



24 March 2023

External Reporting Board
PO Box 11250, Manners St Central,
Wellington 6142

Attention: April Mackenzie

Tēnā koe April

Exposure Draft: *Audit of Service Performance Information*

1. Thank you for the opportunity to comment on the External Reporting Board's (XRB's) Exposure Draft: *Audit of Service Performance Information* (the ED).

Overall comments

2. In our opinion, the ED is a substantial improvement on the existing NZ AS 1. We are confident that we will be able to use the ED, suitably amended to reflect the comments in this submission, as a basis for the audit of performance information presented by public sector entities.
3. We acknowledge the receipt of the recent draft FAQ document prepared by the XRB on 15 March 2023. We have not taken the draft FAQ document into account in preparing our submission.

Requirements about measurement bases or evaluation methods

Requirement to refer to the entity's measurement bases or evaluation methods in the auditor's opinion

4. Paragraphs 51(c), 52, A82 and A83 of the ED and the illustrative auditor's reports require a reference to the pages within the preparer's annual report where the "measurement bases or evaluation methods" are set out.
5. We disagree with this requirement because the reporting requirements for service performance information are set out in PBE FRS-48: *Service Performance Reporting* (PBE FRS 48). PBE FRS-48 does not require the "measurement bases or evaluation methods" to be disclosed in the annual report. Therefore the auditor will not be able to meet the requirements of paragraphs 51(c) and 52.
6. The only disclosure requirement in PBE FRS-48 relevant to measurement is the requirement for disclosure of significant judgements (paragraph 44), that states:

"An entity shall disclose those judgements that have the most significant effect on the selection, measurement, aggregation and presentation of service performance information reported in accordance with this Standard that are relevant to an understanding of the entity's service performance information."
7. In our view, the NZAuASB needs to engage with the NZASB if it wishes to make changes to the disclosure requirements of PBE FRS 48. Until PBE FRS 48 is amended and applicable, we consider it inappropriate for the ED to require the auditor's opinion to refer to the entity's measurement bases or evaluation methods.

Requirement to evaluate/conclude that the measurement bases or evaluation methods are available to intended users

8. Associated with our observations in paragraphs 4 to 7, we also question the requirements in paragraphs 26(f) and 48(b) of the ED for the auditor to evaluate/conclude whether the measurement bases or evaluation methods are “available to intended users”. We are not clear what is intended by these requirements.
9. One interpretation of what the ED is aiming to achieve might be explained by reference to paragraph A3 of the ED.

That paragraph explains that a measurement basis or evaluation method that might be used to indicate that 100% of water supplied was safe to drink is that the water complied with “Drinking Water Standards for New Zealand”. This is an objective standard and the auditor would be able to conclude that no further disclosure needed to be made by the entity because intended users would be in possession of clear information about drinking water quality.

The other measurement basis or evaluation method referred to in paragraph A3 as a drinking water standard is “internally generated safe drinking water criteria”. The auditor might reasonably conclude that this standard is unclear and will not provide users with the information necessary for them to know whether the drinking water is safe. In this situation the auditor will ask the entity to clarify the disclosure in its annual report so that a user will know if the standard means that “100% of water supplied was safe to drink”. If the entity refuses to include the additional disclosures required by the auditor then the auditor would need to assess if the disclosures were “materially misstated” and, if so, report the matter as a qualification in the auditor’s opinion.

10. Collectively paragraphs 26(f), 48(b) and A82 of the ED imply that it is the auditor’s responsibility to make disclosure deficiencies in the entity’s annual report “available to intended users” in the audit report regarding “the method used to measure or evaluate the service performance” (in paragraph A82). Slightly different terminology is used in paragraphs 26(f) and 48(b) – “measurement bases or evaluation methods” – which adds to our confusion. We believe this is not the intention of the ED.
11. Furthermore, the auditor’s evaluation/conclusion in paragraphs 26(f) and 48(b) of the ED would not be limited to the “measurement bases or evaluation methods”. That evaluation/assessment would be extended to all of the components that the auditor needs to consider when assessing if the service performance report is “appropriate and meaningful”, including:
 - The “selection of elements/aspects of service performance”; and
 - “Performance measures and/or descriptions”.

We consider that this observation has implications for the expression of the audit objective (refer to paragraphs 13 and 14 below) and has flow-on consequences for the opinion section of the illustrative audit reports in Appendices 4 and 5 to the ED. The opinions focus on “the entity’s measurement bases or evaluation methods” but make no specific reference to the entity’s “selection of elements/aspects of service performance” or to “performance measures and/or descriptions”.

12. In our view:
 - The requirements in paragraphs 26(f) and 48(b) of the ED need to be clarified or removed; and
 - The wider implications for the audit objective and the illustrative audit reports need to be considered.

