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Our ref KPMG submission - Proposed Amendments to PES 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client.docx

14 July 2017

Dear Sir

ED NZAuASB 2017-1 - Proposed Amendments to PES 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client

KPMG welcomes the opportunity to provide comments on the consultation paper issued in May. We have reviewed that paper, and our comments are set out below.

1. **Do you agree with the proposals to adopt the revised international requirements dealing with long association?**

   In general we agree with the rationale to adopt international requirements to ensure that the New Zealand requirements maintain consistency with the international requirements.

   However we do believe that in the case of long association, the size of the NZ economy has a significant impact on the application of the revised rules. The changes are more likely to hinder audit quality than help. As an example, a listed entity would essentially require 4 licensed audit partners to service the client. Those being:
   - Current engagement partner,
   - Current EQCR
   - 2nd Engagement partner (in cooling off period)
   - 2nd EQCR (in cooling off period)

   If the auditor also audited a competitor client who requested separate teams, this would require at least a further 2, if not a further 4 audit partners to service this client.

   Given the size of the NZ economy, there is unlikely to be 6 or more audit partners at one audit firm who all have equal expertise in a particular industry. Therefore by default, an audit partner with less industry experience will be required to rotate onto the client to achieve the long association rules. For smaller firms this number of partners would not be achievable which reduces the choice of auditors for entities.

2. **Do you agree that:**

   a. **The New Zealand PIE definition remains appropriate in light of the international changes made to the long association provisions?**

      We do not believe the New Zealand definition of a PIE is appropriate. If international harmonisation is the aim, then the PIE definition should also be

harmonised with other jurisdictions. The current definition captures a far larger number of entities than any similar definition in other jurisdictions that apply similar independence requirements. We note none of the following jurisdictions:

- UK
- USA
- Canada
- Australia

apply a PIE definition that is implicitly based on the accounting framework chosen. Instead they are based on whether the entity has exposure to the public at large or its size relevant to the economy.

As noted above it is far more extensive than is experienced internationally and also deviates from international standard in that it is based solely on an accounting framework rather than whether the entity is of public interest. An implicit assumption has been made that if an entity prepares tier 1 financial statements it must be large which has proven to be untrue in practice.

We believe it would be more appropriate to define a PIE as an entity that is classified as having higher public accountability by the Financial Markets Authority. As regulator of the market they have determined which entities are of public interest and require additional oversight given the impact they have on the market. We also note for the For Profit sector this definition is largely consistent with the definition of entities that are required to apply the tier 1 financial reporting framework. For PBE entities we believe entities should only be a PIE if they are required to prepare tier 1 accounts. Voluntary preparation should not force an entity to be classified as a PIE.

b. applying the revised requirements to all PIEs as defined in New Zealand is in the public interest?

We believe that provided the PIE definition is updated to be consistent with other international definitions the requirements should be applied equally to all PIEs.

3. Do you consider that it is in the public interest to retain entities that voluntarily report using the tier 1 reporting requirements within the New Zealand PIE definition?

As discussed above we do not believe this is appropriate.

If not, do you consider that including such entities within the New Zealand PIE definition:

a. creates even further auditor supply pressures, that are contrary to, rather than in the public interest?

We believe this is the case.

b. has any other unintended consequences?

We note a number of entities which we audit who previously voluntarily applied the tier 1 accounting framework have been electing to adopt RDR reporting. This is mainly driven by the more stringent independence rules of PIEs. Our expectation is the NZAuASB would be actively trying to encourage New Zealand entities to adopt the highest level of disclosure, something which is being discouraged by the PIE definition.

We note that a large number of entities have previously voluntarily applied the tier 1 accounting framework for a variety of reasons, the most common being:

- Compliance with an incorporation/formation document;
- Group reporting required Tier 1;
- The entity elected to adopt tier 1 from the outset as they expect to eventually be in a position where mandatory adoption will be required and do not wish to transition; or
- To allow greater comparison with both national and international competitors.

4. For dual listed entities (listed on the NZX and ASX), do you consider there to be unintended consequences of having different rotation requirements for the engagement partner for listed entities in New Zealand and Australia? If so, please explain.

We are not aware of any unintended consequences. However it does seem unusual that a reduced cooling off period is acceptable in a developed economy (such as Australia), yet not able to be achieved in NZ.

5. Do you agree with the New Zealand proposal to align the auditor rotation requirements for audits of financial statements and other recurring assurance engagements for public interest entities? If not, why not?

Whilst we understand the underlying rationale to reduce the familiarity threat, and agree with the concept, there could still be challenges due to the size of the NZ economy. Recurring assurance engagements provided by the audit partner would not be impacted (as the audit partner would be rotating in any case), however recurring assurance engagements may be delivered by a non-audit partner who is a specialist in a field (such as IT). This could create a significant issue if there are not enough specialists to deliver that assurance work.

6. The transitional provisions provide for an alternative cooling off period permitted under legislation or regulation that will have effect for audits of financial statements for periods beginning prior to 15 December 2023. The NZAuASB requests feedback on the impact of this transitional provision in the New Zealand context.

As discussed in the webinar on the 22nd June this requirement is not applicable to the New Zealand situation without additional legislation or regulation. We believe this would only be valuable if the NZAuASB elected to change the definition of a PIE and did not have time to implement the changes before the new rotation requirements came into effect. In which case it would be useful to delay the implementation of the rotation requirements under the transitional provisions until the new PIE definition is effective.

7. **Do you consider any further compelling reason amendments are needed? If so, what amendments should be made and why?**

   We have no further comments.

8. **Do you have any other comments on ED NZAuASB 2017-1?**

   We have no further comments.

Yours faithfully

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Partner