NOVEMBER 2023

Audit Quality Monitoring Report

1 July 2022 – 30 June 2023

FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

Purpose of this report

The Auditor Regulation Act 2011 (the Act) requires the Financial Markets Authority – Te Mana Tātai Hokohoko (FMA) to prepare an annual report on the outcomes of the audit quality reviews we performed on the systems, policies and procedures of registered audit firms and licensed auditors in the preceding financial year.

As well as providing a snapshot of the performance of registered auditors during the period 1 July 2022 to 30 June 2023, this report sets out our expectations of the directors and auditors of FMC entities on how to achieve and maintain audit quality.

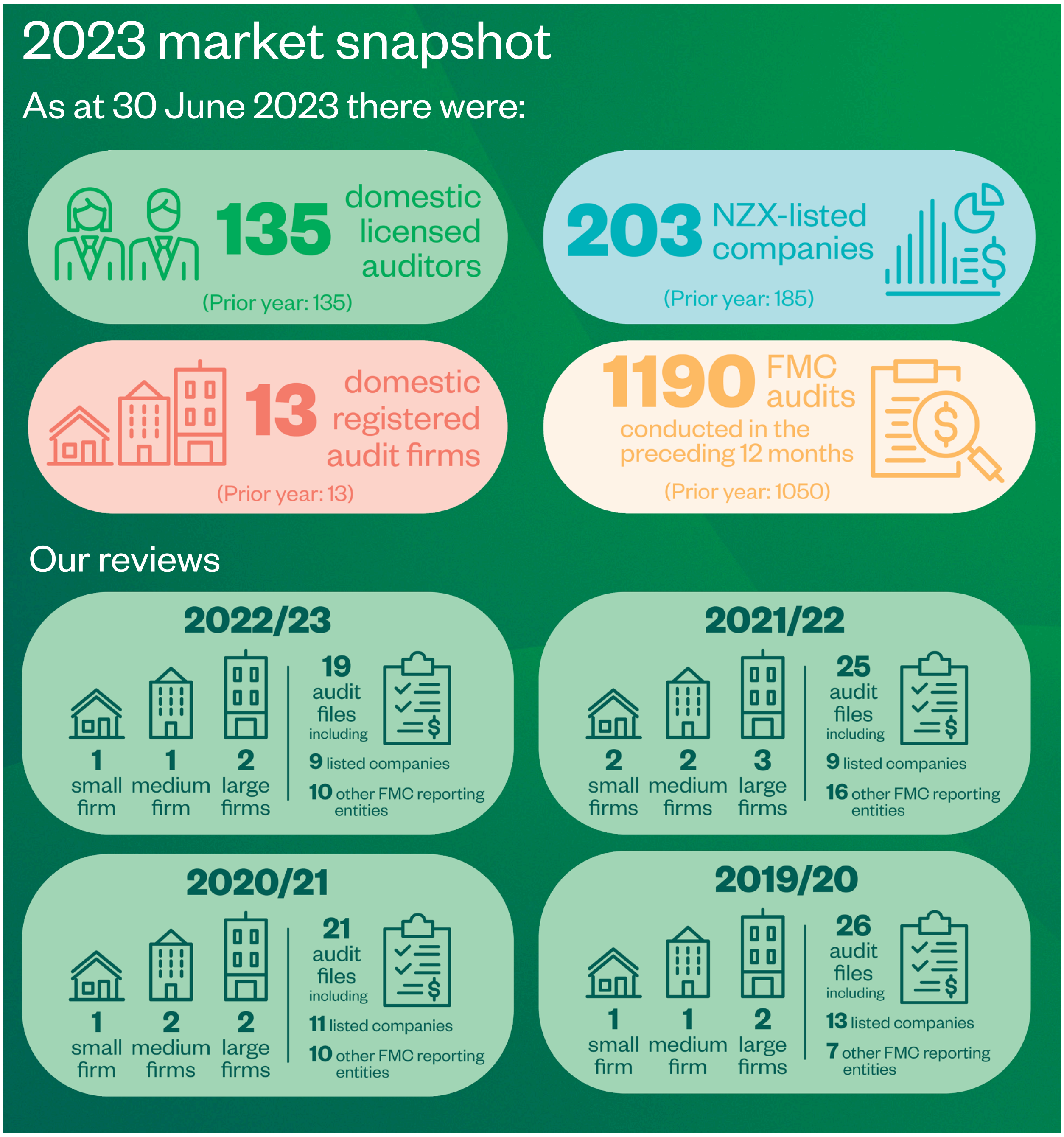
Building on previous years, this report continues to emphasise that high audit quality is vital to ensuring investors can make active choices based on clear, concise and effective information.

The elements of audit quality

Provides investors and stakeholders with assurance that financial statements give a true and fair view	**Audit is performed in accordance with the regulations and standards**	**Driven by a robust risk assessment and thorough understanding of the entity and its environment**
Supported by an independent process and audit evidence, and involves the exercise of professional judgement and scepticism	**Challenges management effectively and obtains sufficient audit evidence for the conclusions reached**	**Reports unambiguously the auditor's conclusion on the financial statements**

Contents

Summary of reviews



Small firms are firms with fewer than four licensed auditors.

Medium firms are firms with multiple offices and fewer than 10 licensed auditors.

Large firms are firms with more than 10 licensed auditors (including Audit New Zealand).

Foreword

As audit firms have returned to on-site client audits, the FMA also returned to on-site audit quality reviews for the year to 30 June 2023. Being present during a review supports more in-depth engagement and better understanding of practices and issues that are arising.

We are pleased to see audit firms continuously improving, with our feedback from prior reviews incorporated into policies and procedures. An improved level of documented audit evidence and evolving use of technology are having a positive impact on audit quality, although inconsistencies in quality remain an area of attention.

Our observations and findings are broadly consistent with international trends in audit quality. It is important to keep an eye out for issues impacting firms around the world, to assess if similar issues could arise in New Zealand. With their willingness and can-do attitude, local audit firms and reporting entities are well placed to adopt changes and respond to emerging trends.

We have identified areas to further improve audit quality and expect both auditors and directors of reporting entities to play their part in making improvements, for example in areas of accounting estimates and the evidence obtained regarding the going concern assumption. We also expect auditors and audit firms to act ethically and in the best interests of key stakeholders, to protect the integrity of the profession.

As reporting and assurance requirements change, for example with the implementation of greenhouse gas assurance, it is important that trust in the profession remains high. Various breaches of ethical requirements overseas, such as cheating on exams, have put a spotlight on the audit profession. We expect audit firms to proactively maintain a culture that enables staff at all levels to speak out on ethical issues and know such concerns will be treated seriously. Audit quality is built on independence and ethics, and those foundations must be maintained.

In the last two years, auditors have focused on uncertainties related to Covid lockdowns and geopolitical challenges. However, there is a growing list of other risks impacting businesses and audits. These vary from increased interest rates and energy prices, to escalating climate risks and cost-of-living pressures. It is important that directors and their auditors remain alert and sceptical when it comes to assessing the impact of these challenges on financial information. Forward-looking information and judgements are fundamental in accounting concepts, and pressure on markets could lead to increased impairment of assets, uncertainty about going concern, and increased risk of fraud.

We will continue to evaluate our oversight of audit quality, to identify improvements and areas to further develop. As signalled in our Auditor Regulation and Oversight Plan 2023-2026, we will be increasing the frequency of our audit quality reviews. We do not expect this will increase the burden on firms, but we do expect this change will ensure we are better placed to respond more swiftly to emerging issues, with the ultimate goal of enhancing audit quality.

Jacco Moison
FMA Head of Audit, Financial Reporting and Climate Related Disclosures

Executive summary

What we have seen

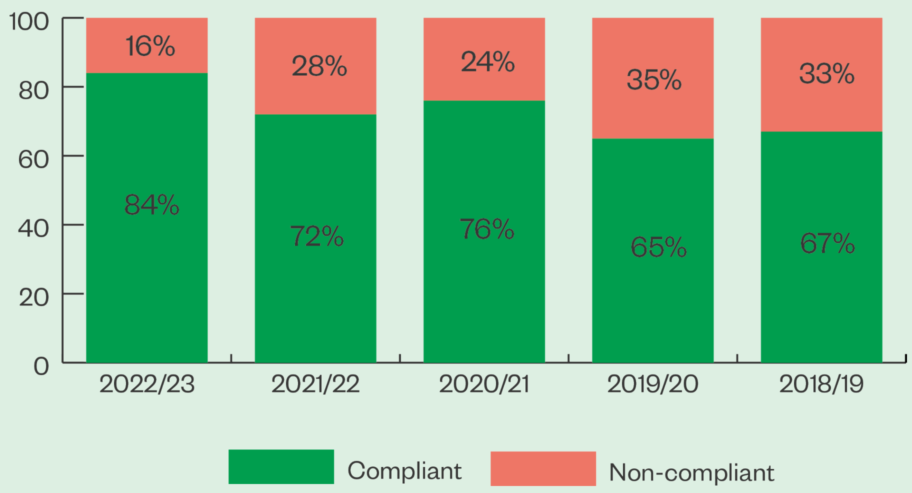
While we have seen audit firms implement improvement measures since our prior reviews, audit quality remains mixed and inconsistent between audit firms, and in some instances between audits within the same audit firm.

After carrying out remote reviews during the Covid period, this year we returned to onsite reviews, allowing more in-depth reviews to be conducted.

We reviewed two large, one medium and one small audit firms. We reviewed 19 audit files, of which nine were of listed entities with balance dates between 31 December 2021 and 30 June 2022. We typically only review each audit firm every two or three years[1], so the number of audit files reviewed fluctuates from year to year.

Although the results can't be directly compared to prior years, it is encouraging to note the percentage of 'non-compliant' audit files decreased to 16% (2021/22: 28%). This compares to an average non-compliant rate of 26% internationally.

Compliance of audit files reviewed



Where we see significant misconduct, we refer these matters to the appropriate disciplinary bodies. We did not make any such referrals this year.

Two disciplinary outcomes from earlier matters where auditors performed below the expected standards were published during the period. One related to findings from our audit quality review, while the other was the result of an external complaint referred to NZICA[2].

1: As set out in our Auditor Regulation and Oversight Plan 2023-2026, we will change our review approach to a yearly review cycle for each audit firm. Going forward we will cover between 20 and 25 audit files each year.

2: The frontline regulator for Chartered Accountants ANZ members who are resident in New Zealand.

These outcomes are a reminder of the importance of auditor independence, having documented sufficient and appropriate audit evidence, and the vital role of the engagement quality review (EQR). Refer to page 29 for more detail on these outcomes.

