Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Public Interest Entity Amendments

Narrow scope amendments to auditing and assurance standards

Consultation document

March 2024

Consultation closes 4 June 2024

Contents

PART ONE:
Introduction

1.

What this consultation is about

The External Reporting Board has issued this consultation document to seek feedback on its proposal to expand the application of the differential requirements in the International Standards on Auditing (New Zealand) and Professional and Ethical Standards to Public Interest Entities.

The International Auditing and Assurance Standards Board (IAASB) is proposing to adopt the definition of a public interest entity as used in the International code of ethics. This will expand the application of certain extant differential requirements in the auditing and assurance standards from listed entities to public interest entities. The differential requirements are necessary to address the significant public interest in the financial condition of certain entities due to the potential impact of their financial well-being on stakeholders.

In line with the XRB's policy and principles of convergence to international standards, the XRB is seeking your views on the applicability of these differential requirements to public interest entities in the New Zealand auditing and assurance standards.

The XRB's definition of a public interest entity (PIE) includes:

- Entities that have public accountability
- Entities that are large.

FMC reporting entities considered to have a higher level of public accountability (FMC HLPA) are public interest entities. Large public sector and not-for-profit entities (e.g., large charities) are also captured as public interest entities under the New Zealand approach.

The proposal to expand the application of the differential requirements to public interest entities will impact audit engagements of large public sector and large not-for-profit entities, for example, large charities.

The main impact is that an engagement quality review and reporting of key audit matters will be required for these engagements. Additionally, there will be specific matters that will be required to be communicated with those charged with governance or in the auditor's report.

Examples of NZ PIEs include

- FMC HLPA entities
- Large public sector entities
- Large charities and other not for profit entities

We are seeking your views on the proposed expanded applicability in the New Zealand market.

This consultation document should be read in conjunction with the IAASB's Explanatory Memorandum and Exposure Draft.

2. How to provide feedback

Responding to consultation questions

We are seeking comments on the questions below. We will consider all comments received before finalising the proposed amendments in New Zealand.

Please feel free to comment on any or all of the questions.

We will put all written submissions on our website unless requested otherwise, and we reserve the right not to publish defamatory submissions.

1. Do you agree that the same definition of public interest entity should be used for the auditing and assurance standards and the professional and ethical standards? If not, please explain why not?
2. For each of the following differential requirements, do you agree with the proposal to extend the application to public interest entities? If not, please explain why not and why in your view it is not in the public interest to do so.
   a) Mandatory engagement quality review.[1]
   b) Required communications with those charged with governance about the firm's system of quality management.[2]
   c) Communications about auditor independence.[3]
   d) Communicating key audit matters in the auditor's report.[4]
   e) Name of the engagement partner.[5]
3. Do you agree that the benefits of the proposals outweigh the expected costs? If not, why not?
4. Are there any other significant public interest matters that you wish to raise?

Figure 1: Timeline

January
International ED issued

March
NZ Consultation paper issued

April 8
Submission to IAASB

May 15
NZ Virtual feedback forum

June 4
Submissions on NZ consultation to XRB

Making a submission

You can provide feedback to us via:

- The consultation page on our website (where you can upload a PDF or complete an online form);
- Emailing your formal or informal comments to assurance@xrb.govt.nz; or
- Attending our virtual feedback forum.

This consultation closes on **4 June 2024**

[1] Professional and Ethical Standard 3, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* paragraph NZ24(f)

[2] Professional and Ethical Standard 3, paragraph NZ34(e)

[3] International Standard on Auditing (New Zealand) (ISA (NZ)) 260 (Revised), *Communication with Those Charged with Governance,* paragraph NZ17.1, and ISA (NZ) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph NZ40(b)(1)

[4] ISA (NZ) 700 (Revised), paragraphs NZ30.1 and NZ40(c)(1), and ISA (NZ) 701, Communicating Key Audit Matters in the Independent Auditor's Report, paragraph NZ5.1

[5] ISA (NZ) 700 (Revised), paragraph NZ50(l)(1)

PART TWO:

Proposed Amendments

3.

Expanding differential requirements to public interest entities

Background

The IAASB is proposing to expand the application of differential requirements applicable to listed entities in its standards to public interest entities.

In adopting the IAASB's standards, the XRB has historically expanded the application of requirements that apply to listed entities to apply to FMC reporting entities considered to have a higher level of public accountability[6]. Examples of such entities include, issuers of equity securities or debt securities under a regulated offer, listed issuers, registered banks, licensed insurers, credit unions, building societies.

