

## **AUDITOR REPORTING ENHANCEMENTS**

### **Explanation of Decisions made by the NZAuASB in Finalising the Auditor Reporting Enhancements and ISA (NZ) 720 (Revised) in New Zealand**

**Issued October 2015**

This document relates to, but does not form part of the International Standards on Auditing (New Zealand) that have been revised as part of the auditor reporting enhancements project. The Auditor reporting enhancements were approved by the NZAuASB in September 2015. It summarises the compelling reason changes made by the NZAuASB to the International Auditing and Assurance Standards Boards (IAASB) International Standards on Auditing (ISAs) and provides the compelling reasoning as to why the changes were made. It also summarises the major issues raised by respondents to Exposure draft 2015-1 New Zealand Specific Amendments to the IAASB's Auditor Reporting Enhancements and ISA 720 (Revised) and how the NZAuASB has addressed them.

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## **BACKGROUND**

1. The IAASB issued new and revised International Standards on Auditing in January 2015, following the approval and consideration of due process by the Public Interest Oversight Board. The new and revised auditor reporting standards were the result of a 4 year project, which included three international consultation documents and numerous outreach activities.
2. The NZAuASB issued ED 2015-1 *New Zealand Specific Amendments to the IAASB's Auditor Reporting Enhancements and ISA 720 (Revised)* proposing to adopt, and in limited instances modify, the new and revised ISAs in New Zealand on 12 May 2015, with a comment deadline of 10 August 2015. The NZAuASB hosted 6 roundtable discussions in Auckland, Wellington and Christchurch.

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

3. Eleven submissions were received from the regulators, one professional body, practitioners, the Institute of Directors, one representative of a preparer and the Office of the Auditor-General. Key issues raised in the submissions received included:
  - the scope of the key audit matter (KAM) reporting requirements;
  - additional independence statements;
  - use of a website for the description of the auditor's responsibilities;
  - the engagement partner's name; and
  - the scope of the reporting requirements for Other Information.

## **HOW THE NZAuASB RESPONDED**

### *The scope of the key audit matter reporting requirements*

4. The NZAuASB proposed a cautious phased approach to introducing the reporting of KAM in New Zealand as follows:
  - a. Mandating the reporting of KAM for "listed issuers" for periods ending on or after 15 December 2016. This is in line with the international requirements but the term "listed entity" is modified to refer to "listed issuer".
  - b. Mandating the reporting of KAM for FMC reporting entities considered to have a higher level of public accountability for years ending on or after 31 December 2018. This is broader than the international requirements and the requirements in Australia.
5. Mixed views were received in response to the proposal to broaden the scope of mandatory reporting of KAM beyond listed entities. Five out of ten submissions received on this (all from practitioners) were concerned that the New Zealand proposals had gone too far, going further than other jurisdictions in requiring non-listed entities to report KAM. Concern was expressed regarding the cost/benefit of such a broad scope in a small jurisdiction like New Zealand, where there are relatively

few licensed auditors. The other five submissions were either supportive of the proposed cautious phased approach, or recommended an earlier adoption by some non-listed FMC reporting entities considered to have a higher level of public accountability. The regulators were especially supportive of including large registered banks, insurers and non-bank deposit takers in the requirement to report KAM as part of the initial reporting requirements from 2016.

6. The NZAuASB agreed that the scope should be finalised as proposed. This is consistent with the approach taken throughout the ISAs (NZ) to amend references from “listed entities” to “FMC reporting entities considered to have a higher level of public accountability”. Given the unique nature of the New Zealand economy, and the comparatively larger proportion of unlisted entities that would have public accountability, the NZAuASB has consistently changed this term in the ISAs (NZ), to capture the most significant and publicly accountable entities to the New Zealand economy, and continues to believe that it is appropriate to do so for the reporting of key audit matters.
7. Conceptually, the NZAuASB is of the view that the reporting of KAM should apply equally to all audits. This is on the basis that an “audit is an audit” and there should be no differential auditing requirements. However, the NZAuASB recognises that there is a cost associated to reporting key audit matters and that internationally the scope of the reporting requirements has been restricted, at least initially, to listed entities. In New Zealand, however, most of the registered banks, insurers, non-bank deposit takers and kiwi saver schemes are not listed, whereas in other jurisdictions many of these types of entities are. The NZAuASB considers that users of the auditor’s report of these non-listed FMC reporting entities would benefit from KAM being reported, and given the nature and the importance of these entities to the New Zealand economy, there is justification for including these entities in the scope of the KAM requirements. The New Zealand capital market is unique in that it has a significant number of unlisted issuers who hold large amounts of investors’ funds. These entities carry large liabilities to investors. The NZAuASB considers that users of the auditor’s report of non-listed FMC reporting entities with higher levels of public accountability would benefit from the reporting of KAM.
8. The NZAuASB considered other alternatives to an appropriate scope for KAM in New Zealand. This included deeming specific types of entities to be in scope and establishing size criteria. While there are merits to these approaches, on balance the NZAuASB determined that it was undesirable to create numerous sub-categories of reporting and auditing requirements within New Zealand.
9. However, in recognition of the significance of the change to the audit profession and the reporting supply chain overall, the possible incremental costs of implementing these requirements, and the relatively small number of licensed auditors available to perform these audits, there is also the need to defer the implementation by 2 years, in order to avoid having a potentially negative impact on audit quality. The NZAuASB

