

**DATE:** 28 August 2019  
**TO:** Practitioners attending the NZAuASB Sept meeting  
**FROM:** Sylvia van Dyk, Director Assurance Services  
**SUBJECT:** Suggested Discussion Topics

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Dear All

Thank you very much for accepting the invitation to the NZAuASB's September meeting.

### **Context for the Discussion**

1. The Board considers the major accounting firms to be among its key stakeholders. Accordingly, it is keen to ensure that it has a good understanding of the matters of interest and concern to the major firms, including matters on trends in the audit market and any issues the firms may wish to discuss on future developments.
2. The Board is also keen to obtain feedback from assurance practitioners on current issues being considered in international standard setting. We have identified the following topics that we would appreciate your feedback on.
  - A. State of the current audit market and emerging issues
  - B. Extent and demand of assurance on EER engagements in New Zealand
  - C. Views on the options noted in the IAASB's discussion paper on the audit of Less Complex Entities (LCEs)
  - D. Views on two options to disclose the auditor's responsibilities on going concern in the interim review report
  - E. Any other matters of interest/concerns that you wish to raise with the NZAuASB
3. We have prepared some background information on the topics, with discussion questions on each topic at the end of the background information. We acknowledge that you may be familiar with the background information but thought it helpful to summarise here to provide context for the discussion.

### **A. State of the current audit market and emerging issues,**

4. There are currently a few debates happening on the future of audit, with various reviews in the UK audit sector, and now in Australia, where the Senate has recently made a referral to the Parliamentary Joint Committee on Corporations and Financial Services for inquiry about Audit Quality and related matters. The outcome of these reviews could have far reaching effects on the future of audit and potentially affect the audit market here in New Zealand, especially the Inquiry in Australia.
5. Some background information on the various reviews are summarised below.

## Parliamentary Inquiry in Australia

6. The proposed scope of this inquiry, tabled by Senator O'Neill (ALP, NSW), is that the following matters be referred to the Parliamentary Joint Committee on Corporations and Financial Services for inquiry and report by 1 March 2020:

"Regulation of auditing in Australia with particular reference to:

- a. the relationship between auditing and consulting services and potential conflicts of interests;
- b. other potential conflicts of interests;
- c. the level and effectiveness of competition in audit and related consulting services;
- d. audit quality, including valuations of intangible assets;
- e. matters arising from Australian and international reviews of auditing;
- f. changes in the role of audit and the scope of audit products;
- g. the role and effectiveness of audit in detecting and reporting fraud and misconduct;
- h. the effectiveness and appropriateness of legislation, regulation and licensing;
- i. the extent of regulatory relief provided by the Australian Securities and Investments Commission through instruments and waivers;
- j. the adequacy and performance of regulatory, standards, disciplinary and other bodies;
- k. the effectiveness of enforcement by regulators; and implications
- l. any related matter."

## Sir Brydon review in the UK

7. The Australian inquiry appears similar to the Sir Brydon review in the UK, which is intended to take a fresh look at the scope of the audit, how far it can and should evolve to meet the needs of users of accounts, what other forms of assurance might need to be developed, and to define and manage any residual expectations gap. It will test the current statutory audit model and ask whether it can be made more effective as currently established or whether it requires amendment.

## Other reviews in the UK to take note of that may have ramifications for audit in New Zealand and Australia are:

8. The independent Kingman review of Financial Reporting Council – Regulation of Providers and Ultimate Product was set up to enhance the regulator's "transparency, independence and reputation and ensure that its structures, culture and processes, oversight accountability, and powers, and its impact, resources, and capacity were fit for the future". The Review reported in December 2018. The UK Government is currently consulting on its recommendations.
9. The Competition and Markets Authority (CMA) launched a market study into the supply of statutory audit services in the United Kingdom in October 2018. It published an update paper in December 2018 and issued its final report Statutory Audit Services Market Study Report on 18 April 2019. The CMA's recommendations were as follows:
  - An operational split of audit and non-audit services within the 'big 4'. This will require a separate CEO, board, financial statements and remuneration.
  - Mandatory joint audits for the UK's largest and most complex companies whereby a 'challenger firm' works alongside a 'big 4' firm.
  - Regulation of UK companies' audit committees to ensure they provide adequate scrutiny of their auditors.
  - The regulator should review the effects of these changes periodically, in the first instance five years from full implementation.

