



5 September 2016

External Reporting Board Policy for dealing with audit reports received under the Companies Act 1993 and the Financial Markets Conduct Act 2013

Purpose of the Policy

1. The Companies Act 1993 and the Financial Markets Conduct Act 2013 both require an auditor to send a copy of the audit report, and a copy of the financial statements or group financial statements, to the External Reporting Board (XRB), and other specified parties, if the financial reporting requirements of the respective Acts have not been complied with. However, the two Acts are silent on the purpose of the provisions and on the actions, if any, that the XRB (and the other specified parties) must take when it receives the audit reports.
2. This Policy sets out the processes that the Board of the XRB and its sub-Boards, the New Zealand Accounting Standards Board (NZASB) and the New Zealand Auditing and Assurance Board (NZAuASB), will follow when audit reports are sent to the XRB by auditors in accordance with the Companies Act 1993 and the Financial Markets Conduct Act 2013. The Policy also applies when audit reports are referred to the XRB by any other party.

Policy¹

3. Audit reports received by the XRB will be reviewed by both the NZASB and the NZAuASB.
4. The NZASB's review will be focused on modified audit opinions in relation to material misstatements in the financial statements.
5. The NZAuASB's review will be focused on modified audit opinions in relation to when the auditor has been unable to obtain sufficient audit evidence.
6. Where the reviews raise issues or trends that relate to XRB strategy, these will be referred to the XRB Board for consideration.
7. Reviews by the NZASB and the NZAuASB will consider implications for the relevant standards by ensuring that the modified audit opinions do not raise any issue about the appropriateness, applicability, clarity and/or completeness of the relevant standards.
8. No action needs to be taken by the XRB, the NZASB or the NZAuASB if the modification of the audit opinion results from non-compliance by an entity of an otherwise appropriate standard (that is, a standard that is applicable, clear, complete and has

¹ The Background and Basis for the Policy is set out in Appendix 1.

appropriate accompanying guidance). Such non-compliance is a matter for the appropriate regulator to deal with.

9. Where the modification of the audit opinion has implications for standards, the NZASB and the NZAuASB will consider their respective standards' convergence and/or harmonisation policies. Matters raised may need to be addressed through, or in cooperation, relevant international standards Boards rather than unilaterally, or, where appropriate, through the provision of additional New Zealand guidance.
10. The actions that may be taken by the NZASB and/or the NZAuASB where the modified audit opinions have implications for any XRB standards include, for example:
 - a. amend a domestic standard;
 - b. raise an issue with the relevant international standards board;
 - c. issue guidance; and/or
 - d. re-examine the initial cost-benefit analysis undertaken when the relevant standard was developed.
11. Reviews by the XRB Board (when necessary) will consider the implications for the XRB strategy to ensure that the multi-standards, multi-tier system remains appropriate. The actions that the XRB Board may take where the modified audit opinions have implications for XRB strategy and/or the standards frameworks include, for example:
 - a. Review the XRB strategy and/or standards frameworks;
 - b. Refer a matter an appropriate party for their further action (for example, the regulators and/or policy makers);
 - c. Refer a matter to the appropriate professional body after consultation with the regulators (for example in the rare and unusual circumstances where an audit qualification was considered to be incorrect);
 - d. Engage with or liaise with policy makers and/or regulators;
 - e. Engage with relevant organisations or industries directly and after consultation with the regulators, to determine the cause of the non-compliance, before taking any further action (for example, where the modified audit opinions indicate a trend of persistent non-compliance by a particular industry or with a particular standard); and/or
 - f. Engage with auditors on their duties under the Companies Act 1993 and the Financial Markets Conduct Act 2013 to send audit reports with modified audit opinions to the XRB.
12. In each instance before the XRB Board takes any action, it would, where necessary, liaise with the regulators and/or policy makers.

Review of this Policy

13. This Policy will be reviewed every three years to ensure that it is still appropriate.

Appendix 1: Background and Basis for the Policy

Legislative provisions

1. The Companies Act 1993 and the Financial Markets Conduct Act 2013 both require an auditor to send a copy of the audit report, and a copy of the financial statements or group financial statements, to the XRB (and other specified parties) if the financial reporting requirements of the respective Acts have not been complied with. However, the two Acts are silent on the purpose of the provisions and on the actions, if any, that the XRB (and the other specified parties) must take when it receives the audit reports.

Companies Act 1993

2. Part 11 of the Companies Act 1993 specifies, among other matters, the requirements for a company's financial reporting and audit of its financial statements. It specifies the companies that must prepare financial statements, and that those financial statements must comply with generally accepted accounting practice (GAAP)². Part 11 also specifies whose financial statements must be subject to audit and that the audit must be carried out in accordance with applicable auditing and assurance standards³. GAAP, applicable financial reporting standards and applicable auditing and assurance standards are defined in the Companies Act 1993 by reference to the Financial Reporting Act 2013. GAAP, applicable financial reporting standards and applicable auditing and assurance standards in the Financial Reporting Act 2013 refer to standards issued by the XRB⁴.
3. Within Part 11, section 207C of the Companies Act 1993 provides that the auditor's report of a company must be sent to the Registrar of Companies and the XRB if the requirements of the Companies Act 1993 have not been complied with:

"If the auditor's report indicates that the requirements of this Act have not been complied with, the auditor must, within 7 working days after signing the report, send a copy of the report and a copy of the financial statements or group financial statements to which it relates to the Registrar and the External Reporting Board".

