

**NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS
NOTICE OF DECISION AND ORDER OF THE PROFESSIONAL CONDUCT COMMITTEE**

At a meeting of the Professional Conduct Committee (“the Committee”) of the New Zealand Institute of Chartered Accountants (“NZICA”) held in private on 4 February 2019 in respect of **MICHAEL DEREK WOOD**, a Chartered Accountant and licensed auditor of Auckland (“the Member”), the Committee considered the following matters:

That as a Chartered Accountant in public practice and in relation to a complaint from Jacco Moison on behalf of the Financial Markets Authority (“the Complainant”), the Member:

- (1) In his role as Engagement Quality Control Reviewer (“EQCR”) of four FMC reporting entities¹ failed to adequately identify and/or evaluate and/or document his consideration of significant judgements made by the engagement team in relation to:
 - a. compliance with key audit partner rotation requirements under paragraph 290.149 of PES 1 (Revised); and/or
 - b. in respect of the audit of Entity D for the year ending 31 December 2016, compliance with the four step model when performing substantive analytical procedures for revenue and expenses as required by ISA (NZ) 520,

in breach of paragraphs 20 and/or 21 of ISA (NZ) 220 and/or the Fundamental Principle of Professional Competence and Due Care and/or paragraphs 100.5(c) and/or 130.1 and/or 130.4 of the Code of Ethics (2014)².

The Committee was troubled by the matters raised in the complaint. In particular, that the Member in his role as EQCR in respect of the audits of Entity A, Entity B, and Entity C for the year ending 31 March 2016, and Entity D for the year ending 31 December 2016, failed to identify or adequately evaluate and document his consideration of key judgments made by the audit engagement team regarding independence rotation requirements of the key audit engagement partner.

Particular 1(a)

In finding particular 1(a) to be established, the Committee observed that EQCRs undertake an important role in quality control in audits of FMC entities. Since the Auditor Regulation Act 2011 had come into effect, through the Prescribed Minimum Standards, it had placed a greater emphasis on the accountability of the role.

The Committee considered that while the ultimate accountability still rests with the audit engagement partner, the EQCR has an important responsibility under ISA (NZ) 220 to provide an objective evaluation of significant judgments made, and conclusions reached, in regards to the audit.

One of the key objectives of their role is to provide the audit engagement partner with reasonable assurance that the audit adheres to legal and regulatory requirements. The

¹ Entity A, Entity B, and Entity C in respect of the year ending 31 March 2016; and Entity D in respect of the year ending 31 December 2016.

² And, as applicable, the equivalent provisions of PES 1 (Revised).



underlying reason for effective quality control is to promote public confidence in the industry. This is particularly relevant to independence, as it is in the public interest that independence is not only observed, but is also seen to be observed.

The Committee noted that in his response to the complaint the Member appeared to accept that in relation to the audits of Entity A, Entity B, and Entity C for the year ending 31 March 2016, he had not detected a rotation independence issue arising from the key audit partner's performance of the audits for an eighth consecutive year. The Committee also noted his comments that even if he had identified this, he did not document it on the audit files.

Regarding the audit of Entity D for the year ending 31 December 2016 the Committee considered the Member to have erred in his judgment regarding the applicability of the exception as contained in paragraph 290.150 of PES 1 (Revised).

In the Committee's view the words "rare" and "unforeseen" as contained within the paragraph required a high threshold to be met in order for the exception to be available. It noted that the paragraph provided an example of a key audit partner falling ill, suggesting it was not designed to be applied in circumstances involving commercial transactions the subject of negotiation. Though some merger completion scenarios could be described as outside a member's control, commercial demands could make the deal unpalatable to either side at any time. Further, the Committee did not consider that it was unforeseen that a commercial merger (particularly where it involved four audit firms, such as in this instance) might not eventuate. It was of the view that the Member ought to have been aware of the risk the transaction would not complete, given the complex nature of the negotiations necessary to conclude such mergers.

The Committee also considered there to be significant shortcomings in the level of documentation on the audit files regarding the identification, consideration and application of the rotation issue, which the Member as EQCR should have queried and ensured was properly recorded. It appreciated that the key audit partner wished to keep the merger negotiations confidential from his staff, however, considered there were other ways of documenting the matter, such as including a reference on the audit file to a separately held signed and dated confidential document, or by using a project name to anonymise, as far as possible, the details and existence of the potential merger.

The Committee accepted that there was no evidence before it to suggest that the key audit partner had set out intending to use the exception as a means of remaining the key audit partner in respect of an eighth consecutive year. However, given the significance of the judgment made the Committee considered it would have been prudent in the circumstances for the Member to request further support for the key audit partner's view that the exception applied (for example through legal advice or some engagement with regulators on the subject) and to document that aspect.

Particular 1(b)

After discussing the matters raised in particular 1(b) with both the Member and the Complainant, the Committee did not consider the particular to be established.

It agreed with the Member that, in his role as EQCR of Entity D for the year ending 31 December 2016, he was not required by the relevant standards to review every work paper on the audit file which included, in this particular instance, the engagement team's compliance with the four step model when performing analytical procedures for revenue and expenses.



PENALTY

Having regard to the established particular, the Committee was of the view that the complaint met the threshold to warrant referral to the Disciplinary Tribunal. However, the complaint could be appropriately sanctioned by way of a consent order with terms that the Member be severely reprimanded; and that he pay costs to NZICA of \$1,950.00 in contribution towards the Committee's investigation.

The Committee noted the higher public interest (and higher public expectation) that will generally accompany work undertaken by members who are licensed under the Auditor Regulation Act 2011. That higher public interest will often see license holders found to have breached auditing standards referred to the Disciplinary Tribunal under rule 13.7(d)(x) and 13.7(e). The Committee considered such a referral was not necessary on this occasion given the narrow scope of the matters at issue.

The Committee considered that the sanction above would be a proportionate response to the breaches of the Code of Ethics identified. It noted that it was appropriate for members to pay a contribution towards the Committee's costs, as otherwise such costs are borne by the wider membership.

PUBLICITY

The Committee determined that it was in the public interest that notice of its decision and orders made be published in CA ANZ's official publication *Acuity*, and on its website with mention of the Member's name and location. The Committee considered that it was appropriate, and in the interests of the public and wider membership, for there to be transparency as to its decision and to understand the types of conduct dealt with in this complaint. It was also broadly consistent with recent complaints involving breaches of auditing standards by licensed auditors.

The Committee also determined that pursuant to its obligation under s 42 of the Auditor Regulation Act 2011, and in accordance with Rule 13.75 of NZICA's Rules, notice of its order would be provided to the Companies Office Registrar.

MEMBER'S OPPORTUNITY TO CONSIDER THE ORDER

Written notice of the proposed consent and publicity orders were provided to the Member in writing in accordance with Rule 13.8, and he was given 15 days to consider them and take any advice he wished to. After taking legal advice, the Member confirmed his agreement to the Committee's order.

Rob Pascoe FCA
Chairman
Professional Conduct Committee

27 March 2019

