Audit Quality Monitoring Report

1 July 2018 – 30 June 2019

FMA

FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

Contents

Purpose of this report

Under the Auditor Regulation Act 2011 we must carry out a quality review of the systems, policies and procedures of registered audit firms and licensed auditors at least once every four years. Where we note significant misconduct we refer these matters to the appropriate disciplinary bodies.

We are also required to prepare a report each year on the quality reviews we completed in the preceding financial year. Our reviews help improve audit quality and ensure audit opinions are reliable.

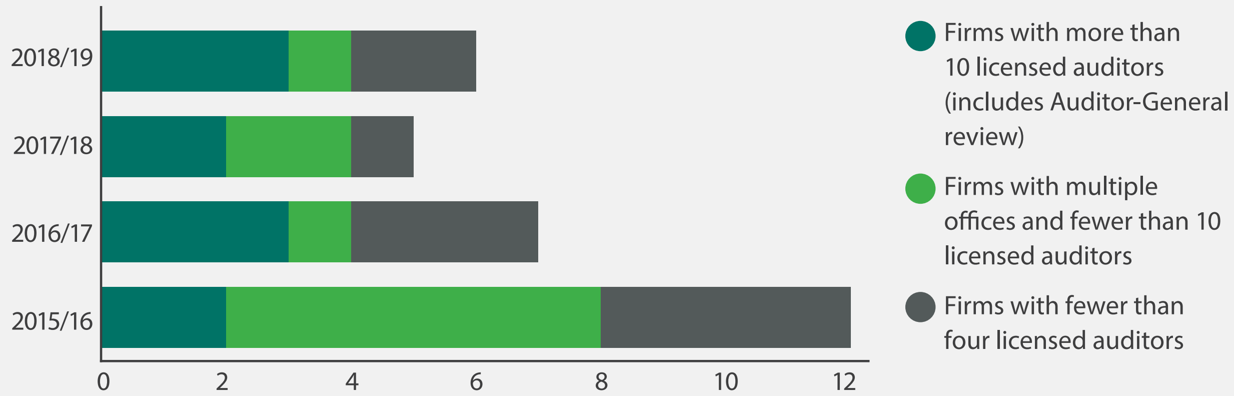
The reviews also help us to achieve our strategic goal of ensuring investors make active choices based on clear, concise and effective information.

This report summarises our findings from the quality reviews we carried out between 1 July 2018 and 30 June 2019. It is for:

- accredited bodies
- auditors
- chartered accountants
- company directors
- investors
- FMC reporting entities.

In this year's report, we highlight our expectations of directors and auditors of financial statements, and the key focus areas our stakeholders need to be aware of. We have also updated Audit quality – a director's guide, our handbook for how directors can contribute to improving audit quality.

Audit firms reviewed



The decrease in the sample size over time reflects the number of registered audit firms, which has dropped from 24 in 2016 to 18 this year.

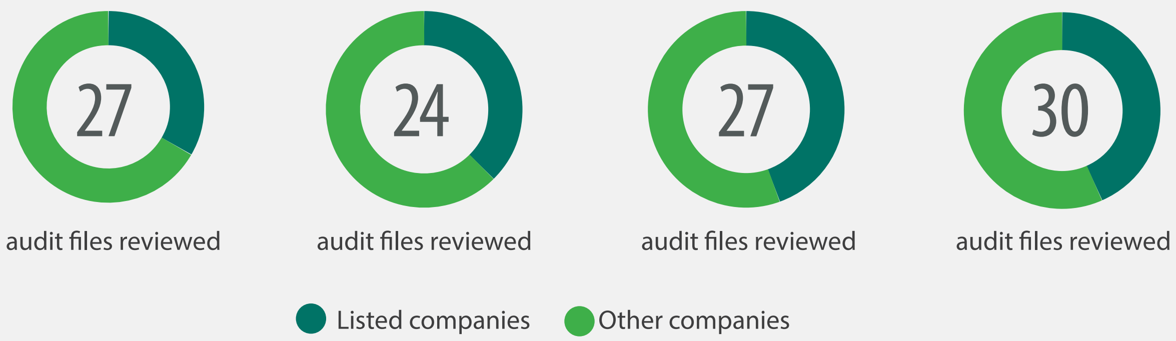
Audit quality reviews

2018/19 6 registered firms reviewed

2017/18 5 registered firms reviewed

2016/17 7 registered firms reviewed

2015/16 12 registered firms reviewed



Market snapshot

At 30 June 2019 there were...

132 domestic licensed auditors

18 domestic registered audit firms

205 NZX-listed companies

1,250 FMC audits

Audit quality in 2018/19

What we have seen

We have seen an improvement in audit quality since our last review cycle. However, we continue to see inconsistencies in how auditors apply the audit standards. This was visible in both our audit quality reviews and enquiries into specific issues. We have not seen any significant differences in audit quality between firms.

Our expectations for auditors

Audit firms need to give consideration to the users of financial statements when carrying out audits. Professional scepticism is not always applied well by auditors or communicated to directors.

Our expectations for company directors

Directors should take responsibility for the quality of their audit by providing high-quality information, as well as sufficient time and resources for the auditor to do their job effectively, and comply with the requirements to keep appropriate accounting records to support key accounting treatments. Low-quality information and/or poor internal accounting records often result in a low-quality audit. Directors should also improve communication to investors about the audit process and how they assess the quality of the audit.

Areas requiring attention

In this report we highlight the key areas that auditors and directors should focus on to improve their audit quality. These are areas identified in our review cycle as contributing to deficient audits or that could impact overall trust in auditing:

- Auditor independence
- Related party transactions
- Auditors response to fraud risk
- Accounting estimates

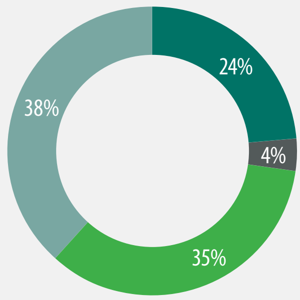
Progress made by the firms reviewed

Each of the audit firms reviewed during this cycle has been reviewed previously. Following each review we ask firms to develop a plan showing how they would prevent any identified issues from reoccurring. In the next review of the firm we test the effectiveness of these plans by comparing our current findings with previous findings to see if they have improved in the areas identified.

We saw improvements in most areas, but noted re-emerging issues associated with related party transactions and evidence obtained relating to accounting estimates. Firms should continue to focus on these areas.

The table below shows how firms performed in the 16 areas identified for improvement.

Level of improvement in areas noted in review



Findings fully addressed
Areas where firms implemented effective systems and procedures since our previous review

No improvements found
Areas where the planned system improvements to address our findings were not implemented or were ineffective

Significant improvement shown
Areas where firms implemented changes based on our findings and improvements were noted on the majority of audit files but were not fully effective across all reviewed files

Some improvement shown
Areas where firms implemented changes based on our findings, but improvements were only noted in some instances and were not fully effective across the majority of all reviewed files

Quality review follow-ups

When we rate an audit file as "non-compliant" we can take a number of actions. Our response depends on the nature of the findings and the timing of our review. In some cases we will also engage with the audited entity to obtain sufficient information to assess whether the financial statements were compliant with the accounting standards.

Outcomes and actions from non-compliant audit files – 2019	Number of files
Material misstatement identified and financial statements restated	2
Follow up with entity – no impact on the financial statements	1
Follow up with entity – additional disclosure required in financial statements	0
Insufficient evidence available to the FMA to make a reliable assessment of material misstatement	2
Investigation/referral in relation to audit conduct	0
Additional audit work required, impact to be assessed	4

Auditor independence

One of the key purposes of an audit is to provide an independent view of whether the financial statements are prepared in accordance with the accounting standards. We continue to find issues with independence through our monitoring – this year resulting in two referrals to the disciplinary body of CA ANZ for further investigation.

