What we heard

A New Zealand conversation about securing trust in audit

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About us

Chartered Accountants Australia and New Zealand (CA ANZ) represents more than 131,000 financial professionals, supporting them to make a difference to the businesses, organisations and communities in which they work and live. Chartered Accountants are known as Difference Makers. The depth and breadth of their expertise helps them to see the big picture and chart the best course of action.

CA ANZ promotes the Chartered Accountant (CA) designation and high ethical standards, delivers world-class services and life-long education to members and advocates for the public good. We protect the reputation of the designation by ensuring members continue to comply with a code of ethics, backed by a robust discipline process. We also monitor Chartered Accountants who offer services directly to the public.

Our flagship CA Program, the pathway to becoming a Chartered Accountant, combines rigorous education with practical experience. Ongoing professional development helps members shape business decisions and remain relevant in a changing world.

We actively engage with governments, regulators and standard-setters on behalf of members and the profession to advocate in the public interest. Our thought leadership promotes prosperity in Australia and New Zealand.

Our support of the profession extends to affiliations with international accounting organisations.

We are a member of the International Federation of Accountants and are connected globally through Chartered Accountants Worldwide and the Global Accounting Alliance. Chartered Accountants Worldwide brings together members of 13 chartered accounting institutes to create a community of more than 1.8 million Chartered Accountants and students in more than 190 countries. CA ANZ is a founding member of the Global Accounting Alliance which is made up of 10 leading accounting bodies that together promote quality services, share information and collaborate on important international issues.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents more than 870,000 current and next generation accounting professionals across 179 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications.

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A New Zealand conversation about securing trust in audit.

Ehara taku toa i te toa takitahi, engari he toa takitini;
Success is not the work of an individual, but the work of many.

Trust in business, government and institutions across the global economy has come under increased scrutiny in recent years. Governance and auditing are no exception: following corporate collapses, the UK and other jurisdictions have held extensive inquiries into the quality and effectiveness of these roles and how they are serving citizens.

The financial statement auditing framework in New Zealand is effective, compares well internationally and bears comparably strong confidence from stakeholders, but this is no cause to rest on our laurels. Trust and confidence in audit needs to remain strong amid ongoing challenges for the quality of audit work and an evolving range of business risks for auditors, as well as management and directors.

Over the past two years, Chartered Accountants Australia and New Zealand has facilitated focused and constructive discussions with a wide group of stakeholders and members about the future of audit and its surrounding governance ecosystem in New Zealand. Representatives from audit firms, shareholders, company directors, management, internal auditors, regulators, standard setters and policy makers have shared their collective understanding.

What we heard is that audit is vital to delivering investor confidence in our business and capital markets. However, there are a range of challenges for the profession. Among these are promoting the value of audit, liability settings, increasing complexity, attracting and retaining auditors, and a perception that audit, rather than internal business controls, should be the primary defence against fraud and misconduct.

On the other hand, the growth of environmental, social and governance reporting and the adoption of new technologies including digital reporting and beyond are exciting opportunities for the profession to enhance its contribution to society.

Auditing and governance in New Zealand are built on a rich foundation of integrity and transparency that has been influential on the global stage and should be safeguarded. However, as our stakeholders clearly articulate, we need step change in several areas for sustainable audit and risk governance to serve New Zealanders into the future. 'What we heard,' aims to further this conversation.

Ainslie van Onselen
Chief Executive
Chartered Accountants Australia and New Zealand

