CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

27 July 2017

Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142
New Zealand

Submission via email: submissions@xrb.govt.nz

Dear Warren

Submission on Exposure Draft NZAuASB 2017-1: Proposed Amendments to Professional and Ethical Standard 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client

We appreciate the opportunity to comment on the Exposure Draft (the ED). We believe that it is essential that audit and assurance teams and firms are independent, both of mind and in appearance, of their clients. Furthermore we support a common international framework for making that assessment and the adoption of that framework in New Zealand. However, through our submissions to the International Ethics Standards Board for Accountants (IESBA) during the development of these changes, we expressed our concern about the potential impact of extended cooling off periods for Engagement Partners (EPs) and Engagement Quality Control Reviewers (EQCRs). There is no evidence to demonstrate that increasing the cooling off period for EPs and EQCRs to an arbitrary period will improve independence. Even if it did, we do not believe the potential gains, which would be incremental at best, justify the practical impacts and potential reduction in audit quality that the increase will cause.

While we accept that the IESBA have issued their changes in relation to extending cooling off periods for EPs and EQCRs, we urge the NZAuASB to continue to raise concerns at the international level about the impact of these changes.

Impacts on the audit market and audit quality

In our submissions to the IESBA we expressed our concerns in relation to the potential impact of extending the cooling of periods for EPs and EQCRs in countries with geographically dispersed audit client bases as we believe it is likely to negatively impact audit quality. Our key concerns are that the extension of cooling off periods will lead to a contraction of the audit market, as smaller firms may find it difficult to maintain a viable client base. Clients may opt to move to larger firms where they will only have to deal with partner change, not firm change when auditor rotation is required. The changes may also increase the number of engagements where the EP and/or the EQCR is located in a different geographic area to the engagement team. A high level of direct audit partner (and EQCR)

Chartered Accountants Australia and New Zealand

33 Erskine Street, Sydney NSW 2000
GPO Box 9985, Sydney NSW 2001, Australia
T +61 2 9290 1344 **F** +61 2 9262 4841

charteredaccountantsanz.com

involvement with the client and the engagement team has been acknowledged to be a key driver of audit quality.

In New Zealand we believe these issues are exacerbated by the extended definition of Public Interest Entities (PIEs) which will impose the extended cooling off period beyond those impacted in other jurisdictions.

Practical difficulties

The coordination of EP and EQCR rotation is already time consuming and costly for firms. Increasing the administrative complexity by introducing differing time-on and cooling off periods for different types of entities and different types of partners will only increase these costs. There is no compelling evidence that increasing the rotation time will, increase audit quality and therefore the costs of increasing rotation times appear to outweigh any benefit.

We also understand that it is likely that the requirements for EQCRs in terms of industry experience and other qualifications will be increased in the revisions being proposed in the International Auditing and Assurance Standards Board's (IAASB) various standard setting projects. This would further reduce the pool of partners who can perform EQCR roles and increase the complexity of rotation management.

Appendix A contains our responses to the specific questions raised in the ED and Appendix B contains more information about Chartered Accountants Australia and New Zealand. If you have any questions regarding this submission, please contact me liz.stamford@charteredaccountantsanz.com.

Yours sincerely

Liz Stamford
Head of Policy
Leadership and Advocacy

Appendix A: Responses to specific questions

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

On the basis that it allows New Zealand to continue to comply with international professional and ethical standards, we agree with the proposals. However, there are concerns to be addressed and actions to be taken to ensure that the potential negative impacts of these changes are minimised.

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 believe the NZAuASB should reconsider the PIE definition, especially in relation to voluntary adopters of tier 1 reporting requirements (see our response to question 3).

(b) applying the revised requirements to all PIEs as defined in New Zealand is in the public interest? If not, please explain why and for which entities. Please expand on whether your concerns are related to auditor supply pressures (quantified where possible), or unintended consequences, or both. It is important we have evidence to justify our decisions. Please bear in mind that the PIE requirements extend beyond the long association requirements, and therefore the impact of amending the PIE definition is not limited to long association considerations.

