List of submissions received in response to the NZAuASB exposure draft dealing with long association

Agenda 3A.1	KPMG
Agenda 3A.2	Ernest & Young
Agenda 3A.3	Deloitte
Agenda 3A.4	Chartered Accountants Australia and New Zealand
Agenda 3A.5	NZX
Agenda 3A.6	Office of the Auditor General
Agenda 3A.7	CONFIDENTIAL
Agenda 3A.8	Silks
Agenda 3A.9	Laura Addinal

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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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4 July 2017

Proposed Amendments to Professional and Ethical Standard 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client

Dear Warren

On behalf of Ernst & Young I am writing to provide comment on the NZAuASB's exposure draft "Proposed Amendments to Professional and Ethical Standard 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client". We welcome the NZAuASB's initiative in requesting comment from constituents regarding the important matters in this exposure draft.

We provide responses as requested as follows:

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

   We support the convergence of New Zealand standards with international standards and therefore agree with the proposal to adopt these revised requirements.

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 agree the New Zealand PIE definition is appropriate. We believe that the definition of a PIE in New Zealand is too broad. The challenges posed by the changes to the long association provisions are exacerbated by the wide PIE definition.

      We note the definition of a PIE in Australia is the same as the international definition. We do not consider that there are significant differences between the Australian economy and New Zealand economy which justifies a difference in the definition of a PIE. The new long association provisions will have a less disruptive impact on the Australian environment as fewer entities are caught under their PIE definition.

      As the New Zealand PIE definition is so broad and because the timeframe for adoption of this amendment is so short, a very large number of entities' audits will be impacted by these changes in a very short timeframe. In our view, this may negatively impact audit quality.

      The proposed effective date of "periods beginning on or after 15 December 2018" and the IESBA FAQs, which make it clear that a lead audit partner must have completed their cool-off prior to the start of the audit period following the aforementioned date, mean we have already passed the final date for rotation of most audits under the old rules. This makes the new rules retrospective. Given the very large number of entities caught under the PIE rules in New Zealand and the relatively small auditor marketplace, this provides significant challenges to rotate audits affected in a fashion which promotes and maintains audit quality, especially in specialist industries. We note that the exposure draft itself states in paragraph 22 that "audit firms will need time to consider the implications, especially in remote locations or in industries that require specialist expertise".

As we understand the new rules,

- For a December year-end, the new rules apply to the year-ending 31 December 2019, so an engagement partner must have cooled-off for the 2017 and 2018 years. This means that December 2016 is the last year that a partner can sign-off without needing to cool-off for 5 years, instead of 2 years.

- For a June year-end, 30 June 2020 would be year 1 of the new rules, so an engagement partner must have cooled-off for FY 2017/8 and 2018/9, and the year-ending 30 June 2017 is the last year that a partner can rotate and still only cool-off for 2 years.

In our view, a hurriedly introduced 5 year cooling off period may actually lead to diminished audit quality due to the small number of industry experienced partners available. We would contrast New Zealand with the US market where audit partners generally only work in 1-2 industries and are therefore much better placed to rotate on to new clients in the industry they are experienced in.

Many entities which fall under the PIE definition are located in smaller towns and cities of New Zealand, where the supply of partners through which to rotate is (much) smaller. The larger accounting firms can allocate clients to partners in other offices, but we consider it more beneficial to have partners located geographically close to their clients. Such a solution may not be available to smaller firms.

As a final observation, we note that many of the entities captured as PIEs in the table in paragraph 17 will be covered by the standards issued by the Auditor General.

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

We agree that applying the revised requirements to a narrowed PIE definition is in the public interest. As previously outlined, we think that the definition of a PIE in New Zealand as it currently stands is too broad.

We acknowledge that the PIE definition does not only impact long association matters. However, the proposal extends a retrospective arm to a very broad range of entities.

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?*

No, we do not consider it is in the public interest to retain entities that voluntarily report using tier 1 reporting requirements within the New Zealand PIE definition. The reason clients choose to voluntarily report under Tier 1 has little to do with the public interest and has no link to whether it is appropriate to apply more stringent auditor long association provisions (or other provisions related to being a PIE).

Some of these voluntary Tier 1 entities are small and adopt Tier 1 for ease of reporting to parent entities. We are not aware of a justifying rationale for capturing entities which voluntarily choose to adopt Tier 1 financial reporting as PIES and therefore requiring compliance with the long association provisions related to PIEs.

