragraphs in APES 320 that contain requirements and guidance for assurance practices only are:

- paragraphs 19-27 (equivalent paragraphs in PS-1 are 36-44.1);
- paragraph 56 (guidance only; the equivalent paragraph in PS-1 is 76);
- paragraphs 57-59 (equivalent paragraphs in PS-1 are 77 -80);
- paragraphs 60-73 (equivalent paragraphs in PS-1 are 81-94);
- paragraph 77 (part of guidance contained in the first bullet point; the equivalent guidance in PS-1 is in paragraph 110);
- paragraphs 78 (part) to 87 (equivalent paragraphs in PS-1 are 111-120); and
- paragraph 92 (equivalent paragraph in PS-1 is 125).
- For purposes of compliance with the monitoring requirements contained in APES 320 paragraph 74 and the related guidance in paragraph 78, firms may take into account quality reviews conducted by the ICAA or CPA Australia.
- APES 320 includes public sector perspectives at the end of the Standard.