

**NEW ZEALAND AUDITING STANDARD 1
THE AUDIT OF SERVICE PERFORMANCE INFORMATION**

Explanation of Decisions made

Issued February 2019

This document relates to, but does not form part of NZ AS 1, *The Audit of Service Performance Information* which was approved by the NZAuASB in February 2019. It summarises the major issues raised by respondents in response to Exposure draft NZAuASB 2017-2 and the subsequent limited scope review draft and how the NZAuASB has addressed them.

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NEW ZEALAND AUDITING STANDARD 1

THE AUDIT OF SERVICE PERFORMANCE INFORMATION

Explanation of Decisions made by the NZAuASB in Finalising NZ AS 1

Issued by the New Zealand Auditing and Assurance Standards Board

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BACKGROUND

1. This Explanation of Decisions Made summarises the NZAuASB’s considerations in developing NZ AS 1 *The Audit of Service Performance Information*.
2. There is no international equivalent auditing or assurance standard that addresses the audit of service performance information directly and the NZAuASB therefore identified the need to develop a domestic standard. The NZAuASB was mindful of the need to, and importance of, remaining consistent with the principles in EG Au1A¹ and the requirements of the International Standards on Auditing (ISAs), issuing a standard that is framework neutral, applicable to the audit of service performance information prepared by Tier 1 to Tier 4 entities, and to develop a standard that is workable and understandable for New Zealand.
3. The NZAuASB issued an exposure draft ED NZAuASB 2017-2 (the ED) in September 2017 with a comment deadline of 20 December 2017. The NZAuASB received 9 comment letters, obtained additional feedback through 2 roundtable discussions on the ED and received feedback from the NZASB.
4. The NZAuASB revised the proposals to address concerns raised on exposure and sought fatal flaw feedback on revised limited scope review draft in August 2018. It did so by notifying the respondents to the 2017 ED of the revised proposals and making the limited scope review draft of the proposed standard available on the XRB website for two months.
5. There was general support for the development of a domestic standard. There was support for the two-step approach described in the [invitation to comment](#) (ITC) and the need to emphasize the concurrent nature of the audit of the financial statement information and the service performance information. However, there was a wide range of opposing views on a number of topics explored in the ITC in response to the specific proposals.

MAJOR ISSUES RAISED BY RESPONDENTS

6. The NZAuASB analysed all comments received. The most substantive issues that involved meetings with stakeholders and further deliberations by the Board included:
 - Alignment with PBE FRS 48² as opposed to alignment with language used in the ISAs.
 - The use of the term “criteria” and the definition of “service performance criteria”.
 - Reference to the qualitative characteristics described in PBE FRS 48.
 - Materiality considerations.
7. Other key issues raised in the submissions received included:

¹ EG Au1A Framework for Assurance Engagements

² PBE FRS 48 *Service Performance Reporting*

- Concern at the perceived level of prescription in the ED and the cost/benefit ratio.
- Criticism of the length and readability of the ED but some submitters seeking additional application guidance.
- Mixed views on proposed assertions.
- Lack of support for opining on the suitability of the service performance criteria.
- Some concern at allowing a long-form auditor's report.
- Confusion as to the need for reference to both the ISAs (NZ) and the domestic standard in the auditor's report.

HOW THE NZAuASB RESPONDED

Substantive Matters

Alignment with PBE FRS 48

8. One respondent, and feedback from the NZASB, raised concern at a perceived disconnect between the auditing standard and the requirements of PBE FRS 48. The ED made use of assurance terminology, including terms like criteria and characteristics of suitable criteria. These terms are not used in PBE FRS 48.

Response by the NZAuASB

9. Whilst mindful of the need to link to the financial reporting requirements as much as possible, the NZAuASB considers that it is necessary, for both conceptual and practical reasons, for the auditing standard to be based on established assurance requirements and to meet the preconditions for an assurance engagement described in EG Au1A and the International Framework for Assurance Engagements. The preferred approach is to use assurance terminology but link to the financial reporting requirements where appropriate. This approach was explicitly supported by other stakeholders in response to the ED.
10. The ISAs are developed to be framework neutral, applicable to the audit of financial statements regardless of the applicable financial reporting framework. The NZAuASB considers that the advantages of remaining framework neutral to develop NZ AS 1 outweigh any perceived risks. In New Zealand, NZ AS 1 will be applied to audit service performance information prepared by Tier 3 and even Tier 4 entities, and therefore should not be a response only to PBE FRS 48, but also to Public Benefit Entity Simple Format Reporting – Accrual and Public Benefit Entity Simple Format Reporting - Cash.