We have focused on the threat to independence that arises from audit firms providing other services ('non-assurance' services) to entities they audit. The perception that the audit was not performed independently (because the auditor may not have properly assessed work done by their own firm) can provide significant damage to trust in the audit profession.

While the data obtained from our reviews did not find a direct correlation between audit quality and the level of non-assurance work provided by the audit firm, we are nonetheless concerned with the negative public (and international) perception in this area. Given the heightened attention, we expect directors and auditors to give more thought to how other stakeholders may view threats to independence. If there is an indication that there could be a negative perception, we expect the auditor not to perform the non-assurance service.

Disciplinary procedures

This year, the Professional Conduct Committee of Chartered Accountants Australia and New Zealand (CA ANZ) concluded on one complaint involving two licensed auditors, following a referral from the FMA. The lead auditor on the engagement did not comply with the key audit partner rotation requirements. The auditor performing the engagement quality review failed to identify and report the breach. The auditors were severely reprimanded. CA ANZ recovered the $6,350 cost of these proceedings. Additionally, there are a number of other referrals currently being considered by CA ANZ. See page 26 for more information about the FMA's role in disciplinary procedures.

International developments

Audit quality has come under scrutiny in a number of jurisdictions over the past year, most noticeably the United Kingdom and Australia. The governments in both countries have initiated inquiries into audit quality, competition in the market and the role of the regulator. These inquiries are ongoing. Any determinations made as a result of these inquiries may have a flow-on effect on international auditing standards and practices.

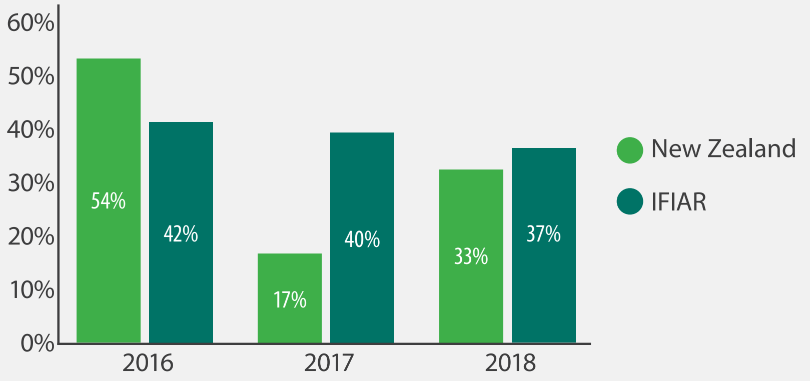
International comparison

The quality of work by New Zealand auditors appears to be similar to that of their international counterparts. Every year the International Forum of Independent Audit Regulators (IFIAR) compiles the inspection findings of various audit regulators for the six largest audit firms[1] for the audits of listed entities, including New Zealand. The survey findings provide an overview of key trends, the findings of audit quality reviews and the overall percentage of non-compliant audit files.

We have applied the same file rating standards as IFIAR in our audit quality reviews. The graph below compares our 'non-compliant' file ratings with those in the IFIAR report. Although we note a downward trend over time, the results indicate a lack of consistency in quality and the need for further improvement. The New Zealand level of non-compliance in audits reviewed remained at 33% in 2019; the 2019 IFIAR number was not available at the time this report was published.

Non-compliant audits – international comparison

Percentage of non-compliant audit files of listed entities performed by the six largest audit firms



Perceptions of audit quality

Earlier this year the FMA conducted a survey of investors, directors, managers and auditors to better understand the perceptions of audit quality in New Zealand. The research identified a significant gap between the expectations of investors and what auditors are delivering. An investor's perception of audit quality is affected by their experiences as the end user of financial information, for example when a company announces unexpected impairments subsequent to releasing its audited accounts.

We have spoken to audit firms about our expectation that they take the lead in better promoting the value of an audit.

1 BDO, Deloitte, EY, Grant Thornton, KPMG and PwC

Perceptions of audit quality in New Zealand

The survey

This year the FMA conducted a survey of investors, directors, managers and auditors to better understand the perceptions of audit quality in New Zealand. The survey identified a spectrum of confidence in audit quality across those surveyed, and in particular highlighted a significant gap between what investors expect from an audit and what the audit firms are delivering. Those with closer involvement in auditing (ie auditors, managers and directors) were more likely to be trusting of the audit process.

The survey identified differences in expectations in a number of areas, including:

- the independence of auditors
- professional scepticism and an auditor's ability to challenge management and directors when conducting their audits
- the value the audit provides to investors and directors
- level of oversight and publication of results of our quality reviews.

Actions of the FMA following the survey

We have engaged with various stakeholders on the results of our survey. In part, this engagement will help us to enhance our methodology and approach to audit oversight. This includes:

- improving our publications and guidance for auditors, directors and investors
- continuing to engage with key stakeholders and other agencies with an interest in audit
- continuing to monitor and get involved in international developments, and assess the impact of these for New Zealand.

We are also continually looking at ways to improve how we communicate with auditors, directors and the public about audit quality and the findings of our reviews. This includes considering what types of information may be useful to help improve general understanding of the purpose and outcomes of an audit.

Engagement with the audit firms

It is critical that investors understand the value and limitations of an audit to help inform their investment decisions. The findings and insights from the survey have been discussed with auditors in various forums, and we have asked audit firms to develop plans to:

- improve investor engagement between the audit firm and investors
- promote the value of audit to both directors and the wider public
- consider their approach to independence and whether this meets public expectations
- explain how they have responded to international developments.

The accredited bodies (CA ANZ and CPA) are also facilitating discussions with their members on the topics covered in our survey.

International developments in audit quality

Audit quality has come under scrutiny in a number of countries, most noticeably the United Kingdom and Australia. The governments of both of those countries have initiated inquiries, the outcome of which may have a significant impact on the audit landscape in these countries and on international auditing standards.

The inquiries mainly focus on:

- independence and the structure of audit firms
- the level of competition in the market
- the scope of audit procedures
- accountability of audit committees
- auditor oversight and the powers of regulators.

An overview of this activity is included in Appendix 2. We will be monitoring the recommendations made following these inquiries and, where appropriate, will adjust our own approach or propose changes to the New Zealand audit oversight framework.

We will also continue to monitor other jurisdictions on changes in audit legislation that may impact New Zealand.

International Forum of Independent Audit Regulators

The FMA membership in the International Forum of Independent Audit Regulators (IFIAR)[2] allows us to stay connected and understand international developments. This year FMA joined the newly established taskforce relating to internationally relevant developments in audit markets. The taskforce monitors developments within IFIAR member jurisdictions, to analyse the impact on the audit market and the potential impact on audit quality.

2 IFIAR is a forum that comprises independent audit regulators from 55 jurisdictions and has a mission of serving the public interest, including investors, by enhancing audit oversight globally.

Focus area: Directors' responsibility for audit quality

FMC reporting entities and their directors are responsible for preparing financial statements in accordance with the accounting standards set by the External Reporting Board (XRB). To produce compliant financial reports, the entity must have suitable systems, processes and controls, and sufficient resources. To contribute to good audit quality, directors should continually assess whether the finance functions of the entity are sufficiently resourced with the appropriate level of experience and knowledge. Directors should not rely solely on the auditor to ensure the financial statements comply with all financial reporting requirements. This undermines the objective of an audit, which is to provide independent assurance – and it is ultimately the entity's directors and management, not the auditor, who are responsible for the financial statements.

What we have seen

From our audit quality reviews and other work relating to FMC reporting entities' financial reporting, we continue to see a link between the quality of financial information on key accounting treatments held by the entity and the quality of the audit. This assessment is based on both audit files obtained from the auditor, and accounting papers obtained directly from the audited entities.

Following our audit quality reviews this year we engaged with three entities to obtain additional information necessary to conclude on accounting or disclosure matters. In all three instances we found that the entities did not keep sufficient records to properly support their accounting treatments.