While we do not think there are a large number of voluntary Tier 1 reporters, the PIE requirements are encouraging these entities to reduce their disclosure (which may otherwise be of interest to users) purely to enable them to assert compliance with Tier 2 and therefore avoid the PIE definition.

In our view, excluding "voluntary PIEs" from the New Zealand PIE definition is consistent with IESBA's PIE definition and application guidance. These entities have not been caught under the mandatory Tier 1 definition and therefore do not have a large number nor a wide range of stakeholders, do not hold assets in a fiduciary capacity and are not considered to be large. In our view, it was not appropriate to include these voluntary PIEs in the definition in the first instance.

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.*

   Given the close economic ties between New Zealand and Australian entities, it is highly beneficial for the audit standards to be as closely aligned as possible. We do not believe it to be justifiable to require New Zealand entities to apply stricter rotation requirements than their Australian counterparts. In our opinion, every effort should be made to ensure that the New Zealand rotational requirements for listed entities align with those of Australia. As currently proposed, this is not achieved.

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?*

   In our view, alignment of rotation requirements will have little practical impact as in many cases the partner undertaking the other recurring assurance engagement for PIEs is likely the partner undertaking the audit and will already be covered by the rotation requirements. While we do not disagree with the NZAuASB's aligning of section 291 with section 290, we are not clear what the NZAuASB's rationale is for amending this element of the standard for New Zealand. It is not clear that there is a specific difference in the New Zealand environment that would justify a change from the international standard. As a standard taker, in our view, the international standards should be amended in New Zealand where there is a clear difference in our market that would require amendment.

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.*

   To ensure alignment with the rotation requirements in Australia which we understand will be applying the 3 year rotation until 2023, we strongly believe it is essential for this transitional requirement to be adopted in New Zealand. This transitional amendment also allows much needed time for audit firms to prepare for the changes to rotation.

   We are aware of the NZAuASB's current position that to apply the transitional provision in New Zealand would be contrary to its stated strategy of not adopting a lesser standard than the international version. In our view, this is a very literal interpretation that is not in the best interests of the public in New Zealand.

   In our view, it is very possible to make an argument that applying the transitional provisions to all PIEs is not adopting a lesser standard that the international version. In our view, the NZAuASB should argue that because other countries are making use of the transitional provisions, our standard would not be weaker for applying the provision to all PIEs because the country we have closest economic ties to is applying the provisions to the same sorts of entities. In fact, if we do not apply the transition provisions we will be out of step with Australia and other countries.

It is a very literal interpretation of transitional provisions to argue that we cannot apply the transitional provisions in New Zealand purely on the basis that Australian rotation rules are in corporations' law and ours are not.

To allow much needed time for the new rules to be applied is not, in our view, lessening the standard. During the transition period, similar entities in NZ and Australia (and possibly other countries) would be subject to the same rotation rules. In our view, in the public interest, the NZAuASB should take a pragmatic approach to the application of the transitional provisions.

In our opinion, the NZAuASB should apply the transitional provision to all PIEs in New Zealand with the rationale that due to;

- the very broad nature of our PIE definition,
- the unique business environment (with a small number of qualified auditors auditing complex specialised industries and remote locations); and,
- the importance of aligning our rotation rules with those of Australia,

it is in the public interest to allow additional time for the profession to adapt to the new rotation rules so as not to reduce audit quality.

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

   We consider no further reason for amendment.

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

   We have no further comment on this exposure draft.

In summary, we believe that, in the NZ context, the breadth of entities affected and the timeframe to address the new rules is likely to diminish audit quality in the short term. In New Zealand the current proposals combined with the wide PIE definition and lack of application of the transitional provisions will result in one of the smallest economies having some of the strictest rotation rules in the world. We consider it poor process to apply new standards retrospectively (acknowledging that this is due to the timeframe of the international standard's release) and believe there is a strong case to either reduce the number of entities affected (by changing the scope) and deferring the implementation date (to allow a more planned and managed approach).

Please contact me if you would like to discuss this submission further.

Yours Sincerely

Marcus Henry
New Zealand Professional Practice Director
Ernst and Young

CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

27 July 2017

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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)

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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.

31 July 2017

External Reporting Board
By email: submissions@xrb.govt.nz

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

NZX Limited ('**NZX'**) refers to the 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' (the '**Exposure Draft**) published by the External Reporting Board ('**XRB**'). We would like to thank the XRB for the opportunity to make a submission. NZX limits its comments on the Exposure Draft to the proposed auditor rotation changes.

