Te Hui o Te Kaunihera ā-Rohe o Heretaunga

Hastings District Council

Risk and Assurance Committee Meeting

Kaupapataka

Attachments

Te Rā Hui: Meeting date:	**Monday, 12 February 2024**
Te Wā: Time:	**10.00am**
Te Wāhi: Venue:	**Council Chamber** **Ground Floor** **Civic Administration Building** **Lyndon Road East** **Hastings**

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McGlinn Consulting Group Limited

File Note to Audit and Risk Committees

DATE: 29 November 2023

SUBJECT: Audit Quality Reviews by Regulators

Recently regulators in New Zealand and Australia have released their audit quality monitoring reports. These reports cover audits by the larger firms including Audit New Zealand and are focused on entities that the public have invested in.

Whilst the comments are not directly related to Councils, the themes and responsibilities of auditors and audit committees are relevant to Councils. Audit and Risk Committee ("Committee") members need to understand their role is the equivalent to Audit Committees in a listed entity, whilst the Councillors are the equivalent to the Board of Directors.

What is important to note is that a Council is often bigger than many public listed entities in terms of staffing, turnover, assets, and impacts on the community. For these reasons it is important Committees stay abreast of audit quality.

The quality of the audit should be of prime importance to a Committee, however it is tempting for a Committee to focus on price as often it is the one factor that the member can understand. A poor quality audit however creates huge risk for the organisation, and the audit function needs to be adequately funded but it also needs to provide value for money. Value should be considered as quality vs cost with high audit quality being essential. These reports focus on the quality attributes, and the key role of the audit committee in driving audit quality.

THE ROLE OF DIRECTORS (COUNCILLORS), AND AUDIT COMMITTEES (TOGETHER GOVERNANCE)

The reports bring out the need for the audit process to be a team approach between the auditor and the auditee. Governance should focus on [FMA report page 8]:

- **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.

Chartered Accountants and Advisors specialising in Governance, Forensics, and Litigation Support
Director: Graeme McGlinn BCom FCA FA Specialist CFE CMInstD

The FMA report [Page 29] also specifically identifies where Governance can contribute to audit quality. The report states [emphasis added]:

- 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**.

The ASIC report highlights the role of Directors and Audit Committees [ASIC page 30]. They state "*Directors have a primary responsibility for the quality of financial reporting, which is supported by high quality audits. Directors and in particular audit committees have key roles to play in supporting audit quality*."

The ASIC document goes on to summarise the role of the Committee. My comments are in [brackets].

"Many entities have an audit committee whose role is to assist the board of directors to fulfill its corporate governance and oversight responsibilities in areas including annual financial reporting and oversight of the external auditor. The ASX Corporate Governance Principles also state the role of the audit committee is usually to review and make recommendations to the board in relation to:

• the appointment or removal of the external auditor. [For a Council the auditor is appointed by the Auditor General under the Public Finance Act. Committees need to be aware of the monopolistic aspects of this when considering Audit Quality and pricing]

• the fees payable to the auditor for audit and non-audit work

• the rotation of the audit engagement partner

• the scope and adequacy of the external audit

• the independence and performance of the external auditor [Even given the monopolistic nature of the legislation, Committees should actively consider auditor performance as an important control to the legislative position]

• any proposal for the external auditor to provide non-audit services and whether it might compromise independence of the external auditor." [There are strict limits placed on the auditor for other services by the OAG. Notwithstanding this Committee's should independently assess any other services against independence standards and potential perceptions of independence of the auditor. The starting point should be no other services are to be provided by the auditor and any override of the base premise should be carefully assessed and documented.]

Of significance to the legislative monopoly that exists in the audit of Councils (and public sector entities) the ASIC report notes "*some audit committees expressed concern in relation to the lack of depth of the audit market and limited choice companies have. We note that the UK also have observed this market concentration issue and recommendations have been made to address the* *issue in that jurisdiction*." Whilst these comments were aimed at the "Big 4" accounting firms, Committees should be also be aware of the "one provider" risks. There are also risks in moving to other providers that may not have sector expertise. This latter risk is one that the OAG is very aware of and has been created by past audit service provider decisions where Audit NZ is the appointed auditor of most Councils.

Given independence requirements, Councils should consider leaving the option for a third party supplier independent of the Council in all respects should the OAG add to the available panel of auditors. I am aware that currently two of the Big 4 undertake audits in the Council sector following the staff shortages arising from Covid. It will be interesting to see if the OAG allow a better insight to fair pricing of quality audits becomes available to price check Audit New Zealand.

Reading both reports

I would recommend that all committee members read both reports to build their understanding of the role of the Committee in promoting audit quality.

30 January 2024

RISK AND ASSURANCE COMMITTEE

TERMS OF REFERENCE

Fields of Activity

The Risk and Assurance Committee is responsible for assisting Council in its general overview of financial management, risk management and internal control systems that provide:

- Effective management of potential risks, opportunities and adverse effects.
- Reasonable assurance as to the integrity and reliability of the reporting on financial ~~reporting~~ performance of Council, including quality of audit services.
- Monitoring of Council's requirements under the Treasury Policy.
- Monitoring of Council's Strategic Risk Framework.
- Monitoring of Council's legal compliance.
- Monitoring of Council's health and safety compliance.
- Monitoring significant projects, programmes of work and procurement focussing on the appropriate management of risk.
- Oversight of preparation of the Long Term Plan, Annual Report, and other external financial reports required by statute.

In light of the impacts Cyclone Gabrielle has had on the communities in the district, the Committee will pay particular attention to activities affected within its Fields of Activity, including but not limited to and always in support of the work of Council and the Standing Committees:

- Oversight of cyclone-related insurance claims and issues.
- Monitor funding implications associated with recovery costs, including oversight of the process for recoveries from government.
- Monitor valuation process for cyclone-damaged assets, including impairments particularly relating to roading.
- Support post-cyclone expenditure planning by ensuring good process is applied.

Membership – 7 including 4 Councillors

- Independent Chair appointed by Council.
- Deputy Chair appointed by Council.
- 2 external independent members appointed by Council.
- 1 Heretaunga Takoto Noa Māori Standing Committee member appointed by Council.