Service Performance Criteria

11. Mixed views were received on the use of and/or the proposed definition of “service performance criteria”. Some were supportive of the proposals, others suggested enhancements to the definition, whilst others were very strongly opposed to including the term “criteria”. Those who were strongly opposed expressed confusion as to why PBE FRS 48 alone was not the criteria for the engagement.

12. The NZAuASB met with stakeholders who were most strongly opposed to the proposed approach to better understand the concerns. The NZAuASB weighed up those concerns against the support expressed by other stakeholders, as well as considering current developments internationally³ to develop guidance on assurance of non-financial information dealing with similar issues.

Response by the NZAuASB

13. While the NZAuASB considers that the overarching “criteria” for the engagement, in the case of a Tier 1 and Tier 2 entity, is PBE FRS 48, each entity will identify its own service performance to report on and appropriate ways to measure or evaluate that performance. The manner in which an entity measures or evaluates its service performance is an integral part of the criteria for the purposes of an assurance engagement as described in EG Au1A⁴.
14. Financial reporting standards include detailed recognition and measurement criteria for the elements included in financial statements. These are required to be described in the accounting policies in the financial statements. ISA (NZ) 700⁵ requires the auditor to evaluate whether the financial statements appropriately disclose the significant accounting policies selected and applied, including whether the information disclosed is relevant and reflects how the recognition, measurement and presentation criteria in the applicable financial reporting framework have been applied in the circumstances.
15. The NZASB noted in finalising PBE FRS 48, that revisions were made so that the standard could be more readily applied by entities using a range of performance frameworks. The accounting standards are purposefully not prescriptive in establishing recognition and measurement criteria, rather encouraging the entity to tell its own story, while outlining the objective of such reporting. However, the way in which an entity measures or evaluates its performance is what the criteria refer to for the purpose of the audit of the service performance information. There was much support for a two step process, and evaluating the suitability of the criteria is the first step in this two step process. It is a precondition for any assurance engagement that the criteria (with reference to both PBE FRS 48 and the way in which the entity measures or evaluates its service performance) are suitable and are available to users of the auditor’s report.
16. Given the concerns expressed, the NZAuASB proposed describing criteria in a different way in the limited scope review draft:

³ IAASB project to develop guidance related to Emerging Forms of External Reporting (EER) Assurance

⁴ EG Au1A *Framework for Assurance Engagements*

⁵ ISA (NZ) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements* paragraph 13 and A4

- a. To continue to use the language in EG Au1A as the underlying basis of NZ AS 1, given that this is an auditing standard that will be a part of the ISAs (NZ) suite of standards.
 - b. To remove the term “service performance criteria” as there is misunderstanding as to what was meant.
 - c. To remove references to ISAE (NZ) 3000 (Revised), except to make it explicit that the auditor need not apply ISAE (NZ) 3000 (Revised) to the service performance information.
17. The NZAuASB explored many alternative ways to describe “service performance criteria”, rejecting options such as “reporting policies and procedures” or “the reporting process” or “compilation methods” based on discussions with those stakeholders who originated the concerns.
 18. The limited scope review draft standard replaced the term “service performance criteria” with reference to the “selected service performance and methods used to measure, describe, aggregate, present and disclose”. These methods used were defined with reference to the “applicable criteria” to link to assurance terminology.
 19. Feedback in response to the limited scope review draft from the key respondent opposed to “service performance criteria” remained opposed to describing “criteria” in this alternative way.
 20. Taking into account all of the feedback received on the exposure draft and the limited scope review draft, the NZAuASB determined to revert back to “service performance criteria”, to align with established assurance terminology.

Qualitative Characteristics

21. There were mixed views about the proposed application material to assist the auditor in evaluating the suitability of the criteria,. Some feedback was supportive of the application material provided, others sought more practical application material and another noted that evaluation of completeness will be challenging regardless of the amount of application material included.
22. One stakeholder noted that the words used to describe suitable characteristics in the ED⁶ differed from the qualitative characteristics in PBE FRS 48⁷ and considered that there may be a risk in using different words, e.g., causing the auditor to look for or require different things of the preparer than are required by PBE FRS 48.