4. In the context of the requirements of Part 11 of the Companies Act 1993 about audits of a company's financial statements, the reference to non-compliance with "*the requirements of this Act*" in section 207C is read to mean non-compliance with applicable financial reporting standards and applicable auditing and assurance standards.

Financial Markets Conduct Act 2013

5. Part 7 of the Financial Markets Conduct Act 2013 sets out the financial reporting requirements of an "FMC reporting entity"⁵, including the requirements for the

² Sections 200 – 202 of the Companies Act 1993.

³ Sections 206 – 207A of the Companies Act 1993.

⁴ Section 5 of the Financial Reporting Act 2013.

⁵ The meaning of an "FMC reporting entity" is set out in section 451 of the Financial Markets Conduct Act 2013.

preparation⁶ and audit of the financial statements⁷. Financial statements of an FMC reporting entity must comply with GAAP⁸ and the audit of those financial statements must comply with applicable auditing and assurance standards⁹.

6. Similar to the Companies Act 1993, GAAP, applicable financial reporting standards and applicable auditing and assurance standards are defined in the Act by reference to the Financial Reporting Act 2013 (and hence refer to standards issued by the XRB).
7. Within Subpart 3 *Preparation, audit, and lodgement of financial statements* of Part 7 *Financial reporting* of the Financial Markets Conduct Act 2013, section 461G on the auditor's report states:
 - (1) *The auditor's report on the financial statements or group financial statements that are required to be audited under this subpart must comply with the requirements of all applicable auditing and assurance standards.*
 - (2) *If the auditor's report indicates that the requirements of this Part have not been complied with, the auditor must, within 7 working days after signing the report, send a copy of the report, and a copy of the financial statements or group financial statements to which it relates, to—*
 - (a) *the FMA; and*
 - (b) *the External Reporting Board; and*
 - (c) *in the case of an issuer of debt securities or a manager of a registered scheme, the supervisor.*
8. In the context of the requirements of Subpart 3 of Part 7 of the Financial Markets Conduct Act 2013 about financial statements and audit of an FMC reporting entity's financial statements, the reference to non-compliance with "*the requirements of this Part*" in section 461G is read to mean non-compliance with the applicable financial reporting standards and applicable auditing and assurance standards.

Functions of the XRB

9. The functions of the XRB are set out in the Financial Reporting Act 2013. Section 12 of the Financial Reporting Act 2013 provides:

"The Board has the following functions:

- (a) *to prepare and, if it thinks fit, issue financial reporting standards for the purposes of any enactment that requires—*
 - (i) *financial statements or group financial statements to comply, or be prepared in accordance, with generally accepted accounting practice or non-GAAP standards; or*
 - (ii) *a statement, report, or other information to comply, or be prepared in accordance, with financial reporting standards:*
- (b) *to prepare and, if it thinks fit, issue auditing and assurance standards for—*

⁶ Sections 460 – 461 of the Financial Markets Conduct Act 2013.

⁷ Section 461D of the Financial Markets Conduct Act 2013.

⁸ Sections 460 – 461 of the Financial Markets Conduct Act 2013.

⁹ Sections 461F – 461G of the Financial Markets Conduct Act 2013.

- (i) *the purposes of the Auditor Regulation Act 2011 or any other enactment that requires a person to comply with those standards; or*
- (ii) *the purposes of any rules or codes of ethics of an association of accountants where those rules or codes require the association's members to comply with those standards; or*
- (iii) *any other purpose approved by the Minister by notice in writing to the Board:*
- (c) *to prepare and, if it thinks fit, issue authoritative notices for the purposes of the definition of generally accepted accounting practice:*
- (d) *to develop and implement strategies for the issue of standards in order to provide a framework for the Board's overall direction in the setting of standards (including implementing a strategy for tiers of financial reporting in accordance with sections 29 to 33):*
- (e) *to liaise with international or national organisations that perform functions that correspond with, or are similar to, those conferred on the Board:*
- (f) *to perform and exercise the functions, duties, and powers conferred or imposed on it by or under this Act and any other enactments."*

Interpretation of the legislative intent of the provisions of the Companies Act and the Financial Markets Conduct Act for the XRB