Other examples of issues with information provided by the entity that impacts the quality of the audit include:

- The auditor was required to make a large number of audit adjustments related to basic accounting matters. For example, the entity had recorded revenue and costs in the incorrect accounting period. The entity should have better procedures in place to account for these transactions appropriately.
- The entity was unable to provide accounting papers to support key judgements made by management. In some instances this resulted in a qualified audit opinion.
- Information provided by the board and management was not checked for completeness or accuracy internally by the entity.
- Some entities had a very high level of manual processes for financial reporting, which increased the risk of error, fraud and management override of control.
- Boards had insufficient policies and procedures, and/or did not keep proper records in relation to related parties and related party transactions.
- Financial statements did not include information required by the accounting standards.
- Board minutes lacked documentation of key decisions made by directors, potentially impacting the auditor's risk assessment when reviewing the minutes of these meetings. Minutes also lacked discussions by directors challenging management on key accounting estimates.
- Issues raised in management letters or audit committee reports were not timely or appropriately addressed.

Our expectations for auditors

We expect auditors to promptly communicate to directors any instances where the audit team had difficulties getting the appropriate information or the information was of poor quality. We also expect auditors to communicate significant weaknesses identified in the entity's systems and processes in its audit committee report.

Where significant weaknesses are identified in the entity's governance, system or processes, the auditor should assess the impact of these failures as part of its risk assessment and consider if additional audit work is to be performed. We also expect audit firms to share guidance provided by the FMA on improving the quality of the financial statements and the directors' role in audit quality.

If not initiated by the board, auditors should ask to talk to directors separately from management to discuss whether or not any issues with management arose during the audit. If auditors have concerns about any poor conduct by directors they may wish to contact the FMA directly.

What directors can do

Directors should familiarise themselves with the FMA's guidance on audit and financial reporting, including:

- Audit quality a director's guide
- Disclosure of significant accounting estimates
- Improving financial statements.

Directors and audit committees should provide a trusted environment where auditors can raise differences and challenge management opinion without the risk that the audit relationship will be discontinued in the next year. It is therefore important that directors own the relationship with the auditor and resolve any potential conflicts. Not providing a trusted environment may lead to poor audit outcomes.

We expect directors to lead the relationship with their auditor and proactively engage with improving the quality of information provided to auditors. This includes approving all services provided and fees paid to the auditor.

FMA focus

Our audit quality reviews and financial reporting reviews continue to assess the quality of information provided to auditors by FMC reporting entities. We will engage with directors in instances where more information is required to form a view of whether financial statements are free of material misstatements. We may also make recommendations on how directors can improve the quality of information, or issue directions if we believe recommendations are not effective.

Focus area: Auditor independence

Why independence is important

The purpose of an audit is to enhance the degree of confidence users have in the financial statements. The role of the auditor is to provide an independent view on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

If users of financial statements believe the auditor did not appear to be independent, this may impact confidence in the financial statements, trust in the auditor and trust in the audit profession.

What we have seen

Although our reviews have identified improvements in independence considerations by auditors, we continue to find issues in individual audit files.

Our audit quality reviews include looking at audit firms' compliance with independence standards across all selected audit files. For large audit firms we select additional files to review just for compliance with independence requirements, focusing on files where the firm provided extensive non-assurance services to the entity. This year we reviewed eight additional audit files.

Our continued focus in this area has resulted in improvements in auditors' assessment and documentation of their compliance with the independence standards. Communication to those charged with governance regarding services provided by the audit firm, consideration of possible threats to the audit firm's independence and how the firm intends to mitigate the threats has also improved.

From our audit quality reviews and other monitoring work we noted the following issues:

- Two breaches[3] were identified where the auditor did not comply with the requirements of the Professional and Ethical Standards[4]. These breaches related to:
  - the audit firm preparing financial statements and then auditing them
  - the lead auditor on the engagement not complying with the key audit partner rotation requirements.
- Financial statements did not correctly reflect the fees paid to the auditor, resulting in both understated and overstated amounts, and certain services not being disclosed.
- An audit firm did not appropriately document its considerations regarding the impact of a former partner of the firm being appointed as a director of an entity audited by the firm. Although the partner had a one-year stand-down period, the auditor did not take into account:
  - the position the individual had taken at the client
  - the level of involvement the individual would have with the audit or review team
  - the length of time since the individual was a partner of the firm or network firm
  - the former position of the individual within the audit firm or network firm.
- Lack of documentation relating to independence in appearance and how non-assurance services may be perceived by users of financial statements. Examples include:
  - providing non-assurance services costing many times more than the audit fee

3 Both breaches are included into the disciplinary actions set out on page 26.

4 PES 1 Code of Ethics for Assurance Practitioners issued by the External Reporting Board.

- a board having one or more directors that have been a partner at the entity's audit firm
- the audit firm providing a variety of services to the entity across a range of service lines.

- Lack of clarity around how the audit firm ensured that threats to independence were sufficiently mitigated by audit procedures. From assessing documentation on audit files, we have concerns that mitigation measures may not always be effective. Examples include:
  - Where audit firms provide staff on secondment to an audit client, it is unclear if the client's staff or management are appropriately qualified to supervise and ensure that no management responsibilities are provided by the seconded staff member.
  - Where audit firms provide complex tax advisory services that are reviewed by a different tax partner of the firm as part of the audit, the documentation and the limited time taken to perform the review did not always provide assurance that the second partner had sufficiently challenged the advice.
  - Audit firms providing advice on acquisitions that are also subject to impairment testing, which can put the audit firm in a difficult position if findings from the audit contradict the advice provided earlier.

Our expectations for auditors

Auditors should approach independence with the highest integrity and, when in doubt, take a conservative approach. While the Professional and Ethical Standards do allow the provision of certain non-assurance services, auditors should put themselves in the shoes of the financial statement users and consider how this may be perceived. In line with public expectations, we expect auditors to give more consideration to these matters, to protect the integrity of the audit. These considerations should be clearly reflected in the audit files.

FMA focus

As a result of our reviews, audit firms have agreed to provide additional training to all their partners. We will continue to review independence for each audit file and extend our research into the level of non-assurance services audit firms provide to their clients. We will also increase our engagement with FMC reporting entities about concerns of auditor non-compliance with independence requirements, and areas where directors could help improve this compliance.

Directors' role in auditor independence

Directors play a key role in maintaining the independence of the auditor. Directors should think carefully before asking their audit firm to provide other services and should keep in mind how these services could be perceived by the public. Directors should approve all non-assurance services provided by the audit firm, and the fees for these. Where audit firms do provide non-assurance services, directors should challenge the audit firm on how this would impact the audit work, and how the audit team will ensure sufficient scrutiny when testing non-assurance work.

Non-assurance services

The graph below shows the breakdown of fees paid by NZX50 entities to their audit firm for audit, assurance and non-assurance services[5].

Audit fee

The audit fee includes the fees charged for the audit of the financial statements and half-year audits or reviews.

Other assurance fees

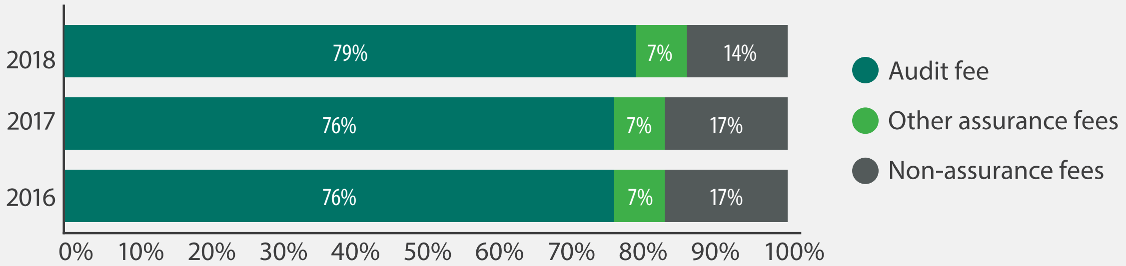
These services provide assurance to the entity in areas other than the financial statement audit. These services don't impact the independence of the auditor. There are certain services, such as assurance related to compliance with Reserve Bank or Electricity Authority requirements, and AML/CFT audits, that we expect the auditor to perform.