Quorum – 4 members

Delegated Powers

Authority to consider and make recommendations on all matters detailed in the Fields of Activity and such other matters referred to it by Council.

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HASTINGS DISTRICT COUNCIL
Te Kaunihera ā-Rohe o Heretaunga

FILENOTE

File Ref: PMD-9-3-22-62

Subject: Risk & Assurance Committee Standing Agenda

The following outlines the regular standing reporting items for HDC Risk & Assurance Committee.

Committee Terms of Reference:

The Risk and Assurance Committee is responsible for assisting Council in its general overview of financial management, risk management and internal control systems that provide;

- Effective management of potential risks, opportunities and adverse effects.
- Reasonable assurance as to the integrity and reliability of the financial reporting of Council.
- Monitoring of Council's requirements under the Treasury Policy.
- Monitoring of Council's Strategic Risk Framework.
- Monitoring of Council legal compliance.
- Monitoring of Council Health, Safety and Wellbeing Risk Management and legal compliance.

Core Business

Focus of the Committee is to ensure effective management of the Council strategic risks, with an open agenda to consider any new areas of risk relevant to Council's objectives.

Council objectives from the current 2021-2023 Long Term Plan being;

- Enable employment and growth
- Housing supply matches need
- Transport network link people, goods and opportunities.
- Water an land resources are used wisely.
- Sustainable development is encouraged and carbon emissions are reduced.
- The natural environment is enhanced and protected.
- Council services are green and healthy.
- Communities are safe and resilient.
- Smart innovation connects citizens and services.
- Youth have positive pathways.
- Great spaces for all people.
- Civic pride, cultural diversity and relationships are strong.

Standard Risk & Assurance Committee Meeting Calendar

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
	1st		2nd			3rd			4th		5th

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Standing Agenda Items

Meeting Date: February

Financial Management

- Treasury Management Policy
- Treasury Activity Report, including debt levels

Risk Management

- Review Committee Terms of Reference (*including roles and responsibilities of the Committee Chair and members around engaging with the auditor and in reviewing major policies)*
- Health, Safety & Wellbeing Update (*policy updates and critical risk reviews)*
- Review Long Term Plan/Annual Plan & Asset Management Plan Summaries.

Assurance

- Standing Items (*e.g. Risk profile for Climate change, Water, Growth, Statutory Change*)
- Financial Audit Report recommendations & Risk Reviews
- Contractor Health, Safety & Wellbeing Performance Report

Meeting Date: April

Financial Management

- Treasury Activity Report, including debt levels
- Procurement Policy
- Insurance deep dive

Risk Management

- Enterprise Risk Framework and Strategic Risk Register (*Note: may include risk deep dive if appropriate*)
- Health, Safety & Wellbeing Update *(policy updates and critical risk reviews)*
- Emerging risks horizon scan (*based on WEF report or any other relevant material to inform register update*)

Assurance

- Contractor Health, Safety & Wellbeing Performance Report Standing Items (*e.g. Risk profile for Climate change, Water, Growth, Statutory Change*)

Meeting Date: July

Financial Management

- Treasury Activity Report, including debt levels
- Health, Safety & Wellbeing Update *(policy updates and critical risk reviews)*

Risk Management

- Asset Management Plan Summaries

Assurance

- Contractor Health, Safety & Wellbeing Performance Report Standing Items (*e.g. Risk profile for Climate change, Water, Growth, Statutory Change*)

Meeting Date: October

Financial Management

- Treasury Activity Report, including debt levels
- Insurance Review for renewal
- Financial statements

Risk Management

- Risk deep dive
- Key policy review (*Note: overview of top 5 key internal policies*)
- Asset Management Plan Summaries
- Health, Safety & Wellbeing Update *(policy updates and critical risk reviews)*

Assurance

- Contractor Health, Safety & Wellbeing Performance Report Financial Audit Reports & Risk Reviews
- Standing Items (*e.g. Risk profile for Climate change, Water, Growth, Statutory Change*)

Meeting Date: November

Financial Management

- Treasury Activity Report, including debt levels
- Annual Report audit report

Risk Management

- Risk appetite report
- Health, Safety & Wellbeing Update *(policy updates and critical risk reviews)*

Assurance

- Contractor Health, Safety & Wellbeing Performance Report Standing Items (*e.g. Risk profile for Climate change, Water, Growth, Statutory Change*)

Regan Smith
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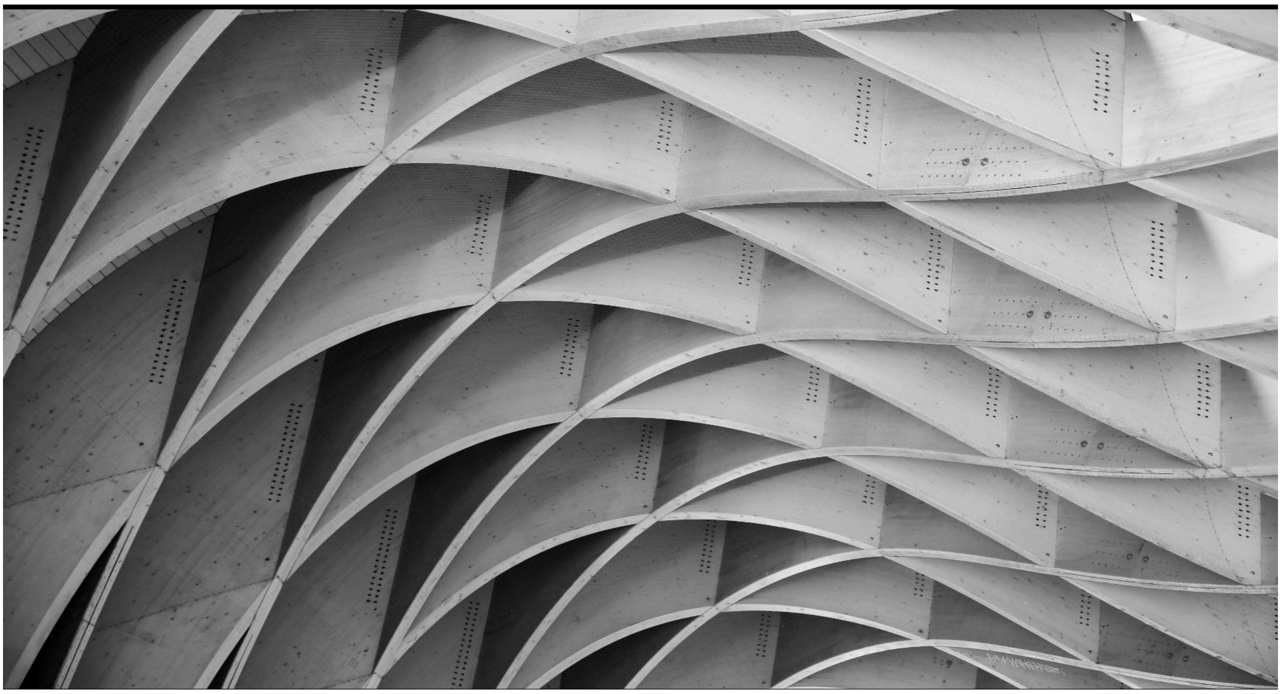
Australian Government
Financial Reporting Council