Focus areas

Audit firms continue to make significant investments into their audit quality and audit software. During this year's reviews we noted firms had updated their audit software and methodologies in preparation for the new standard for identifying and assessing the risks of material misstatement[3]. One firm adopted and applied this standard prior to it coming into force. For our upcoming review cycle, we will focus on the implementation of this standard.

Following the recent findings in Australia[4], we also address in this report the importance of ethical behaviour and our expectations for firms regarding ethics.

From our reviews, we have highlighted the following areas we want audit firms to focus on:

- testing information prepared by management for accuracy and completeness
- duties of an EQR and the process to be followed in finalising the audit
- audit procedures and obtaining evidence in assessing the going concern assumption
- risk assessment procedures
- journal entry testing.

In addition to these topics, we continue to put emphasis on the documentation of audit work performed and the level of evidence obtained.

Our reviews highlighted some key principles that audit firms and directors of FMC reporting entities should consider to further enhance the quality of audits in New Zealand. These principles include:

For audit firms:

- **Appropriate supervision of junior staff**: Engagement leaders and managers should have sufficient training and time to review work of more junior staff on a timely basis, so shortcomings and deficiencies can be addressed before completion of the audit.
- **Careful planning to reflect the revised risk assessment standards**: For material balances, auditors should continue to focus their efforts on the riskiest parts of these balances and transactions by performing a robust risk assessment.
- **Effective engagement quality reviews**: Engagement quality reviews are an important internal control to review in real-time the quality of key audit judgements. Where conducted by experienced partners

3: ISA (NZ) 315 (Revised)

4: PwC Australia handling of confidential Treasury information and professional, ethical or leadership responsibilities with the right level of authority, the EQR can prevent deficiencies in audit performance and audit quality, provided that the reviewer can perform their work independently and without bias.

- **Remediation and root-cause analysis**: It is important that audit firms remediate findings from internal and external reviews, and that the root causes of previous deficiencies are identified and firms take appropriate actions to avoid reoccurrence.

For directors:

- **The roles and responsibilities of the board and audit committee chair around engaging with the auditor are clearly defined, understood, and remain fit for purpose**: These roles and responsibilities should be outlined in a comprehensive governance framework that is subject to regular review.
- **Ensuring the entity has robust internal controls covering its financial systems and preparation of financial statements**: Any significant issues with the internal control system identified by the auditors should be managed and resolved.
- **Providing effective and appropriate challenge to ensure the information is reasonable**: The responsibility of challenging management should be clearly outlined in key governance documents and assessed in board evaluations. Where challenge has been applied, we recommend this is appropriately documented either in papers or minutes of meetings.
- **Holding management accountable for supporting accounting treatments and disclosures**: When discussing key judgements and areas of the financial statements, directors should ensure financial disclosures are supported by robust accounting papers.

Ethics in the audit profession

Ethics is a crucial and topical area for auditors and preparers of financial statements. Auditors' ethical codes are often debated when there is a significant corporate failure or other instances of poor conduct. Recent debate has been prompted by unethical behaviour by audit firms related to:

- the exam cheating scandals by various Big 4 audit firms in many jurisdictions
- confidentiality breaches by PwC Australia.

These incidents raise questions about ethical behaviour across the entire profession. Ethics and firm culture are almost indivisible. There is a good argument that both are reflections of one word: behaviour. How do individuals, across all levels of a firm, and the firm itself behave?

We can go further and define ethics in the workplace and its link to behaviour and firm culture. The Independent Review into Workplace Culture at EY Oceania also pointed out the importance of having the right culture in firms, to drive good outcomes for everyone.

Ethics is the moral code that guides the behaviour of employees; in particular, what is right and wrong about behaviour and decision-making. Ethical decision-making means auditors can stay within what they know is right. This protects the best interests of investors, colleagues and consumers. However, ethical behaviour does not happen in a vacuum. The audit firm itself must codify and exemplify high standards of ethical conduct.

Why is ethical behaviour important?

Ethics in audit firms can stimulate positive staff behaviours that lead to better quality outcomes, just as unethical behaviour can result in organisational demise and loss of confidence in the audits performed.

Unethical conduct, by a firm or an individual auditor, can strain relationships and damage the reputation of the audit firm, but could also have a wider impact on trust in the profession. The increased risk of reputational damage and harm from negative headlines is often elevated for professions such as auditing that openly promote ethical standards in the work and services they provide.

Even if audit firms have good and robust procedures in place, it is not always possible to prevent unethical behaviour. However, what is important is the overall culture and leadership at the firm. A firm's culture should make it safe to report and discuss poor behaviour, including behaviour by senior leadership. How an organisation responds to breaches in ethical standards is crucial in resolving and ultimately preventing unethical behaviour.

What are the requirements?

Ethics is an important part of audit work and is embedded in many parts of the profession. The requirements start with education. Audit exams include papers that test understanding of the ethical requirements for auditors. To become a licensed auditor, every person needs to be considered fit and proper, and have completed an approved course in auditing. To be registered as an audit firm all partners (not only the audit partners) must be a fit and proper person.

When performing audit work, the auditor and the firm need to comply with the assurance standards issued by XRB, which include the following professional and ethical standards:

- PES 1 International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)
- PES 3 Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements
- PES 4 Engagement Quality Reviews

What does the FMA expect from audit firms to encourage ethical behaviour?

Firms must go beyond reactive systems to report unethical behaviour. Firms must actively promote ethical behaviour both in codes and in practice. Employees at all levels must feel able to voice concerns and be able to challenge where necessary. This requires the firm to create a safe environment that is receptive to challenge.

When evaluating audit firms' systems and processes related to culture, we expect to see:

- Appropriate systems to report misconduct (including that of senior leaders) and to investigate and take appropriate action.
- Independent investigation of complaints about ethical conduct.
- Support for staff and partners that report ethical breaches.
- Reporting of all breaches of ethical standards to the global firm, even if a breach does not relate to the audit part of the business.
- Reporting of breaches of ethical standards to the relevant regulator and professional body at the time the firm becomes aware of them.
- Staff and partners being held accountable for breaches.
- Acknowledgement of developments or findings (e.g. exam cheating) across the firm's network or competitors' networks, both domestic and overseas, to assess if similar conduct could occur in their firm.
- Ongoing training in ethics for all staff and partners.
- Transparent information about ethical breaches communicated to staff and partners.

FMA's work in relation to ethical requirements

As part of our audit quality reviews, we assess the design of the audit firm's internal quality control system for compliance with the auditing and assurance standards. This includes checking individual compliance for each audit we review.

In 2023/2024, we will perform specific reviews of all audit firms' implementation of the new quality management standards. These standards are effective from December 2022 and are equivalent to the International Standards on Quality Management.

As part of our assessment of audit firms' quality management we will assess if the firm:

- Demonstrates a commitment to quality through a culture that recognises and reinforces the importance of professional ethics, values and attitudes.
- Has policies and procedures in place to comply with the professional and ethical requirements as set out in Professional and Ethical Standard 1 (PES 1) International Code of Ethics for Assurance Practitioners.
- We will also verify, through review of the firm's system and processes and a sample of audit engagements, whether the policies and procedures are appropriately executed.

FMA expectations and powers in relation to breaches of the ethical requirements.

We are responsible for the oversight of audit firms in relation to the audit of financial statements. That means we have limited powers when it comes to other services audit firms provide, such as tax, advisory and accounting services. The Auditor Regulation Act provides us with two main powers to act on non-compliance:

- the power to issue directions to audit firms to make changes to policies and procedures;
- the power to take disciplinary action either through the accredited body or directly when agreed by the accredited body.

Even though auditor regulation and standards deal with the audit side of firms, culture and conduct issues cannot be isolated, as culture, which drive conduct, is embedded across the whole firm.

The conduct of those who provide financial services, including auditors, affects the consumers of those services, which is all New Zealanders. High standards of conduct support fair, efficient and transparent markets – and the confident participation in those markets of businesses, investors and consumers.

Poor conduct can destroy confidence and discourage participation in our financial markets. Conduct is particular to each business or person and their circumstances. As an audit regulator, we don't prescribe a culture or set of ethical standards. We do expect firms to work on identifying the behaviours that comprise their culture and then to maintain and improve that culture to uphold the ethics and conduct we expect. One of the key objectives of audit oversight is to promote the quality, expertise and integrity of the audit profession in relation to FMC audits. With major growth in retail investing we are seeing more Kiwis entrusting their wealth to the share market or other investments in FMC reporting entities. The audits of these entities provide the necessary trust and comfort that their financial information is robust.

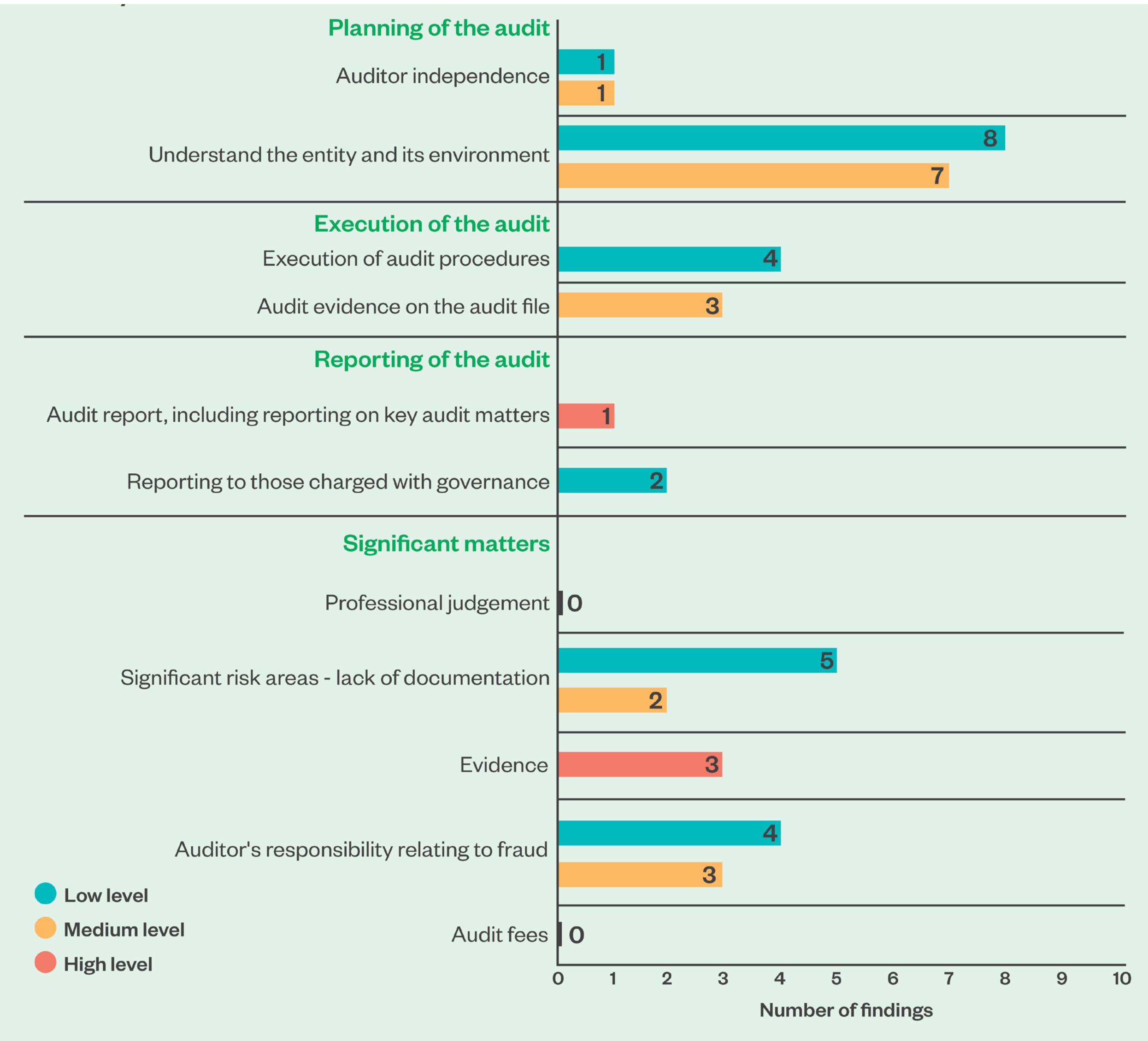
In our monitoring of audits and audit firms, we are not only focusing on compliance with audit standards, but also considering developments and trends in the audit market, such as public information on ethical breaches, that could impact the quality of audits going forward or require additional focus.