The audit objective

13. In our view, the objective of the audit in paragraph 7 of the ED should include the term “presents fairly” (or fairly reflects), or have a guidance paragraph explaining when and when it is not appropriate to use this term.
14. Paragraph 8(b) of the ED states that the auditor may achieve the objective ... by considering ... “Assess whether the reported service performance information fairly reflects the actual service performance and is not materially misstated.”

We see the phrase “fairly reflects” as being the outcome of the auditor assessing both whether “appropriate and meaningful” performance information is presented by the entity (as per paragraph 8(a)) and whether the actual service performance is reliable, in that it is a faithful representation of what actually happened (as per paragraph 8(b)).

We question why the term “fairly reflects” is used in paragraph 8(b) but is not used in paragraph 7.

15. Our observations in paragraphs 13 and 14 should also be reflected in the way the opinion is expressed in the illustrative example audit reports in Appendices 4 and 5.

Our comments on the individual Consultation Questions are attached to this letter.

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

Nāku noa, nā



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Responses to the Consultation Questions

Alignment with the financial reporting standards

Question 1. Do you agree that the proposed standard strengthens the alignment between the auditing and financial reporting standards? If not, why not and what further changes do you recommend?

Establishing relationships between service performance information and financial information

The ED contains requirements (in paragraphs 2 and 10) and application material (in paragraphs A4 and A5) that emphasise that the audit of the service performance information is to be carried out concurrently with the audit of the financial statements. This is fundamental to an effective audit of financial and service performance information.

There is often no direct relationship between the financial statement disclosures and the service performance information, and establishing that relationship can be challenging. As a consequence, it is difficult to convey how an integrated approach to the audit of service performance and financial information can be carried out without some good examples to refer to. Good examples may not currently be available, but should emerge as auditors' experience with the audit of service performance information develops.

We acknowledge we have received the recent draft FAQ document prepared by the XRB on 15 March 2023. We have not taken the draft FAQ document into account in preparing our submission. This is a good way of facilitating improvements in the audit of service performance information.

Application of financial audit processes to the audit of service performance information

There is a tendency to directly transfer accepted financial audit processes to the audit of service performance information. Sometimes that approach is inappropriate.

An example is paragraph 19 in the ED where the elements of the entity's system of internal control (that are expected to exist for financial information) are unlikely to exist in the same way for service performance information. The situation outlined in paragraph A67 of the ED is more likely to be encountered by auditors when obtaining an understanding of the processes that produce "appropriate and meaningful" service performance information. The consequence is that, as stated in para A67, the auditor may find it more challenging and will need to think differently to identify the risks of material misstatement and the design of audit procedures to mitigate those risks.

We recommend that paragraph 19 of the ED is amended to reflect the different nature of service performance information that the auditor should take into account when gaining an understanding of the control system; in particular, service performance information that is appropriate and meaningful.

A paragraph from the draft standard prepared by the Auditor-General in 2021 (AG-4: *The audit of performance reports*) is included below. In our view, this paragraph (or something similar) could be included in the finalised standard to convey the nature of service performance information that is "appropriate and meaningful".

"The 'reasonable assurance' evidential standard is required to be met by the auditor when providing assurance over performance information. However, the subjective nature of performance information that is appropriate and meaningful means that the auditor may need to apply different procedures to those that are generally associated with the provision of assurance over financial information. For example:

- (a) Audit techniques used to evidence the fair presentation of performance information are likely to resemble the procedures the auditor applies when establishing the reasonableness of accounting estimates.*
- (b) It is unlikely that performance information that is appropriate and meaningful can be directly sourced back to traditional management information systems and source records.*
- (c) Specialist competencies may be required to effectively audit performance information.*

Having provided a broad description of the nature of service performance information, the ED could provide guidance on how the auditor might understand the “control” system for service performance information. That guidance would likely encourage the auditor to understand the sources of the data and any associated analysis carried out by the entity to determine its service performance information. An important aspect of the “control” system would be to understand how the entity uses that service performance information for internal decision-making purposes.

The purpose of understanding the control system is to identify the risks of material misstatement and to determine appropriate audit responses to those risks.