NZX agrees it is important for New Zealand's auditor rotation requirements to be of a high standard and, to the extent practicable, to align with international codes. Given the large number of companies listed on both NZX and ASX another important consideration in the New Zealand context is to ensure alignment with the position in Australia to the extent practicable.

Changes to sections 290 and 291 of the New Zealand Professional and Ethical Standard 1

NZX is interested to see the outcome of this review, and what the market preference is for auditor rotation periods regarding the new proposed seven year "time-on" period and increasing the mandatory "cooling off" period from two to five years cycle to match the International Code of Ethics. We note that lengthening the time between rotations may reduce the pressure on an already small pool of auditors and issuers within New Zealand.

As noted above, a number of issuers are listed on both the NZX and ASX exchanges. In Australia, the Corporations Act 2001 establishes both a "time on" and a "cooling off" period that differs from international requirements for listed entities. There are 30 companies that are listed on both the NZX Main Board and the ASX Main Board, who have the status of 'Foreign Exempt' companies on the ASX. The impact of a Foreign Exempt listing status is that these companies do not need to meet the majority of ASX's requirements. As a result, these companies will need to meet the NZX requirements in relation to auditor rotation but we need to better understand how this interacts with any auditor rotation requirements under the Corporations Act 2001. The total number of dual listed issuers is approximately 35 (both Foreign Exempt and ASX Standard Listed issuers). Alignment between regimes in New Zealand and Australia will remain a concern for dual listed companies.

There will be a difference between the maximum number of years an auditor has "time on" under PES1 (7 years) and NZX's current rules (5 years). This means that any public interest entity who is listed must meet the lower NZX requirement.

NZX Main Board Listing Rule Review

In August 2016, NZX sought views on whether auditor rotation timeframes should be updated from five to seven years "time-on". Many who responded were broadly comfortable

with the current five year audit partner rotation requirement but noted that extending the timeframe to seven years would align with the underlying ethical standards by the XRB PES1. In addition, a number of submitters highlighted that NZX should not seek to impose requirements in this area given the separate legal requirements.

NZX intends to commence a review of its Listing Rules this year and will raise this matter as part of the review. We plan to release an initial consultation paper in September 2017 and it will be helpful for NZX to consider the feedback received to XRB's current review as part of our review process.

NZX's rules are currently silent about a "cooling off" period in respect of auditor appointments. While we did not raise the question of introducing a "cooling off" period at that time, this is something we can consult on with stakeholders in the context of the NZX Main Board Listing Rule review. We will consider the impact of transitional relief for issuers as part of the consultation process.

NZX again thanks the XRB for the opportunity to submit comments on the Consultation Paper and is happy to discuss any of these comments further.

Yours sincerely

Hamish Macdonald
General Counsel and Head of Policy

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31 July 2017

File Ref: AU/APS/2-0002
AU/APS/6-0012

Warren Allen
Chief Executive
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WELLINGTON 6142

Dear Warren

ED NZAuASB 2017-1: PROPOSED AMENDMENTS TO PES 1 (REVISED) PROVISIONS ADDRESSING THE LONG ASSOCIATION OF PERSONNEL WITH AN ASSURANCE CLIENT

As you will be well aware, the translation of the international requirements on auditor rotation to the New Zealand context is not easy.

The Auditor-General has previously submitted on the international proposals in submissions to the International Ethics Standards Board for Accountants (IESBA) dated 7 November 2014 and 11 May 2016. Copies of these submissions can be found on the International Federation of Accountants website.

The significant matter that we wanted to draw to the attention of the IESBA was that the proposals, when translated to the New Zealand context, did not seem to reflect a proportionate response to those entities to whom the IESBA was primarily seeking to target. Whilst the IESBA was somewhat vague in defining the nature of the targeted entities, our sense was that the requirements were primarily aimed at those entities that solicit funds (such as donations and investments) from the public. In the New Zealand context this group of entities would be described as "FMC reporting entities considered to have a higher level of public accountability" under the Financial Markets Conduct Act 2013.

We have some difficulty in the decision by the NZAuASB to automatically apply the international requirements to a seemingly wider group of entities in New Zealand (being those entities falling under the New Zealand definition of public interest entity) without attempting to establish comparability with the notion of a public interest entity internationally. As a consequence we do not know if the proposals achieve comparability with the international standard. We understand that comparability with international requirements is the primary principle applied by the NZAuASB in its standards setting activity.

We suspect the proposed New Zealand requirements will exceed international requirements. We do not have any difficulty with an "international plus" requirement, as long as the anticipated benefits of that approach exceed the cost. To date, we have yet to be persuaded that the proposals satisfy the "cost/benefit" test.