10. The Business Energy Industrial Strategy (BEIS) Parliamentary Inquiry have issued their own report on the Future of Audit, which refers to matters discussed in the CMA, Brydon and Kingman independent reviews with the following recommendations:

- Calls for the CMA to aim for a full structural split of audit and non-audit services within the Big Four, a segmented market cap and the use of joint audits for FTSE 350 companies.
- Support for the CMA's proposal to increase regulatory oversight of audit committees, but recommends that if this does not work, independent appointment of auditors by the regulator should be considered.
- It agrees that the FRC needs replacing with a new statutory body - the Audit, Reporting and Governance Authority (ARGA) and recommends that the Government introduce the necessary legislation in the next session of Parliament to establish ARGA.
- It also welcomes the possible introduction of a strengthened framework around internal controls on a similar basis to Sarbanes-Oxley.

#### **Happenings in New Zealand.**

11. In New Zealand there is also a current debate on whether audit quality is as good as it should be, and what the role of the standard setter, regulator and those charged with governance are to ensure confidence in the capital markets remain feasible.
12. Another key issue is the expectation gap investors have about the role of the auditor, as highlighted in the survey the FMA recently conducted. There is a need to open the debate about the role of audit and audit expectations. The question is how to get the conversation started, which should involve the IoD, the Corporate Governance Group, CFO's etc.
13. In response to the international debate, the International Ethics Standards Board for Accountants (IESBA) will be issuing an ED on proposed amendments to the Code of Ethics on the provision of non-assurance services (NAS). We expect the proposals will be more robust than those in the current Code of Ethics but will not go so far as proposing to prohibit NAS. However, we are aware that the FMA is concerned about the level of NAS being provided to some audit clients, and that our Auditor-General is thinking about prohibiting NAS by auditors to public sector clients. This may have an impact on to what extent we adopt the IESBA proposals in New Zealand, which may also be further impacted by the results of the Australian Inquiry on the relationship between auditing and consulting services and potential conflicts of interests.

#### **Discussion questions:**

1. What concerns do you have about the state of the current audit market and emerging issues, for example the debate on the future of audit, audit quality and the provision of non-assurance services?
2. How are the New Zealand firms intending to respond to the Australian Inquiry?
3. What are your views on the provision of NAS to audit clients in New Zealand? What would the effect be on the audit market should the provision of NAS be prohibited?
4. What is the role of the standard setter in all this?
5. Any other comments?

## **B. Extent and demand of assurance on EER engagements in New Zealand.**

14. Extended External Reporting (EER) encapsulates many different forms of reporting, including - but not limited to - integrated reporting, sustainability reporting, and other reporting by entities about environmental, social and governance matters.
15. As noted in the XRB's Strategic Plan 2019-2024, the XRB expects changes and developments in external reporting resulting from the need for entities to report more widely about their strategies, business models, risks and impacts, not just on financial capital, but on other capitals, (as they relate, for example, to environmental, social, governance and other related matters). Entities are expected, within their "corporate" reports, to complement the reporting of their financial results with non-financial information to give a more comprehensive picture of their performance and impact. The XRB plans to continue an active role in leading the development of this extended external reporting (EER) in New Zealand as it relates to users of "corporate" reports.
16. The NZAuASB's aim is to work with others to ensure any assurance gaps are identified, understood, researched if necessary and addressed. The Board is therefore interested in your views about the extent and demand of assurance on EER engagements in New Zealand.

### **Discussion questions:**

5. What type of EER information is assurance being sought on in New Zealand?
6. Why do you think assurance is sought - what are the drivers? Is assurance sought for internal or external purposes, or both?
7. What type of assurance engagements are undertaken on EER (reasonable, limited, selected metrics, whole report, controls etc.)?
8. What assurance standards are being used in performing the assurance engagements?
9. What do you consider the most challenging aspect about performing assurance on EER information?
10. Are you aware of any innovative assurance practices that are being used or developed to enhance credibility and trust on EER in New Zealand?