Oversight of Audit Quality in Australia–A Review

November 2023



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In the spirit of reconciliation, Financial Reporting Council acknowledges the Traditional Custodians of country throughout Australia and their connections to land, sea and community. We pay our respect to their Elders past and present and extend that respect to all Aboriginal and Torres Strait Islander peoples.

Contents

About the FRC

The Financial Reporting Council (FRC) is responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, providing strategic advice in relation to the quality of audits conducted by Australian auditors, and advising the Minister on these and related matters to the extent that they affect the financial reporting framework in Australia.

The FRC monitors the development of international accounting and auditing standards, works to further the development of a single set of accounting and auditing standards for world-wide use and promotes the adoption of these standards. It is a statutory body under Part 12 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act).

Refer to the FRC's website for details of the members and the Declarations of Interest which are included in the public meeting papers.

Executive Summary

Confidence in the quality of auditing is paramount to the effectiveness of the financial reporting framework in Australia and fostering confidence in the integrity of our markets. The FRC is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia, including providing strategic policy advice and reports to the Minister and the PABs[1] in relation to the quality of audits conducted by Australian auditors.[2]

In 2019 the FRC conducted an assessment of the adequacy of auditor disciplinary functions in Australia and produced a report Auditor Disciplinary Processes. This report included some recommendations for ASIC, the CADB, CA ANZ, CPAA, and the IPA. The FRC have continued to monitor the results of the disciplinary processes of the different bodies, and their responses to the recommendations.

The FRC has been monitoring developments in relation to audit quality and noted there was a lack of visibility and granular data on auditor disciplinary tools, actions and outcomes from PABs, audit firms and regulators. To address this the FRC have conducted a review to assess gaps in how audit quality system is supported and monitored in Australia. The FRC have considered if improvements are necessary to address any gaps or overlaps in processes, and how they could be better co-ordinated between stakeholders.

The Government announced on 6 August 2023 that Treasury would be examining the regulation of consulting, accounting and auditing firms, including issues such as governance, transparency, executive responsibility, management of conflicts of interest and dealing with misconduct. The FRC's recommendations may assist deliberations of that review.

In summary, the FRC considers that auditors are subject to a robust set of professional standards designed to support the performance of high audit quality audits. However, the FRC considers that the system could benefit from more independent oversight to ensure all auditors are complying with the required standards. The recommendations relate to:

- All auditors should be subject to regulatory oversight on a timely basis.
- ASIC's program should review more audit files on an annual basis.
- ASIC should publish an audit surveillance strategic plan with stated objectives and key performance indicators, and have ongoing communication with the PABs as to the scope of the program.
- The PABs should consider the objectives of their quality review programs and co-ordination with ASIC.
- The PABs should report more comprehensively on the scope and results of their quality review programs.

1 Refer to the Glossary for a list of the abbreviations and acronyms used in this report.
2 Refer s 225(2C) Australian and Investments Commission Act 2001 (the ASIC Act).

- Relevant ethical standards should be given force of law and be subject to a compliance review by a regulator.
- There should be consideration as to whether the PABs' investigatory and disciplinary processes are combined and performed by a single independent body.

Refer to our findings and recommendations for more details.

The FRC thanks all stakeholders who generously shared their time and assisted us in performing this review.

Scope and Methodology

The review considered how audit quality and compliance with auditing and ethical standards by auditors is supported and monitored, including processes to identify breaches and escalation to disciplinary action. The FRC's mandate includes a focus on audit quality and also includes processes used by auditors to comply with applicable codes of professional conduct.[3] Therefore, the FRC has included compliance with ethical standards which supports overall firm culture and directly or indirectly audit quality within the scope of this review.

This review involved obtaining an update on the status of the recommendations from the 2019 disciplinary review, and an understanding of:

- existing audit and ethical education, and accreditation requirements, for auditors; and
- the firms',[4] PABs' and regulatory quality review processes to understand each stakeholder's responsibilities in relation to supporting and monitoring audit quality.

For completeness the FRC also considered the roles of the standard setters, CADB and Audit Committees in promoting and supporting audit quality. This review did not include the surveillance programs of SMSFs conducted by the ATO.

During the course of the review, it was noted that CA ANZ recently completed its PCFR which focused on the disciplinary process once an issue is raised. This is useful in the context of the FRC review.

The FRC has also monitored the Federal Parliamentary and other inquiries[5] underway in response to recent controversies over the behaviour of certain individuals at some large audit firms, and potential breaches of the ethical standards. Whilst the inquiries are about the broader accounting profession and not specifically audit quality, they have highlighted potential issues associated with regulatory and firm responses to breaches of the ethical standards, transparency, accountability and the governance of the firms, which may be detrimental to audit quality if not addressed. In this report, the FRC makes some observations in these areas.

