XRB & FMA, 2017

Key audit matters
A stock take of the first year in New Zealand

November 2017

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

FMA
FINANCIAL MARKETS AUTHORITY

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Introduction to XRB

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Te Kāwai Ārahi Pūrongo Mōwaho

The External Reporting Board (XRB) is the independent Crown Entity responsible for accounting and assurance standards in New Zealand. The New Zealand Auditing and Assurance Standards Board (NZAuASB) has delegated authority from the XRB Board to develop or adopt, and issue auditing and assurance standards. All XRB standards are designed to give New Zealanders trust and confidence in the financial reporting of our organisations, across the for profit, not-for profit and public sectors.

Introduction to FMA

FMA
FINANCIAL MARKETS AUTHORITY

The Financial Markets Authority (FMA) plays a critical role in regulating capital markets and financial services in New Zealand. They are the New Zealand government agency responsible for enforcing securities, financial reporting and company law as they apply to financial services and securities markets. FMA also regulate securities exchanges, financial advisers and brokers, auditors, trustees and issuers – including issuers of KiwiSaver and superannuation schemes. Jointly, they oversee designated settlement systems in New Zealand, with the Reserve Bank of New Zealand (RBNZ). The FMA's vision is to promote and facilitate the development of fair, efficient and transparent financial markets.

About this publication

Auditors in New Zealand and around the world have been required to amend their auditor's reports effective for audits of financial statements for periods ending on or after 15 December 2016. These represent the most visible change to the auditor's report in more than 50 years. As the principal communication between the auditor and users of audited financial statements, the new auditor's report is intended to be more informative and more transparent.

The purpose of this publication is to provide a stock take of the New Zealand experience in the first year of adopting the revised auditor's report, specifically focussing on the reporting of key audit matters (KAMs). We briefly consider the impact of the other amendments on page 24-25. To prepare this publication we analysed the new style auditors' reports issued in New Zealand. We also conducted interviews and online surveys with investors, analysts, auditors, directors and management. We thank those who have generously shared their views and experiences with us.

We hope this publication provides further insights and learnings to help improve New Zealand auditor reporting.

A focus on key audit matters (KAMs)

The biggest change to the auditor's report is the communication of KAMs. The requirement to report KAMs, at this stage, is for a subset of audits only. It is mandatory for all auditors of listed issuers from December 2016 and for all FMC reporting entities considered to have a higher level of public accountability[1] from December 2018.

The auditor's report is no longer limited to a binary "pass/fail" opinion. The driver for these changes was a demand from users for the auditor to provide more insights about the audit process.

KAMs provide an opportunity to share the matters that, in the auditor's judgement, were of most significance in the audit of the current period financial statements. KAMs are selected from matters communicated with those charged with governance.

The auditor is required to identify the KAMs, explain why they are a KAM and to say something about how the KAM was addressed. The specifics of the description are left to the judgement of the auditor. The auditing standards do not require a lengthy description of the auditor's procedures, nor do they require an indication of the outcome of the procedures. The new report is intended to be less boilerplate and provide more specific, useful and relevant information about the audit of an entity.

Understanding key audit matters

What KAMs do:

- ✔ Provide greater transparency about the audit that was performed.
- ✔ Highlight the matters that required the most audit attention.
- ✔ May provide users with a basis to further engage with management and those charged with governance.

KAMs are NOT:

- ✖ A replacement of, or supplement to, the preparer's perspective reported in the financial statements.
- ✖ Intended to "fill the gaps" for disclosures viewed as incomplete.
- ✖ Necessarily a business risk nor an "issue" that the entity needs to resolve.
- ✖ A substitute for the auditor to express a modified opinion.
- ✖ A separate opinion on an individual KAM.

[1] A FMC reporting entity or a class of FMC reporting entity that is considered to have a higher level of public accountability than other FMC reporting entities:
- Under section 461K of the Financial Markets Conduct Act 2013; or
- By notice issued by the FMA under section 461L(1)(l) of the Financial Markets Conduct Act 2013.

Appendix 2: Other changes

In addition to the inclusion of KAMs, the new auditor's report includes further additional changes:

Key change	Reason for the change
Going concern	
• Descriptions of the respective responsibilities of management and the auditor for going concern are included in the auditor's report. • A separate section under the heading "Material Uncertainty Related to Going Concern" must be included when a material uncertainty exists and is adequately disclosed. • New requirement for the auditor to evaluate the adequacy of disclosures in "close call" situations, when events or conditions are identified that may cast significant doubt on an entity's ability to continue as a going concern but no material uncertainty is concluded.	Going concern is of significant interest, particularly following the global financial crisis. It is in the public interest for there to be increased focus on going concern matters by management and auditors.
Auditor's Independence and Ethical Responsibilities	
Affirmative statement about the auditor's independence and fulfilment of relevant ethical responsibilities.	Emphasizes the importance of complying with ethical requirements as a basis for the audit and increases the focus on auditor independence.
Disclosure of Name of Engagement Partner	
Disclosure of the name of the engagement partner for audits of financial statements of FMC reporting entities considered to have a higher level of public accountability.	Increases transparency and provides the engagement partner with a greater sense of personal responsibility and accountability. The objective of the change is to improve audit quality.
Another aspect that users responded to positively was the requirement to identify the engagement partner's name. Some users commented that this enhanced their comfort and added to the credibility of the audit opinion.	
Ordering of Sections	
The "Opinion" section is required to be presented first, followed by the "Basis for Opinion", unless law or regulation prescribe otherwise.	Recognises the importance of the auditor's opinion on the financial statements to users.

"Good to have the opinion upfront". A key point noted from users is that they value the audit opinion, this is of most importance. In fact, this is what they really look for from the auditor – a tick or the cross – i.e., is the opinion modified or not. Having this opinion stated upfront in the auditor's report is therefore a good move in meeting user's needs.