Audit quality review findings

Individual file reviews

As set out in our annual plan, our individual file reviews focused on key audit areas, areas of common findings from our previous reviews, and common findings identified by international audit regulators.

The chart below shows the number and level of findings identified in the four key audit areas across the 19 individual files that were part of this year's reviews.



Firms' system of quality management

As part of our audit quality reviews, we assess the controls audit firms have in place to perform audits to an adequate standard, and whether these comply with the relevant Professional and Ethical Standards (PESs). In December 2022 a new quality management standard was introduced. Our focus for the last year of the old standard, covered by this report, was on the monitoring functions firms have in place. We did not identify any significant deficiencies in firms' quality control frameworks, and their quality control systems remained appropriate in terms of the old standard, ensuring they were able to perform quality audits. However, we did identify two instances where firms did not comply with aspects of the PESs related to engagement performance.

As communicated in our annual Auditor regulation and oversight plan, we will prepare a separate report for the 2023/2024 review cycle covering the findings from our thematic review of the new system of quality management and the implementation of the standard across all registered audit firms.

The new standard puts more focus on internal control procedures and reviews the firm must perform to ensure quality management in their firm is effective.

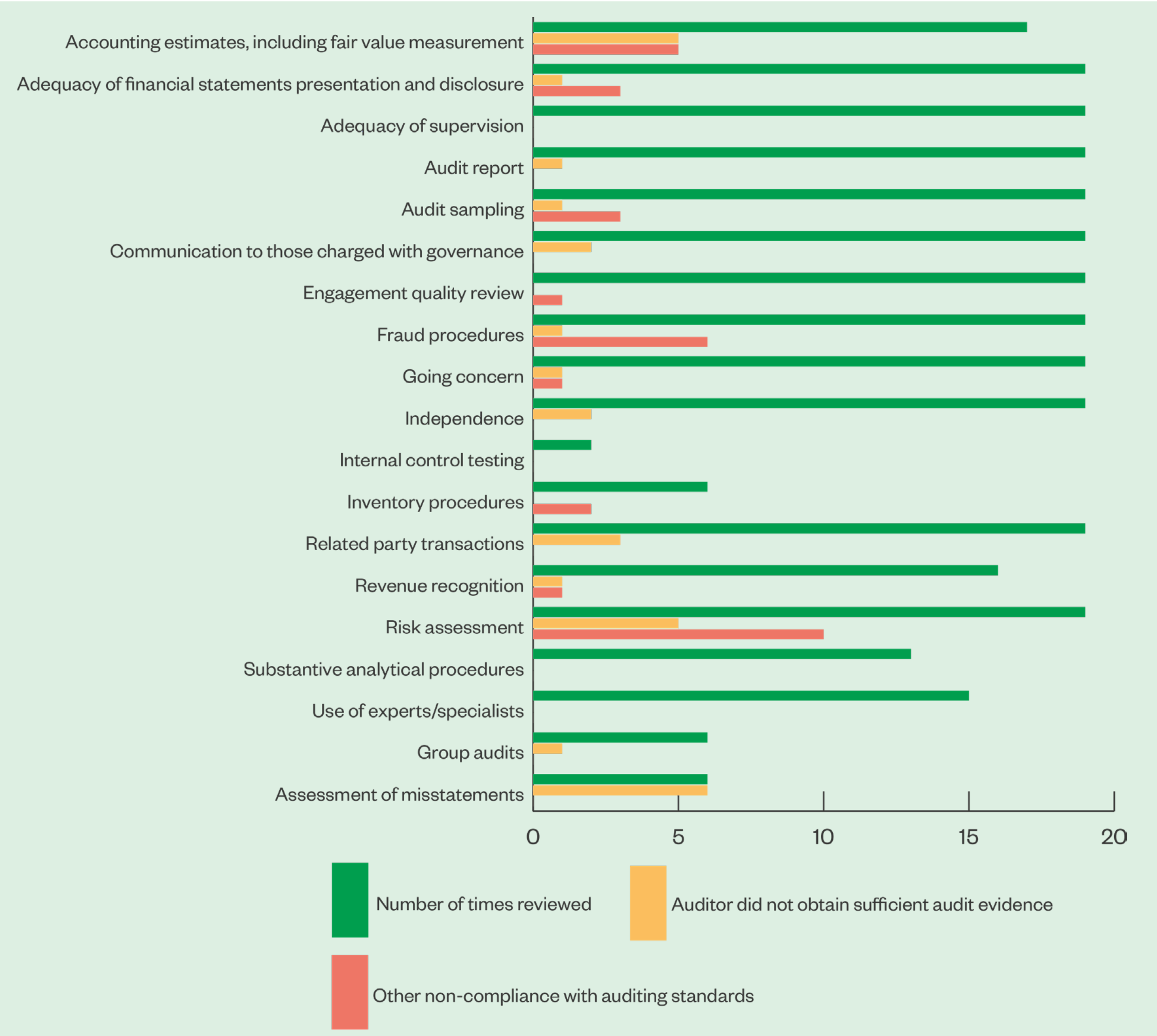
Analysis of our file reviews

When reviewing audit files, we assess whether the auditor complied with the Assurance Standards, and otherwise exercised reasonable care, diligence and skill in carrying out the audit.

Our reviews focus on key areas rather than the entire audit file. The areas we look at are either:

- fundamental to overall audit integrity, such as auditor independence, and sufficient oversight by the engagement leader and EQR partner; or
- selected based on the potential risks they pose – for example, they may be significant to the entity's financial statements, include complex issues for the auditor, and/or involve significant judgements.

The table below shows how many times we reviewed these key areas across the 19 audit files in our sample, how frequently we noted issues, which findings were due to the auditor not obtaining sufficient audit evidence, which findings were a result of other non-compliance with the auditing standards.



Level of compliance in each file

This year the rate of non-compliant audit files decreased to 16%, down from 28% the prior year.

As we reviewed fewer files than the previous review cycle, and the audit firms and files we review are different each year, it is difficult to compare the results directly. However, the decrease in findings is encouraging.

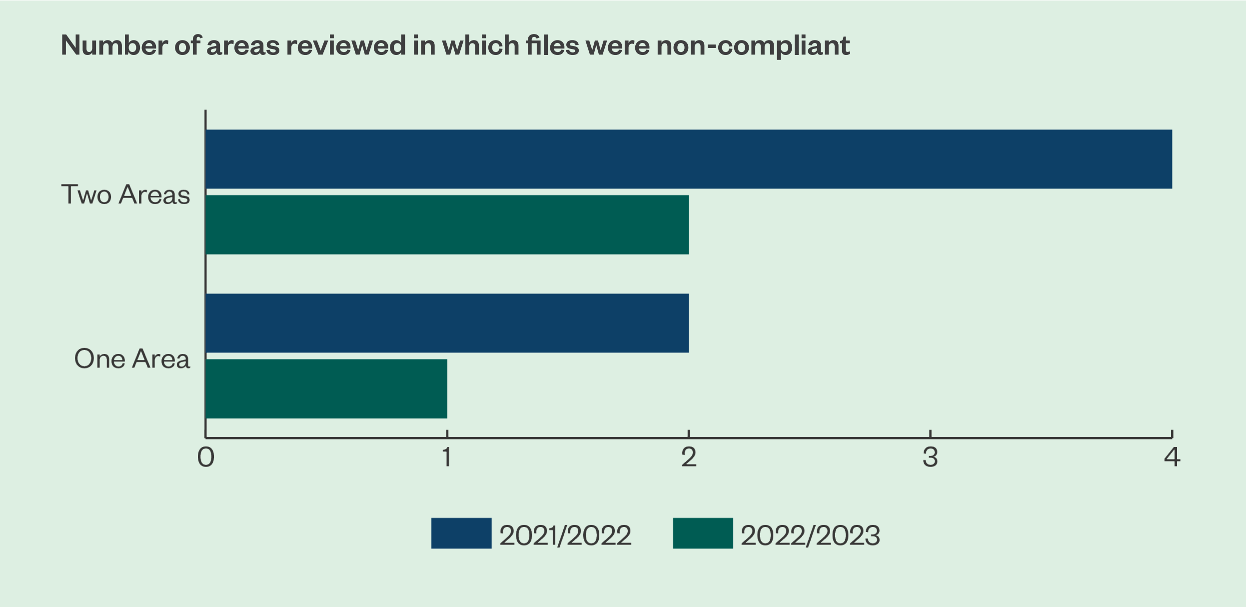
We did still identify instances where the auditors did not obtain sufficient audit evidence, or did not sufficiently document the work they performed, specifically around risk assessment. We expect audit firms to continue to focus on this and apply the learnings from this review cycle going forward.