Another paragraph from the draft standard prepared by the Auditor-General in 2021 (AG-4: *The audit of performance reports*) could be also included in the finalised standard. That paragraph includes guidance to help auditors develop responses to mitigate the risks of material misstatement to the service performance information, and is included below:

“The auditor always needs to maintain an awareness of the possibility of bias in the reported service performance information. The entire process of assessing the integrity of data through to the reporting of service performance information places significant demands on the auditor, particularly when maintaining an awareness of bias. An approach that the auditor may take to assessing the fair presentation of service performance information might involve the following procedures:

- (a) As much as possible, the audit procedures should attempt to draw on the relationships that exist between the financial and service performance information, to achieve an effective and efficient audit;*
- (b) Assessing if the data used by the entity is likely to allow reasonable conclusions to be drawn about the entity’s service performance;*
- (c) Testing the integrity of the data used by the entity;*
- (d) Assessing the appropriateness of any independent research the entity is using to substantiate its service performance;*
- (e) Identifying and reading any relevant reviews about the entity’s service performance. Where discrepancies are observed between the findings reported in such reviews and the service performance reported by the entity, the auditor will need to obtain persuasive evidence that the entity’s reported service performance is fairly presented;*
- (f) Understanding how the data is being used to draw conclusions. For instance, is the data being used selectively to achieve a pre-determined result?; and*
- (g) Establishing if the reported service performance information is consistent with the conclusions drawn following the analysis. This includes checking if the service performance information omits some conclusions from the analysis and whether the descriptions used by the entity in presenting its service performance contain ambiguity and bias.*

Sector specific material

Question 2. Do you agree that the sector specific material is useful to ensure that the standard is fit for purpose in both the public and not-for-profit sectors?
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Particular challenges exist for the audit of performance information in the public sector. We acknowledge that it may be beyond the “general purpose” intent of the ED to address some of these challenges, although they may be encountered when auditing some larger entities in the not-for-profit sector.

We have identified three issues where further guidance would be very helpful. We recommend that the XRB does this by issuing FAQs to support the finalised standard.

Attribution as an assertion to assess appropriateness of service performance information

We recommend that guidance about the attribution assertion in paragraph A61(b) could be expanded to provide guidance on the application of attribution for entities (such as policy Ministries) that have policy responsibility for areas. Attribution will also be important for some entities in the not-for-profit sector whose role is to advocate for changes that will lead to improvements in whatever they are advocating for.

We have some concerns that the ED is too “strong” in pushing attribution as an assertion that must be met in order for service performance information to be appropriate and meaningful. For example paragraph A38 of the ED states:

“The auditor may consider whether the service performance information inappropriately attributes service performance to the entity.”

And the qualified audit opinion (Illustration 1 in Appendix 5) states: “The entity has not been able to provide evidence of its role in those particular improvements and therefore should not have reported this improvement.”

In the public sector, we consider it important that higher level measures of the difference that the public sector is making, including measures of outcomes and wellbeing are reported. In many cases movements in higher level concepts (such as child poverty, homelessness etc) cannot be attributed to the actions of a single agency but, in our opinion, that does not mean no public entity should report this important information.

Auditor’s role in relation to targets

We do not find the ED to be clear about the auditor’s role in relation to targets (i.e. the target of achievement for a performance measure set by the entity at the start of the reporting period). Does the auditor’s assessment of whether the service performance information is appropriate and meaningful require consideration of the reasonableness or appropriateness of targets? We think it does.

We think the assessment of targets is implied in the ED through the use of the terms “the performance measures and/or descriptions has used to report on what it has done” and the “measurement basis or evaluation method used” (these terms are referred to in paragraph 8(a) of the ED, and throughout the ED).

We would expect all entities to report against targets or expectations even if they are not stated in advance of the reporting period. Reporting targets or expectations provides a context against which to assess actual performance.

The main comment about targets when assessing if the service performance information is appropriate and meaningful is in paragraph A39, which states:

“The auditor may consider whether: If the entity reports targets, how those targets may obscure a proper understanding of the entity’s service performance.”

We recommend that the meaning of paragraph A39 is clarified together with the auditor’s role in relation to targets set for assessing an entity’s service performance information.

Identifying other information when some of the service performance information is outside the general purpose financial report and is incorporated by cross-reference

Paragraphs A1 and A28 of the ED and paragraph 33 of PBE FRS 48 acknowledge that some service performance information can be located outside the service performance report (or outside the general purpose financial report).

We ask that the finalised standard provide guidance on how “other information” is determined in these circumstances. Does the auditor of the service performance information have to treat all information within the cross referenced document as “other information” and perform the ISA (NZ) 720 requirements across the full content of all documents or websites containing cross-referenced service performance information?

We consider this could be an onerous and unreasonable expectation on the auditor. We recommend that the finalised standard clarify that cross-referenced document content should not be treated as other information. For example, can these other information obligations be avoided if the cross-referencing is to specific pages of the other document containing service performance information?

Simplified language and examples to assist

Question 3. Do you agree that the proposed revised standard is easier to understand? If not, please be as specific as you can and make suggestions as to what might assist to clarify the standard further.

