

**AG PES 3 (AMENDED): AUDITOR-GENERAL'S STATEMENT ON
QUALITY CONTROL**

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Introduction

Scope of this Statement

1. This Auditor-General's Auditing Statement:
 - (a) establishes the Auditor-General's requirements in relation to PES 3 (Amended): *Quality Control* (PES 3) (Amended) issued by the External Reporting Board, which applies to all assurance providers; and
 - (b) provides additional guidance to reflect the public sector perspective.

Application

2. Compliance with this Statement is mandatory for the firm. For the purposes of PES 3 (Amended), "firm" in the public sector is defined as:

Where a statutory officer (such as the Auditor-General) appoints an employee or other suitably qualified person (Appointed Auditor) to perform audits or other assurance services on that officer's behalf for the purposes of this Professional and Ethical Standard, the term "firm" refers to the combination of the statutory officer, the Appointed Auditor, and, if applicable, the firm of which the Appointed Auditor is a partner, member, or employee.
3. PES 3 (Amended) was issued to establish the system of quality control that is required to be applied by the firm (in paragraphs 1 to 59 and A1 to NZA75.1 of PES 3 (Amended) for assurance engagements).
4. This Statement applies to the work carried out by the Auditor-General or on behalf of the Auditor-General and specifically to:
 - (a) annual audits for reporting periods beginning on or after 1 April 2020; or
 - (b) all work other than annual audits beginning on or after 1 April 2020.
5. PES 3 (Amended) and AG-PES 3 (Amended) (which establish the overall framework for quality control) are designed to apply to the system of quality control for all the work carried out on behalf of the Auditor-General.

Background information

6. Producing work that meets appropriate standards of quality is fundamental to the reputation and credibility of the Auditor-General and ultimately to the Auditor-General's ability to fulfil the Auditor-General's mandate. This Statement, in conjunction with PES 3 (Amended), assists the Auditor-General to establish and maintain an appropriate system of quality control that covers all of the Auditor-General's work.
7. Quality control procedures for annual audits are specified in ISA (NZ) 220: *Quality Control for an Audit of Financial Statements*.

Objectives

8. The objectives of the firm ("firm" is defined in paragraph 2 above) are to:
 - (a) establish and maintain a system of quality control to provide reasonable assurance that:
 - (i) the firm and its personnel comply with the Auditor-General's Auditing Standards and applicable legal and regulatory requirements; and
 - (ii) reports issued by the Auditor-General, the Deputy Auditor-General, their staff, and Appointed Auditors and their staff are appropriate in the circumstances;
 - (b) implement quality control procedures at the engagement level for annual audits in keeping with the requirements of ISA (NZ) 220: *Quality Control for an Audit of Financial Statements*;¹ and
 - (c) implement quality control procedures that are appropriate for all work carried out by, or on behalf of, the Auditor-General (other than the annual audit) in order to provide reasonable assurance that:
 - (i) the work complies with the Auditor-General's Auditing Standards and applicable legal and regulatory requirements; and
 - (ii) any report issued is appropriate in the circumstances.

¹ The ISA (NZ) Auditing Standards are scoped so that they apply to audits of "historical financial information". However, for the purposes of the Auditor-General's Auditing Standards and Statements, all references to "historical financial information" should be read as the audit of "historical financial and performance information".

Definitions

9. For the purpose of this Auditor-General's Auditing Statement, the defined terms have the meanings attributed:
- (a) in the Glossary of Terms issued by the New Zealand Auditing and Assurance Standards Board (the NZAuASB glossary) of the External Reporting Board (although, where a term with a specific meaning in the New Zealand public sector differs from the NZAuASB glossary, the New Zealand public sector definition shall prevail); and
 - (b) in the Auditor-General's Glossary of Terms.

Requirements

Engagement acceptance and continuance procedures

10. Appointed Auditors shall complete acceptance and continuance procedures before planning the annual audit, as required by PES 3 (Amended).
11. Appointed Auditors shall contact the Assistant Auditor-General – Audit Quality if:
- (a) the acceptance and continuance procedures indicate that there are significant risks in carrying out the annual audit that ordinarily may have led the Audit Service Provider to decline the audit engagement; or
 - (b) the annual audit may pose significant risks to the Auditor-General (ref: para. A1).

Determining whether work other than the annual audit should be carried out

12. The Auditor-General, the Deputy Auditor-General, their staff, and the Audit Service Provider and their staff shall determine whether work carried out by, or on behalf of, the Auditor-General, other than the annual audit, should be carried out by having regard to AG PES 1: *Code of ethics for assurance practitioners*.

Requirements for engagement quality control review for annual audits

13. An engagement quality control review shall be carried out for:
- (a) FMC reporting entities, including related other assurance engagements;
 - (b) all long-term plan (LTP) audits²; and
 - (c) all annual audits assessed as high-risk audits (Ref: Para. 14 below for further guidance on assessing high risk audits).
14. Subject to the provisions in paragraph 13 above, Appointed Auditors shall perform their own risk assessments of all annual audits to determine whether the annual audit should be subject to engagement quality control review. The risk assessments shall be performed annually and confirmed with the individual delegated responsibility with overseeing compliance with AG PES 3. The following are some relevant factors when assessing “high risk”:
- (a) entities that are likely to be privatised, either wholly or in part;
 - (b) entities where there is significant media or political interest;
 - (c) entities that engage in large and complex financial transactions;
 - (d) entities where there are complex revenue recognition and measurement audit risks, or high-risk contracts;
 - (e) where the entity has a history of aggressive accounting treatments;
 - (f) entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g. certain financial institutions and/or entities with non-routine material actuarial estimates). Revaluations of property plant and equipment would typically be excluded unless a consideration of (e) and (i);
 - (g) engagements that involve regulatory reporting on financial or non-financial information with a high degree of judgement;
 - (h) entities where there may be significant doubt about the validity of the going concern basis of accounting;
 - (i) entities where issues have been encountered such as audit engagements with recurring internal or external inspection findings, unremediated significant deficiencies in internal control, or a material restatement of