For more details on common findings and themes, see page 18.

We rate a file as non-compliant if:

- the audit or parts of the audit are not performed in accordance with the Auditing and Assurance Standards
- insufficient audit evidence is obtained in at least one key risk area
- the auditor failed to identify a material misstatement in the financial statements
- the auditor breached independence requirements; or
- an incorrect audit opinion was issued.

The table below shows the number of areas in which files were non-compliant, from our last two review cycles.



Follow-up on non-compliant audit files

When we rate an audit file as 'non-compliant' we can take several actions. Depending on the nature of the findings and the timing of our review, we assess the best approach to remediation, which may involve contacting the entity to enquire about the accounting treatments applied. In the table below we set out what we found:

Results from non-compliant audit files[5]	Number of files 2022/23	Number of files 2021/22
Financial statements materially misstated	1	1
Insufficient evidence available to make a reliable assessment of material misstatement	1	4
Insufficient evidence, additional audit work required, impact to be assessed	1	2
Investigate or refer to disciplinary body	0	0

For the audit files where we concluded that insufficient evidence was obtained in a significant risk area, the areas impacted were:

- valuation of insurance liabilities, specifically reinsurance testing[6]
- going concern assessment and subsequent events assessment.

International comparison and developments

We track our year-on-year results for New Zealand against those reported by the International Forum of Independent Audit Regulators (IFIAR). IFIAR provides an overview of the findings of various audit regulators, including the FMA, from reviews of listed entity audits performed by the six largest audit firms (Big 6)[7]. Last year 51 jurisdictions were included in IFIAR's survey.

The survey provides key trends, review findings, and the overall percentage of non-compliant audit files[8]. Since first tracking this statistic, the percentage of audits with findings in IFIAR's overall sample has declined

5: Where we rate an audit as 'non-compliant', it does not necessarily mean the financial statements do not show a true and fair view or require restatement. Equally, where we rate an audit as 'good' or 'compliant' this is not an endorsement that the financial statements are free from misstatement.

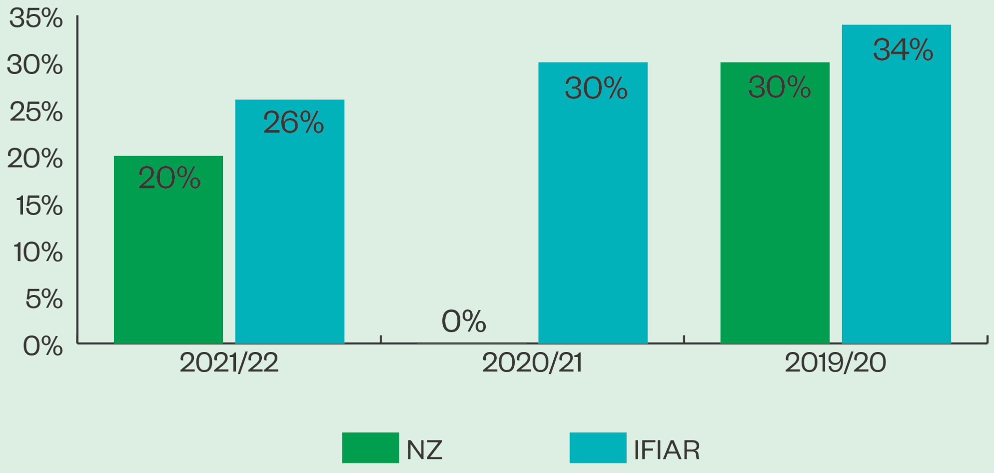
6: During the subsequent audit of an entity following our review of its audit file, the audit team had to confirm the data used in financial models to determine the insurance liability was accurate and complete, and there were no misstatements in the data that could have a material impact on the valuation of the insurance liability. Based on the work performed, the audit team concluded the data was accurate and complete. We will assess this as part of our upcoming audit quality review of the firm.

7: The 'Big 6' – BDO, Deloitte, EY, Grant Thornton, KPMG, and PwC

8: We apply the same file rating standards as IFIAR in our audit quality reviews.

from 47% to 26% in 2022. The New Zealand percentages can fluctuate significantly between years as we review a limited number of files from the Big 6 and may select FMC audits that are not listed entities.

Percentage of non-compliant audit files of listed entities performed by the Big 6



International relationships are important for the purposes of the Auditor Regulation Act, to promote the recognition of the professional status of New Zealand auditors in overseas jurisdictions.

Our international activities through IFIAR include:

- Chairing IFIAR's Emerging Regulators Group (ERG). The ERG is a support network to assist smaller and emerging audit regulators to address the unique challenges they face, and to provide a forum for smaller members to identify ways IFIAR may be able to further support their needs.
- Providing and facilitating webinars on key topics such as climate change disclosures, trends in auditing and/or challenges of smaller regulators.
- Attending meetings of the Global Audit Quality Working Group as observers. This group is responsible for IFIAR's ongoing dialogue with the Big 6, to promote continuous improvement in audit quality.

We continue to assess international developments and share information with fellow regulators on audit-related topics and developing trends such as climate-related assurance and suggested reforms for the audit profession.

Common findings and themes

In this section we provide more detail on the common themes identified in our reviews, and our expectations for auditors and directors to ensure issues do not reoccur. In most instances, our findings were not isolated to certain files, firms or partners, but rather themes identified throughout the review sample. In other instances, the findings may not be widespread, but significant enough to share with the wider market, to avoid similar issues.

Testing information prepared by management for accuracy and completeness

Auditors must ensure information provided by management and directors can be relied upon, if the auditor intends to use that information as audit evidence.

For information produced by the entity to be reliable audit evidence, the auditor evaluates whether it is:

- accurate and complete
- sufficiently precise and detailed for their purposes.

We noted the following two areas where auditors should improve the assessment of the data provided by management.

Management's assessment of accounting estimates

When auditing accounting estimates, one of the procedures the auditor has to perform in response to the risk is testing how management made the accounting estimate, and specifically assessing whether the integrity of the significant assumptions and the data used in complex modelling has been maintained in applying the method.

Substantive analytical procedures

With substantive analytical procedures, the auditor needs to evaluate the reliability of the data from which their expectation of recorded amounts or ratios is developed. Auditors should also consider the source, comparability, nature and relevance of information available, and any controls performed by the entity when preparing the data.

Management's assessment of accounting estimates

One of the files we reviewed was an insurance company that had to estimate its insurance liabilities, which incorporate reinsurance assets as a component of the financial statements line item. The estimate for the insurance liability was calculated using a complex financial model with several assumptions. The information used in the financial model was derived from various sources and contracts, including the terms of reinsurance contracts.

The auditor used the expertise of an actuary to assist with assessing whether the financial model calculated the intended insurance liabilities appropriately and whether the assumptions used were reasonable.

We found that between the actuary and the audit team, no procedures were performed on the data used in the financial model relating to the terms of reinsurance contracts to ensure it was accurate and complete.

Substantive analytical procedures

Substantive analytical procedures are intended to be used where classes of transactions or account balances are made up of large volumes of transactions and where two or more data characteristics have a correlation. The purpose of using these analytics is to obtain substantive evidence in an effective way.

We have seen auditors use substantive analytical reviews to obtain audit evidence for various account balances, but this year we saw auditors used analytics mainly to test revenue. In almost all instances, the auditor elected to follow a fully substantive approach, consisting of test of detail and substantive analytical procedures. The auditor therefore did not assess and test any controls in relation to revenue. The underlying data used by the auditor to set their expectation when performing the substantive analytical review should therefore have been tested substantively through test of detail. We noted the following issues when testing the data:

- The auditors tested data as part of other audit procedures. However, they did not document clearly that the data tested was used in the substantive analysis.
- The auditor referenced work papers where procedures were performed that should cover the testing of the data. However, when reviewing those work papers, it was not clear how the procedures performed addressed the audit risk and demonstrated that the data was accurate and complete.

What auditors should take into account

- As part of their risk assessment process on how management determines estimates, the auditor should get an understanding of what data is used in calculating the accounting estimate.
- When using an auditor's expert, instructions should be clear on who is responsible for testing the underlying data and how this work should be documented. Often this is the responsibility of the audit team, and they should inform the auditor's expert about all relevant data that could significantly impact the estimate.
- The auditor should identify the data that will be used in substantive analytical procedures, and design test procedures to ensure the underlying data is accurate and complete. The auditor should test the underlying data either by:
    - testing the controls around how the data is produced and entered into the financial model; or
    - testing the data on a sample basis back to source documents to ensure the data is accurate and complete.

How directors should contribute to audit quality

- Directors should ensure financial statements comply with the financial reporting framework and the entity has proper accounting records to support financial statements. This includes having policies and controls to support preparation that capture all transactions and address material disclosures. Directors should ensure the entity prepares accounting papers to support decisions and treatment for unusual or more complex transactions. Where they believe the accounting team has insufficient experience or the matter is complex, they should obtain independent accounting advice.
- Board minutes should record decisions and discussions on the key accounting estimates made by directors.

Performing procedures and obtaining evidence over going concern assumption

The adoption of the going concern assumption is one of the fundamental accounting concepts used in the preparation of financial statements. An entity that cannot rely on the going concern assumption may be unable to realise its assets and discharge its liabilities in the normal course of business. Therefore, the value of those assets and liabilities may well be impaired in its financial statements. This might have significant impact on the value of an investor's investment. The auditing standards recognise the importance of good disclosure surrounding going concern, and therefore specific audit procedures are required. During our review we noted the following two instances where the sufficiency of evidence obtained to support the going concern disclosures was impacted.

Assessment of selling a major asset

Post balance sheet, the shareholders approved the decision to sell their main cash-generating asset. A prospective buyer was identified, and the entity entered into a sale agreement. The sale was finalised and concluded a day after the financial statements were signed and the audit report issued. With the sale concluding, the shareholders voted for the entity to be liquidated.

The auditor performed an assessment on whether the transaction constituted an adjusting post balance sheet event. They rightfully concluded that the sale did not meet the requirements of an adjusting post balance sheet event, and assessed the post balance sheet event was appropriately disclosed. The entity concluded and disclosed a material uncertainty in the notes to the financial statements, and the auditor included a material uncertainty paragraph in the audit report.

The auditor did not consider the impact of the transaction on the going concern assumption, whether the sale of the asset would force the entity to stop trading, and whether the going concern assumption remained appropriate.

The auditor did not consult on the matter or obtain a second opinion on whether their assessment of the going concern assumption remained appropriate.

Evidence obtained regarding the going concern assessment

At year-end, the financial statements were prepared on the going concern assumption. The entity had a history of losses and negative cash flows and relied on shareholder support. The entity concluded that there was a material uncertainty and disclosed this fact in the notes to the financial statements.

