

**PES 3 (AMENDED) QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS  
AND REVIEWS OF FINANCIAL STATEMENTS, AND OTHER ASSURANCE  
ENGAGEMENTS**

**Explanation of Decisions made by the NZAuASB in Finalizing PES 3(Amended)**

**Issued January 2013**

This document relates to, but does not form part of Professional and Ethical Standard (PES) 3 (Amended) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance*, which was approved by the NZAuASB in December 2012. It summarises the changes made by the NZAuASB to the International Federation of Accountants (IFAC) Code and provides the compelling reasoning as to why the changes were made. It also summarises the major issues raised by respondents ED 2012-7 Professional and Ethical Standard 3 (Amended): *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*, and how the NZAuASB has addressed them.

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## **BACKGROUND**

1. The NZAuASB issued an exposure draft ED 2012-7 Professional and Ethical Standard 3 (Amended): *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements* on 22 May 2012, with a comment deadline of 30 August 2012.
2. PES 3 was not structurally aligned with the international equivalent standard, International Standard on Quality Control (ISQC) 1, issued by the International Auditing and Assurance Standards Board (IAASB). PES 3 included:
  - Quality control requirements at the firm level (as included in ISQC 1); and
  - Quality control procedures at an individual assurance engagement level for engagements other than audits of historical financial information, which is not included in ISQC 1. These requirements and guidance replicate the requirements of ISA (NZ) 220, *Quality Control for an Audit of Financial Statements*, which establishes quality control requirements at the engagement level but only applies to audits of historical financial information
3. ED 2012-7 proposed to make structural changes to the existing PES 3 by splitting the existing PES 3, and creating a new quality control standard PES 4. Proposed PES 4 was to cover the quality control requirements and application guidance at the engagement level for assurance engagements other than an audit of financial statements. This would enable a cleaner adoption of ISQC 1 at the firm level and more clearly indicate any New Zealand additional requirements. The proposals did not propose substantive changes to the existing quality control requirements. Seven submissions were received from professional bodies, firms and the Office of the Auditor-General.

## **MAJOR ISSUES RAISED BY RESPONDENTS ON EXPOSURE**

4. Respondents had mixed responses to the proposals. Some supported the proposed structural changes, while others queried the need for PES 4 at all. Some of them suggested that to reduce repetition, PES 3(Amended) should note that assurance providers should also consider the requirements in ISA (NZ) 220 where appropriate to other assurance engagements. Others preferred the existing approach, having one PES 3 to incorporate all quality control requirements.

## **HOW THE NZAuASB RESPONDED**

5. The NZAuASB has considered the specific requirements from proposed PES 4 which are currently not covered by the international standards. On balance, the NZAuASB decided that to reduce the level of repetition, and to more closely align with the international standards, it would be more appropriate to include any additional engagement level quality control requirements within the other assurance standards (ISAE (NZ) 3000, which will come under revision with the current IAASB project as well as the review standards which the NZAuASB expects to expose in Q1 of 2013).

The NZAuASB therefore agreed to withdraw the existing PES 3, issue PES 3 (Amended) and decided not to finalise PES 4 as proposed. Instead the NZAuASB decided to expose for comment additional New Zealand quality control requirements for individual assurance engagements within the New Zealand review engagement standards and when ISAE (NZ) 3000 is revised.

## **AMENDMENTS MADE TO ISQC 1 BY THE NZAuASB**

6. PES 3(Amended) is based on and closely aligns with ISQC 1. PES 3(Amended) however differs in scope from ISQC 1. ISQC 1 applies to related service engagements. The NZAuASB applied the Principles of Convergence to International Standards in developing this standard, and has only amended the international standard where there are compelling reasons to do so. Additional requirements are clearly identifiable as NZ paragraphs and are also described in the conformity with international requirements at the end of the standard. This explanatory document explains the compelling reasons identified by the NZAuASB to amend ISQC 1.

### *Scope*

7. PES 3(Amended) applies only to audits and reviews of financial statements and other assurance engagements. Related service engagements are not covered by the mandate of the NZAuASB, and are therefore scoped out of PES 3(Amended).

### *Emphasis on Sufficient Time*

8. Paragraph NZ31.1 emphasises that having appropriate time available is a consideration in assigning the engagement team. In paragraph 26 of ISQC 1, the IAASB has drawn attention to the fact that the firm must have the capabilities, including time and resources to perform the engagement. Again in paragraph A24, time is included as a component of capability. The application guidance to paragraph 30, paragraph A30 stresses that the engagement partner should have sufficient time to discharge their responsibilities.
9. The NZAuASB agreed to emphasise time in the requirement in paragraph 31 to similarly stress that time is an important part of being capable of performing the engagement. This is not intended to change the meaning of the ISQC 1 requirement but rather to emphasise, given its importance, that having sufficient time is part of the requirement to have the capability to perform the engagement.
10. Paragraph NZ34.1 adds a requirement to document the reasons alternative courses of action from consultations were undertaken. The NZAuASB is of the view that it is important, as a matter of maintaining the quality of documentation for assurance engagements in relation to exercising professional judgment, that in the event alternative courses of action from consultations are undertaken, the reasons for the decision to do so must also be documented.