Given that the IAASB is looking to expand the applicability of certain requirements, to align with the definition of a public interest entity, the XRB is proposing to expand its differential requirements to public interest entities as defined in Professional and Ethical Standard 1[7] (the Code of Ethics).

These differential requirements are necessary to address the significant public interest in the financial condition of certain entities due to the potential impact of their financial well-being on stakeholders. The purpose of the differential requirements is to meet the heightened expectations of stakeholders regarding the audit engagement, thereby enhancing stakeholders' confidence in the entity's financial statements that can be used when assessing the entity's financial condition.

Fig 1: What impact will the proposals have on audit engagements of NZ public interest entities?

	Engagement Quality Review	Key Audit Matters	Communication of other matters
FMC HLPA entities	No change	No change	No change
Large public sector	Required	Required	Required
Large charities	Required	Required	Required

Under the proposals, in addition to FMC reporting entities considered to have a higher level of public accountability, the differential requirements would apply also to audits of large public sector and not-for-profit entities. That means, reporting of key audit matters and mandatory engagement quality review as well as communication of other specific matters will be required for audit engagements of large public sector entities and large not-for-profit entities, for example, large charities.

The differential requirements do not change the work effort required for an auditor to conclude whether the financial statements are fairly presented.

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6 Section 461K of the Financial Markets Conduct Act 2013 prescribes the FMC reporting entities considered to have a higher level of public accountability.

7 Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*

How will the proposed changes apply in New Zealand?

The definition of a public interest entity adopted in New Zealand, as defined in the Code of Ethics includes any entity that meets the Tier 1 criteria in accordance with XRB A1[8] and is not eligible to report in accordance with the accounting requirements of another tier.
Accordingly, the New Zealand PIE definition captures:

- Entities that have public accountability; and
- Entities that are large, as defined by XRB A2[9]

FMC reporting entities considered to have a higher level of public accountability are deemed to have public accountability. Large public sector and not-for-profit entities,[10] for example, large charities are also captured under the New Zealand approach.

The XRB's objective of linking the public interest entity definition to the tier 1 criteria in XRB A1 was for understandability and simplicity (i.e., not introducing unnecessary complexity to the multi-sector, multi-tier approach). It is also considered appropriate that audits or reviews of entities that can only report using tier 1 financial reporting requirements should be subject to the most rigorous and stringent independence rules.

- **Understandability**
- **Simplicity**
- **Heightened expectations of users**

The Code of Ethics includes more stringent independence requirements applicable for auditors and reviewers of public interest entities. For example, the key audit partner is required to rotate more frequently on a public interest entity engagement. In addition, auditors of public interest entities are prohibited from performing certain non-assurance services for public interest entities, whereas on non-public interest entity engagements the auditor can apply a threats and safeguards approach which may enable them to perform some non-assurance services that would be otherwise prohibited. The public interest entity definition was developed for purposes of the Code of Ethics and has not previously been applied in the context of the auditing requirements.

The XRB is now considering expanding the application of the differential requirements in its auditing and professional and ethical standards to apply to all public interest entities.
Applying the differential requirements to all entities determined to have public accountability may enhance audit quality. The more stringent requirements in the Code of Ethics apply to audit and review engagements of entities using the tier 1 accounting requirements, whereas the stricter auditing requirements apply only to a subset of those entities. This has created layers in the standards with only FMC reporting entities with higher public accountability explicitly subject to the more rigorous requirements.

Using the most onerous audit and independence requirements is in the public interest for all entities that have public accountability.

8 External Reporting Board Standard (XRB) A1, *Application of the Accounting Standards Framework*

9 External Reporting Board Standard (XRB) A2, *Meaning of Specified Statutory Size Thresholds*

10 The New Zealand Accounting Standards Board has a current project to consider amendments to increase the Public Benefit Entity tier size thresholds.

Differential requirements explained

I. Mandatory engagement quality review

Mandatory engagement quality reviews are already required broadly in New Zealand.

Professional and Ethical Standard 3[11] requires an engagement quality review for audits of FMC reporting entities considered to have a higher level of public accountability, and for all engagements where an engagement quality review is required by law or regulation. Additionally, firms are required to establish policies and procedures that address engagement quality reviews as an appropriate response to address quality risks.

Under the existing differential requirements, whether a tier 1 reporting entity audit engagement in the public sector or not-for-profit sector is subject to an engagement quality review depends on the assessed risk. Under the proposal, public sector and not-for-profit tier 1 reporting entity audit engagements that are not assessed as high risk would be subject to mandatory engagement quality review.