Non-assurance fees

Non-assurance services have a higher independence risk as they may create self-review, self-interest or advocacy threats. These threats should be appropriately addressed by the audit firm. The level of non-assurance services is not the only benchmark for independence concerns – the nature of the services and the closeness of the relationship between the audit firm and the entity and its personnel also play a role in the assessment of independence.

From our reviews we have not found any correlation between the level of non-assurance services provided and the quality of the audit. As shown in the graph below, the level of non-assurance services compared to audit services is relatively low for NZX50 entities.

Fees for services provided to NZX50 entities by their auditor



5 The breakdown of fees was obtained from the entities' publicly available financial statements. Where entities operate in multiple jurisdictions we have only included the fees for the New Zealand business, if this information was separately disclosed. Where this was not separately disclosed, the entire audit fee was included.

Focus area: Related party transactions

Why related party transactions are important

New Zealand's financial reporting framework requires entities to disclose any related party transactions, describing the nature of the relationships, amount of transactions, and balances. This enables users of the financial statements to understand the nature and impact of these transactions and relationships on the financial statements, and whether the transactions were beneficial to the entity.

Although related party transactions may occur in the course of normal business, because the entities are not entirely independent of each other, the transactions may carry a higher risk of material misstatement in respect of:

- non-identification or non-disclosure
- complexity of transactions and ability to appropriately account for them
- fraud being conducted by the entity or the related parties
- the entity's ability to continue in business as a going concern, if the entity's interest is subordinated to that of related parties, or the transactions put undue pressure on the entity's performance.

The auditing standards require auditors to obtain sufficient audit evidence regarding the accuracy and completeness of disclosure of related parties and related party transactions in the financial statements. When entities state that the transactions are on an 'arm's-length' basis, it is also important that the auditors verify this or otherwise ensure relevant information about the transaction is disclosed in the financial statements.

What we have seen

In our first review cycle we noted a number of compliance issues when applying the accounting and auditing standards in respect of related party transactions. Although audit firms put remediation plans in place to address our findings, we continue to find issues where auditors did not always:

- assess the audit risk appropriately. Often auditors rated related party transactions as low risk even when there were significant transactions
- make enquiries to understand any procedures the entity had in place to identify related parties and related party transactions, and what controls, if any, existed to review and ensure accuracy and completeness
- search for undisclosed related parties, for example by reviewing the Companies Office register for directors or key management personnel, to determine if the entity's list was complete
- perform procedures to review the completeness and accuracy of related party transaction disclosures. Auditors often reconciled the information to prior-year disclosures or documents prepared internally by the entity, without considering if other records existed or any other related party transactions were evident in the system
- identify that work papers

throughout the audit process had identified related parties or transactions that were not disclosed in the financial statements

- identify that some transactions occurring within the entity were unusual, and therefore failed to try to understand why they were occurring and, if those transactions involved related parties, the additional risks posed by that
- question the rationale of directors allowing certain related party transactions to take place. There was little evidence of professional scepticism being applied when reviewing these transactions and, in particular, little challenging of management assertions that the transaction has been made at arm's length
- resist pressure from an entity to restrict access to certain sensitive information about related party transactions or key management personnel expenditure, which we believe can impact the quality of the audit
- in instances where work on sensitive information was performed by the most senior team members, we were concerned that findings or issues were not properly recorded, shared with other team members and considered as part of other audit work.

Related parties and materiality

The concept of materiality is described in the accounting standards issued by the XRB. An FMC reporting entity has to consider whether a related party transaction is material, due to either its size or its nature. A materiality test based on size alone can result in transactions not being disclosed if the size of related party transactions is small in comparison to the operations of the entity.

It is important for users of financial statements to understand relationships and dealings between an entity and its related parties, including directors and senior management. Transactions between related parties are therefore often deemed material due to their nature, regardless of their size, and in our opinion should be disclosed.

Our expectations for auditors

Audit firms should consider if their current procedures are sufficient to address risks associated with related party transactions. It is important that auditors apply sufficient professional scepticism when reviewing related party information, including whether all related parties and transactions have been captured. It is also important to ensure sufficient work has been done when an entity states in its financial statements that related party transactions have been conducted on an arm's length basis. The adequate disclosure of related party transactions is critical for investors to understand relationships the entity has that are not independent, and the impact these relationships have on the business. We therefore expect disclosure requirements to be complied with in all instances.

What directors can do

Directors have a number of duties under the Companies Act when it comes to related parties. Under the FMC Act 2013 special rules apply for related party transactions for registered schemes and DIMS providers. The FMC Act also notes that financial statements must comply with NZ IFRS. Directors are also required to provide specific representation to their auditors that related party relationships and transactions have been appropriately accounted for and disclosed in the financial statements. Certain related party relationships are difficult for auditors to identify, so it is important for directors to have appropriate policies and procedures in place, and to ensure these are complied with.

Guidelines for establishing appropriate processes to report related party transactions to your auditors include:

- Directors and management should ensure they are aware of their various legal obligations and the requirements of accounting standard NZ IAS 24.
- Board meetings should include an agenda item to remind directors to review and affirm appropriate disclosure of all relationships and transactions. This affirmation should be appropriately minuted and included in the entity's interests register.
- Board and management should have a clear policy in place regarding related party transactions. This should include a robust process for determining if related party transactions are in the best interest of the entity and investors. The process should include appropriate documentation and approval requirements. Related party transactions should be assessed by the board, and any conflicted members should be excluded from this assessment.
- Management should have procedures in place to review the accuracy and completeness of related party lists and related party transactions.
- Clear sanctions should be put in place for failure to disclose related parties or related party transactions.
- Directors should trust the auditor's policies and processes for keeping information confidential, even with sensitive matters such as related party transactions and key management personnel remuneration. Entities must not request this information be treated differently than any other audit evidence.
- The disclosure of related parties and related party transactions in the financial statements should be reviewed in detail by the board to ensure everything is appropriately disclosed.
- The board should have a procedure to ensure regular monitoring of the entity's processes and controls takes place, including capturing all related party information. This would include policies for all board and staff members to follow.

FMA focus

The audit firms reviewed confirmed that, although their audit methodology did include the necessary processes to obtain the required evidence for related party transactions, the execution of audit work in this area did not always meet the required standard. As a result of our reviews, audit firms have agreed to provide additional training to all audit personnel and include a specific monitoring process to test the effectiveness of this training. We will increase our focus on related party transactions in our quality reviews, and engage with entities regarding any instances of non-compliance found.

Focus area: Auditor response to fraud risk

Auditors provide assurance that the financial statements, taken as a whole, are free from material misstatement caused by fraud or error. The auditing standards require auditors to perform audit procedures to assess the risk of fraud and to obtain sufficient audit evidence to mitigate the risks identified as part of their assessment.

In each audit, auditors must assess the risk of fraud due to management override and the possibility of fraud in revenue recognition. It is also important for auditors to understand other laws and regulations that entities have to comply with, especially if they have regulatory requirements set by agencies such as the FMA or the Reserve Bank of New Zealand. In these instances it is important to review the entity's historical compliance with laws and regulations. Non-compliance with regulatory requirements often has significant impact on the overall financial statements. Therefore, management may be incentivised to commit fraud by adjusting financial records to meet licence conditions, for example net tangible asset calculations.

Why is it important?