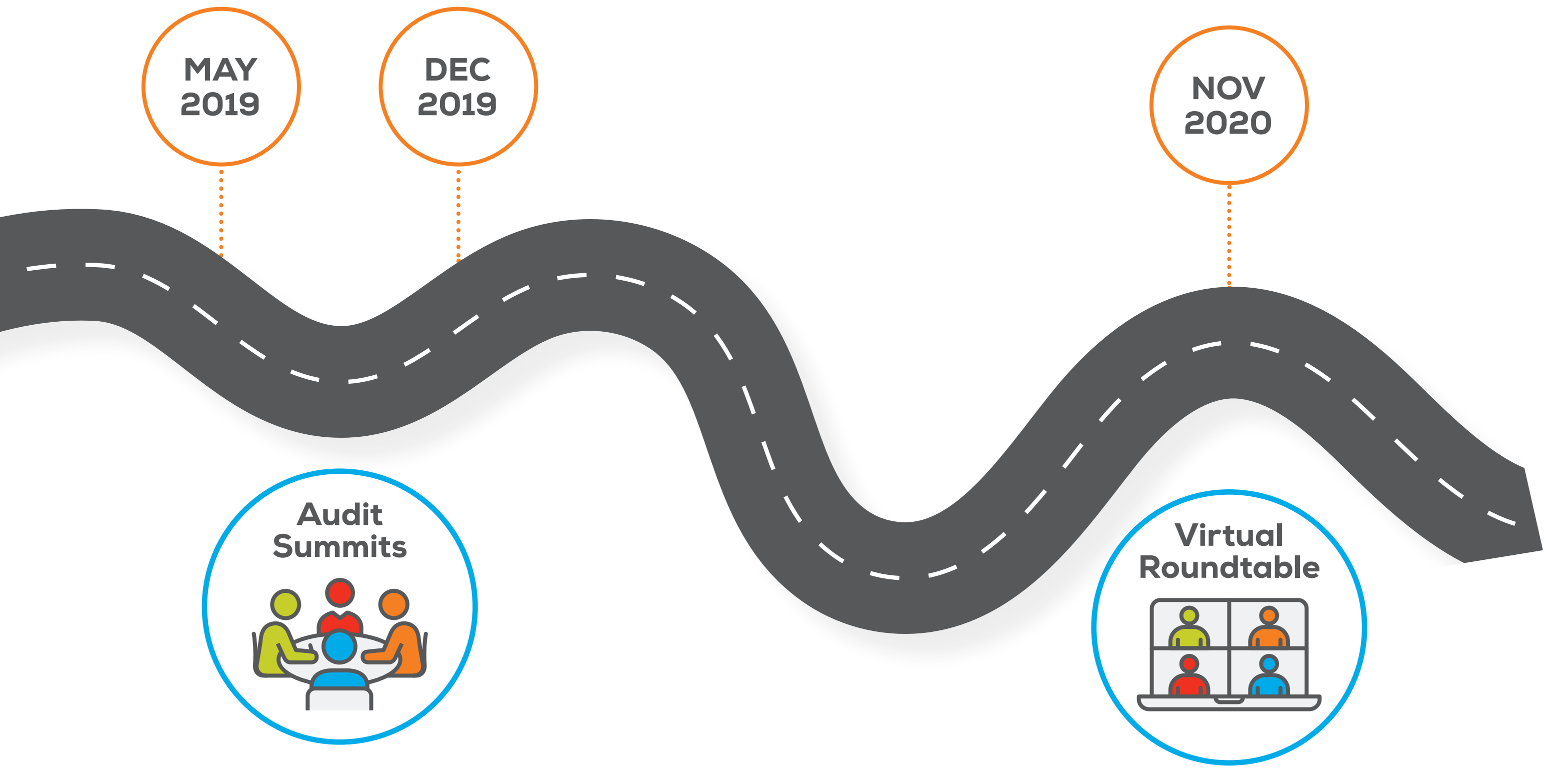
Introduction

Embracing change and building trust are key challenges for the audit profession. In response, Chartered Accountants Australia and New Zealand (CA ANZ) has facilitated broad and robust discussion on the future of audit and its interplay with the governance ecosystem, to identify opportunities and strengthen the profession's ability to adapt and build trust.

While this is a conversation cognisant of the current global state of affairs, it remains firmly grounded within the unique New Zealand context. The New Zealand audit market is small and has a relatively small licensed auditor population. Both of these factors create specific challenges for New Zealand.

Over the past two years, Chartered Accountants Australia and New Zealand has held two audit summits and a virtual roundtable alongside extensive direct outreach with key stakeholders. CA ANZ has brought together and engaged with senior representatives from across the New Zealand investment and business community and the aim of this paper is to synthesise these discussions for the conversation to continue.