Response by the NZAuASB

23. The NZAuASB acknowledges the risk raised that these characteristics are not identical to the qualitative characteristics in PBE FRS 48 but considers the risks to be

⁶ ED NZAuASB 2017-2, paragraph A17

⁷ PBE FRS 48, paragraph 9

low. In fact, the NZAuASB considers that this risk already exists for all audits of financial statements but has never been advised that this is creating any difficulties for the audit of financial statements. For example, ISA (NZ) 210⁸ and ISA (NZ) 700 (Revised)⁹ both refer to relevant, reliable, comparable, understandable and neutral rather than the qualitative characteristics as described in the PBE FRS 48 or the PBE Conceptual Framework. The NZAuASB has raised this matter with the IAASB.

24. The characteristics under EG Au1A¹⁰ already differ from the qualitative characteristics in the PBE Conceptual Framework. Although the words differ, there is significant overlap. The NZAuASB are of the view that if the qualitative characteristics are met then the methods used will also be considered to be suitable.
25. The NZAuASB agreed to retain the words used in EG Au1A to describe suitable criteria. The advantages of doing so include remaining framework neutral, aligning with established assurance terminology and the ISAs (NZ), and avoiding the need to amend the auditing standard each time the accounting standards are updated. These words highlight the role of the auditor in a framework neutral manner and are equally applicable to the audit of service performance information prepared using the Tier 4 requirements which do not include reference to any qualitative characteristics.
26. Although NZ AS 1 continues to refer to the characteristics described in EG Au1A, additional application material has been added to bridge the gap to PBE FRS 48 in response to the concerns raised.
27. An amended appendix 2 has been included to emphasize the similarities between the qualitative characteristics in PBE FRS 48 and the characteristics of suitable criteria. The application material emphasises that where the auditor evaluates that the qualitative characteristics have been appropriately applied, the methods used by the preparer will be considered to be suitable. For this reason, the NZAuASB does not consider that the standard will have unintended consequences.
28. Additional application material has also been added to assist the auditor when evaluating the suitability of methods used where an entity's process is still developing. This highlights that the auditor may still be able to conclude, in early stages of reporting, that the selected service performance and the methods used are suitable, even where the preparer does not report on a particular measure because of a lack of process or systems to support such reporting. This can be done where there are clear disclosures in the service performance information of the reasons for exclusions. Over time, it is expected that the entity will develop such systems.
29. Additional application material has been added to emphasize that the work effort to evaluate the suitability of the methods used may correlate with the potential for management bias. If the methods are sourced from externally established

⁸ ISA (NZ) 210, Agreeing the Terms of Audit Engagements, Appendix 2

⁹ ISA (NZ) 700 (Revised), paragraph 13, A2

¹⁰ EG Au1A, paragraph 44

performance frameworks, or developed in conjunction with the intended users, the auditor's work effort may be reduced, given a lower risk of management bias.

Materiality

30. One submission highlighted the challenge of determining materiality when auditing service performance information, queried the materiality requirements and sought additional practical application material. This stakeholder also queried the requirement to identify and assess the risk of material misstatement at the general purpose financial report level.
31. Given the challenges of and difference in establishing materiality for the service performance information from the financial statement information, it is not practical for the auditor to assess the risk of misstatement at the general purpose financial report level. It was noted that in the public sector, the approach has been to provide a separate opinion on the service performance information, illustrating how the audit is performed concurrently over two related but different types of information. This does not require assessment of the risk of material misstatement at the general purpose financial report level.

Response by the NZAuASB

32. The NZAuASB has elevated a paragraph from the application material to a requirement, to highlight that when considering materiality, the auditor is evaluating both:
 - a. The judgements made by the preparer in selecting what to report on and how to report; and
 - b. Individual and collective misstatements in the reported information that are likely to significantly influence decisions of intended users.
33. The evaluation of the suitability of the service performance information is therefore part of the auditor's determination of materiality.
34. Further changes made to the materiality requirements and application material include:
 - a. Removing the arbitrary distinction made in the ED between materiality levels and materiality factors, as these considerations impact on both quantitative and qualitative information. This has resulted in some re-ordering of the application material.
 - b. Removing references to performance materiality because the auditor is dealing with multiple units of account in the context of service performance information.
 - c. Adding additional emphasis on tolerance for error and examples of things to think about in establishing materiality to address calls for more practical guidance.

35. The NZAuASB removed the requirement to identify and assess the risk of material misstatement at the general purpose financial level.