Fraud has a significant impact on investors' trust, not only in the area impacted by the fraud but also in the overall integrity of the entity's financial statements and governance. The auditing standard identifies the importance of fraud and sets out specific procedures to identify potential frauds. Directors are required to make written representations to the auditor about their duties in relation to fraud.

What we have seen

As part of our audit file reviews we look at the auditor's assessment of the risk of fraud and the audit procedures they perform to address the identified risks. Our reviews have identified that fraud risk procedures require improvements. In recent years we noted that audit firms are using more automated tools to obtain audit comfort in this area. These tools are often used to review journal entries and may include a larger population of transactions than when manual procedures are performed.

Our reviews have identified the following areas that require improvement:

- Discussions with directors, management and staff to assess any fraud risk factors, including discussing known fraud and the potential of fraud.
- Understanding factors that may amount to financial reporting fraud, for example application of incorrect accounting principles or management biases in valuations or impairments.
- Documentation of the audit team's fraud risk discussion to ensure the entire team has visibility of the risks when performing their audit work. We noted instances where fraud risk indicators were detected through the audit work but not appropriately addressed.
- Use of professional scepticism, including:
  - questioning management and obtaining sufficient evidence when transactions don't follow the normal course of business, for example transactions performed directly by directors

- assessing why entities make changes to their accounting treatments, whether these changes meet the requirements of the standard, and the potential impact of these changes
- obtaining a full understanding of complex transactions. Auditors should understand the impact of these transactions on the financial statements as a whole. Questions should also be asked if these transactions don't have clear benefits for the entity.

- Testing journal entries. During our reviews we noted the following examples that did not comply with the standards or impacted the effectiveness of the audit procedures performed:
  - The audit documentation regarding the fraud risks identified did not match the audit work over journal entries, and therefore the testing did not address the risks. For example, the auditor assessed that there were risks of fraud in revenue recognition, but no revenue journal entries were selected as part of the sample.
  - The auditor did not document their audit work regarding the completeness of the journal entries tested.
  - When testing journal entries, the auditor did not review the supporting documentation.
  - The auditor identified that the control environment was not effective, but this did not seem to have an impact on the level of testing performed by the audit team. Examples of an ineffective control environment included a very high level of manual journal entries throughout the period, no segregation of duties, and no approval processes regarding the processing of journal entries.
  - Audit teams did not identify any high-risk journal entries due to the risk criteria selected in their automated analytical software, and therefore did not test any journal entries.

Our expectations for auditors

We expect auditors to increase their efforts to identify the risk of fraud. They should plan and carry out appropriate procedures to address identified risks. Given material misstatement due to fraud can occur throughout the period, and may involve extensive efforts to conceal how the fraud is accomplished, we expect auditors to be alert to this and not simply take a predictable 'check-the-box' approach to testing the risk of fraud. The audit standard requires auditors to perform a level of unpredictable procedures to address this risk, which should be clearly documented in their approach. We expect auditors to collaborate more with their firm's internal fraud specialist when designing appropriate procedures for the entities they audit.

What directors can do

- Review if the entity's policies and procedures to prevent fraud are sufficient. This includes ensuring there is segregation of duties, especially in relation to the processing and approval of journal entries and access to bank accounts.
- Ensure that there are policies and procedures in place to detect potential fraudulent transactions and that these procedures are regularly tested for effectiveness.
- Annually perform a detailed risk assessment of areas of potential fraud. This should include an assessment of financial reporting fraud and areas of management and director bias.
- Discuss the entity's risk assessment with the auditors as part of the audit planning process and ask for feedback on the effectiveness of the procedures.
- Consider if specific reviews or assurance engagements are required by an independent third party in areas where there is a heightened risk of fraud.
- Assess if management incentive schemes are appropriate and ensure they don't increase the risk of fraudulent behaviour, such as management biases in key areas of the financial statements.
- Question auditors about the audit procedures performed in response to the risk of fraud (without the presence of management), such as:
  - which fraud risks the auditor has identified
  - how the auditor addresses the risk of management override
  - how the auditor has tested journal entries, and if and how they used specific data analysis tools to perform this testing
  - whether they have involved any experts in detecting fraud
  - whether your policies and procedures for preventing fraud are fit for purpose.

FMA focus

The audit firms agreed that the audit files needed more documentation and evidence to support how the risk of fraud is addressed. Our findings often included specific concerns about how journal entries were tested. The firms have agreed to provide additional training to all audit personnel in this area. We will continue to review the auditors' assessment of fraud risks and the work done to mitigate these risks in our audit file reviews.

Focus area: Accounting estimates

Why is it important?

The appropriateness of estimates and judgements is important because of their impact on financial results and the going concern of the company. To make these assessments, entities may use their own staff or a third-party expert to support its estimates and judgements. Experts that may be used include actuaries, financial analysts, valuers and engineers.

Examples of areas that may be impacted by estimates and judgements include (but are not limited to):

- valuations of certain assets and liabilities at fair value
- investments in unlisted entities
- complex accounting for revenue transactions
- assessment of the going concern of the entity
- impairment assessments on significant assets.

What we have seen

In our audit file reviews, we look at the quality of the financial statement disclosure in relation to estimates and judgements. Significant changes from the prior year or large impairments may cause us to look more deeply at the work completed around estimate and judgements. Some recent reviews revealed a lack of disclosure in these areas, particularly for estimates and judgements containing a high level of uncertainty.

The auditing standards set out the objectives and the steps auditors should take in relation to estimates. When experts are used in these areas the standards set out what auditors should consider in relation to the expert's work. We often see auditors try to provide evidence to support the expert's judgements and estimates, rather than forming their own judgement. This is not the intention of the standard, which requires audit teams to perform procedures to test if the estimates are reasonable, for example by developing a point estimate or a range of estimates. When reviewing the work of an expert, the auditor should challenge the methods and assumptions used by the expert.

Over the past few years we have noted improvements by auditors in documenting their assessment of more complex areas of estimate and judgement, but more work is needed in the following areas:

- Assessing the reliability of estimates used in prior year financial statements.
- Questioning or testing management assumptions such as growth assumptions and budgets.
- Evaluating key assumptions and performing sensitivity analysis to determine the impact of each assumption, and consideration that multiple assumptions can move together at the same time.
- Assessment of whether the financial statement disclosure is clear and concise, and includes all key information for investors to assess the impact of (sometimes small) changes in key assumptions.
- When auditors are relying on experts (either the firm's internal experts, or experts used by the entity) we expect to see the following:
  - The assessment of the completeness, accuracy and reasonableness of source

data used by the expert.

- The audit team's documentation of the understanding of the expert's work. This includes identifying key data and assumptions that impact the overall valuation, the instructions sent to the expert and the methods used by the expert.
- Auditors sufficiently addressing the impact of the management expert's or internal expert's disclaimers regarding completeness of information or reliability of data.
- The work of experts may vary significantly in scope. The auditor needs to understand the expert's scope and perform additional audit work to mitigate any areas that were not included in the expert's scope.

Our expectations for auditors

Auditing estimates and judgements may include auditing complex valuations. Challenging the entity in these areas requires highly skilled staff. We expect audit teams to set appropriate thresholds within which these judgements can move. It is important that auditors require the entity to provide sufficient disclosure in the financial statements about the impact of the changes in the assumptions supporting these valuations.

The engagement partner should be involved in planning and executing these procedures, and is expected to attend key meetings. In complex areas that are outside the expertise of the auditor, we expect the audit firm to engage its own expert to assess the relevance and reasonableness of the key assumptions and methods used. If insufficient information is available, the auditor should assess the impact of this on the audit opinion.