The auditor prepared several work papers to assess management's assessment of going concern. However, it was not clear what evidence the auditor obtained and therefore on what basis the auditor assessed that the material uncertainty was appropriate and the related disclosures of the material uncertainty were adequate.

The auditor documented that the budget and forecast used by management in their going concern assessment were too aggressive and could not be relied upon. The auditor then prepared their own assessment to determine whether the entity would be able to meet its obligations in the foreseeable future. This work paper did not clearly document that no further reliance was placed on management assessments and how the auditor was comfortable that reliance on a significant shareholder's support was appropriate and supported.

What auditors should take into account

- When assessing the sale of a significant asset subsequent to the balance sheet date, the auditor should not only consider whether the transaction is an adjusting post balance sheet event, but should also consider the impact of the transaction on the going concern assumption, and whether the use of the going concern assumption remains appropriate.
- We recommend that auditors consult with their technical teams/professional practice groups in instances where going concern is a close call or leads to a modification of the opinion.
- When the auditor performs their assessment of management's going concern assessment, they should:
    - prepare a clear work paper summarising the work performed, evidence obtained and conclusion reached
    - clearly indicate the purpose of the forecast, what work was performed, and the conclusion reached
    - in instances of uncertainty, clearly document how the entity is intending to meet its future cashflow needs. This should at a minimum cover the 12 months after signing the audit opinion
    - clearly document why they believe the shareholders will be able to provide future assistance, including shareholders' financial ability (although ideally management should obtain guarantees for future assistance from shareholders in writing).

How directors should contribute to audit quality

We expect directors of FMC reporting entities to ensure robust disclosures around going concern status. In instances where there is a material uncertainty, disclosure should include key aspects of the going concern assumption, such as:

- the principal events or conditions that give rise to going concern risk when they occur
- the material uncertainty related to those events or conditions; and
- the plans in place to address those uncertainties.

To ensure the directors make all the required disclosures and meet all requirements of ISA (NZ) 570, NZ IAS 1 and FRS 44, they should discuss these with the auditors at an early stage of the engagement.

We will continue to monitor both the going concern disclosures in financial statements and modified audit reports in relation to the going concern assumption.

Risk assessment

In December 2022, ISA (NZ) 315, Identifying and assessing the risks of material misstatement (Revised), became mandatory, although some audit firms implemented this standard early. This standard deals with the auditor's responsibility to identify and assess the risks of material misstatement, whether due to fraud or error. This risk assessment should be performed at both the financial statement level and the assertion level. The auditor performs this risk assessment at the planning stage of the audit, through procedures performed when obtaining an understanding of the entity and its environment, including the entity's internal controls. However, the auditor should assess the risk throughout the audit to ensure their understanding of the risks remains appropriate.

By gaining an understanding of the risks, the auditor can form the basis for designing and implementing responses to the assessed risks of material misstatement, including the timing and extent of work required.

It is important that the auditor obtains a good understanding of their client, the market it operates in and the regulatory environment it is subject to. The auditor should also seek an understanding of what controls management have implemented to identify and/or prevent misstatements, and what elements of the financial statements are susceptible to fraud. The auditor should then ensure they design and execute procedures that address the identified risks. Below we have outlined several instances where the auditor did not comply with the standard.

Material balances and classes of transactions assessed as non-significant risks

The auditor assessed several material balances, classes of transactions and disclosures as non-significant. In our review, it was not evident what procedures the auditor performed and what evidence the auditor obtained to conclude that the risk for these balances was not significant.

Further, the auditor did not obtain an understanding of the business processes, what transactions made up the accounts, and how they were processed. The auditor also did not assess the control environment to determine if there were any controls in place that may mitigate risks.

Although the auditor assessed the risk related to these accounts as not significant, they are still required by the standards to perform some substantive procedures to obtain audit evidence. The substantive procedures can either be a substantive analytical procedure or a substantive test of detail. The auditor elected to perform a substantive analytical procedure. However, based on the evidence on the audit file, the substantive analytical procedure did not meet the requirements of the standard.

Other findings in the work regarding risk assessment that we identified across multiple files include:

- The audit file did not clearly document the risks at a financial statement level and at an assertion level.
- The audit team did not include an assessment of inherent risk factors or an assessment of the degree to which the accounting estimate was subject to estimation uncertainty.
- The audit documentation supporting the understanding of the revenue stream was insufficient for an experienced auditor, who had no previous connection with the audit to understand the nature, timing and the extent of the audit procedures performed.
- In documenting the walk-through of the revenue cycle, the auditor did not address how reports used by management were prepared, so it was unclear if the reports could be relied upon in the auditor's work.
- The audit documentation of significant risks was inconsistent between the documentation of risks on the audit file, the risks communicated to the board, and the risks discussed by the audit team at the planning meeting. No documentation was available about why these were different.
- We continue to note that auditors base their conclusion on whether controls are effective on a walkthrough procedure alone. A walkthrough procedure provides reasonable assurance on the design effectiveness and implementation of the relevant control, but without testing the control no conclusion can be reached that it is operating effectively.
- There is no clear connection between the risks documented on a financial statement assertion level and the audit work performed in the detailed testing.
- In the audit report, as part of the key audit matters the auditor reported that they "assessed the internal controls and systems relating to livestock stock management". However, they did not test and place reliance on controls. Therefore, this statement in the key audit matters could be perceived as stating the internal controls are operating effectively and misleading to readers.

What auditors should take into account

- To be able to assess the risk of material misstatement, auditors should perform procedures to obtain an understanding of account balances, classes of transaction and disclosures, including what the accounts are made up of and how the transactions are recorded.
- The auditor should perform the risk assessment at an assertion level and assess whether there is any likelihood of material misstatement for each assertion.
- If the auditor assessed that the risk of material misstatement is remote, then they should ensure the procedures designed and performed are appropriate substantive procedures that will identify material misstatements at an assertion level.
- If the auditor decides to perform substantive analytical review, this should be performed in accordance with ISA (NZ) 520 to provide the auditor with appropriate assurance.
- If the auditor does not test the effectiveness of the controls, then in the work paper they should only conclude whether the controls are appropriately designed and implemented.
- The auditor should ensure the documentation on the audit file is sufficient to identify the risks the auditor has assessed and what audit evidence was obtained. Any work performed in previous years that is still relevant in the current year should be transferred and placed on the current year audit file as audit evidence.
- The auditor should ensure the risks discussed by the audit team and those communicated to those charged with governance are consistent with the risks assessed on the audit file, or should clearly document the circumstances that required a change of the risk assessment.

Other areas of focus

Obtaining and documenting sufficient evidence (and inconsistencies in audit files) remains an issue in our reviews. We want auditors to focus on the following areas when documenting their evidence.

Engagement quality review (EQR)

The EQR is an important process in ensuring audit quality on an engagement level. The audit standards require specific procedures to be performed independent of the audit team. The prescribed minimum standards issued by the FMA require that the EQR partner is a licensed auditor.

Where audit files did not meet the minimum standards, insufficient EQR was often a contributing factor. Key points for the lead engagement partner to consider in relation to an EQR include:

- Not to date the auditor's report until completion of the EQR.
- The auditor should ensure the EQR is conducted in a timely manner and at appropriate stages during the audit engagement.
- The audit team should communicate frequently with the EQR partner throughout the audit engagement to ensure a no-surprise approach and allow time for the audit team to address the findings.
- This year we saw some instances where the failure of the EQR resulted in significant findings. These include:
  - The auditor issuing the audit report before the EQR was completed.
  - The EQR not being involved through the audit, only at the end.
  - The auditor not addressing the observations raised by the EQR, including that sufficient evidence was not obtained in several sections assessed as significant risks.
  - The EQR only performed their review after the date of the audit report.

What auditors should take into account

- It is the lead engagement partner's responsibility to ensure all queries raised by the EQR partner are adequately addressed, and the EQR partner has provided clearance before the auditor dates and signs the audit report. The auditor should ensure all audit work is completed and they have obtained sufficient appropriate evidence to support the audit opinion before the audit report is issued.
- The EQR should be completed before the audit report is dated and signed. Ideally the EQR partner should perform their review in a timely manner throughout the various stages of the audit. The EQR partner should take reasonable steps to prevent or stop non-compliance by the lead engagement partner in accordance with section 10 of the Act.

Journal testing

Overall, auditors performed the appropriate procedures to address the significant risk of management override of controls, specifically related to journals processed. However, we did still identify issues with the risk assessment performed by the auditor to determine what journals are deemed risky, as well as the selection of the sample to be tested, and auditors not performing procedures to ensure the completeness of the population of journals from which the sample was selected.

We found the following areas where audit teams must improve:

- Understanding the client's journal process, including who is able to post and approve journal entries.
- Implementing procedures to ensure the journal listing used in the testing is complete, e.g. to get an understanding of the automatic numbering or reconciliations to the general ledger.
- Designing a clear scope, including risk-based criteria to assist the auditor to select the journal entries that should be tested, explaining why these criteria were chosen, and executing the procedures as designed.
- Documenting how the sample selected for testing the journals at year-end was selected based on the risk factors.
- Ensuring the procedures performed are appropriate to address the risks as assessed and documented on the audit file.

What auditors should take into account

- As part of getting an understanding of the journal process, the auditor should document who in the organisation is able and allowed to process journals, the difference between automated and manual journals, and how the system verifies the integrity of the journals.
- When selecting journals for testing on a risk basis, documentation should provide sufficient information about how the risk criteria have been established and how the auditor ensured that testing only the selected entries was sufficient to address the identified risks.
- When the auditor indicates that both journals at year-end and journals processed throughout the year are high risk, they should ensure the sample selected for testing includes both types of journals.
- The auditor should perform all the planned procedures, or document why certain procedures were not performed as planned. Alternatively, the auditor should update the planning documentation and risks assessment documentation to ensure the work performed is aligned with their procedures.

Audit evidence

The standards require an auditor to obtain sufficient appropriate audit evidence to support their opinion. This means that when forming their opinion, the auditor should base their decision on evidence gathered during the audit. The evidence should be sufficient and should cover all material areas of the financial statements. Evidence can be in various forms and can be obtained from various sources, including documentation of the work performed by the auditor and the conclusions reached.