Those at the events were keen for the audit profession to play a proactive role and for New Zealand to get ahead of the external issues confronting the profession in other countries. It is clear that there is work to do in both boosting the understanding of audit, and firmly grasping the opportunities for it to evolve as the risks and expectations of business and capital markets develop.



What we heard

Participants at the events discussed the importance of working collaboratively toward fostering a constructive conversation for the audit profession to continue delivering on stakeholder trust in the face of evolving audit roles and regulation, and to ensure the profession remains sustainable.

It was acknowledged the audit profession needs to be active in promoting the value of the service it provides, building trust and confidence in the profession, and ensuring that the profession is an attractive long-term career prospect. The need to safeguard and bolster audit as an attractive profession, one that draws upon and retains the best and brightest talent, was a constant throughout many the discussions.

However, you cannot have a conversation about the future of audit without also looking at the wider ecosystem. There was a strong feeling that for audit to move forward, the entire corporate reporting and risk management system needed to evolve. These discussions emphasised the need for accountability in high-quality corporate reporting and integrity across the whole corporate reporting and risk management chain.

The main ideas stakeholders gravitated towards included approaches to address public confidence and trust in audit. Included in this was ensuring audit and the surrounding governance ecosystem feasibly cover all expected key risks, and sharpen oversight of audit quality.

From our engagement, three key themes emerged. The following pages share these in more detail.

1 Confidence

Preserving confidence in the audit and auditor independence – ensuring public expectations in audited financial statements and capital markets are clearly understood and applied by regulators and standard setters in setting rules for auditor independence, mitigating conflicts of interest and applying appropriate safeguards.

2 Risk

The relevance of external audits within the lines of defence against risk – bringing in the roles of management, directors, and audit and risk committees in the ecosystem to address significant risks (such as corporate frauds and misconduct) in an increasingly complex business environment.

3 Quality

A continuous focus on audit quality – investing in sharpening the skillset of auditors by attracting talented individuals and providing innovative training on fraud detection and the exercise of professional judgement and scepticism, along with the importance of regulation and oversight toward high quality audits.

Confidence

To maintain confidence, public expectations must be clearly understood and applied to setting rules for both auditor independence and mitigating conflicts of interest.

Non-audit services

As it relates to non-audit services, auditor independence has been raised by stakeholders as a key consideration when it comes to securing trust and confidence in audit. Participants discussed the already comprehensive provisions in the ethical code that have been established, but also the need for these to be revisited to make sure they are consistent with evolving expectations and that both the profession and its stakeholders, including investors, understand what they mean.

Some participants pointed to the pros and cons of a ban on non-audit/assurance related services, while others recognised the importance of the current principles-based approach – albeit with room for considering where these standards might be strengthened and clarified. There is a risk in the blacklist or ban approach of oversimplifying what is a nuanced and complex challenge for the profession and its stakeholders, and of diminishing emphasis on the higher values and ethics underpinning audit by seeking to replace these with prescriptive rules.

Some of the possible solutions raised in the discussions included audit and risk committees strengthening their oversight of non-audit services and New Zealand participating in the international moves toward strengthened audit independence standards within the auspices of the International Ethics Standards Board for Accountants (IESBA).

Audit fee disclosures

Entities that prepare financial reports under the Tier 1 accounting requirements must disclose fees paid to their external audit firm (including any network firm) separately for 'audit' and 'non-audit' services.

Participants raised that stakeholders are sometimes confused by the disclosures and this can lead to the assumption that all the 'non-audit' services are consulting, advisory or other types of services that could compromise independence.

Auditor independence could also be perceived to be threatened when the non-audit services fees are a significant portion of the total fees charged by the audit firm without clarity on what those fees relate to.

Participants suggested that greater disaggregation of the fees paid to the external auditor for 'non-audit' services (e.g. into 'assurance', 'audit/assurance related', and 'non-audit/assurance related' services) could provide greater clarity.