What directors can do

- Engage early with your auditor and advisers on complex accounting matters to ensure that all information is provided to the auditor on a timely basis.
- Provide clear and concise disclosures regarding the key estimates in the financial statements. When valuations are affected by small changes to these estimates, the impact of these should be disclosed.
- When using external experts, ensure they are sufficiently independent from management, and identify areas of management bias.
- Meet with independent advisers and/or management on key accounting matters to obtain a good understanding of judgements made, to assess the impact of these judgements on the accounting treatment.
- Challenge management and experts on key assumptions that impact valuations.
- Where management or external experts include disclaimers in their valuation report, ensure you fully understand the effect of these disclaimers on the overall level of uncertainty of the valuation, and how this should be disclosed in the financial statements.
- Ensure that auditors receive information on a timely basis, to allow them sufficient time to audit the more complex parts of the business.
- Discuss with the auditors their understanding of:
  - the business and its risks
  - key judgements made by management and the evidence they obtained to support the outcomes of their audit work
  - management biases as a result of performance-based incentives.
- If the auditor and management had different views, understand how they resolved their differences and how the auditor supported their views with appropriate evidence.
- Facilitate an open dialogue where the auditor can discuss challenges with the audit committee about management's estimates and judgements.

FMA focus

Due to the significant impact of estimates and judgements, we will continue to include these areas in our audit quality reviews. Our Financial reporting reviews also focus on this area. In response to our findings, audit firms told us that they will provide additional training for their audit staff in this area and include this as an area of focus in their internal quality reviews. We will review whether these measures have been effective at reducing issues in this area.

Focus area: Auditing credit unions

There are currently nine credit unions operating in the New Zealand financial market, with an approximate retail exposure of $550m. These entities have a large number of small investors, and therefore issues in this sector may have a far-reaching impact on market confidence.

Some credit unions operate their own systems, but others rely on the provision of shared, centralised support services. Audit firms may therefore audit an individual credit union, the service organisation, or both.

In the last two reporting periods we have reviewed a number of credit union audits. These audits are not highly complex, but the auditor still needs to exercise an appropriate level of professional scepticism.

What we have seen

We noted a number of areas where the auditors did not obtain sufficient evidence to support their audit opinion.

In most files reviewed we noted issues in both the design of the audit approach and the execution of audit procedures. The most common finding was in relation to auditors placing reliance on the credit union's operating system without performing required audit procedures. This was particularly evident when the audit firm was not the auditor of the service organisation. It is important that sufficient procedures are performed to ensure reliance can be placed on these systems.

Examples of issues noted

During our reviews we noticed a number of issues relating to the following parts of the audit:

Internal controls

- There was no clear documentation of the auditor's assessment of material risks at each assertion level. The auditor often failed to identify key controls, which resulted in insufficient testing.
- Where testing of controls did occur, the auditor did not always appropriately consider whether the initial design of the control was effective. Where deficiencies were identified, the auditor did not assess the impact of those deficiencies and whether additional procedures were required.
- Where the credit union relied on the control environment of a service organisation, the auditor did not always:
  - test the underlying application controls of the credit union
  - assess the controls appropriately, especially to understand the scope and limitations
  - assess the impact of limitations of the controls report on the audit.

Substantive testing (test of detail)

The most common findings related to the testing of the existence and accuracy of member loan balances. Issues identified included the following:

- The auditor did not apply the firm's sampling methodology when selecting sample sizes, and samples were not representative of the entire population.
- In testing the existence of loans, the auditor often relied on documents produced by the entity rather than information from independent sources, such as the original signed loan document. Insufficient audit evidence was obtained regarding reliability of internally produced documents.

Substantive analytical procedures

When testing interest income and expenses, auditors often performed substantive analytical procedures. These procedures were often not performed in accordance with the standards and therefore did not provide sufficient audit evidence. The main findings include:

- Assessing whether there were plausible relationships between historical financial data and non-financial data in order to fully understand trends and reasons behind particular movements.
- Insufficient evidence was obtained to support unexpected movements.
- Relying on entity-produced reports without checking or testing aspects of reliability, such as controls over the preparation of the information, to determine integrity of the data.

Our expectations for auditors

It is important that the auditor's knowledge and understanding of the credit union is appropriately documented. Areas we expect auditors to improve include the following:

- Documentation of their understanding of the entity's control environment, including assessment of the design.
- Ensuring a robust risk assessment is made at each assertion level. This should include mapping the appropriate controls assessment, controls testing and substantive testing.
- When relying on controls, these should be appropriately tested throughout the period. If reliance is placed on the IT environment, ensure this is appropriately tested, including the credit union's systems and the application controls it intends to rely on.
- When a substantive testing approach is taken, this should include an appropriate sample of existing and new loans to ensure it represents the entire population being tested.
- If the auditor does not request third-party confirmations from members, they should carefully consider and document what additional procedures are required to obtain sufficient evidence over the accuracy and existence of loans.

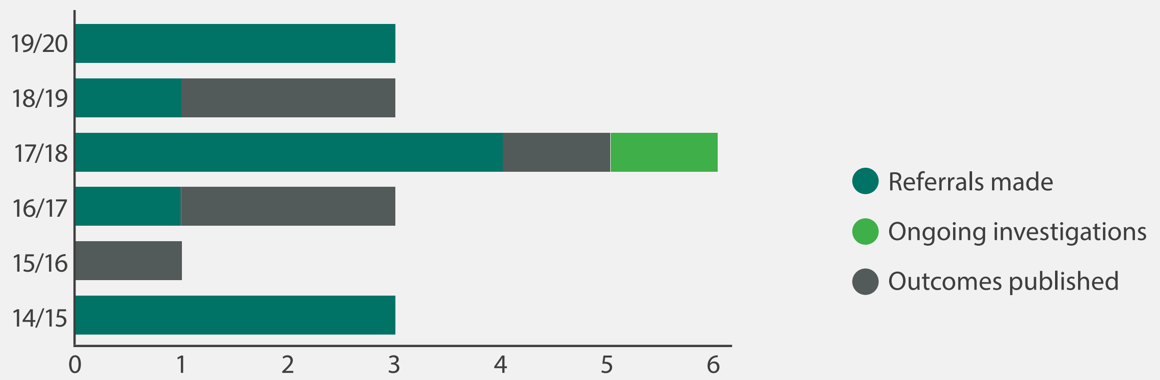
Disciplinary procedures

One of the functions of accredited bodies, as set out in the Auditor Regulation Act, is to take appropriate action against misconduct by licensed auditors. Our role is to review whether the accredited bodies have appropriate systems, policies and procedures to meet the requirements for taking action against misconduct. Accredited bodies have the primary role to investigate auditor conduct. The FMA is only able to investigate matters that accredited bodies decide not to investigate or have asked us to investigate.

Following our audit quality reviews, we may ask the relevant accredited body to assess if the auditor has breached the Auditing and Assurance Standards. These referrals are made if we believe the potential breaches have had a significant impact on audit outcomes, or where Professional and Ethical Standards have been breached.

The graph below provides an overview of how many matters we have referred or have been involved in with accredited bodies. This includes any instances up to the date of issuing this report.

Number of matters referred to accredited bodies



Areas of concern being investigated include:

- Independence in relation to providing non-assurance services
- Auditing of related party transactions
- Auditing of estimates and judgements
- Reasonable care, diligence and skill applied by the auditor

In the 2018/19 year, the Professional Conduct Committee of Chartered Accountants Australia and New Zealand (CA ANZ) concluded on one matter involving a breach of independence for the long-association of the audit partner.

Outcomes of disciplinary procedures are documented on the audit register and on the accredited body's website.

Future focus

Our 2019/20 quality reviews and audit file selections will continue to focus on the risks that the nature of the FMC reporting entity's business pose to investors, and will build on the results of our previous reviews.

In our audit quality reviews we will increase our focus on the successful implementation of audit firms' post-review plans, and improvement in the areas highlighted in this report.

