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By email: submissions@xrb.govt.nz

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Dear Robert,

FMA submission on Amendments to Professional and Ethical Standard 1: Non-Assurance Services

The FMA is responsible for regulating auditors who carry out audits of FMC reporting entities. In doing so the FMA has established an independent oversight system to promote the quality, expertise, and integrity in the audit profession . We also must promote the recognition of the professional status of New Zealand auditors in overseas jurisdictions.

The FMA appreciates the opportunity to comment on the proposed amendments set out in the Exposure Draft of Amendments to Professional and Ethical Standard 1: Non-Assurance Services. In Appendix A we have set out our responses to NZAuASB's specific questions.

Importance of an independent audit profession

From the start of the audit oversight regime, the FMA has highlighted the importance of an independent audit profession. The purpose of an audit is to enhance the degree of confidence users have in 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 auditors do not appear to be independent, this may impact confidence in the financial statements, trust in specific auditors, trust in the audit profession and ultimately trust in New Zealand's financial markets.

In this submission, we have considered our work at the FMA in relation to the oversight of registered audit firms and licensed auditors and specifically included the following when considering the importance of auditor independence:

- Our observations from our audit quality reviews of all registered audit firms
- Our 2019 survey of Audit Quality Perceptions Research
- International developments in, and inquiries into, the audit profession

Our observations from our audit quality reviews of all registered audit firms

Although our audit quality reviews have identified improvements in independence considerations by auditors over time, 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.

In recent years we have made several referrals of suspected breaches of the Professional and Ethical Standards. These referrals relate to breaches where auditors have applied interpretations of the Professional and Ethical Standards justifying that these services were permitted. These services would be prohibited under the new standards. We are of the view that the additional requirements are needed and will strengthen the overall framework to avoid similar future breaches.

2019 survey of Audit Quality Perceptions Research

In 2019 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 audit firms are delivering. Those with closer involvement in auditing (ie auditors, managers and directors) were more likely to trust the audit process.

This gap between investors and the profession's view of itself was also clearly visible when participants were asked about the independence of auditors in conducting their audits. In the survey 27% of the investors disagreed that 'Auditors are sufficiently independent from the entities they audit, in comparison to 5% of the auditors and 9% of the directors.

International developments and enquiries into the audit profession

In recent years audit quality has come under scrutiny in several countries, most noticeably in the United Kingdom and Australia. The governments of both of those countries have initiated inquiries, the outcome of which are likely to have a significant impact on the audit landscape in these countries. Both inquiries focused on independence of auditors and suggested strengthening the requirements for auditor independence. We also note that other countries are considering, or have already considered, whether additional requirements are needed to strengthen independence requirements. As a result, several countries have added additional requirements to their laws to restrict the non-assurance services auditors can provide to their clients.

Office of the Auditor-General

We also support the Office of the Auditor-General's view that independence lies at the heart of trust and confidence in the audit profession. Without being, and being seen to be, independent an auditor simply cannot carry out their function effectively. In our view, if auditor independence is not sufficiently well protected the profession is likely to lose standing and reputation, and the public is increasingly likely to question the value of auditing. In short, our position is that auditors should not be involved in non-assurance work for the entities they audit, and standards should reflect this position.

Support in strengthening the code

We welcome the overhaul of the independence requirements, and are pleased that the NZAuASB is proposing to introduce more stringent requirements than the IESBA. Although the code is more prescriptive and provides more clarity on independence there is still significant emphasis on auditors following a robust process. When following the proposed code, we expect not only auditors, but also directors, will 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 auditors will not perform the non-assurance service to protect trust in the audit profession. Although the code makes specific distinction between Public Interest audits and other audits, auditors should consider that independence is important for all audits. Therefore, auditors need to apply the same independence principles for all audits in order to maintain trust in the profession as a whole.

If you wish to further discuss any of the matters raised in this letter, please let me know. I would welcome further discussion.

Appendix A – Responses to the questions for respondents

(i) New Zealand-specific changes to tax advisory and tax planning services

Question 1. *Do you agree that the provision of tax advisory and tax planning services to an audit client that is a PIE should be prohibited? (Refer NZ R604.15 – NZ 604.15 A1)*

We support NZAuASB’s proposal to prohibit tax advisory and tax planning services to an audit client that is a Public Interest Entity (PIE). The provision of tax advisory and tax planning services is in direct conflict with the audit and presents a threat to audit independence. Tax advisory and tax planning work is intended to minimise the tax obligations on an entity. Therefore, the work explores the various interpretations of tax law and can result in arrangements that may be challenged by the tax authorities. This situation places the assurance practitioner firm in the position of justifying a tax position and advocating for the entity on one hand and in providing independent assurance on the entity’s financial statements on the other. This is a clear conflict of interest and threat to independence that cannot be adequately managed by safeguards.