Auditor tenure

Participants raised that there is a threat to independence in appearance where audit firm tenures are perceived by stakeholders as being too long.

Research on auditor independence suggests the audit partner rotation regime already in place addresses the actual threats to auditors' objectivity effectively, however perceptions of independence are equally important alongside actual independence of mind. Participants pointed to the balance needed between firms gaining experience over their tenure and delivering more effective and efficient audits against the need to maintain public confidence.

One of the solutions discussed was a periodic, comprehensive governance-led review of auditor tenure, with an audit quality and independence lens. This was generally seen as preferable to suggestions around mandatory firm rotation or tendering which weaken the decision making and oversight functions of audit and risk committees.

Audit firm governance and transparency

The importance of and challenges associated with maintaining and growing trust in auditing was discussed at length. It was highlighted that when it comes to the work of auditors, full transparency is not possible as their role involves providing assurance on information based on access to extensive confidential data. This means demonstrating transparency and governance is especially important when it comes to organisations providing audit services.

Representatives from audit firms shared several current initiatives being taken to invest heavily in establishing a culture committed to delivering consistent, high-quality audits, including the oversight of compliance, quality and independence.

Participants also suggested that greater transparency in relation to audit firms and their governance arrangements could promote confidence in audit firms and quality. In this area, participants drew on comparisons to Australia that requires transparency reporting by audit firms that audit 10 or more significant entities, although some were sceptical as to how well-used they are by investors.

Auditor liability

Investors are increasingly calling for wider assurance, particularly around non-financial and future-orientated information. There is generally greater uncertainty over these matters and therefore more professional judgement is required. The key challenge for auditors is how to address the inherent subjectivity and increased risk of management bias, and to manage potentially unrealistic expectations about the extent to which auditors can reduce the inherent subjectivity. The absence of a safe harbour for auditors means that, for some, the risk may be too great.

New Zealand is increasingly out-of-step with international jurisdictions in this regard. Australia has liability capping across the entire accounting profession, as well as proportionate liability. Other countries, particularly those within the EU, have also introduced mechanisms or schemes to allow auditor liability capping. In the United Kingdom, audit firms are able to limit their liability in contract which is not currently possible in New Zealand because of the uncertainty regarding section 529 of the Financial Market Conduct Act 2014.

With the rise of class actions and litigation funding, auditors explained how they are constrained by the prospect and scale of potential litigation which is creating a barrier in responding to stakeholder demands. Participants recalled that auditor liability capping was intended to form part of the auditor regulation regime that commenced in 2011 and also noted a lack of progress on the 2014 Law Commission Review's recommendation that a capped liability scheme for auditors conducting FMC audits should be introduced.[1]

The current joint and several liability regime means auditors are often deep-pocket defendants. Auditors tend to settle claims rather than face protracted legal battles that may damage their reputation. This means they may pay more than their fair share of responsibility and subsequently incur higher insurance premiums. Auditor liability capping would provide certainty and clarity to both auditors and investors; investors could have confidence over the amount of insurance cover available in the event of a claim. Addressing legal liability concerns is critical to ensuring that the audit profession remains attractive and competitive, resulting in a well-functioning sustainable audit market.

1 Recommendation 13, https://www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20R132.pdf

Risk

Addressing risks such as fraud and misconduct in an increasingly complex business environment must involve all lines of defence, including management and CFOs, boards, audit and risk committees, auditors, and regulators.

Internal controls

When it comes to fraud, participants agreed that prevention is better than cure and that a strong internal control environment and risk management framework is the best chance an entity has to tackle fraud risk. Internal controls over financial reporting and other risk areas are the most important tools directors and management have to manage risks, prevent fraud, and ensure they have operational oversight. There was a feeling amongst participants that greater emphasis could be placed on internal controls as a primary line of defence.

The discussion centred on how directors might report more meaningfully on their internal controls and the potential role of the external auditor in relation to that reporting. A framework for internal controls, reporting, and assurance (similar to the Sarbanes Oxley regime in the United States) was canvassed by participants. The US experience has been that many companies were able to leverage benefits from their improved controls that far outweighed the compliance cost. This included increased investor confidence, reduced financial reporting misstatements, and other such desirable outcomes.