While we have seen an improvement in the quality of evidence obtained and the way the evidence has been documented on audit files, below are some examples where the auditor did not document evidence appropriately:

- The work paper on file to evidence the auditor's assessment of management's value in use and assessment of the cash generating unit was not in the final work paper and did not agree with the audit committee report communicated to the directors.
- It was not evident that all documentation and correspondence of the instructions to the component auditor and the work performed by the component auditor was on the audit file.
- The audit team did not perform all the procedures as set out in the scope for all items in the revenue sample.
- The auditor reviewed management's assessment of the reclassification due to the 'software as a service' arrangements, specific to amounts reclassified as prepayments. However, the auditor did not perform any procedures or obtain appropriate evidence to corroborate management's assessment.
- The auditor did not obtain sufficient appropriate audit evidence to support the conclusion that related parties had been fairly stated. The relevant transactions included revenue and compensation paid to key management personnel.
- On several occasions, we noted that the auditor obtained legal confirmations that contained several claims and assessments made against the entity. However, it was unclear what further work was performed by the auditor to ensure that no provisions or contingency disclosures were required in the financial statements.

What auditors should take into account

- The auditor should ensure the final work papers in the audit file reconcile to the financial statements that are on the audit file. When the audit team is making last-minute changes to a work paper, they should either work on the work paper on the audit file or ensure the final version has been merged back/saved back onto the audit file.
- The auditor should ensure the instructions, work papers provided and audit evidence obtained by the component auditor, along with any correspondence, has been saved on the audit file. The auditor should also document conclusions reached by the component auditor and the impact of their work performed on the group audit.
- The auditor and their team should check that all work papers are reviewed before signing off, to ensure procedures have been completed for all the samples. We recommend that managers and audit partners follow training to ensure audit papers are reviewed in such a way that misstatements are picked up. Management should also ensure partners and managers have sufficient time to perform the review.
- The auditor should ensure the procedures performed are appropriate in response to the assessed risks, and sufficient appropriate evidence has been obtained to support the conclusion that related parties have been fairly stated.
- Where the auditor obtained legal confirmations with possible claims, but did not identify any related provisions or contingencies, the auditor should clearly document why no provisions or contingency disclosures were required in the financial statements.

How directors should contribute to audit quality

- Directors should lead the relationship with their auditor and proactively engage in conversations with the auditors to produce effective and high-quality information.
- Directors should be available and ensure significant issues with management are discussed, appropriately addressed and resolved in a timely manner.
- Directors should check if information included in audit committee reports is complete and accurate based on their knowledge and understanding.
- Directors should ensure there are processes in place to address the risk of error, fraud and management override of controls.
- Directors should focus on related party transactions, and establish if the entity has monitoring systems in place to verify the completeness and accuracy of related party relationships and transactions.

Disciplinary proceedings

Accredited bodies have the primary responsibility for investigating potential auditor misconduct. The FMA can investigate only those matters that accredited bodies have referred to us or decided not to investigate. We can also investigate auditors that we have licensed directly.

When we have concerns about compliance with the Auditing and Assurance standards following an audit quality review, we have various tools available to us including:

- Requiring an audit firm or auditor to perform additional work to address our findings.
- Requesting a remedial action plan to address the compliance issues.
- In our next review, reselecting files from the previous review to assess whether the audit firm has taken appropriate action to address our findings.
- Issuing directions to remediate any findings.
- Referring complaints to the accredited body to be dealt with under its disciplinary procedures.

Matters may also be referred to the relevant accredited body for further investigation following a complaint or any other intelligence we obtain.

We consider several elements when determining if a referral is needed, including:

- Did the issue have a significant impact on the audit's outcome?
- Did the auditor or audit firm breach the Professional and Ethical Standards?
- What is the overall quality of the audits performed and is there a pattern of non-compliance by the auditor?

Where matters are referred to the accredited body, we try to assist with the evidence we have obtained as part of our reviews and provide further evidence where needed.

As at the date of this report, there are two ongoing investigations in relation to audits of FMC entities, either by the FMA or accredited bodies.

During the period, two disciplinary outcomes were published, in relation to the 2015 audit of Wynyard Group Limited (Wynyard) and the 2017-2019 audits of Fonterra Co-operative Group Limited (Fonterra).

Wynyard

We made a complaint to NZICA concerning the Wynyard audit following one of our audit quality reviews, which had raised the concerns about:

- The audit firm's independence, as Wynyard had engaged PwC's Transaction Services team during the audit period. The team was contracted to provide Wynyard with a limited scope due diligence report as part of Wynyard's $30 million dollar capital raise, disclosed as subsequent events in the financial statements.
- The audit work performed to support Wynyard's going concern assumption as disclosed in the financial statements and if sufficient evidence was obtained regarding its assessment.

- The role the EQR partner played in performing their obligations in relation to the engagement.

NZICA's Appeals Council and Disciplinary Tribunal decisions in respect of the lead engagement partner and engagement quality review partner were published on the CA ANZ website in December 2022. Our related media statement can be found here.

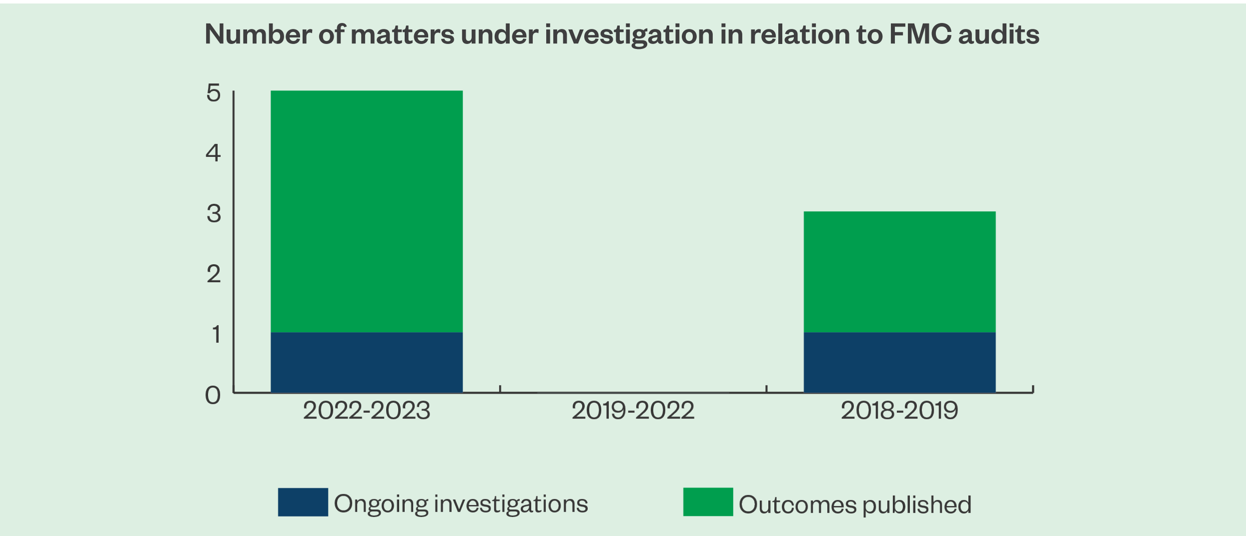
Fonterra

In the Fonterra case, we referred to NZICA a complaint received from the public concerning the audits performed by PwC. NZICA's investigation of the complaint considered matters such as independence in appearance following the appointment of two former partners to the board and impairment of financial assets, and included consideration of the role of the EQR partner in relation to key judgements and conclusions reached by the engagement team. NZICA's Disciplinary Tribunal decisions in respect of the lead engagement partner and EQR partner were published in full on the CA ANZ website in August 2023. The related media statement can be found here.

Key observations

The findings from these cases clarify for auditors what is required in terms of assessment and documentation of threats to independence (both actual and in appearance), and evidence and documentation when assessing going concern and other key areas of judgement. The decisions also note that the importance of the EQR in the audit should not be underestimated. We expect that auditors will learn from these cases to ensure core areas of their audits are performed to the required standards.

The graph below provides an overview of how many matters are under investigation, either directly by the FMA or following our referral to the accredited body.



Appendix 1: Audit oversight regime

Oversight of FMC auditors

The Ministry of Business, Innovation and Employment (MBIE) sets the policies for the oversight of auditors of FMC reporting entities. The regulations are set out in two key pieces of legislation:

- the Financial Market Conduct Act 2013 (FMC Act), which establishes which entities require their financial statements to be audited by a licensed auditor/registered audit firm
- the Auditor Regulation Act 2011 ('AR Act' or 'the Act'), which sets out the rules regarding the licensing and oversight of auditors of FMC reporting entities.

What are FMC reporting entities?

The FMC Act defines an FMC reporting entity as:

- an issuer of a regulated financial product (for example managed investment schemes and other registered schemes)
- listed entities
- registered banks and licensed insurers
- credit unions and building societies
- a number of other licensed entities under the FMC Act.

Financial Markets Authority

The FMA is the Crown entity responsible for enforcing securities, financial reporting and company laws as they apply to financial services and financial markets. This includes the regulation of auditors of FMC reporting entities, and the accreditation and monitoring[9] of professional bodies. We also license and register overseas auditors and audit firms.

External Reporting Board

The External Reporting Board (XRB) is an independent Crown entity responsible for standards related to auditing in New Zealand. In relation to FMC reporting entities, the XRB has issued the following standards:

- Accounting Standards, which each FMC reporting entity must comply with
- Auditing and Assurance Standards, which all auditors must comply with when auditing FMC audits.

9: CA ANZ: https://www.fma.govt.nz/news-and-resources/reports-and-papers/accredited-body-report-new-zealand-institute-of-chartered-accountants/

CPA Australia: https://www.fma.govt.nz/news-and-resources/reports-and-papers/accredited-body-report-cpa-australia/

The standards are based on international standards: the International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA) and the various standards issued by the International Ethics Standards Board for Accountants (IESBA).

Professional bodies

Two professional bodies in New Zealand are accredited by the FMA: Chartered Accountants Australia and New Zealand and CPA Australia. To be accredited, these bodies are required to have adequate and effective systems, policies and procedures in place to perform the following functions:

- licensing domestic auditors and registering domestic audit firms using the standards set by the FMA
- monitoring those auditors and registered audit firms
- promoting and monitoring the competence of these members
- taking action against misconduct.

All licensed auditors can be found on the Auditors Register.

Monitoring audit quality

We issue an annual Auditor and Regulation Oversight Plan. This plan helps licensed auditors, registered audit firms and accredited bodies to understand how we will approach auditor regulation and which areas we will focus on during our reviews.

We report annually on our findings by issuing the Audit Quality Monitoring Report (this report). The publication Audit Quality: A director's guide is also available to directors.

Quality review methodology

We assess an audit firm's compliance with the standards and the requirements of the Act by:

- looking at the audit firm's overall quality control systems for performing compliant FMC audits
- reviewing a selection of individual FMC audit engagement files to see if a file complies with the above systems and the Auditing and Assurance Standards issued by the XRB.