We understand that the definition of "public interest entity" in New Zealand was developed in the context of financial reporting. That definition was then applied to the independence provisions of the Code of Ethics in circumstances where the definition was seen as "proportionate" to the threat to independence. In our opinion, the NZAuASB needs to make a similar assessment on the application of the proposed requirements to "public interest entities". We think a proportionate response is to apply the requirements to "FMC reporting entities considered to have a higher level of public accountability". We would note that this is the same category of entities that are subject to the key audit matters requirements in ISA (NZ) 701: *Communicating Key Audit Matters in the Independent Auditor's Report*.

We have included our responses to the questions asked by the NZAuASB in the Attachment to this letter.

If you have any questions about our submission, please contact Roy Glass at roy.glass@oag.govt.nz.

Yours sincerely

Todd Beardsworth
Assistant Auditor-General (Accounting and Auditing Policy)
Office of the Controller and Auditor-General of New Zealand

Email: todd.beardsworth@oag.govt.nz

Attachment - Responses to Questions for Respondents

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

   No, not in the manner set out in ED NZAuASB 2017-1. Please refer to the comments in our covering letter, which provides the context for our disagreement.

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?*

   The New Zealand PIE definition is appropriate for the original purpose for which it was created, being to define those entities that are subject to Tier 1 financial reporting requirements in New Zealand. However, the PIE definition is not appropriate for the proposed changes that respond to concerns about auditors' long association with an entity. Please refer to the comments in our covering letter.

   (b) *Applying the revised requirements to all PIEs as defined in New Zealand is in the public interest?*

   One can argue that every enhancement made to a professional and ethical standard, or to an auditing standard, is in the public interest. However, the public interest benefit must, at a minimum, outweigh the costs associated with the enhancement.

   In this instance, as discussed in the covering letter, it is not apparent to us that the public interest benefit equals, or exceeds, the cost of applying the proposals to public interest entities. Furthermore, we do not consider that the NZAuASB has provided sufficient evidence to justify applying the proposed requirements to public interest entities.

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?*

   We do not agree that it is in the public interest for the proposed requirements to be applied to entities that voluntarily report using the Tier 1 financial reporting requirements. We do not consider that the NZAuASB has provided sufficient evidence to justify applying the proposed requirements to public interest entities. Consequently, the case for applying the proposed requirements to entities who voluntarily elect to apply the Tier 1 financial reporting requirements has not been justified.

   As discussed in our response to Question 2(b) above, the proposed requirements must satisfy the cost/benefit test.

   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?*

   In our opinion, applying the proposed requirements to entities that voluntarily report using the Tier 1 financial reporting requirements will create auditor supply pressures, over and above the auditor supply pressures that will be created in applying the proposed requirements to public interest entities.

(b) *Has any other unintended consequences?*

In most circumstances, the new requirements will necessarily result in additional audit costs. Rather than incur additional audit costs, some entities that voluntarily report using the Tier 1 financial reporting requirements may decide to adopt a lesser form of reporting that they are permitted to apply. The consequences of this decision will be to deprive users of the financial statements of (potentially) useful information. In addition, the proposed requirements may deter some entities from voluntarily adopting Tier 1 reporting.

The consequence of these decisions is lesser reporting, which is unsatisfactory from a public interest perspective.

In our view, the NZAuASB needs to reflect on the deterrent effect of the proposed changes on voluntary improvements in financial reporting. It makes no sense that an entity is "penalised" for voluntarily adopting better reporting.

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.*

The Auditor-General is the auditor of a small number of dual listed public entities. Because the proposed requirements for New Zealand listed entities will be more stringent than those entities listed in Australia, there are unlikely to be any unintended consequences from an Auditor-General's perspective.

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 do not agree that the proposed auditor rotation requirements should be applied to public interest entities, for the reasons included in the covering letter.

However, it does make sense to apply any enhanced requirements uniformly across all recurring assurance engagements (including audits of financial statements) carried out within an entity.

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 have not fully engaged with the transitional provisions. Nonetheless, auditors should be permitted a reasonable lead time to transition to the new requirements because of the resourcing implications of the proposals.

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

Please refer to the comments in the covering letter.