is aware that the reporting deadlines for entities have also recently been shortened, and considers that the addition of the reporting on key audit matters could put additional pressure on auditors, which could impact negatively on quality. For this reason, the NZAuASB is reluctant to require key audit matters for all FMC reporting entities considered to have a higher level of public accountability from 2016, as preferred by other submitters. The NZAuASB considers that this information is accessible to the regulators by request if required during the transitional period. The NZAuASB considers that 2 years is an appropriate and cautious transition period, as it will allow a phased approach to the reporting of Key Audit Matters, enabling auditors to learn from the experience of reporting key audit matters for listed issuers. The NZAuASB is still committed to reviewing this scope, and to consider whether KAM should be required in the auditor reports of all tier 1 entities as part of the post implementation review scheduled for 2 years after implementation.

*Additional independence statement*

10. The IAASB requires, for auditor reports of listed entities, that the auditor's responsibilities paragraphs include a statement that the auditor is required to disclose to those charged with governance all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards.
11. There is an existing requirement in New Zealand for all auditor reports to disclose any interests in or relationships with the client other than that as auditor. This New Zealand requirement will be retained in the revised standards. The NZAuASB had proposed to amend the above mentioned "new" statement required by the IAASB to apply to all entities, on the basis that this disclosure is already made in more detail in New Zealand, i.e. not only is the information disclosed to those charged with governance but it is disclosed in the auditor's report.
12. Submissions received generally did not support this proposed modification to the international requirements. There is no compelling reason to add this statement to all auditors' reports, given that additional independence statements are already required for all entities. The disclosure would be duplicated and therefore is unlikely to enhance audit quality. Whilst the NZAuASB does not consider that the IAASB requirement should be removed, there is no compelling reason to modify the scope of this new requirement.
13. In line with other changes to the use of the term "listed entity", the NZAuASB agreed not to remove the IAASB requirement, but to apply it to all FMC reporting entities considered to have a higher level of public accountability. This will avoid the further distinction between the audit requirements.

## *Use of a website*

14. The IAASB requirements permit, in limited circumstances where law, regulation or national auditing standards expressly permit the auditor to do so, for the description of the auditor's responsibilities to be moved out of the auditor's report and referred to a website of an appropriate authority. No law or regulation permits such practice in New Zealand. The XRB or a regulator such as the FMA would be examples of an appropriate authority.
15. The NZAuASB did not propose to maintain such a website, and therefore, in New Zealand the conditions of the use of website would not have been available to practitioners. The NZAuASB considered that information about the responsibilities of the auditor is critical to understanding the objectives of an audit and is critical to ensure users understanding of the auditor's report. Moving this information to a website potentially disconnects this critical information from the auditor's report, which may widen the expectation gap in New Zealand.
16. Submissions received favoured the option to make use of a website reference. Feedback indicated a level of confusion as to whether or not the reference to a website would be permitted, as the New Zealand standard would not prohibit such use, but rather it would be implicitly excluded as an option. Constituents also queried whether the compelling reason test had been met as New Zealand is not different from the rest of the world in this respect, i.e. the risk of an expectation gap exists globally. The NZAuASB had proposed to retain the option of moving this material to an appendix, where there is also a risk of disconnect.
17. In finalising the standard, the NZAuASB considered that if the New Zealand standard did not prohibit the use of a website, there was a risk that the standard could be misinterpreted and a regulator like the FMA would be able to maintain such a website, and thereby enable use of the website reference. In this regard, the standard should be clear as to whether the use of a website was permitted or not. The NZAuASB agreed that the compelling reason test had not been met to prohibit the use of a website, and decided that the XRB should maintain such a website, permitting the use of a reference to the website in New Zealand auditor reports. The auditor can still exercise their judgement to determine the most appropriate place to position this material, either in the body of the report, in an appendix or by way of a reference to a website.
18. The NZAuASB will create a webpage with the appropriate wording. There will be different options available and practitioners should take care to cross refer to the appropriate webpage as examples will be created for FMC reporting entities considered to have a higher level of public accountability, other entities and for consolidated financial statements.