Other Matters

Perceived Level of Prescription and the Cost/Benefit Ratio

36. Concern was raised, in one submission, that many smaller PBE entities have limited financial resource and capability and they are likely to find the preparation of service performance information challenging, given the level of judgement involved and customised nature of the information. The cost of designing and implementing relevant performance measures, including relevant controls around those performance measures, and capturing and monitoring the relevant data may be prohibitive. This may result in the cost of an audit being disproportionately high and may be inhibited by the lack of verifiable information. This may result in a significant number of qualified auditor reports.
37. Additional guidance was sought to facilitate comparability across sectors to reduce the cost of preparing and auditing the service performance information.
38. Submitters suggested some alternatives for the XRB to consider, for example raising the minimum threshold for entities requiring an audit of the service performance information, enabling an opt out of the audit of the service performance information or treating the service performance information as other information.

Response by the NZAuASB

39. The XRB is not responsible for determining when the general purpose financial report is required to be audited. This is established in legislation (for example the Charities Act 2005) or by an entity itself. It is therefore not within the mandate of the NZAuASB to provide for an opt out or to establish a higher audit threshold. Rather the NZAuASB is tasked with developing an auditing standard that promotes consistency amongst auditors, when the service performance information is audited.
40. The NZAuASB was mindful of the risk of undermining the confidence of the audit of the financial statement information and therefore determined to remain compliant with the requirements of the international assurance standards when performing a reasonable assurance engagement.

Length and Understanding

41. Conflicting views were expressed related to the length of the ED, and the amount of application material included. Some submitters were critical of the length of the ED, suggesting that the standard should only include a minimum number of requirements, specific to service performance information. Some submissions identified specific requirements that they considered could be removed. Some feedback supported the

level of application material provided, whilst others sought additional application material.

Response by the NZAuASB

42. The NZAuASB is committed to developing a domestic auditing standard that will form a part of the ISAs (NZ) in New Zealand. The domestic auditing standard will require the auditor to apply all the ISAs (NZ) to the service performance information. This does require a level of prescription, consistent with the requirements for any audit engagement. The domestic auditing standard will however focus on the specific aspects of auditing service performance information that differs from the audit of the historical financial information.
43. To address the concerns around length and understanding, the NZAuASB shortened and streamlined the ED by:
 - a. Avoiding repeating the requirements of the ISAs (NZ).
 - b. Moving and merging the section on “Preconditions for the Audit of General Purpose Financial Report” with the section on “Understanding the Entity”. Given that the auditor is engaged to audit the general purpose financial report, even where the auditor has concerns over what and how the entity has selected to report its service performance, the auditor will continue to audit the financial statements. This emphasizes that the timing of the evaluation of what and how the entity selects to report its service performance, does not only occur on acceptance of the engagement, rather is an iterative process. Additional application material has been added to make the iterative process explicit.
 - c. Removing the section “Evaluation of Misstatements Identified During the Audit” as feedback highlighted that this is not sufficiently different in application to service performance information, and the differences are covered in the application material on establishing materiality.
 - d. Merging the requirements on:
 - Audit Considerations Relating to an Entity Using a Service Organisation;
 - Special Considerations – Audit of Groups; and
 - Using the Work of Another Practitionerinto one requirement for the auditor to consider the relevant ISAs (NZ).
44. One submitter sought additional guidance where the auditor needs to obtain evidence about services delivered by third parties (e.g. contractors or service organisations) especially when those third parties are directly responsible for collecting the service performance information that is reported by the reporting entity. The NZAuASB

considers that ISA (NZ) 402¹¹ should be applied to the service performance information in these circumstances. It would be up to the auditor to consider how that standard should be applied to the service performance information.

Assertions

45. The majority of submissions were supportive of the assertions identified in the ED, however some concern was raised about adding new assertions (notably the assertion of “attribution” and “consistency”) and confusion over how “completeness” as an assertion differs from “completeness” as a qualitative characteristic.

Response by the NZAuASB

46. The NZAuASB agreed to add application material from ISA (NZ) 315 (Revised)¹² to emphasize that the assertions included in the standard may be used by the auditor but the auditor may wish to express them differently.
47. The NZAuASB agreed to retain the assertion “Attributable to the entity”, and considers that in some instances, this may require additional work effort by the auditor, however acknowledges that it may not always apply. The new application material highlights that this is not a requirement, and allows flexibility to combine attribution and occurrence. However, the NZAuASB still considers that the assertion of attribution may be an important consideration in the context of service performance information.
48. In response to queries related to the need for an assertion related to classification, the NZAuASB again considered that the application material is flexible and may be reworded by the auditor. The NZAuASB continues to be of the view that the way in which a matter is described (e.g. described as high/medium/low) is covered by accuracy, however an auditor may wish to describe this as classification. The NZAuASB was reluctant to introduce the term “classification” as the different categories of service performance information (i.e. outputs, outcomes and impacts) was removed when PBE FRS 48 was finalised.
49. The NZAuASB agreed to remove the assertion related to consistency, noting that there is already a requirement in the standard for the auditor to evaluate any changes, where an entity changes the way in which it reports its service performance.