² An engagement quality control review may not be required for the audit of an amendment to a long-term plan (LTP amendment). This is because an LTP amendment may be different in nature, risk and complexity to an LTP. Appointed Auditors shall perform their own assessment to determine if an LTP amendment audit should be subject to engagement quality control review. In making their assessment the Appointed Auditor shall consider if:

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

- comparative information in the financial statements;
- (j) where the entity is assessed as having a weak control environment such as weak or poor governance, a dominant CEO or dysfunctional senior management team which is not being effectively countered by strong governance;
 - (k) entities where an actual or suspected fraud has been identified that exceeds performance materiality or where the fraud is large enough to attract national media attention;
 - (l) the continuance and acceptance assessment completed has the entity assessed with a high “integrity” risk; and
 - (m) risk(s) or condition(s) included in the Audit Service Providers policies for when an engagement quality control review is required.
15. Where provision for an engagement quality control review is included in a proposal to carry out an annual audit on behalf of the Auditor-General and cited in the audit engagement agreement, the terms of the audit engagement agreement take precedence over the provisions in paragraphs 13 and 14 above, and the involvement of an engagement quality control reviewer will continue to be required in those annual audits.
16. Appointed Auditors shall apply the Auditor-General’s policies and procedures for engagement quality control reviews for annual audits in paragraphs 17 to 23. The Auditor-General’s policies and procedures take account of paragraphs NZ35.1 to 44 of PES 3 (Amended).

Auditor-General’s engagement quality control review procedures

17. The engagement quality control reviewer shall be an individual with sufficient appropriate experience and authority to act as the Appointed Auditor on the audit for which they are assigned as the engagement quality control reviewer.
18. In addition to meeting the Auditor-General’s independence standards required of Appointed Auditors, the engagement quality control reviewer shall remain operationally independent of both the engagement team carrying out the annual audit and the public entity.
19. The Appointed Auditor shall keep the engagement quality control reviewer informed of significant issues as they arise but shall acknowledge the engagement quality control reviewer’s operational independence by ensuring that they do not become involved in the resolution of issues. Resolution of issues shall occur within the

engagement team or by using other resources within or available to the firm.

20. If, after they have been appointed, it emerges that the engagement quality control reviewer may not be able to perform an objective engagement quality control review, the Appointed Auditor shall find a suitable alternative. If a suitable alternative engagement control reviewer cannot be found, the Appointed Auditor shall consult the OAG.
21. The precise nature, timing, and extent of the engagement quality control review will be left to the engagement quality control reviewer's professional judgement. However, as a minimum, the engagement quality control review shall include the matters set out in paragraph 22 below. The engagement quality control review shall be completed before the audit report is signed.
22. As part of performing the engagement quality control review, the engagement quality control reviewer shall:
 - (a) obtain an understanding of the entity's purpose, significant activities during the current year, and significant financial and performance reporting issues and risks;
 - (b) review the engagement team's evaluation of the firm's independence in relation to the annual audit;
 - (c) evaluate the judgements made – in particular, with respect to materiality and significant risks;
 - (d) evaluate the adequacy of engagement planning;
 - (e) evaluate judgements made about:
 - (i) the materiality and disposition of corrected and uncorrected identified misstatements; and
 - (ii) the severity and disposition of identified control deficiencies;
 - (f) determine whether appropriate consultations have taken place on difficult or contentious matters;
 - (g) read other information in documents containing the content that is subject to audit and evaluate whether the Appointed Auditor has taken appropriate action with respect to material inconsistencies with the content that is subject to audit or material misstatements of fact that the engagement quality control reviewer is aware of;
 - (h) review any document summarising the audit conclusions and confirm with the Appointed Auditor that there are no significant unresolved matters;
 - (i) discuss any significant and unresolved matters with the Appointed Auditor and ensure that the matters are appropriately resolved before the audit report is signed;
 - (j) assess, based on professional judgement, whether the documentation selected

- for review reflects the work performed in relation to the significant judgements made by the Appointed Auditor and support the conclusions reached;
- (k) determine whether appropriate matters have been communicated, or identified for communication, to the entity and to other parties, such as the OAG; and
 - (l) read the material that is subject to audit and the auditor's report that the Appointed Auditor is proposing to issue and ensure that the audit opinion is appropriate and that the auditor's report is worded in keeping with the Auditor-General's Statement AG ISA (NZ) 700 (Revised): *Forming an opinion and reporting on financial and performance information*.

23. The engagement quality control reviewer shall maintain sufficient documentation to demonstrate compliance with the requirements of this Statement.

Requirements for quality control review for work other than the annual audit

24. The Auditor-General, the Deputy Auditor-General, their staff, and Appointed Auditors and their staff shall apply the review responsibility and procedures in paragraphs 33 and A35 of PES 3 (Amended) in relation to work other than the annual audit.

Application and other explanatory material

Engagement acceptance and continuance procedures in relation to annual audits

(ref:para. 11)

- A1. It is important that the OAG is made aware of significant risks because the Auditor-General cannot decline an annual audit, and it is often inappropriate to decline other work because of public interest considerations. As a result, it would be necessary in this situation for the OAG, in conjunction with the Appointed Auditor, to actively manage the risks to the Auditor-General.