We review the 'Big Four'[10] firms every two years, and all other audit firms every three years. As a result of our Memorandum of Understanding (MOU) with the Auditor-General, we may review audits of FMC reporting entities carried out by private audit firms on behalf of the Auditor-General. The results of these reviews are included in this report and our findings are communicated directly to the Auditor-General.

10: Deloitte, EY, KPMG and PwC

All our reviews undergo a robust moderation process. Each audit quality review assessment report is peer-reviewed by a reviewer not involved in the initial review. Our final report goes to the Auditor Oversight Committee (AOC) for consideration. The AOC provides an independent forum to review the consistency and fairness of all quality review reports. The AOC comprises a diverse group of professionals including former auditors, company directors, and others with relevant experience who are independent of the audit profession.

Quality control framework

The requirements of a quality control system are set out in the Professional and Ethical Standards, and the Auditing Standards. Our assessment of an audit firm's quality control system focuses on whether:

- the system complies with the relevant standards
- the system's policies and procedures are followed
- the system contributes to high-quality FMC audits.

We also evaluate whether the audit firm's internal monitoring of its audit quality control system is effective. This internal monitoring includes the audit firm performing an engagement quality review (EQR) on each audit file. The EQR process is designed to provide an objective evaluation of the significant judgements the audit team has made, and the conclusions reached in the auditor's report.

We have prescribed additional requirements[11] for the EQR given its importance to the audit process. We expect the EQR partner to be suitably qualified and have relevant experience to enable them to give an objective evaluation. We therefore require the EQR to be licensed.

Individual file reviews

We carry out individual audit file reviews to check the auditor has complied with Auditing and Assurance Standards, and exercised reasonable care, diligence and skill in carrying out the audit.

Key attributes of audit quality are:

- an independent audit is carried out by a licensed auditor
- the auditor demonstrates appropriate levels of professional scepticism
- adequate and appropriate audit evidence is obtained
- the auditing and assurance standards are followed
- an appropriate audit opinion is issued.

11: Paragraph 8(1)(f) of the Auditor Regulation Act (Prescribed Minimum Standards and Conditions for Licensed Auditors and Registered Audit Firms) Notice 2012

Risk-based file selection

We choose audit files to review at random, as well as selecting audits from higher-risk sectors and industries.

- Risk-based selections include businesses that are more vulnerable to risks from existing and emerging market conditions, such as businesses that are newly listed or experiencing significant growth, or other higher-risk businesses that have compliance issues such as qualified audit reports.
- Non-risk-based selections include audit files selected to cover auditors previously not reviewed, or to provide sufficient coverage of the audit firm's work.

Our selection of audit files tends to be primarily focused on risk. The audit firms and audit files we review change each year, so it is difficult to compare year-on-year results. Trends in audit quality should be analysed over several years to better understand what progress has been made. Due to the small sample sizes and the selection approach, the result may not be indicative of the overall quality of audit firms reviewed.

Audit files selected on a risk basis are often more complex and therefore have a higher chance of being non-compliant than those selected at random. Historically, our risk-based selections have had a higher level of non-compliant files. The tables below show the split between risk-based and non-risk-based sampling, and the number of files we have rated non-compliant.

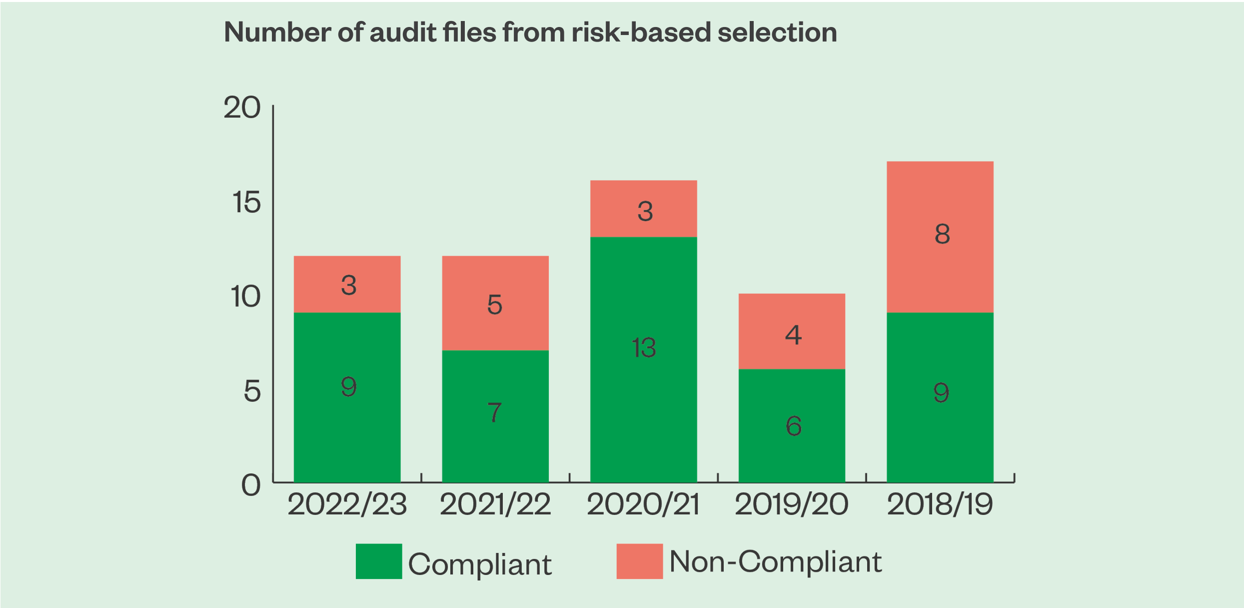
File selection and ratings for individual audit files

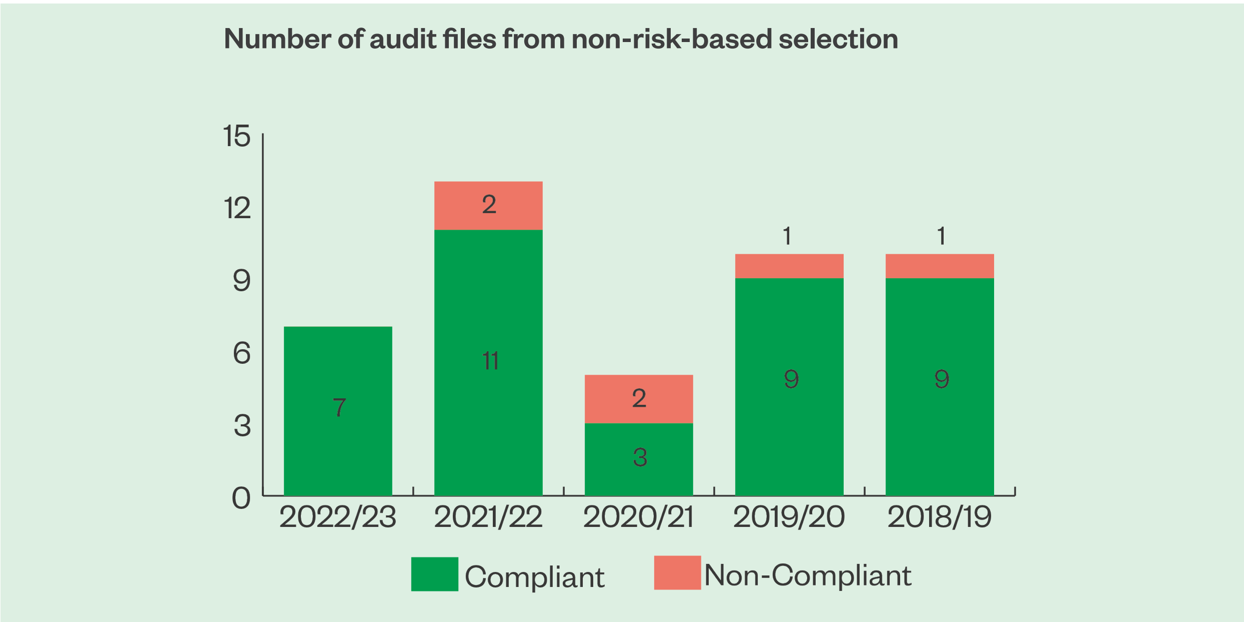
The number of audit files we select for each audit firm is determined by the number of licensed auditors at the audit firm, the number of FMC audits completed and the results of the audit firm's previous review.

In selecting specific files for review, we consider:

- Businesses of significant public interest, given the value of financial products issued to the public (such as KiwiSaver schemes, banks, insurance companies and businesses listed on the NZX).
- Businesses and industries that are more vulnerable to risks from existing and emerging market conditions, such as newly listed businesses, or businesses that experienced significant growth.
- Other businesses considered higher risk, such as finance companies, or businesses that have non-compliance issues such as qualified audit reports, or that have not complied with laws and regulations.
- A cross-section of different licensed auditors in each registered firm.

If a previous review found an audit file did not meet the required standards, it is likely we would review that auditor or audit file again.


Number of audit files from risk-based selection
20
15
10
5
0
3
9
5
7
3
13
4
6
8
9
2022/23
2021/22
2020/21
2019/20
2018/19
Compliant
Non-Compliant


Number of audit files from non-risk-based selection
15
12
9
6
3
0
7
2
11
2
3
1
9
1
9
2022/23
2021/22
2020/21
2019/20
2018/19
Compliant
Non-Compliant