The PIE definition needs to balance the public interest with the consideration of which entities truly need to be held to PIE standards. We believe that the NZAuASB should consider the potential impact on the audit market and the flow on effects on audit quality and the maintenance of a strong financial market in New Zealand.

Other jurisdictions such as the European Union, the United Kingdom and the United States are held up as examples that five year partner rotation is manageable. However there are significant differences in the population, the geographic isolation, and in the size of the entities being regulated in those markets compared to New Zealand. Therefore comparisons in relation to the manageability and impacts of the rotation process are not appropriate as the capacity issues in the market are not the same. In the US partner rotation applies only to SEC issuers and has not been extended to PIEs.

US SEC issuers, due to the size of the market, are substantially larger than the majority of issuers in New Zealand's capital market. The US also provides exemptions to rotation requirements for smaller firms (less than 10 audit partners) with small numbers of clients who are registrants (less than five), so the regulator has acknowledged the potential for these requirements to adversely impact the smaller end of the market. Similar concessions have been made in Canada in relation to exempting smaller listed entities from certain independence requirements (including partner rotation) due to a view that requiring those entities to comply with the full rotation requirements would adversely impact those entities and smaller audit firms.

In New Zealand, we have not seen extensive audit failure under the current rotation requirements. Further extending the cooling off period in New Zealand imposes a regulatory burden on audit firms and clients that is disproportionate to their size compared to entities subject to the same level of regulation in other jurisdictions.

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? 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 that the supply pressure created by the extension of the cooling off period will only be exacerbated in entities who voluntarily adopt tier 1 reporting requirements. This is not in the public interest.

(b) has any other unintended consequences? It is important that we have evidence to justify any changes so please explain why, including where possible evidence to support the number of entities that are voluntary PIEs, and explanations as to why entities elect to do so, to support your view that it is not in the public interest to include these entities as PIEs.

Entities who are voluntarily adopting tier 1 reporting requirements do not have the same characteristics as other PIEs and therefore the impact of their activities on the public interest is decreased. It is unnecessary for them to be subject to these additional requirements merely because they have voluntarily chosen to hold themselves to a high standard of financial reporting. In fact, it may have the unintended consequence of discouraging entities from choosing to make this election. This in turn has implications for financial reporting quality in New Zealand.

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.

Managing the rotation process is resource intensive and complex for firms. Having different requirements in the two jurisdictions will only make this more difficult for firms to manage. They would have to satisfy whichever is the stricter requirement which may place them at a disadvantage in managing relationships with dual listed entities versus those who are only listed in New Zealand or Australia.

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?

We support consistency with the international requirements and this is not consistent. We do not believe there is a compelling reason to deviate from the international requirements in this regard. These engagements do not have the same potential impact on the public interest as a financial statement audit and the IESBA Code provides sufficient guidance on safeguarding independence.

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.

We understand that extant New Zealand legislation does not contain the kind of alternative that would allow New Zealand to use the transitional provision. In Australia, Corporations Act entities will be able to use the transitional provision. This provides further complications for dual listed entities.

In our submission to the Accountants Professional and Ethical Standards Board (APESB) in Australia, we encouraged the APESB to continue to advocate that the transitional provision be removed and for them to monitor audit quality impacts over this time. That is so a jurisdictional overlay remains available to Australian entities post 2023, unless there is compelling evidence that the increased cooling off period has improved audit quality in the intervening period. We also encouraged the board to work with the Federal Government to have measures in place to align the Corporations Act rotation requirements with the APESB Code.

We understand the New Zealand Stock Exchange is currently looking at ways to align its requirements, including auditor rotation, with Australia. We encourage the NZAuASB to support Trans-Tasman alignment to reduce the burden on dual listed entities and to continue to pursue trans-Tasman harmonisation. Any harmonisation process would need to consider both the current Australian requirements and future changes that may occur post 2023. We also encourage the NZAuASB to consider ways to monitor the impact on the market and audit quality in New Zealand so that evidence is available to make decisions and pursue change when these provisions are next reviewed by the IESBA.

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

No.

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

No.

Appendix B: About Chartered Accountants New Zealand and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 120,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.
We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.