In performing this review, the FRC conducted targeted interviews with representatives from the 6 largest audit firms, the PABs and ASIC, as well as looking at publicly available statistical and qualitative information about their processes and the findings from their quality reviews. The FRC also met with a broader range of regulators and stakeholders as detailed in Appendix 3. The FRC has relied on the accuracy of the information and feedback provided to us by stakeholders.

The FRC also reviewed relevant legislation and publicly available information about how audit quality is supported and monitored in Australia, as well as the systems in place in some overseas jurisdictions.

3 S.225(2C)(a)(iii) of the ASIC Act.
4 The 6 largest audit firms plus a sample of mid and smaller firms.
5 For example the PJC Inquiry: Ethics and Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry, Senate Inquiry into Management and Assurance of Integrity by Consulting Services and the NSW Government's use and management of consulting services.

Findings

The FRC's main findings are:

- ASIC is the statutory regulator who has the power to perform audit surveillance, however there is no legislative requirement for ASIC to undertake proactive surveillance of auditors. As a result, ASIC design their program based on their overall strategy, competing priorities and budgetary pressures.
- There has been a decrease in ASIC's inspection of audit files in the past few years.
  During 2022 ASIC introduced a new integrated approach to conducting financial reporting and audit surveillances. ASIC continue to select audit files for review when there is an identified or suspected error in the financial report, and the number of audit files selected for review where there is no identified or suspected material misstatement of the financial report has been significantly reduced. This has resulted in a decrease in the number of audit files reviewed from 45[6] in 2021/22 to 15[7] in 2022/23. Whilst the FRC support the continued focus on high quality financial reporting, the FRC consider that there should be a greater number of auditors and audit files reviewed on an annual basis.
- ASIC have indicated that staff resources dedicated to audit surveillance have been reduced in recent years, and the FRC notes that ASIC have less staff dedicated to this role than some overseas jurisdictions. As a result, compared to equivalent bodies, ASIC's program is relatively small.[8] In addition, it is not clear if the new program results in the largest 6 audit firms being reviewed annually.
- The auditing standards require audit firms and auditors to comply with the QMS and ethical standards, which are important in supporting audit quality. The Corporations Act requires auditors to comply with the QMS and ethical standards only to the extent they apply to the performance of an individual audit.[9] As a result, ASIC can only enforce compliance for parts of the standards by the individual auditor, and not the firm.
- In the past ASIC have reviewed discreet components of a firm's system of quality management, however this has been limited. ASIC did not review any components of the system of quality management in 2022/23 however have indicated they will do so in the future.
- The current regulatory framework in Australia is sometimes described as a co-regulatory framework with the PABs being co-regulators of auditors who are their members, with ASIC. However, the PABs do not have any statutory responsibilities or powers to oversee audit quality, and their quality review programs of their members are designed to be educative to support their members, and to promote continuous improvement. The programs are not designed to assess and report on audit quality.

6 Refer to Rep 743 ASIC reports on audit inspection findings for 12 months to 30 June 2022
7 Refer to Rep 774 Annual financial reporting and audit surveillance report 2022–23
8 Refer to Appendix 1 for a comparison of the scope and size of some overseas jurisdictions audit inspection programs.
9 Corporations Act s 307A requires auditors to conduct audits of financial reports prepared under Part 2M.3 in accordance with Australian Auditing Standards.

- Each PAB has its own separate investigatory and disciplinary function. There is a perceived conflict of interest between the role of the PABs in managing the conduct of their members, given that membership fees are a significant source of income for the PABs and their role in representing the interests of their members. Whilst each PAB has adopted processes to enhance the independence of their disciplinary functions, the perceived conflict remains.
- Not all auditors are subject to regulatory oversight nor are all auditors required to be a member of a PAB.
- The ethical standards that the PABs' members must comply with are set by the APESB and are based on their international equivalent. However, the APESB is not a statutory body and their standards do not have force of law. Also the APESB is funded by the PABs and the board members are drawn from the PABs, except for the Chairman who is required to be an independent person who is not a member of the PABs.[10]
- The number of cases referred to the CADB is historically low. ASIC and APRA may refer RCAs to the CADB to sanction inadequate or improper performance of duties or the 'fit and proper' requirement.
- There are restrictions on the PABs' ability to share information when they identify breaches.

10 Refer to the APESB's Website for an overview of the Board of Directors.

Recommendations

The FRC have a number of recommendations but acknowledge that some of these recommendations:

- may need further consideration to ensure they are workable and do not have any unintended consequences.
- may require additional or alternate sources of funding and legislative change.

The FRC welcomes further discussion with all stakeholders on the best way to achieve the intended outcomes of supporting the highest level of audit quality.

The FRC recommends:

1. ASIC's program of reviewing audit files only when financial reports are known or suspected to be misstated, should be augmented with a program that selects audit files on a risk and rotational basis for review, with the overall objective to review all auditors over an established time period.

The Government should give consideration to whether ASIC undertakes this additional program and are funded to do so, or whether there should be a new independent body established whose legislated responsibility is to perform an audit surveillance program. There should also be consideration as to whether the audit surveillance program covers all RCAs over an established time period, or all auditors i.e., not just RCAs. This would require consideration as to whether all auditors should be required to be members of a PAB or some other minimum competency accreditation system.

This body could also be responsible for conducting surveillance of financial reporting, and surveillance of the disciplinary and enforcement processes currently being performed by ASIC and the PABs. There should be consideration as to whether this body also provides oversight of the broader accounting profession and consulting services.

2. ASIC should consider:

2.1 Publishing an audit surveillance strategic plan with stated objectives and key performance indicators, including establishing a minimum coverage and cycle regarding the frequency of inspection of auditors.

2.2 Ongoing communication with the PABs as to the scope of the program to allow the PABs to consider the impact on their programs in particular which firms to review.

2.3 Including greater emphasis on oversight of the adequacy of audit firms' compliance with the QMS and monitoring of compliance with ethical standards routinely in its surveillance program.[11]

2.4 Allowing auditors to appeal through an internal independent process when they do not agree with a finding. This process should be transparent to the auditors.

2.5 Communicating its findings to the AUASB, AASB and APESB respectively on possible areas for improvements in their standards.