There was little support among participants for adopting as detailed and prescriptive an approach as the US due to anxieties expressed regarding cost and management time burdens. However, there was general support for a proportionate regime that selects from the most useful parts of the US approach.

Corporate reporting

There was an overwhelming agreement that corporate reports are increasing in length and complexity. In particular, financial statements are becoming too technical for a lay person, even for technical experts – that is, they can be difficult to use.

Participants discussed the development of non-financial reporting in response to the growing demand from investors for information on environmental, social and governance (ESG) matters, and the potential role of the auditor in relation to that reporting. It was noted that integrated reporting, which attempts to bring together financial and non-financial reporting in a coherent framework, is also gaining momentum. This was considered a positive step.

The importance of continued engagement with international standard setters to inform best practice in financial and non-financial reporting standards was emphasised, as was the need to support ongoing efforts to enhance extended external reporting (EER) and assurance thereof in New Zealand.

Digital reporting

Following the conversation wherein participants expressed concerns about the relevance, understandability and volume of reporting, the focus switched from *what* is reported to *how* it is reported.

It was noted by participants that stakeholders are seeking much more accessible real-time information. Participants suggested that digital reporting could be part of the solution as it provides the opportunity to reshape the way financial information is used, and reports can be tailored to the needs of users.

We know that many major economies around the world are increasingly adopting digital financial reporting, particularly eXtensible Business Reporting Language (XBRL). However, in countries where digital reporting is still just voluntary, like Canada and Australia, there has been no uptake to date.[2]

Some participants felt it was time to make digital reporting mandatory, while others questioned whether New Zealand had sufficient economies of scale to make digital reporting feasible and raised concerns over the cost for preparers.

Business failure risks

Participants raised that there is still some misunderstanding in the market around directors' and auditors' respective responsibilities for going concern despite the expansion of this in the enhanced auditor's report. Investors shared that they want more detail on uncertain events that could cast doubt on the going concern assessment.

There is a growing acceptance that even non-financial risks can have financial consequences, and investors expect these to be covered by the audit. Investors are looking for reassurance about the resilience and future prospects of a business to help their decision-making and are calling for evolution in auditing and assurance towards a more risk focused and forward-looking approach. CA ANZ research also shows that there is public demand for a greater scope for auditors to help prevent corporate collapses.[3]

One of the solutions discussed was requiring board or audit and risk committee reporting on key risks to business continuity and how these are mitigated, with appropriate safe harbours/caveats subject to independent external assurance.

2 https://www.charteredaccountantsanz.com/news-and-analysis/insights/research-and-insights/the-future-of-financial-reporting
3 https://www.charteredaccountantsanz.com/news-and-analysis/media-centre/press-releases/research-reveals-public-want-more-from-audit

Proportionality

The increasingly disproportionate impact on SMEs and SMPs as requirements are added to address listed entity matters was raised as a key concern by participants.

It came to be understood that the global response is not fit-for-purpose in New Zealand given the size of entities and the market. When it comes to any potential policy responses in New Zealand, they would need to be scoped carefully to ensure they do not overburden small businesses.

Quality

Constantly improving audit quality is essential – demanding robust, transparent oversight, well-resourced independent audit and risk committees, while continuously sharpening auditors' skillset and use of professional judgement and scepticism.

Audit oversight

CA ANZ research shows that investors have a high level of confidence in audited financial statements released by listed entities, underpinned by the belief that auditing is well regulated, and investors trust auditors the most to protect their interests.[4]

It was acknowledged that high-quality auditing is driving trust and confidence in the audit profession in New Zealand. However, it was noted that the further parties are removed from the audit process, the harder it is for them to judge multi-faceted audit quality. Auditors were of the view that the bar against which audit quality is measured keeps rising, therefore work on continuous improvement is always necessary.