In our approach we take into account the findings of our financial statement reviews. We are also mindful of national and international developments impacting the audit industry, and will assess whether we need to change the way we administer our oversight to meet our objectives.

More information on our key focus areas and how we conduct our reviews can be found in our Auditor Regulation and Oversight Plan 2019-2022.

Appendix 1 – Audit oversight regime

Oversight of FMC auditors

The Ministry of Business, Innovation and Employment (MBIE) sets the policies for the oversight of auditors of FMC reporting entities. The regulations are set out in two key pieces of legislation:

- The Financial Market Conduct Act 2013 (FMC Act), which establishes which entities require their financial statements to be audited by a licensed auditor/registered audit firm
- The Auditor Regulation Act 2011 (AR Act), which sets out the rules regarding the licensing and oversight of auditors of FMC reporting entities

What are FMC reporting entities?

The FMC Act defines an FMC reporting entity as:

- an issuer of a regulated financial product (for example managed investment schemes and other registered schemes)
- listed entities
- registered banks and licensed insurers
- credit unions and building societies
- a number of other licensed entities under the FMC Act.

Financial Markets Authority

The Financial Markets Authority (FMA) is the Crown entity responsible for enforcing securities, financial reporting and company law as they apply to financial services and financial markets. This includes the regulation of auditors of FMC reporting entities, and the accreditation and monitoring[6] of professional bodies. The FMA also licenses and registers overseas auditors and audit firms.

External Reporting Board

The External Reporting Board (XRB) is an independent Crown entity responsible for standards related to auditing in New Zealand. In relation to FMC reporting entities, the XRB has issued the following standards:

- Accounting Standards, which each FMC reporting entity must comply with
- Auditing and Assurance Standards, which all auditors must comply with when auditing FMC audits.

Both standards are based on international standards: the International Financial Reporting Standards (IFRS) and International Auditing Standards (IAS).

Professional bodies

Two professional bodies in New Zealand have been accredited by the FMA: Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia. To be accredited these bodies are required to have adequate and effective systems, policies and procedures in place to perform the following functions:

- licensing domestic auditors and registering domestic audit firms using the standards set by the FMA
- monitoring those auditors and registered audit firms
- promoting and monitoring the competence of these members
- taking action against misconduct.

All licensed auditors can be found on the Auditors Register.

6 CA ANZ reports; CPA Australia reports

Monitoring the quality of audits

At the beginning of each year the FMA issues an Auditor Regulation and Oversight Plan. This plan helps licensed auditors, registered audit firms and accredited bodies to understand how FMA will approach auditor regulation and which areas we will focus on during our reviews.

Annually we report on our findings by issuing the following reports:

- Audit Quality Monitoring Report (this report)
- Audit quality: a director's guide.

Quality review methodology

We assess an audit firm's compliance with the standards and the requirements of the AR Act by:

- looking at the firm's overall quality control systems for performing compliant FMC audits
- reviewing a selection of individual FMC audit engagement files to see if a file complies with the above systems and the Auditing and Assurance Standards issued by the XRB.

We review the 'Big Four' firms every two years, and all other firms every three years. As a result of our Memorandum of Understanding (MOU) with the Auditor-General, we may review audits of FMC reporting entities carried out by private audit firms on behalf of the Auditor-General. The results of these reviews are included in this report and our findings are communicated directly to the Auditor-General.

All of our reviews undergo a robust moderation process. Each audit quality review assessment report is peer-reviewed by a reviewer not involved in the initial review. Our final report goes to the Auditor Oversight Committee (AOC) for consideration. The AOC provides an independent forum to review the consistency and fairness of all quality review reports. The AOC comprises a diverse group of professionals including ex-auditors, company directors, and others with relevant experience who are independent of the audit profession.

Quality control framework

The requirement of a quality control system is set out in the Professional and Ethical Standards, and Auditing Standards. Our assessment of an audit firm's quality control system focuses on whether:

- the system complies with the relevant standards
- the system's policies and procedures are followed
- the system contributes to high-quality FMC audits.

We also evaluate whether the firm's internal monitoring of its audit quality control system is effective. This internal monitoring includes the firm performing an internal engagement quality control review (EQCR) on each FMC audit file.

The EQCR is a process designed to provide an objective evaluation of the significant judgements the audit team has made and the conclusions reached in the auditor's report.

We have prescribed additional requirements[7] for this EQCR given its importance to the audit process. We expect the EQCR partner to be suitably qualified and have relevant experience to enable them to give an objective evaluation. They should also be involved in key decision-making to make sure the audit has an effective process.

7 Paragraph 8(1)(f) of the Auditor Regulation Act (Prescribed Minimum Standards and Conditions for Licensed Auditors and Registered Audit Firms) Notice 2012

Individual file reviews

We carry out individual audit file reviews to check the auditor has complied with Auditing and Assurance Standards, and exercised reasonable care, diligence and skill in carrying out the audit.

Key attributes of audit quality are:

- an independent audit is carried out by a licensed auditor
- the auditor demonstrates appropriate levels of professional scepticism
- adequate and appropriate audit evidence is obtained
- the auditing and assurance standards are followed
- an appropriate audit opinion is issued.

File selection and ratings for individual audit files

The number of audit files we select for each audit firm is determined by the number of licensed auditors at the firm, the number of FMC audits completed and the results of the firm's previous review.

In selecting specific files for review, we take into account:

- businesses of significant public interest given the value of financial products issued to the public (such as KiwiSaver schemes, banks, insurance companies and businesses listed on the NZX)
- businesses and industries that are more vulnerable to risks from existing and emerging market conditions, such as newly listed businesses, or businesses that experienced significant growth
- other businesses considered higher-risk, for example finance companies, or businesses that have non-compliance issues such as qualified audit reports, or non-compliance with laws and regulations
- a cross-section of different licensed auditors in each registered firm.

If a previous review found an audit file did not meet the required standards, it is likely we would review that auditor or audit file again.

File ratings

When we complete a file review, the reviewer gives each individual finding on that file a rating from low to high, and proposes a final overall file rating from the following categories:

Good

We either had no findings or the findings relate to improving some documentation or minor non-compliance with the auditing standards. The reviewer is satisfied that all audit procedures have been performed around key risk areas and sufficient audit evidence was obtained.

Compliant, but improvements needed

We identified areas in the file where the audit wasn't performed in accordance with the audit standards. However, overall the reviewer found there was sufficient and appropriate audit evidence obtained in the key risk areas.

Non-compliant

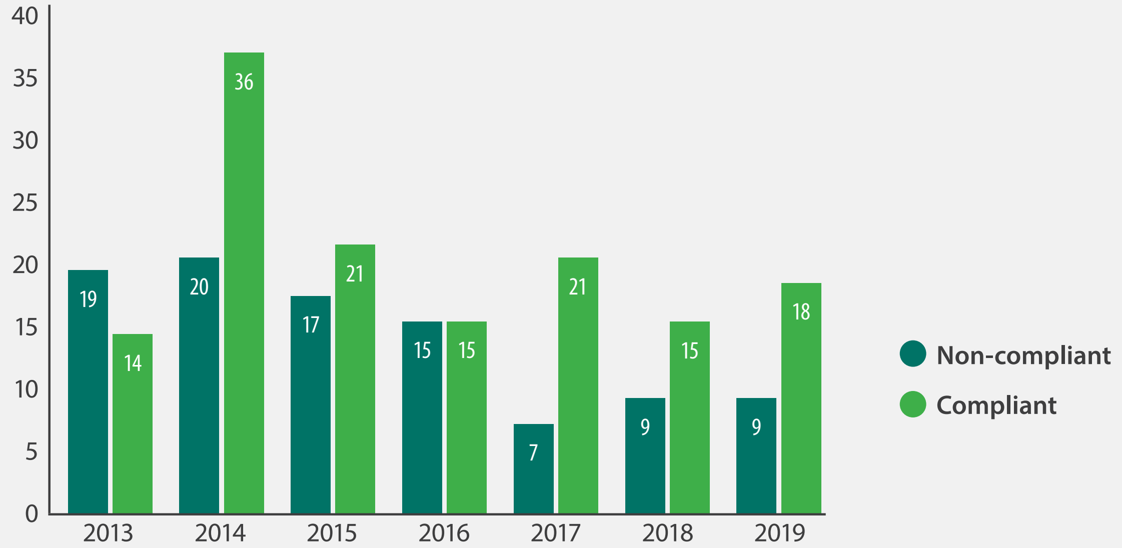
The file showed several areas where the audit wasn't performed in accordance with the standards. The reviewer found insufficient or inappropriate audit evidence obtained in at least one key risk area of the audit, or the review showed a material misstatement that required restatement of the financial statements and/or the audit opinion.