These measures would enhance the transparency of ASIC's program and its escalation policy. ASIC should also consider how to finalise reviews and report findings to the firms on a timelier basis.

3. In relation to their Quality Review Programs, the PABs should consider:

3.1 The objectives of their programs and co-ordination with ASIC.

3.2 Preparing public reports to provide detail of their monitoring and quality review programs including key performance indicators and results. This reporting should also confirm their compliance with IFAC's SMO 1, and their conclusions on the audit quality of their members.

3.3 More comprehensive reporting on the scope and results of their programs to the FRC.[12]

3.4 Communicating identified areas for improvements in the standards to the AUASB, AASB and APESB respectively.

The nature of the PAB's quality review programs may be revised depending on ASIC's and the government's response to recommendation 1.

4. The Government should give further consideration to requiring auditors to comply with relevant ethical standards and for compliance to be appropriately enforced through appropriate legislation.

This should include consideration as to whether ethical standards are set by an independent statutory body (consistent with the AASB and AUASB). This could help address any perceived conflict of interest. Consideration should also be given whether ASIC would be the most appropriate Government body to undertake the enforcement role.

11 ASIC have indicated they will review aspects of the QMS in 2024/25.
12 We acknowledge that data on the high level findings is provided to the FRC and reported in our Annual Reports.

5.	**The Government should give further holistic consideration, in consultation with the PABs, CADB and ASIC, to the PAB's investigatory and disciplinary processes and whether they should be undertaken by a single independent body.**

This would further manage perceived conflicts of interest and should include consideration of the PABs being required to refer auditors to the CADB when there appears there may be a failure to comply with s 1280(c) (fit and proper person) of the Corporations Act.

6.	**In relation to information sharing, the Government should consider the need for a holistic review to understand if there is a need for legislative reform to:**
6.1	Allow regulatory bodies (e.g., ASIC, ATO) and the PABs to communicate with each other when they become aware of matters of non-compliance with legislation (except clearly minor), auditing standards and ethical standards.
6.2	Require audit firms to report identified (except for clearly minor) non-compliance with auditing and ethical standards to ASIC, PABs (if members), and other relevant regulatory bodies (e.g., Tax Practitioners Board, ATO).
6.3	Streamline reporting to different bodies including regulatory bodies.

Such reforms may reduce the risk of breaches to PABs' by-laws or legislation such as privacy laws. Appropriate communication between relevant regulatory bodies would also assist with resolving matters more quickly and effectively.

Other observations

During the performance of this review the FRC observed other matters which we consider could be addressed to improve oversight of audit quality and compliance with ethical standards.

- Large audit firms' corporate governance:
  - Large audit firms should be subject to annual reporting and audit requirements similar to those for listed companies under Chapter 2M of the *Corporations Act 2001* (Corporations Act) and the ASX Corporate Governance Principles. This would lead to more transparency on their financial results, remuneration practices and governance structures.
  - The large audit firms to review their corporate governance practices as well as ensuring there are appropriate and sufficient (e.g., majority) independent non-executive personnel allocated to oversight roles including the governing body of the audit division and of the firm.

- Monitoring of the quality of work conducted by all auditors and other accountants:
  - Not all practicing auditors are required to be members of a PAB, and other than RCAs and SMSF auditors, are not subject to statutory oversight.
  - Not all professional accountants are required to be members of a PAB, and other than liquidators and tax practitioners[13] are not subject to statutory oversight.
  - Therefore, there are parts of the profession where there is insufficient monitoring of the quality of their work. While our recommendations cover oversight of all auditors, further consideration is required as to how this can best be achieved, as well as how other accountants would be subject to oversight.
- Number of RCAs and competition in the audit market:
  - From our discussions with the audit firms and PABs we are aware that attracting and retaining talent in the audit profession is challenging. There has also been a fall in the number of RCAs in recent years.[14] The FRC are not aware whether this is creating issues with supply of auditors or not. The FRC note that there should be consideration as to whether it is necessary to conduct a review to determine if the number of RCAs are adequate, and whether there need to be strategies to increase the supply of auditors or reduce the demand for RCAs. This should also be considered as Australia prepares for assurance over sustainability reporting.
  - The audit market is highly concentrated with the largest 4 firms auditing 95.50 per cent of the largest 200 companies by assets.[15] In our research on their perceptions of audit quality discussed above, some ACCs commented that there is limited choice in appointing an audit firm as they require auditors with global scale and multi-skills. The FRC note that there should be consideration as to whether it is necessary to conduct a review to determine if this is an issue that needs addressing. There should be consideration as to whether there may be barriers to greater competition.

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13 These are subject to some form of statutory supervision.
14 The number of RCAs was 3077 at 30 June 2023 and 6163 at 30 June 2005. These numbers were provided by ASIC.
15 Refer Submission 4 to the PJC Ethics and Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry.

Overview of Framework

Australia's legislative framework for oversight of RCAs and audit quality is mainly set out in the Corporations Act[16] as follows:

- Auditors of entities required to report under the Corporations Act must be registered with ASIC (i.e., RCAs and Authorised Audit Companies).
- Auditors of SMSF are required to be registered with ASIC. The ATO is responsible for surveillance of SMSF auditors, and ASIC is responsible for determining whether auditors referred by the ATO should be deregistered or suspended.
- ASIC has regulatory responsibility for surveillance, investigation, and enforcement of the financial reporting requirements and audit requirements of RCAs.
- ASIC and APRA have powers to refer RCAs to the CADB who act as an expert independent disciplinary tribunal to consider applications for the cancellation or suspension of the registration of auditors.
- Auditors must comply with auditing standards issued by the AUASB which have force of law in the performance of an audit.
- The auditing standards require auditors[17] and firms who conduct audit engagements, to comply with the QMS and with ethical standards issued by the APESB in the performance of an audit.

However, auditors of entities not covered by the Corporations Act or the Superannuation Industry (Supervision Act) 1993 (SIS Act) are not subject to regulatory oversight by ASIC or other government regulators. In addition, not all auditors are required to be members of a PAB.