We strongly support the inclusion of simplified language in all standards. In addition, it is important that the requirements paragraphs in a standard only specify the key requirement. Too often we encounter requirements paragraphs in auditing standards where the key requirement is clouded by many “sub-requirements”. This leads to confusion, unnecessary compliance costs, and adds to the risk of the standard being misapplied.

We agree that the ED is easier to understand than the existing NZ AS 1.

Examples are very useful. However, it is difficult to include examples when a standard is covering a new area. This situation creates the need to develop and issue examples in the form of FAQs (after the standard has been issued) as auditors develop their experience in auditing service performance information. This appears to be a process that the XRB has embraced. We support this process.

Examples of auditing service performance information concurrently with financial information would be very helpful as auditors develop experience in “integrated auditing”. These examples will be extremely useful in contributing to the development of more innovative (and effective) audit approaches.

No added compliance costs

Question 4. Do you agree that the proposed revised standard will not increase compliance costs, when compared to existing NZ AS 1?

The Auditor-General did not apply NZ AS 1 for the audits of performance reports in the public sector. We have no basis for comparing the compliance costs of NZ AS 1 with the ED.

Application Date

Question 5. Do you agree with the proposed application date of NZ AS 1 (Revised)?

Question 6: Do you agree with the proposal to defer the application date of extant NZ AS 1 to align with the application date of NZ AS 1 (Revised) i.e., for periods beginning on or after 1 January 2024?

We agree with the proposed application date for the ED.

We agree with the proposal to defer the application date of extant NZ AS 1 to align with the application date of the ED.

Other comments

Question 7. Do you have any other comments on the proposed standard? If so, please specify.

Provision of an illustrative audit report when the auditor concludes that the service performance information is not appropriate and meaningful

Paragraph 55(a) of the ED requires the auditor to modify the opinion when the auditor concludes that the service performance information is not “appropriate and meaningful”.

Our sense is that auditors may encounter this situation. Consequently, we recommend that (one or more) illustrative audit reports are included in Appendix 5 when the auditor encounters service performance information that is not “appropriate and meaningful”.

Preparing this audit report will be challenging, particularly if you consider that our comments in paragraphs 11 to 15 of the covering letter have validity. We would be happy to work with XRB staff to develop (one or more) illustrative audit reports for inclusion in Appendix 5 to the ED.

Emphasis of matter paragraphs (A87)

Paragraph A87 describes examples when an Emphasis of Matter or Other Matter paragraph may be included in the auditor’s report.

A further example of an issue that can lead to the auditor including an Emphasis of Matter paragraph is where there are significant measurement uncertainties in the reported performance of a measure. One public sector example is an emphasis of matter about the uncertainty in the measurement of greenhouse gas emissions where this is a measure within the service performance information.

We would suggest that this is a good example to include in paragraph A87 of the ED.

Other observations

We noted some minor matters in the ED that require consideration. We include them here for the sake of completeness.

Para Ref	Observation
15(b)(iii) and 53(c)(iii)	Should the words “in all material respects” be added after “prepared”? This would then be consistent with paragraphs 7 and 46.
15(b)(iv) and 53(c)(iv)	Should the word “represents” be replaced by “presents fairly” or “fairly reflects”?
32	Needs to include “other than those that are clearly trivial”.
32	Uses the term “unadjusted”. ISA (NZ) 450 refers to these as “uncorrected”. Paragraph 42(g) also uses “uncorrected”. Suggest replace “unadjusted” with “uncorrected”.
32	Double check the references to the application material.
40	It would be more helpful if instead of just asking the auditor to identify if a management’s expert has been used, it directed the auditor to apply the relevant requirements in ISA (NZ) 500. This would make paragraph 40 a more robust requirement.
42(f)	ISA (NZ) 265 refers to significant deficiencies in internal control and defines these as being “of sufficient importance to merit the attention of those charged with governance”. The ED does not refer to “significant deficiencies” and refers to deficiencies that “are of sufficient importance to merit attention”.
61(b)	Is “accounting policies” the correct term to use here, when we are dealing with service performance information?

Para Ref	Observation
62	<p>Suggest a minor change, or words to that effect.</p> <p><i>Public Sector</i></p> <p>Where the entity presents a comparison of published prospective service performance information with the service performance information, the auditor shall:</p> <p>(a) Check that evaluate whether the prospective service performance information that is included in the document subject to audit agrees with the information presented in the published prospective service performance information; <u>or</u></p> <p>(b) <u>Check that any changes have been clearly explained in the service performance information that is included in the document subject to audit.</u></p>
A39 last bullet	Should "report" be "service performance report"?
A70 first sentence	Should "financial statements" be "service performance information"?
A75	We do not understand this paragraph. Should the words "with another entity" be deleted?
A77 last sentence	"performance" should be "performed".