Question 2. *Do you foresee any unintended consequences of this prohibition?*

A consequence of this provision is that an audit firm that also provides tax services for its audited entity will need to request the entity to find another tax provider. We do not see this as an unintended consequence but necessary to ensure that the assurance practitioner doesn’t compromise its independence in relation to the audit services to its clients.

Question 3. *Do you agree that advising an audit client in their tax return preparation or any adjustments arising therefrom is a form of tax advisory services? As such, consistent with the addition of NZ R604.15 such services would be prohibited for PIEs. (Refer NZ 604.11 A1)*

We agree that advising an audit client in their tax return preparation or any adjustments arising therefrom (Part A of subsection 604 of the Code) is a form of tax advisory service. Entities when engaging their audit firm to provide tax return preparation services expect that the tax adviser of the audit firm will point out tax treatments that would reduce their tax expenses and instances that the incorrect tax treatment is applied. Instances of tax preparation in our view lead to a self-review threat (where the auditor is reviewing the firms’ own work) and advocacy threat when challenged by the tax authorities.

The International Ethics Standards Board for Accountants (IESBA) noted that tax return preparation services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice and therefore are unlikely to create a threat. We disagree with that view as this description does not consider that tax law is constantly changing, requires significant judgement and that that precedents can only be set when there are disagreements with interpretation between tax preparers and tax authority. Further the IESBA’s views did not reflect on of the self-review threat and advocacy threat.

Question 4. *Are there any other tax services contemplated by proposed subsection 604 for which you consider the requirements should be further strengthened and, if so, why?*

The assurance practitioner should also consider if tax services can be provided when considering the conceptual framework of the Code. We believe that the self-review threat or

advocacy threat in relation to tax services would be present when providing tax services to nonpublic interest entity (PIE). Practitioners applying the code should be reminded that although NZR604.15 specifically prohibits tax advisory and tax planning services for PIE audits, this does not mean that these services are allowed for non-PIE entities without assessing the risk as set out in the conceptual framework of the code.

(ii) Any other Non-assurance services

Question 5. *The NZAuASB has not identified any further aspects of the IESBA's provisions that need to be strengthened in New Zealand. We are, however, keen to hear whether stakeholders consider there is a need to further strengthen any specific provisions.*

In principle, assurance practitioners should not be permitted to provide non-assurance services to audit clients, review clients, or assurance clients to PIEs.

(iii) Audit-related services

Question 6. *Do you agree that additional services performed by the audit firm will generally not create a self-review threat to the firm's independence when the services are related to the audit engagement?*

It is the nature of the additional services and the client that will determine whether a threat to independence arises, recognising that the threat is not necessarily limited to a self-review threat.

Although assurance services are unlikely to threaten independence they still should be assessed against the overall conceptual framework. If services will be performed for other third parties, the assurance practitioner should consider other threats, for example advocacy threat.

Question 7. *Do you agree that the examples listed would not generally create a self-review threat to independence? Are there other types of services, that would generally not create a selfreview threat to independence, that you consider need to be included as examples? (Refer NZ 600.14 A1)*

We agree that the examples of engagements listed in NZ 600.14 A1 would generally not create a threat to independence.

Question 8. *Do you agree that the additional application material emphasising the need to apply the conceptual framework to identify, evaluate and address threats to independence, other than the self-review threat, is helpful to ensure diligent application of the conceptual framework? (Refer NZ 600.14 A1)*

We agree that the additional application material in NZ 600.14 A1 that emphasises the need to apply the conceptual framework to identify, evaluate, and address threats to independence, other than the self-review threat, is helpful to ensure a robust application of the conceptual framework.

Assurance practitioners should approach independence with the highest integrity and, when in doubt, take a conservative approach. While the Professional and Ethical Standards and the conceptual framework may allow the provision of certain non-assurance services, assurance practitioners 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 assurance practitioners to give more consideration to these matters, to protect the integrity of the audit.

Question 9. *Do you consider additional requirements or application material is needed in relation to audit-related services, to address perceptions of auditor independence? If yes, please provide details.*

The independence requirements of the Code are complex to understand for public. Assurance practitioners should encourage entities to appropriately disclose these services and provide context for why these have been performed by the assurance practitioner. We would also support the XRB to enhance the disclosure requirements of audit and non-audit services in FRS-44.

(iv) Effective Date

Question 10. *For engagements entered into before 15 December 2022, for which work has already commenced, the transitional provision provides that the firm may continue the engagement under the extant provisions of the Professional and Ethical Standard 1 for up to 12 months. Do you agree with the transitional provision? If not, please explain why not and what alternative you propose.*

We agree with the transitional provisions, however we expect that audit firms would not enter into new engagements after the Code is finalised.