10. In determining the intent of legislation in providing for the XRB to receive the audit reports under section 207C of the Companies Act 1993 and Section 461G of the Financial Markets Conduct Act 2013, regard needs to be had to the functions (and role) of the XRB under the Financial Reporting Act 2013.
11. Under the Financial Reporting Act 2013, the key function of the XRB is the setting of accounting and auditing & assurance standards, and the development and implementation of a strategy for an accounting standards framework (XRB strategy). The standard-setting and strategic functions of the XRB are in contrast to the functions of the other specified parties. Those parties have, among other functions, regulatory powers to take enforcement action (where necessary). The functions of the XRB do not extend to the ability to take enforcement action against an entity's non-compliance with the respective Acts. Therefore, unlike the other specified parties, the XRB does not have a legislative responsibility to take any direct regulatory action or make contact with the preparers or auditors of the financial statements about any aspect of the non-compliance.
12. Any action the XRB takes in relation to receiving the audit reports should be consistent with the XRB's role and functions: the actions taken should be for the primary objective of assessing, based on the nature of the non-compliance, whether the non-compliance set out in the audit reports indicates a need to clarify and/or modify accounting standards, auditing & assurance standards and/or the XRB strategy.

What type of audit opinions are we concerned with?

13. Audit reports may contain unmodified audit opinions (unqualified opinions) or modified audit opinions (qualified opinions, adverse opinions or disclaimers of opinion).

14. In the context of the requirements of section 207C of the Companies Act 1993 and section 461G of the Financial Markets Conduct Act 2013, audit reports that are sent to the XRB would be all audit reports that contain modified audit opinions. These would be audit reports that contain audit opinions that indicate non-compliance with the financial reporting and/or audit requirements of the Companies Act 1993 or the Financial Markets Conduct Act 2013.
15. Accounting standards require financial statements to present fairly the financial position, financial performance and cash flows of an entity. There is a presumption in accounting standards that application of applicable financial reporting standards, with additional disclosures when necessary, results in financial statements that achieve such a fair presentation¹⁰. In auditing standards¹¹, the recognition of this presumption requires the financial reporting framework that is used to be a “fair presentation framework”. Auditing standards acknowledge that in complying with a fair presentation framework, additional disclosures may sometimes be necessary and, in extremely rare circumstances, departures may also be necessary.
16. Auditing standards¹² set out the types of modified audit opinions and the circumstances when a modification of an audit opinion is required. An auditor is required to modify the opinion in the auditor’s report when:
 - a. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
 - b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
17. A material misstatement of the financial statements, based on the audit evidence obtained, may arise in relation to:
 - a. The appropriateness of the selected accounting policies;
 - b. The application of the selected accounting policies; or
 - c. The appropriateness or adequacy of disclosures in the financial statements.
18. A material misstatement of the financial statements, based on auditor’s inability to obtain sufficient appropriate audit evidence (also referred to as “a limitation on the scope of the audit”), may arise in relation to:
 - a. Circumstances beyond the control of the entity;
 - b. Circumstances relating to the nature or timing of the auditor’s work; or
 - c. Limitations imposed by management.
19. The XRB’s interest (and ability to take some action) is more likely to be in those modified audit opinions that indicate material misstatements in the financial statements that arise from audit evidence obtained by the auditor. As these modified

¹⁰ NZ IAS 1 *Presentation of financial statements* and PBE IPSAS 1 *Presentation of financial statements*.

¹¹ ISA(NZ) 700 *Forming an opinion and reporting on financial statements*.

¹² See ISA(NZ) 700 *Forming an opinion and reporting on financial statements*.

opinions focus on material misstatements in financial statements, the issues that arise are more likely to be related to accounting standards (than to auditing & assurance standards or the XRB strategy).

20. The XRB interest (and ability to take action) is less likely in relation to the audit reports received that cover modified opinions that arise from “a limitation on the scope of an audit”. This is because these are often more likely to arise from “practical” issues and are often less likely to arise as a direct result of applying, or not applying, XRB standards or the XRB strategy. Therefore, the XRB is less likely to need to modify accounting standards, auditing & assurance standards or the XRB strategy or take other action (for example, issuing further guidance) in response to this type of modified audit report.
21. Nevertheless, limitations imposed by management may be related to, for example, the governing body considering that an accounting standard requirement is not practicable. Similarly, while auditors not complying with auditing & assurance standards falls, prima facie, within the role of the regulator to take action (rather than within the role of the XRB), such non-compliance may indicate that further guidance is required.
22. As such, for the purpose of this policy, all modified audit opinions will be reviewed to determine if any XRB action is required.

What entities and standards are involved?

23. The Companies Act 1993 covers all companies incorporated under that Act. These may be for-profit companies or public benefit entities (PBEs).
24. The Financial Markets Conduct Act 2013 covers FMC reporting entities. These may be entities under any organisational structure (companies, credit unions, building society etc).
25. Entities under both Acts may be in:
 - a. For-profit Tier 1 and Tier 2¹³; or
 - b. PBE Tier 1, Tier 2 or Tier 3¹⁴.
26. Therefore, the modified audit opinions could potentially affect all the accounting standards (except the Tier 4 standards) and all auditing & assurance standards issued by the XRB.

¹³ A Tier 2 for-profit entity that is not an FMC reporting entity may opt out of the audit requirements.

¹⁴ A Tier 4 PBE is not required to have an audit. A Tier 3 PBE with expenses of less than \$1 million is also not required to have an audit.