Key change	Reason for the change
Other information in documents containing financial statements	
A new and separate "Other Information" section clarifies that the auditor's opinion does not cover the other information, but describes the auditor's responsibilities related to the other information, identifies what information was obtained at the date of the auditor's report and what information is expected to be obtained at a later date.	Provides transparency about the auditor's work relating to other information.
Enhanced Description of the Responsibilities of the Auditor	
Description of auditor's responsibilities for the audit and key features of the audit have been enhanced and expanded.	Provides greater transparency of the audit process and provides enhanced understanding of the role of the auditor and the nature of audit work. The revised standard is more flexible as to where this information is located, and now permits this information to be located in an appendix or included by reference to a website that is maintained by the XRB.

Reference to auditor's responsibilities

Our analysis found that in most cases the auditor's preference was to reference those responsibilities to the XRB website (78% of the reports).

Other information

The new "other information" section is now included to clarify what part of the annual report has been audited. The new section outlines the auditor's responsibility for other information in the annual report (i.e., other than the financial statements and the auditor's report).

These changes are proving to be challenging in practice. Auditors we interviewed told us that they are grappling with how to describe what information has or has not been read for consistency at the date of the auditor's report. This has raised queries about what the auditor's responsibilities are in relation to the other information – "what does read for consistency mean".

Directors we interviewed noted that a positive impact of this change has been that the annual reporting timetable has been brought forward in some instances. This has resulted in the annual report being published at the same time as the financial statements reporting deadline.

Placement of the auditor's report

The auditing standards do not stipulate where the auditor's report is to be included relative to the financial statements. With the enhanced focus on improving the value of the auditor's report to the user, we hope the positioning of the auditor's report is given greater consideration. Our analysis found that there is currently variation in practice, with most annual reports including the auditor's report after the financial statements.

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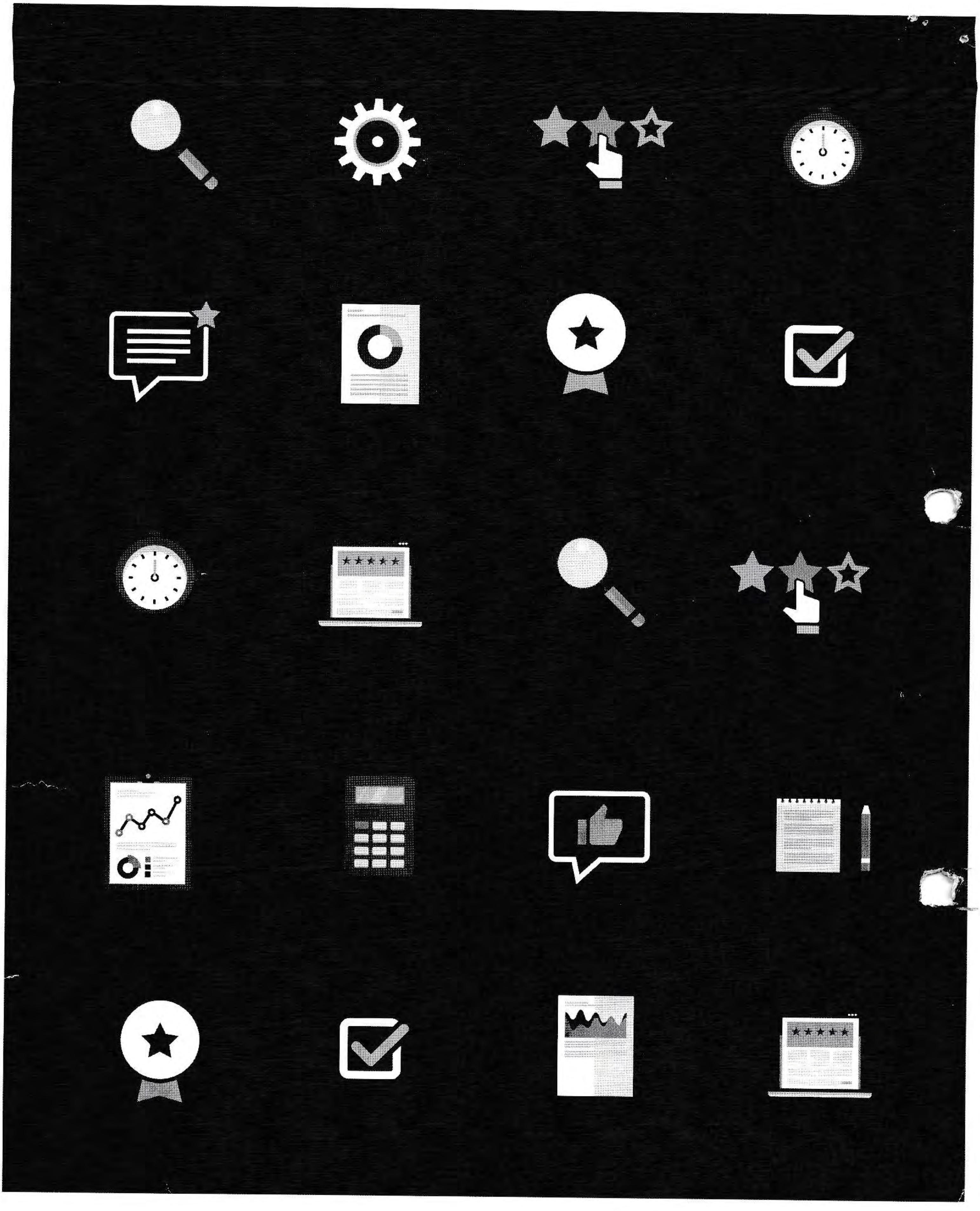

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