File ratings

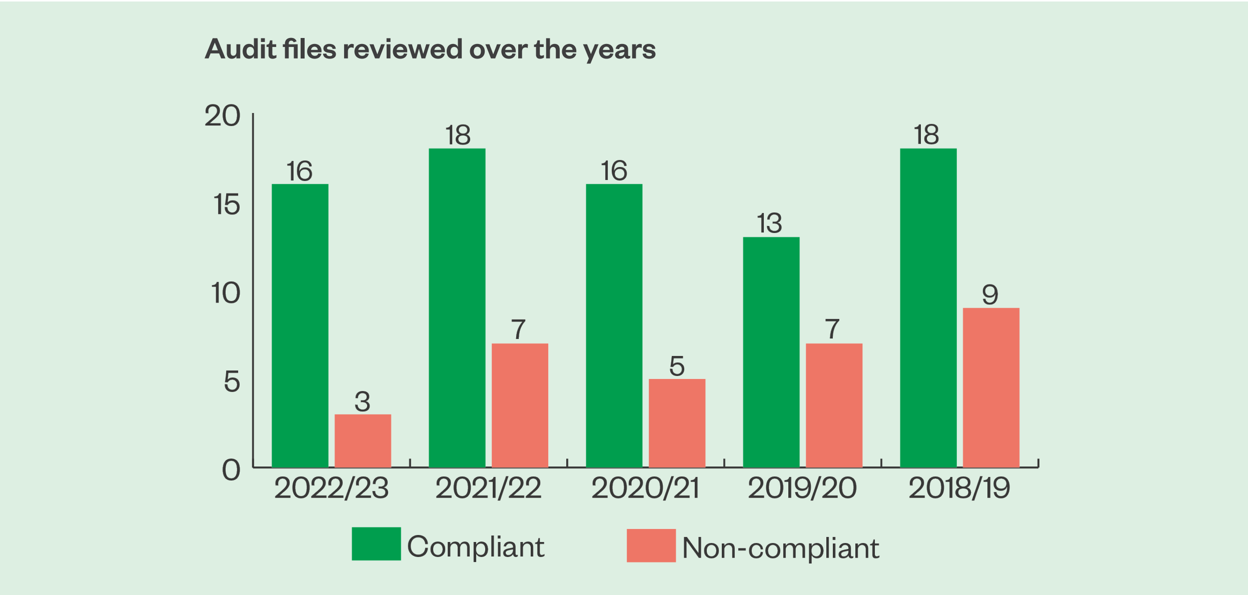
When we complete a file review, the reviewer gives each individual finding on that file a rating from low to high, and proposes a final overall file rating from the categories below:

- Good – we either had no findings or the findings relate to improving some documentation or minor non-compliance with the auditing standards. The reviewer is satisfied that all audit procedures have been performed around key risk areas and sufficient audit evidence was obtained.
- Compliant, but improvements needed – we identified several areas in the file where the audit wasn't performed in accordance with the audit standards. However, the reviewer found that overall, there was sufficient and appropriate audit evidence obtained in the key risk areas.
- Non-compliant – the file showed several areas where the audit wasn't performed in accordance with the standards. The reviewer found insufficient or inappropriate audit evidence obtained in at least one key risk area of the audit, or the review showed a material misstatement that required restatement of the financial statements and/or the audit opinion.

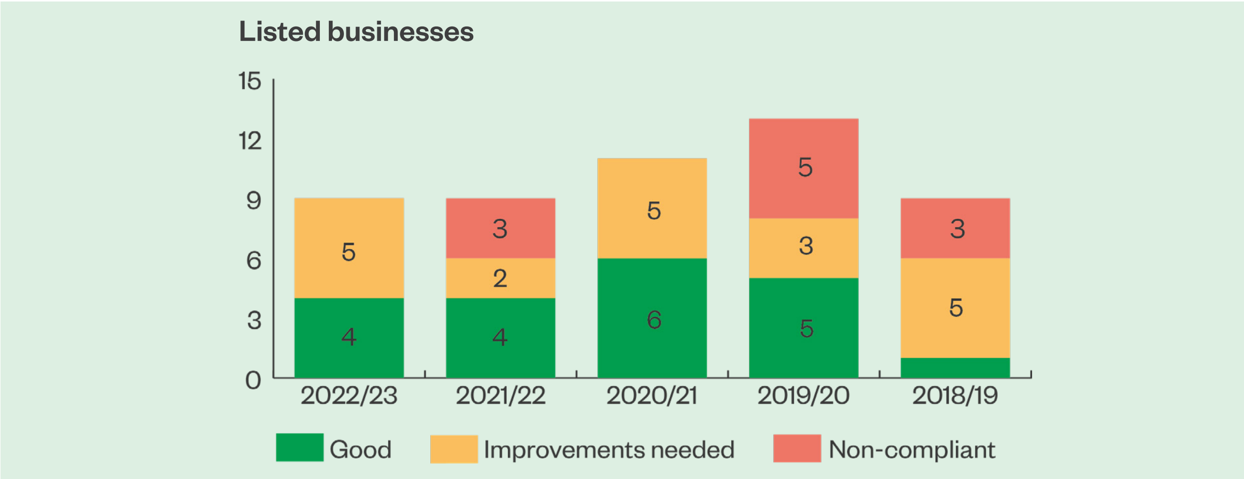
The ratings are moderated by the AOC.

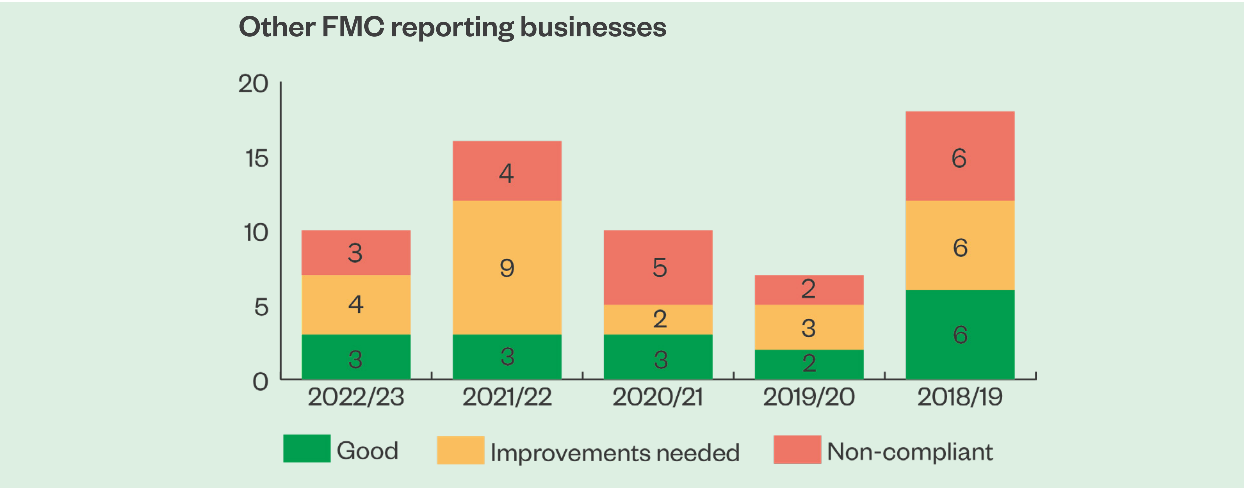
Summary of review ratings

The graph below provides an overview of how we rated the individual audit files reviewed over the last eight years.



This is broken down further between listed and other businesses as follows:





Background to our rating criteria

Our reviews focus on audit processes and procedures, and do not assess whether the underlying audited information is correct. Where we rate an audit as non-compliant, it does not necessarily mean the financial statements do not show a true and fair view or require restatement. Equally, where we rate an audit as good or compliant this is not an endorsement that the financial statements are free from misstatement.

Possible post-review actions

Following an audit quality review, we consider if further action is required. Actions we could take include:

- Requiring an audit firm to perform additional work to address our findings.
- Requiring an entity to restate the financial statements if we find material misstatements.
- Completing a follow-up review within 12 to 18 months of the previous review to ensure the audit firm has taken appropriate action to address our findings.
- Issuing directions to remediate any findings.
- Referring complaints to the professional body to be dealt with under its disciplinary procedures.

Appendix 2: Market data

	30 June 2023	30 June 2022	30 June 2021	30 June 2020	30 June 2019
Domestic licensed auditors	135	135	138	135	132
New licences issued to domestic auditors	7	4	9	10	11
Domestic auditor licences cancelled	7	7	6	7	8
Domestic registered audit firms[12]	13	13	14	14	14
Domestic audit firms licensed	0	0	0	1	0
Domestic audit firms' registrations cancelled or expired	1	0	0	1	1
NZX-listed companies	203	185	186	178	205
FMC audits	1,190	1,050	1,130	1,200	1,250
Firms reviewed	4	7	5	4	6
Audit files reviewed	19	25	21	20	27

12: This includes two brand names with five individual licences. We have included these as 2 registrations as we combine the reviews of this individual licences. This disclosure has changed from previous year where they were disclosed as separate firms.

Glossary

Accounting standards /NZ IFRS	The New Zealand equivalent to International Financial Reporting Standard issued by the External Reporting Board.
the Act or AR Act	Auditor Regulation Act 2011
AOC	Audit Oversight Committee established by the FMA to provide an independent forum to review the consistency and fairness of all quality review reports. The members of AOC are a diverse group of professionals including former audit partners, company directors, and others with relevant experience.
Audit firm	Registered audit firm as defined by the Act.
Auditing and Assurance Standards	The auditing and assurance standards issued by the External Reporting Board.
Auditing standards	International Standard on Auditing (New Zealand) to be applied in conducting audits of historical financial information as issued by the External Reporting Board.
Auditor	Licensed auditor as defined by the Act.
Culture	A reflection of shared beliefs and one of the most important factors in explaining motivation, commitment, and decision-making. It is an intangible factor that explains why larger groups of people do similar things, talk in similar ways and use similar tools to achieve an outcome.
EQR	Engagement Quality Review. This is a process designed to provide an objective evaluation, on or before the date of the auditor's report, of the significant judgements the engagement team has made and the conclusions it has reached in formulating the auditor's report.
EQR partner	Licensed auditor who performs the EQR. This may be a licensed auditor who is not a partner in the audit firm.
Going concern	Under the going concern assumption, a business is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless those charged with governance plan to liquidate their business, cease operations, or have no alternative than to stop doing business.
IFIAR	International Forum of Independent Audit Regulators
ISA (NZ)	International Standard on Auditing (New Zealand) issued by the External Reporting Board.
FMC reporting entity	Has the same meaning as in section 6 of the Act.
FMC audit	Has the same meaning as in section 6 of the Act.
Materiality	Information is material if its omission or misstatement could influence the economic decisions of users taken based on the financial statements.

Accounting standards /NZ IFRS	The New Zealand equivalent to International Financial Reporting Standard issued by the External Reporting Board.
NZICA	NZICA and the Institute of Chartered Accountants of Australia (ICAA) formally amalgamated on 1 January 2015 to form the Chartered Accountants Australia and New Zealand (CA ANZ). After the amalgamation, NZICA continues to regulate the accountancy profession for Chartered Accountants ANZ members who remain resident in New Zealand (and by virtue of their residence continue to be NZICA members) according to the NZICA Act 1996, and the terms of the amalgamation agreement. For the audit oversight regime, NZICA continues to be the accredited body.
PES	Professional and Ethical Standards issued by the External Reporting Board.
Quality review	A review of an audit firm as defined by the Act.

AUCKLAND – Level 5, Ernst & Young Building | 2 Takutai Square, Britomart | PO Box 106 672 | Auckland 1143

WELLINGTON – Level 2 | 1 Grey Street | PO Box 1179 | Wellington 6140