All members of a PAB are required:

- To have a CPP if they provide services to the public for reward[18]. This includes auditors of entities not required to report under the Corporations Act.
- To comply with ethical standards issued by the APESB.

The PABs also have programs to monitor their members' compliance with their by-laws and the auditing and ethical standards. The effectiveness of the PABs' quality review programs to monitor their members is not overseen by an independent body.

Similar to auditors, not all accountants are required to be registered with a government agency or a regulator, and there is no requirement to be a member of a PAB.

16 Pt 2M.3, Division 3 and Part 2M.4
17 ASA 102 Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements.
18 Each PAB has a by-laws requiring members who provide services to the public to have a CPP.

Education and Registration of Accountants and Auditors

Each PAB has eligibility criteria for admittance to membership being an accredited degree or qualification plus successfully completing their specific post-graduate programs and relevant work experience.

The PABs require all members who provide services to the public to complete a Public Practice Program, or equivalent, which includes modules covering ethical and regulatory obligations. Once a member has a CPP there are ongoing obligations to maintain appropriate, sufficient professional indemnity insurance, and to complete CPD requirements which is are at least 120[19] hours of relevant professional development activity in each rolling three-year period. The PABs have recently mandated that the CPD must include ethics training for members.[20] Compliance with these obligations is monitored through their quality review programs and in addition the PABs select members randomly to check they are in compliance with the CPD requirements.

- Auditors of certain entities must be registered with ASIC as an RCA. The following legislation requires certain entities to be audited by an RCA:
- Most entities that report under Chapter 2M and Chapter 7 of the Corporations Act.
- Those charities required to prepare an audited report under the *Australian Charities and Not-for-profits Commission Act 2012* (ACNC Act).[21]
- Co-operatives National Law.[22]

There are numerous State and Territory Legislation with different requirements and these often require that auditors must be an RCA or a member of an PAB. However, there may be instances where an audit is required but there is no minimum registration or qualifications and experience required of the auditor[23.]

To be registered with ASIC, RCAs must satisfy the requirements of s1280 of the Corporations Act which include requirements for qualifications, experience, and being a fit and proper person. Conditions can be imposed by ASIC for ongoing registration as an RCA as to continuing education, professional indemnity insurance and engagement quality assurance. Refer to ASIC's RG 180 Auditor Registration for further information.

19 Australia Regulations & Guidance for Members | CA ANZ (charteredaccountantsanz.com), Now you're a CPA: what's next? | CPA Australia, CPD Records Feature (publicaccountants.org.au)
20 CA ANZ requires members to undertake a minimum of 2 hours of verifiable ethics training per triennium. IPA have also introduced 3 new competency areas of CPD with one being Professional and Ethical Standards Pronouncement-7-V41-CPD-6-Sep-2022.pdf (publicaccountants.org.au), and CPA Ethics requirements for CPD | CPA Australia which is minimum 2 hours a year, and 10 hours over 3 years.
21 Under the ACNC Act, Medium and Large charities must have their audit conducted by an RCA, an audit firm or an authorised audit company.
22 Co-operatives (Adoption of National Law) Act 2012 No 29
23 As discussed in CA ANZs Summary of Research into Statutory audit and assurance requirements and the demand for RCAs in Australia some state and federal legislation refers to an appropriate person, some fit & proper person, a specified auditor

The criteria for initial and ongoing registration as an RCA is a high level of qualification and is intended to ensure that only those with the required skills have that designation. Auditors who are not RCAs may perform audits where permitted by the relevant legislation. The PABs have their own restrictions on what types of engagements members can undertake based on their qualifications.

The Superannuation Industry (Supervision) Act 1993 also requires SMSF auditors to be registered with ASIC which is a separate and distinct accreditation from an RCA.

The ATO is responsible for surveillance of SMSF auditors, and ASIC is responsible for determining whether auditors referred by the ATO should be deregistered or suspended.

Registered SMSF auditors have reporting requirements to both the SMSF trustees and the ATO.

The Audit Firms

Audit firms and auditors must comply with relevant regulation contained in the Corporations Act, auditing standards, ethical standards and their relevant PAB regulations.

How Audit Firms Monitor Audit Quality and Compliance with Professional Standards

The FRC met with the assurance and quality leaders from the largest 6 audit firms and a small number of mid-tier and smaller firms, to understand how they support and monitor audit quality. Each firm we met with emphasised that audit quality, and compliance with auditing standards was extremely important and a high priority for leadership, and there has been a significant focus and investment on initiatives and processes to improve quality.

Systems of Quality Management

All firms[24] that perform audits or other assurance engagements must comply with the recently enhanced QMS issued by the AUASB which came into effect in 2023.[25] The QMS are designed to improve the robustness of firms' systems of quality management to support compliance with ASAs and applicable legal and regulatory requirements.

The QMS reinforce that 'quality management is not a separate function of the firm; it is the integration of a culture that demonstrates a commitment to quality with the firm's strategy, operational activities and business processes'.[26] The QMS require the firm's leadership (i.e., CEO or equivalent) to have ultimate responsibility and accountability for quality. In addition to supporting and monitoring supporting audit quality there are requirements relevant to:

- Compliance with and responding to breaches with the professional and ethical standards.
- Audit quality in the performance of individual audit engagements.
- Quality review programs.
- Continuous improvement through identification and responding to root causes of identified deficiencies.

All the audit firms the FRC met with advised that whilst they already had systems of quality management in place, the new QMS have required an enhancement in their quality controls.

In addition, audit firms report that they have invested in the following to improve audit quality:

- Continual staff training on technical and ethical standards.

24 The QMS apply to audit, assurance and related services provided by audit firms.
25 QMS replace the previous Auditing Standard Quality Control for Firms that Perform Audits which have been in place since 2010.
26 ASQM 1 paragraph A30.

- Technology solutions being used in the conduct of audits which enhance audit quality as they allow analysis of entire populations and data sets. This is particularly relevant for larger firms and audit clients.
- A number of internal quality reviews which are run at different stages of the audit (i.e., during and after) and for different purposes. Internal review programs of the largest firms on completed engagements are taken seriously and are run with an element of independence as much as practical. For example, being run by a partner from another office including from overseas.
- Accountability frameworks which take into account findings from external and internal quality reviews in partner and staff performance reviews. Depending on severity, negative review findings will impact remuneration.
- Compliance with auditing and ethical standards is also taken seriously and the largest firms have processes in place for staff to confirm their compliance and to identify breaches.