Opining on the Suitability of the Service Performance Criteria

50. The invitation to comment sought views as to whether it was preferable for the auditor’s opinion to be explicit on the auditor’s evaluation of the suitability of the entity’s service performance criteria. Only one submission preferred the alternative

¹¹ ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

¹² ISA (NZ) 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, paragraph A128.

opinion and there was strong support for the opinion to remain implicit on the suitability.

Response by the NZAuASB

51. The NZAuASB agreed to maintain the approach as proposed, and there is no requirement for the auditor to opine on the suitability of the methods used. This is consistent with the reporting requirements of any assurance engagement, where there is no requirement to opine on the suitability of the criteria.
52. It is however a precondition of an assurance engagement for the “criteria” to be available to the intended users.
53. The entity’s service performance criteria may be made available as part of the service performance information. The auditor is required to evaluate whether those methods are transparent and clear so that the user understands how the service performance has been measured or evaluated. Where the methods used are complex, the explanation of the methods used needs to be made clear, and may not be apparent from the performance measure. Additional application material has been added to explain various ways in which the methods used may be made available to the user.
54. It is also a requirement of an assurance engagement that the opinion identify the “criteria” used to measure or evaluate the underlying subject matter. For this reason, the standard requires that the opinion refer to the service performance criteria, in recognition that there is a sub-layer of applicable criteria below FRS 48 which is used for each individual engagement.
55. For financial statement information, the financial reporting standards establish detailed recognition and measurement criteria and the preparer must disclose these accounting policies as part of the financial statements. ISA (NZ) 700 (Revised)¹³ requires the auditor to evaluate whether the financial statements appropriately disclose the significant accounting policies in an understandable manner.
56. For the service performance information, the accounting standard is encouraging the entity to tell its own story and therefore does not establish detailed recognition and measurement criteria, leaving it up to the entity to determine while requiring the preparer to meet the objectives of the qualitative characteristics in accordance with the applicable financial reporting framework. It is still necessary however that the user understand how the entity has measured and described its service performance and that the auditor refer to these criteria in the opinion.
57. One submitter remains opposed to the inclusion of the requirements to make the criteria available and for the opinion to identify the criteria, considering that these requirements may have unintended consequences.

¹³ ISA (NZ) 700 (Revised), paragraph 13

Allowing a Long-Form Auditor's Report

58. There were mixed views as to whether the standard should refer to a long-form report. Whilst some submitters were supportive of allowing flexibility, others were concerned that this may give undue prominence to the service performance information.

Response by the NZAuASB

59. The NZAuASB determined it appropriate to permit flexibility where such information better meets the needs of intended users, noting that this is not mandatory. A definition of long-form report has been added to the amended standard as suggested by one respondent.

Reference to the ISAs (NZ) and NZ AS 1

60. Feedback from one submission and from roundtable participants raised concern at requiring references to both the ISAs (NZ) and NZ AS 1 in the engagement letter and auditor's report. This is an area identified as confusing for both the auditor and the user and most likely to give rise to inadvertent non-compliance with the standard.

Response by the NZAuASB

61. When developing the ED, the NZAuASB was mindful of the prescriptive requirements in the ISAs (refer paragraph 43 of ISA 700 (Revised)), and was mindful to ensure that the requirements of NZ AS 1 adhere to the ISAs. It was for this reason that the proposal to refer to both the ISAs (NZ) and NZ AS 1 was developed.
62. The NZAuASB determined that the auditor's report should reflect the fact that while the auditor is engaged to audit the general purpose financial report, there are "two legs" to that report. For this reason, the opinion should reflect two bullets to distinguish the service performance information leg from the financial statement leg. While the two are related, the subject matter differs, the materiality considerations differ and the auditor is therefore opining separately on the service performance information, as noted in the materiality section above.
63. The NZAuASB heard support for emphasising the need for a concurrent audit of these two legs. In order to emphasize this in the auditor's report, reference has been added to the consistency between the financial statement information and the service performance information.
64. As there is a need to distinguish between the financial statement information and the service performance information in the report, the NZAuASB agreed to retain the reference to both the ISAs (NZ) and NZ AS 1 as proposed in the ED. This enables compliance with both the ISAs and the ISAs (NZ).