### *The engagement partner's name*

19. The IAASB requires that the name of the engagement partner be included in the auditor's report for listed entities.
20. The NZAuASB proposed to expand this requirement to apply to all entities in New Zealand. This was on the basis that conceptually there should be no distinction between the audit requirements based on the client type. Application to all entities would promote consistency and result in a standard that was simpler to comply with. The NZAuASB considered that distinguishing between listed entities and other clients adds an unnecessary level of complexity. Applying the requirement to all audits avoids the need to decide whether or not to add the engagement partner's name, avoiding an unintentional breach of the requirements.
21. The cost to disclosing the engagement partner's name is not considered to be high. The NZAuASB proposed that the benefit of simplicity outweighed this cost.
22. Feedback received queried whether the compelling reason test had been met, with a majority of respondents preferring that the requirement should be limited to listed entities, consistent with the international requirements.
23. The NZAuASB noted that in Australia and other jurisdictions where it is already existing practice, or required by law, to disclose the engagement partner name, this is not generally applied as broadly as to apply to all audit engagements. For example, in Australia, this will be applied to entities that are required by law or regulation to do so. It is also not existing practice in New Zealand to disclose the partner's name on all audits. Whilst it may be simpler to comply with the standards if consistently required for all audits, from a practice management perspective firms can require or voluntarily disclose the engagement partner name. On balance, the NZAuASB reconsidered whether there were compelling reasons to differ from the international standards as well as the Australian standards, and agreed not to require the disclosure of the engagement partner's name for all audits in New Zealand.
24. However, the NZAuASB has consistently amended the term "listed entity" to refer to "FMC reporting entity considered to have a higher level of public accountability". The term "listed entity" is not defined in legislation or in the ISAs (NZ). For this reason, consistent with the use and scope of all audit requirements that apply to listed entities, the requirement will be amended in New Zealand to apply to FMC reporting entities considered to have a higher level of public accountability. This is to avoid creating further distinctions between categories of entities in the ISAs (NZ).

### *The scope of the reporting requirements for other information*

25. The IAASB standard requires a section on other information to be included in the auditor reports of all listed entities, even where the auditor expects to obtain other information after the date of the auditor's report. The objective of the reporting requirement is to improve transparency for entities where laws or regulations are most



likely to clearly set out the expected nature, content and timing of such other information. The IAASB standard encourages reporting when other information is subject to the auditor's responsibilities for all other entities.

26. The NZAuASB proposed to amend the scope of this requirement to apply to all FMC reporting entities considered to have a higher level of public accountability. The NZAuASB considers that the users of the reports of all FMC reporting entities will benefit from the additional transparency, where those entities prepare other information that is subject to the auditor's responsibilities under the standard. In addition, a 'listed entity' is not a defined term in the New Zealand standards. All instances of listed entity has been amended to refer to FMC reporting entities considered to have a higher level of public accountability. The NZAuASB does not want to further distinguish audit requirements by type of audit client.
27. The submissions received were generally not supportive of the reporting requirements as a result of the difficulty in timing that is foreseen. In New Zealand, in most instances the other information is only received after the date of the auditor's report.
28. Whilst the NZAuASB acknowledges the practical challenges that the standard creates, the Board does not consider that extending the scope from listed entities to FMC reporting entities is overly onerous in New Zealand. The international standard encourages such reporting and the NZAuASB considers that users of reports of FMC reporting entities would also benefit from any additional transparency that this reporting provides.

## **RATIONALE FOR AMENDMENTS MADE TO THE IAASB'S AUDITOR REPORTING ENHANCEMENTS**

29. In addition to the NZAuASB's response to the key matters raised in response to the exposure draft outlined above, this section documents the remaining compelling reasons identified by the NZAuASB to amend the Auditor Reporting Enhancements as finalised by the IAASB. The NZAuASB applied the [Principles of Convergence to International Standards](#) in developing any amendments to the auditor reporting package in New Zealand, and has only amended the international standards where there are compelling reasons to do so. Additional requirements are clearly identifiable as NZ paragraphs and are also described in the conformity with international requirements at the end of the ISAs (NZ).