Quality Review Programs

In addition to internal quality review programs, audit firms and auditors are subject to some level of external oversight to monitor compliance with regulation through the following:

- Reviews by representatives of their global network on a rotation basis (depending on the structure)
- ASIC's audit surveillance program
- International regulators, being the PCAOB (United States) and CPAB (Canada)
- PABs' quality review programs of their systems of quality controls on a cyclical basis.

When an audit firm belongs to a network firm they are subject to monitoring activities by the network on their systems of quality management and often reviews of engagement files. These are done on a rotational basis.

ASIC has in the past reviewed selected audit files of the largest 6 audit firms annually, and audit files of other audit firms of listed entities based on their risk-based sample. However, as noted in the *ASIC's Oversight of Auditors* section of this report ASIC has recently changed its inspection program and it is not clear if the largest 6 audit firms will continue to be reviewed every year.

The audit firms we met with provided feedback that they whilst they did not always agree with ASIC's findings they agree that ASIC's audit surveillance program has resulted in an improvement in audit quality. They also provided the following feedback where ASIC's program could be enhanced:

- More attention should be given to firm wide quality management systems which are designed to support audit quality.
- ASIC focus on a small part of the file and do not review the file more holistically.
- The relative inexperience of the inspectors.
- There being no transparent escalation process for firms if they strongly disagree with the findings in the future.

Note that ASIC do not agree with all elements of this feedback.

The PABs review their members on a rotational basis which under the IFAC's SMO 1 should be every 3 years for audit firms of PIEs and 6 years for other audit firms. We understand that the PABs have conducted reviews of the largest 6 audit firms on a periodic basis. In addition, the PABs monitor whether its members have quality control systems in place. The PABs do not review audit files at the 6 largest audit firms as they consider this an overlap with ASIC's program. Refer to the *Professional Accounting Bodies Oversight of Auditors* section of this report for more information on their programs.

Transparency Reports

Audit firms who perform more than ten audits of listed entities are required to prepare a Transparency Report[27] to communicate certain information relevant to the firm's structure and their systems of quality management. Refer to ASIC Information Sheet 184 for full details of the required reporting. The Transparency Reports are an opportunity for the audit firms to communicate matters relevant to management of quality with the objective to enhance confidence in the firm's quality.[28]

Governance of the Audit Firms

The audit firms are usually large partnerships and managed by executive boards and governed by governance boards, members of which are usually partners. Concerns have been raised as to whether structure of the large firms means they are not subject to the provisions of Corporations Act and best practice corporate governance principles. For example, there may not be an appropriate level of independent governance and oversight, and that the Corporation Act's provisions in relation to director's duties and penalties do not apply.[29]

The FRC discussed this with the audit firms and note that whilst some firms have introduced some non-executive personnel to oversight roles there is no requirement for them to do so, and the involvement of non-executives could be further enhanced. We note that there have been recent announcements from some large firms that they are introducing enhancements to their governance arrangements. We also note that there is a government inquiry into the structure of the firms which will be examining these matters.

27 Section 332 of the Corporations Act.
28 Refer to the individual firms' websites for a copy of their Transparency Reports.
29 Refer AFR Article PwC tax scandal has exposed partnerships as regulatory havens (afr.com).

Professional Accounting Bodies Oversight of Auditors

Each PAB is a member of IFAC and is required to comply with IFAC's SMOs. The SMOs provide clear benchmarks to IFAC member organisations and core competencies for PABs to serve and function in the public interest.

Each PAB currently maintains and monitors their members' professional competence through:

- Eligibility for membership with academic criteria plus completion of their specific post-graduate programs and relevant work experience.
- Providing ongoing training, guidance, and tools.
- CPD requirements.
- Quality review programs of individual members and firms.

Quality Review Programs

The PABs are required to perform quality review programs which are governed by IFAC's SMO 1. SMO 1 covers how to plan and perform quality assurance reviews of firms and individual members (including auditors) and take appropriate corrective action for non-compliance. SMO1 allows PABs to give due consideration to quality review programs operated by other appointed authorities (e.g., ASIC) to ensure there is no undue overlap between the programs. The FRC understands that the 3 PABs in Australia conduct reviews of members who are auditors who they believe will not be reviewed by ASIC, and as a result, the PABs do not review engagement files of the largest 6 and some mid-tier firms.

There is no formal agreement in place or communications between ASIC and the PABs, as to the scope of their programs. The FRC understand that ASIC communicate to the PABs which firms and files they have reviewed, however we consider this could be enhanced to include up front communication on the scope of their respective programs.

The PABs review all members with a CPP (generally the partner) and/or firms however each has a different program for auditors. SMO 1 allows the PABs to have different approaches to how they run their programs. Jurisdictions may adopt a cycle-based, risk-based, or mixed approach. SMO 1 details that generally, firms that perform audits of financial statements of PIEs should be reviewed at least every 3 years (6 years for firms that audit non-PIEs). However, some firms may need to be reviewed more frequently, meaning that the cycle may be shortened, for example, when the results of the previous quality assurance review were less than satisfactory.

The PABs are required to perform ongoing self-assessments of their compliance with each of the SMO requirements. However, the PABs do not report publicly whether they are in compliance with the SMOs including whether the number of reviews being performed on an annual basis is sufficient to meet the SMO 1 requirements.

The purpose of PABs' quality review programs is educative and different to ASIC as the statutory regulator. The PABs' reviews are a high-level assessment of compliance with professional and technical standards. The quality review programs undertaken by each PAB:

- Are focused on supporting members and promoting continuous improvement.
- Monitor compliance with their by-laws and professional standards.
- Ensure there is documentation to support that there is a system of quality management in place but may not critically assess whether this is in compliance with QMS.
- Consider whether there is documentation to support the auditor's conclusions, however, do not substitute their judgement with the key judgements that were made by the auditor.
- Whilst slightly different for each PAB, measure the results as satisfactory/compliant, requires re-review / non-compliant, or unsatisfactory/disciplinary action required.