II. Reporting of key audit matters in the auditor's report

When introducing the requirements for key audit matters in New Zealand, the XRB signaled its intent to explore expanding key audit matters to all public interest entities at a later date.

Key audit matters are those matters that, in the auditor's professional judgement were of most significance in the audit of the financial statements. Key audit matters are selected from matters communicated with those charged with governance.
Key audit matters:

- Enhance the communicative value of the audit report by offering better transparency about the audit.
- Provide additional information to users to understand the professional judgement of the auditors.
- Help in understanding the areas of crucial management judgement in audited financial statements.
- May encourage users to further engage with those charged with governance and management with reference to information in the key audit matter.

Key audit matters may voluntarily be included in auditors' reports. For example, the auditors' reports for the Financial Statements of the Government of New Zealand, Auckland Council and Te Whatu Ora include key audit matters.

The XRB's recent Trust and Confidence research report, Views from Audit Committee Chairs highlights the benefits of the reporting of key audit matters from the perspective of audit committee chairs.

[11] Professional and Ethical Standard 3, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements or Other Assurance or Related Services Engagements*

III. Communications with those charged with governance

Under the differential requirements, the auditing standards require communications with those charged with governance about:

- compliance with relevant ethical standards, including
  - relationships and other matters that in the auditor's professional judgement may reasonably be thought to bear on independence
  - in respect of threats to independence that are not at an acceptable level, actions taken to address or eliminate those threats.
- how the system of quality management supports the consistent performance of quality audit engagements.

Cost vs benefit

The benefit of creating consistent financial reporting, requiring the application of the highest financial reporting requirements, and then having those financial statements audited using the most robust auditing and independence requirements comes with increased costs. Expanding the differential requirements to public interest entities will capture approximately 450 additional audit engagements across the regime. The XRB has recently lifted the public benefit entity tier thresholds. We would therefore expect to see a small decrease in the number of entities meeting the criteria to report in accordance with the tier 1 reporting requirements.

Fig 2: Tier 1 Public sector and not-for-profit reporting entities

Public sector for profit*	116
Public sector PBE*	222
Not-for-profit PBE^	126

The benefit of extending the requirements to all public interest entities, is that it maintains a consistent level of audit requirements and avoids creating sub-levels of assurance requirements. However, under a risk-based audit approach it is not clear that expanding the differential requirements to all public interest entities is needed, nor whether this would have a positive impact on audit quality that would exceed the cost of requiring it.

* Public sector information supplied by staff of the Office of the Auditor-General

^ Not for profit information obtained from the NZ Accounting Standards Board *PBE Tier consultation*

Transparency about other information

ISA (NZ) 720 (Revised)[12] deals with the auditor's responsibility relating to other information included in the entities annual report. ISA (NZ) 720 (Revised) includes requirements for auditors of FMC reporting entities considered to have a higher level of public accountability to report on other information that has not been received by the date of the auditor's report.

Consistent with the IAASB proposals, the XRB does not propose to expand this differential requirement to apply to public interest entities. Rather, the requirement to report on other information that has not been received by the date of the auditor's report will continue to apply to FMC reporting entities considered to have a higher level of public accountability only.

Discussion of the differential requirements related to other information is included in this consultation paper for completeness.

Questions for respondents

1. Do you agree that the same definition of public interest entity should be used for the auditing and assurance standards and the professional and ethical standards? If not, please explain why not.

2. For each of the existing differential requirements, do you agree with the proposal to extend the application to public interest entities? If not, please explain why not and why in your view it is not in the public interest to do so.

    a) Mandatory engagement quality review.[1]

    b) Required communications with those charged with governance about the firm's system of quality management.[2]

    c) Communications about auditor independence.[3]

    d) Communicating key audit matters in the auditor's report.[4]

    e) Name of the engagement partner.[5]

3. Do you agree that the benefits of the proposals outweigh the expected costs? If not, why not?

4. Are there any other significant public interest matters that you wish to raise?

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[12] ISA (NZ) 720 (Revised), *The Auditor's Responsibilities Relating to Other* Information, paragraphs NZ21.1 and NZ22.1

[1] Professional and Ethical Standard 3, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* paragraph NZ24(f)

[2] Professional and Ethical Standard 3, paragraph NZ34(e)

[3] International Standard on Auditing (New Zealand) (ISA (NZ)) 260 (Revised), *Communication with Those Charged with Governance,* paragraph NZ17.1, and ISA (NZ) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph NZ40(b)(1)

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[5] ISA (NZ) 700 (Revised), paragraph NZ50(l)(1)

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