### *Responsibility for the financial statements*

30. In New Zealand, changes have previously been made to the ISAs to clarify that in New Zealand those charged with governance often have responsibility for the preparation and fair presentation of the financial statements on behalf of the entity and therefore it is appropriate for the financial statements to refer to that responsibility. This also reflects existing best governance practice in New Zealand that the responsibility for the financial statements rests with those charged with governance

rather than management. Currently, the auditor reports in New Zealand commonly refer to the responsibilities of the directors or appropriate title for those charged with governance. The NZAuASB is proposing to retain this change as it remains appropriate and consistent with New Zealand best practice for the auditor report to describe the responsibilities of those charged with governance rather than to management for the financial statements.

31. The NZAuASB is aware and simultaneously consulted on the impact of the recent amendments to the Companies Act 1993 to refer to the company's responsibility rather than the directors' responsibility for the preparation the financial statements. However, the Act remains clear that the authority to manage the affairs of the company rests with the directors, who are also personally liable if the entity does not comply with the financial reporting obligations. The NZAuASB has determined that amendments to the New Zealand contextual paragraph added to ISA (NZ) 700 (Revised) and ISA (NZ) 570 (Revised) should be amended, consistent with changes to other ISAs (NZ), to more appropriately reflect the legislative requirements in New Zealand.

#### *Consistency with the international requirements*

32. In New Zealand, legislation requires that the audit is performed in accordance with the XRB standards. These standards include Professional and Ethical Standard (PES) 1 (Revised) not the IESBA Code. The title of the standard has been consistently amended throughout the suite of New Zealand Auditing standards. This addition will clarify that PES 1 (Revised) is as least as stringent as the IESBA Code to clarify that in New Zealand, the auditor must refer to PES 1 (Revised) but may refer to both PES 1 (Revised) and the IESBA Code. This modification clarifies the application of the international wording in the New Zealand context and clarifies that in New Zealand, auditors can refer to both.
33. Paragraph NZ51.1 has been amended to clarify that in New Zealand, the auditor must conduct the audit in accordance with the ISAs (NZ) but in so doing will also comply with the ISAs. Reference to both ISAs and ISAs (NZ) is permitted but is not required.

#### *Independence*

34. The additional New Zealand statement has historically been required by the auditing standards in New Zealand and the NZAuASB considers it appropriate to continue to do so. New Zealand is a small jurisdiction, where it is likely that the auditor will have some association with an audit client, given the small nature of the market. This added requirement is considered important in order to promote transparency. In addition, because it has been best practice and has been required by New Zealand auditing standards for many years, the removal of such disclosure is likely to raise more questions and could undermine the credibility of any other independence statement now required by the ISA.

35. Submissions received were overwhelmingly in support of retaining this existing New Zealand requirement.

#### *Accounting Standards Framework*

36. Additional New Zealand paragraphs were added to existing ISA (NZ) 700 as a result of legislative changes to the Financial Reporting Act 1993 and the introduction of the New Zealand Accounting Standards Framework. These paragraphs provide guidance to the auditor as to the applicable financial reporting frameworks that apply in New Zealand. These paragraphs will be retained.

#### *Relevant period*

37. Paragraph NZ13.2 has been carried forward from existing ISA (NZ) 570. This paragraph requires that the auditor's assessment of the use of the going concern basis of accounting should cover, as a minimum, a period of 12 months from the date of the auditor's report. The IAASB requirement refers to a minimum of twelve months from the end of the reporting period.
38. The NZAuASB continues to consider that the compelling reason test has been met to modify the international requirement in New Zealand. Historically the New Zealand auditing standards referred to the 12 months from the date of the auditor's report. Therefore this is established best practice in New Zealand. Given the recent focus on going concern matters, the NZAuASB considers that audit quality may be significantly enhanced where the auditor's assessment covers a minimum of twelve months from the date of the current auditor's report. This would mean that the auditor has considered the appropriateness of the use of the going concern basis of accounting up until the date that the audit is formally completed for the next period.

#### *Appendix*

39. The NZAuASB has added an appendix in extant ISA (NZ) 570 *Linking Going Concern Considerations and Types of Audit Opinions*. The NZAuASB will retain but update this appendix to reflect the revisions to ISA (NZ) 570 (Revised).
40. In addition, the NZAuASB agreed, when finalising the standards, to add an appendix to ISA (NZ) 720 (Revised) *Decision Tree for Other Information Reporting in the Auditor's Report*. The NZAuASB agreed that such an appendix would assist practitioners to understand when the new reporting requirements apply and would be helpful clarification.