The ratings are moderated by the AOC.

Summary of review ratings

The schedules below provide an overview and explanation on how we rated the individual audit files reviewed over the last seven years.

Audit file ratings



This is broken down further between listed and other businesses as follows:

Listed entities

	Compliant		Non-compliant
Year	Good	Improvements needed	Significant improvements
2019	1	5	3
2018	3	3	3
2017	2	8	2
2016	-	6	7
2015	5	6	2
2014	1	9	4
2013	2	2	3

Other FMC reporting entities

	Compliant		Non-compliant
Year	Good	Improvements needed	Significant improvements
2019	6	6	6
2018	1	8	6
2017	4	6	5
2016	-	9	8
2015	2	8	15
2014	2	24	16
2013	3	7	16

Background to our rating criteria

Our reviews focus on audit processes and procedures, and do not assess whether the underlying audited information is correct. Where we rate an audit as non-compliant, it does not necessarily mean that the financial statements do not show a true and fair view, or require restatement. Equally, where we rate an audit as good or compliant this is not an endorsement that the financial statements are free from misstatement.

Our reviews cover different audit firms each year and files are selected on a risk basis. The sample is therefore not statistically representative, and the summary of results needs to be interpreted cautiously. Our findings do, however, provide insights in trends into audit quality and highlight areas for improvements applicable for the majority of FMC audits.

Possible post-review actions

Following an audit quality review we consider if further action is required. Actions we could take include:

- Requiring an audit firm to perform additional work to address our findings.
- Requiring an entity to restate the financial statements, if we find material misstatements.
- Completing a follow-up review within six to 18 months of the previous review to ensure the firm has taken appropriate action to address our findings.
- Issuing directions to remediate any findings.
- Referring complaints to the licensed auditors' professional body to be dealt with under its disciplinary procedures.

Appendix 2 – Overseas inquiries into auditing

Sir Donald Brydon's Review into UK audit standards (United Kingdom)	Ongoing review into the scope and quality of audits in the UK. The review includes: • Understanding the needs and expectations of stakeholders who make use of company audits • The scope of audit • How assurance is provided and how that assurance can be made more effective for investors • How any change to the current statutory audit model will impact on potential liability of auditors • How communication of audit findings to users can be improved to enable that information to be of more use. • The potential benefits and opportunities for international engagement and cohesion across the world on auditing standards.
Sir John Kingman's reviews into the Financial Reporting Council (United Kingdom)	Independent review of the Financial Reporting Council. The report made 83 recommendations including: • Establishing a new regulator, the Audit, Reporting and Governance Authority • Providing appropriate powers to the newly formed regulator to perform its work effectively
CMA Market Study into the audit market (United Kingdom)	Review of competition in the UK audit market. The following recommendations were made: • Audit committee scrutiny • Mandatory joint audits, including at least one Non-Big Four firm, for most large companies; peer reviews for the largest; and measures to mitigate the effects of a Big Four failure • An operational split between the audit and non-audit practices of the Big Four • A five-year review of progress by the new regulator
Business, Energy and Industrial Strategy Select Committee inquiry into "The Future Of Audit" (United Kingdom)	An inquiry into the likely impact of the CMA market study and the review of the FRC (by Sir John Kingman) in improving quality and competition in the audit market and reducing conflicts of interest. The report draws a number of conclusions and makes recommendations regarding how the legislation establishing the newly formed regulator should be drafted.
Inquiry into the regulation of auditing (Australia)	The Parliamentary Joint Committee on Corporations and Financial Services inquiry will look at: the relationship between auditing and consulting services, and potential conflicts of interests; the level and effectiveness of competition in audit and related consulting services; audit quality, including valuations of intangible assets; at the role and effectiveness of audit in detecting and reporting fraud and misconduct; the adequacy and performance of regulatory, standards, disciplinary and other bodies; and the effectiveness of enforcement by regulators. The report is due by 1 March 2020.

Appendix 3 – Market data

	30 June 2019	30 June 2018	30 June 2017	30 June 2016
Domestic licensed auditors	132	138	141	146
Domestic registered firms[8]	18	19	21	24
NZX-listed companies	205	190	195	186
FMC audits	1,250	1,300	1,300	1,700
New licences issued to domestic auditors	11	5	7	8
Domestic auditor licences cancelled	8	8	12	12
Domestic auditor registrations cancelled or expired	14	2	3	4
Firms reviewed	6	5	7	12
Audit files reviewed	28	24	27	30

8 This includes six registrations of firms that operate under two brand names

Glossary

Accounting standards /NZIFRS	The New Zealand equivalent to International Financial Reporting Standard issued by the External Reporting Board.
AR Act	Auditor Regulation Act 2011
AOC	Audit Oversight Committee. This is a committee established by the FMA that provides an independent forum to review the consistency and fairness of all quality review reports. The members of AOC are a diverse group of professionals including ex-auditors partners, company directors, and other people with relevant experience.
Audit firm	Registered audit firm as defined by the AR Act.
Auditing and Assurance Standards	The auditing and assurance standards issued by the External Reporting Board
Auditing standards	International Standard on Auditing (New Zealand) to be applied in conducting audits of historical financial information as issued by the External Reporting Board
Auditor	Licensed auditor as defined by the AR Act.
CA ANZ	NZICA and the Institute of Chartered Accountants of Australia (ICAA) formally amalgamated on 1 January 2015 to form the Chartered Accountants Australia and New Zealand (CA ANZ). After the amalgamation, NZICA continues to regulate the accountancy profession for Chartered Accountants ANZ members who remain resident in New Zealand (and by virtue of their residence continue to be NZICA members) according to the NZICA Act 1996, and the terms of the amalgamation agreement. For the purpose of the audit oversight regime, NZICA continues to be the accredited body.
EQCR	Engagement Quality Control Review. This is a process designed to provide an objective evaluation, on or before the date of the auditor's report, of the significant judgments the engagement team has made and the conclusions it has reached in formulating the auditor's report.
EQCR partner	Licensed auditor who performs the EQCR. This may be a licensed auditor who is not a partner in the audit firm.
Financial statements assertions	When auditing accounting balance in the financial statements, the auditor should ensure the following assertions are covered: existence/occurrence, rights and obligations, completeness, accuracy, valuation, presentation/classification.
FMC reporting entity	Has the same meaning as in section 6 of the AR Act

FMC audit	Has the same meaning as in section 6 of the Auditor Regulation Act.
Going concern	Under the going concern assumption, a business is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless those charged with governance plan to liquidate their business, cease operations, or have no alternative than to stop doing business.
IFIAR	International Forum of Independent Audit Regulators
ISA (NZ)	International Standard on Auditing (New Zealand) issued by the External Reporting Board
Materiality	Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.
Professional scepticism	An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
PES	Professional and Ethical Standards issued by the External Reporting Board
Non-assurance service	Any engagement provided by the audit firm that doesn't meet the definition of "an engagement in which an assurance practitioner 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".
Quality review	A review of an audit firm as defined by the AR Act.

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