## **C. Views on the options noted in the IAASB's discussion paper on the audit of LCEs**

17. A hot topic now is the scalability of the auditing standards and if they continue to be fit for purpose for the audits of smaller and less complex entities.
18. The IAASB recognizes the global call for action to address issues of complexity, length, understandability, scalability, and proportionality related to using the International Standards on Auditing.
19. To further understand the challenges of using ISAs in audits of less complex entities and to gather views about possible actions to address these challenges, the IAASB issued a Discussion Paper *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs* at the end of April 2019. Comments are due to the IAASB on 12 September 2019.

20. The [Discussion Paper](#) provides an overview of the IAASB's journey, challenges that have been identified to date, and a number of possible actions that could be undertaken to address the identified challenges.
21. The scope of the IAASB's paper is limited to those matters within the IAASB's direct control (for example, technological solutions to make the ISAs more accessible, while an obviously attractive option, are not considered). Matters such as the style and scalability of the ISAs are within scope. The paper is asking for feedback on three possible potential actions, which are:
- A. Reviewing the ISAs;
  - B. Developing a separate auditing standard for audits of LCEs; and
  - C. Developing guidance for auditors of LCEs or other related matters.
22. The definitional question of what is an LCE assumes greater importance were option B to be considered. The working definition proposed by the paper draws on the current ISA definition of a "smaller entity", and is as follows:

"An entity which typically possesses qualitative characteristics such as:

- a. Concentration of ownership and management in a small number of individuals (often a single individual- either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- b. One or more of the following:
  - i. Straightforward or uncomplicated transactions;
  - ii. Simple record-keeping;
  - iii. Few lines of business and few products within business lines;
  - iv. Few internal controls;
  - v. Few levels of management with responsibility for a broad range of controls; or
  - vi. Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all these characteristics"

**Discussion questions:**

- 11. Which of the three possible potential actions in paragraph 21 above do you support, and why?
- 12. If a separate standard is developed for LCEs, should regulated entities in the capital markets be excluded from the definition of an LCE?

**D. Views on the disclosure of auditor's responsibilities on going concern when the auditor performs a review engagement on the interim financial statements (NZ SRE 2410)**

23. Preparers of financial statements are responsible for assessing their entity's ability to continue as a going concern. So, what is the auditors' responsibility to evaluate the appropriate use of the going concern basis of accounting during an interim review?

24. The NZAuASB is exploring the best way to describe the auditors' responsibilities in relation to going concern in the interim review report.
25. The interim review report issued by auditors will be changing, and we are interested in your views about the proposed changes.
26. Bear in mind that an interim review is not the same as an audit. During a review, the procedures performed by an auditor are much less than those performed during an audit
27. Secondly, the auditor is not guaranteeing that the entity is a going concern. Future events or conditions may cause an entity to cease to be one.
28. The NZAuASB now proposes to require a description of the auditors' responsibilities in the interim review report and is interested in your understanding of two possible options for wording to include within the review report.
29. One of these two options will follow the words in the review report as illustrated below:

*Extract from review report*

**The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand) and consequently does not enable us to obtain assurance that we might identify in an audit. Accordingly, we do not express an audit opinion on those financial statements.**

### Option 1

Based on the review procedures performed, we conclude on whether anything has come to our attention that causes us to believe that the use of the going concern basis of accounting by those charged with governance is not appropriate and whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If a matter comes to our attention that causes us to believe that a material uncertainty related to going concern exists, we are required to draw attention in our review report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our conclusion. However, future events or conditions may cause the entity to cease to continue as a going concern.

### Option 2

We make enquiries whether those charged with governance have changed their assessment of the entity's ability to continue as a going concern. When as a result of this enquiry or other review procedures, the auditor becomes aware of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall:

- enquire of those charged with governance as to their plans for future actions based on their going concern assessment, the feasibility of these plans, and whether they believe that the outcome of these plans will improve the situation; and
- consider the adequacy of the disclosure about such matters in the financial statements.

### Discussion question

13. What do you understand by these two options and how do they compare with your understanding of a review engagement?

### **C. Other matters of interest**

14. Do you have any points of interest about auditing *the Revenue, Financial Instruments and Leases financial reporting standards (even though we are the NZAuASB) that the XRB would want to take back to the NZASB.*

15. Are there any other matters of concern/interest that you would like to raise with the Board?