Participants discussed the need for ongoing review and benchmarking of regulatory oversight of audit quality to international regulatory best practice to consistently enhance New Zealand audit regulatory inspections and enforcement. One useful reference point noted in this regard was the *OECD Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections* that provides an overarching framework to support initiatives on improving regulatory enforcement and inspections.[5]

Investor engagement

Many participants shared their experiences which indicated a widespread lack of investor engagement or interest in the audit. Reasons suggested for this included there currently being no formal mechanism for investors to engage with the auditor or the audit committee. In turn, there is little room for investors to meaningfully engage with the audit process.

There was a general feeling that AGMs are the right place for investors to engage with the auditor and audit process and that these could be better utilised. However, other participants commented that there is a need to find new and innovative ways to engage investors with the audit across the board from large institutions to retail investors.

4 https://www.charteredaccountantsanz.com/news-and-analysis/news/2021-investor-confidence-survey
5 https://www.oecd.org/gov/regulatory-enforcement-and-inspections-9789264208117-en.htm

Auditor attraction and retention

There was a strong message that there is a shortage of suitably qualified and experienced auditors, especially in rural, regional and remote areas. Audit acts as a rich training ground and auditors are very desirable to other sectors of the economy due to their vast transferable skillset. Audit firms shared that whilst they have traditionally relied on this natural attrition for a pyramid structure, increasing regulatory and other demands are requiring more experienced auditors, forcing firms to revisit their model.

Participants emphasised how audits are becoming increasingly complex, and the importance of firms having access to people with appropriate experience and expertise to provide the public goods of assurance and integrity. The multidisciplinary firm model was generally seen as preferable to suggestions such as audit-only firms or operational splits because providing wider services beyond audit is a valuable attraction for specialist talent and enables firms to develop teams with the skills and expertise needed for high-quality audits.[6]

There are tremendous threats to the attractiveness of the profession that need to be mitigated, but also there are opportunities – these are covered comprehensively in CA ANZ's publication; *Talking Talent – Attracting and retaining the most important ingredient for audit quality: People.*[7]

Audit and risk committees

The director community shared their concerns about the rapidly expanding remit of audit and risk committees in response to a piecemeal approach by policymakers to encapsulate all the different sorts of risks that are materialising. This is putting pressure on resourcing and 'over-boarding' is coming under increased scrutiny.

Several 'new' risks are emerging, ranging from cyber security to climate change and even organisational culture. This led into a discussion as to whether directors serve not only the company's shareholders but all its stakeholders – including wider society – and how regulator expectations of boards have shifted and increased significantly in recent years.

There is a risk that increased responsibilities (and personal liability) will be a significant deterrent to directors, and potential directors, seeking board roles. This could reduce the supply of suitably qualified professionals going forward in what is already a small market.

Possible solutions canvassed were a formal remit for audit and risk committees, and there were calls to review the framework for directors' duties to provide clarity in relation to which stakeholders they serve, and certainty around their core duties.

6 https://www.charteredaccountantsanz.com/news-and-analysis/insights/research-and-insights/are-multidisciplinary-firms-good-for-audit-quality
7 https://www.charteredaccountantsanz.com/news-and-analysis/insights/research-and-insights/attracting-and-retaining-talent-in-the-audit-profession

Fraud detection

CA ANZ research shows that the auditor's role in relation to fraud is misunderstood – the public have high expectations of auditors when it comes to detecting fraud.[8] Most participants agreed it is critical for auditors to respond to these increasing expectations to remain relevant, while recognising there are always going to be inherent limitations. For example, where there is collusion and a balance needs to be struck.

Comparisons were drawn to other countries such as the UK which has moved in advance of international standards and revised its auditing standard on the responsibilities of auditors relating to fraud. It makes auditors' obligations clearer, enhances the risk assessment they carry out, and sets clearer requirements for the auditor.

Participants suggested that a similar approach to the US could also work well whereby focused, case-study based fraud detection training has been implemented widely by the Center for Audit Quality (CAQ).

8 https://www.charteredaccountantsanz.com/news-and-analysis/media-centre/press-releases/research-reveals-public-want-more-from-audit

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