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

Rotation of the External Quality Control Reviewer

There is a particular issue around the rotation of the engagement quality control reviewer (EQCR) that has not been addressed in the proposal, and that we believe requires consideration. The independence of the EQCR from the operational aspects of the audit is fundamental to the EQCR role. Therefore, it follows that the EQCR can move directly from the EQCR role to another key audit partner (KAP) role without a cooling-off period, as long as the move occurs within a seven-year time-on period. However, the effectiveness of the EQCR role would be significantly diminished if the individual is able to move directly from an operational role to an EQCR role, within a seven-year time-on period, without a cooling-off period. This is because the individual performing the EQCR would be monitoring their own work (carried out in a prior period), and this would effectively negate the benefit of the EQCR.

Restrictions on Activities During the Cooling-off Period

Paragraphs 290.164 and NZ291.141.11 place restrictions on what an individual can do during the cooling-off period.

We are concerned that these paragraphs permit a degree of contact with the entity, and that this contact will effectively negate the purpose of the cooling-off period – being to remove the threats to independence that may arise when an individual is involved in an audit or review engagement over a long period of time. The proposed requirements (at paragraph 290.148) specifically state that a self-interest threat may be created through an interest in maintaining a close personal relationship with a member of senior management or those charged with governance.

Such contacts can be maintained under the proposed standard in the following ways:

- Paragraph 290.164(c) permits on-going contact as long as the individual is ***not responsible*** for ***leading*** or ***coordinating*** the firm's professional services to the audit or review client or ***overseeing*** the firm's relationship with the audit or review client [emphasis added].

  By implication, paragraph 290.164(c) permits a current key audit partner to engage in such activities, which is questionable.

- Paragraph 290.164(d)(i) would permit an individual to interact with senior management or those charged with governance provided the interaction was not ***significant*** or ***frequent*** [emphasis added].

In summary, the cooling-off restrictions permit on-going interaction during the cooling-off period. The opportunity given by the proposed standard that permits interactions between an individual and the entity during a cooling-off period effectively negates the whole purpose of the auditor rotation proposals.

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File ref: / DOCID: 195150.0
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From: Cameron Town <ctown@silks.co.nz>
Sent: Sunday, 28 May 2017 12:45 a.m.
To: submissions
Subject: audit rotation

Submission

I am writing to submit some commentary on the proposed audit rotation i.e.

Extending the cooling off period to 5 years for the engagement partner; and
Extending the cooling off period to 3 years for the engagement quality control reviewer.

We are a regional audit practice with three licensed auditors and I have concerns that a broad change as this could affect regional audit practices and the overall possible effect this may have on a continual reduction in licensed auditors in New Zealand.

This could lead to issues with only a few audit practices holding a monopoly in the audit space of FMC entities. With a reduction in number of possible audit firms the possible impact this will have on timeliness and cost to the smaller FMC entities.

Ensuring all current licensed auditors have sufficient FMC audit work to ensure they are maintaining standards and improving quality, which is at the forefront of the objectives of the FMA, then this proposal for smaller to medium size practices may potentially hinder this overall objective of the FMA in regards to audit quality. This also may lead to some practices to consider whether they wish to continue to engage in the FMC assurance engagements.

We audit a number of FMC entities where the investment is passive in nature i.e. forestry and what benefit would the users of the financial statements in such investments where the forestry is in the growth phase of the investment where very few transactions occur on an annual basis in extending the cooling off period.

Consideration to a benchmark or minimum capitalisation threshold of the entity or listed on the stock exchange where shares are actively traded on a regularly basis then the benefits may warrant the proposed further cooling off period.

Further possible industry related sectors where investment capital has been raised and the nature of the investment is long term in years or maturity such as forestry then the cooling off period becomes a potential burden.

Kind regards
Cameron Town BBus, Grad Dip ProfAcc, CA (CPP) (extn: 825)
Chartered Accountant
Audit Principal
ctown@silks.co.nz

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File ref: / DOCID: 195149.0
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From: Laura Addinall <Laura@laca.net.nz>
Sent: Wednesday, 10 May 2017 11:21 a.m.
To: submissions
Subject: Auditor Rotation

Hi there

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

Para 290.168 might have eluded to my query…nevertheless I have the following comment/concern:

I could not find reference in the ED regarding assurance engagements for PBEs (especially Tier 3 and 4; and lower spectrum Tier 2s). For these entities there are a limited number of "one-man" audit practices (that charge at a rate these charities can afford) to facilitate the auditor rotation.
A proposal to mitigate the risk associated with "Long Association of Personnel" for the above-mentioned clients, would be to require Peer Review after the 7 cumulative years of engagement, in lieu of the "cooling off" period.

With thanks

Laura Addinall (CA)
Director: LACA Limited
Serving with Excellence

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