The FRC did not review the PABs' quality review programs in detail, however, did review parts of the programs which guide the reviewer i.e., their programs/checklists, and note that they are comprehensive and include for the reviewer to check compliance with some of the Auditing Standards. However, there may be variations in the effectiveness of a review as it is dependent on the quality of the reviewer and the level of robustness in their approach.

As detailed in the *Audit Firms* section of this report, the PABs do not review audit files at the 6 largest audit firms as they consider this an overlap with ASIC's program. They review the 6 largest firms on a periodic basis and review their overarching systems of quality management.

Only fundamental breaches of professional standards are referred to disciplinary action, and therefore only a small percentage of firms / auditors are referred to disciplinary action in any given year.

Communication of results of Quality Review Programs

The PABs communicates the results of their quality review programs to members for educative purposes and encourage continuous improvement.

The PABs also communicate at a high level, the results of their programs to the FRC and publicly in either a separate publication available on their website, and / or their Annual Report.

However, the reporting to the FRC and available publicly could be enhanced to provide more detail on:

- An overview of their program and key performance indicators ie. how often they review members etc.
- The results including the auditing standards which are not being complied with.
- Compliance with SMO 1.
- Whether the findings indicate a broader issue with audit quality which should be addressed.

This increased transparency may assist with addressing any perception of a conflict of interest in the PABs assessing the quality of their members, and the robustness of their programs.

Co-regulators

The PABs are sometimes described as co-regulators of auditors who are their members, with ASIC. However, the PABs do not have any statutory powers or responsibilities in regard to audit oversight and therefore are not co-regulators. Whilst IOSCO's principles detail that if providing audit oversight, the PABs should be overseen by the regulator, this is not applicable in Australia. In some overseas jurisdictions there are legislated responsibilities for the PABs, or the regulator has the authority to direct the work of the PABs. For example, in New Zealand there is legislation[30] requiring the NZICA, and CPA to monitor registered auditors and audit firms, promote, and monitor the competence of their members and develop an investigative and disciplinary system.[31] Similar arrangements exist in the UK for audits of unlisted entities.

Monitoring Members' Compliance with PAB's Regulations and By-laws

As part of the annual renewal, members confirm they have been in compliance with the by-laws and specifically CPD requirements and they have notified the PAB of any disclosure event. The PABs assess compliance with their by-laws as part of their Quality Review Program.

The PABs also review CPD records as part of their Quality Review Program and in addition check a sample of members records on a periodic basis.

Members' Disclosure and Notification Events

The PABs have slightly different regulations and by-laws but have member notification and disclosure events. Notification events are those that make a member liable to disciplinary sanctions, whilst a disciplinary event are those of a serious nature such as an indictable offence, for example, an offence under the Tax Administration Act, or is insolvent.

CA ANZ Professional Conduct Framework Review

In July 2022 CA ANZ commenced a periodic PCFR with the final report issued on 7 June 2023. The PCFR examined the alignment of the Australian and New Zealand By-Laws and Rules, the composition, powers and structure of the PCC and tribunals including how breaches of ethics are communicated to members, member protocols and guidance on disclosure obligations and the interaction between academic misconduct in the CA program with the By-Laws and Rules.

The findings were that the Disciplinary Framework met or exceeded the standards set by IFAC and international and peer benchmarks. There were a number of recommendations which CA ANZ have accepted and has committed to implement. Many recommendations, require amendments to By-Laws and member approval, which has now occurred. A recommendation relevant to this review is an expansion of the role of the PCOC to include a broader oversight role in respect of monitoring members' compliance. This also aligns the PCOC's responsibilities with NZICA who has a statutory

30 Auditor Regulation Act.
31 Refer to Appendix 1 for a comparison of ASIC's program with the PCAOB, UK FRC, New Zealand's FMA and CPAB.

responsibility to maintain and monitor compliance with, and enforce, professional and ethical standards.

Professional Standards Scheme

The PABs have schemes approved by the PSC under professional standards legislation. This is very important to the PABs as their members potentially can participate in the Professional Standards (Limitation of Liability) Scheme.

The professional standards schemes are in place to support associations (i.e., PABs) to improve and maintain professional standards and conduct of their members. The PSC conduct ongoing compliance and requires the PABs to submit an Annual Professional Standards Report on their actions, policies and decisions relevant to how they improve and maintain professional standards. Some of the PABs indicated that this reporting is extensive and other bodies may benefit from having access to this.

The PSC reviews the PABs at least every 5 years. This includes matters such as their membership entrance requirements, conduct and discipline processes, and continuous education.

ASIC's Oversight of Auditors

ASIC has regulatory responsibility for surveillance, investigation, and enforcement of the financial reporting and audit requirements of RCAs. ASIC is responsible for administering the requirements of the Corporations Act as it relates to auditor independence (Divisions 3, 4 and 5 of Part 2M.4) and audit quality (Division 3 of Part 2M.3). This is done through ASIC's audit surveillance program which has an objective to promote the improvement and maintenance of audit quality. ASIC focuses on audits of financial reports of PIEs prepared under the Corporations Act.[32]

The audit surveillances program mainly consists of risk-based reviews and ASIC also perform separate surveillances as a result of complaints or linked to other information received, or another investigation.

Change in Audit Surveillance Program

In November 2022 ASIC announced that it would combine the financial reporting and audit surveillance programs to focus on the entire financial reporting chain. ASIC now routinely select audit files for surveillance where there is a known or suspected material misstatement of the financial report. Audit files may also be selected based on other available intelligence.

On 18 October 2023 ASIC released the results of this program in the Annual Financial Reporting and Surveillance Report 2022–23 report. ASIC's report summarised the findings from both financial reports and audit files and emphasises the role of preparers and auditors in improving the quality of financial reporting and audit. As a result of the new approach there has been a reduction in the number of audit files reviewed from 45 in 2021/22 to 15 in 2022/23. Of the 15 files 11 had findings. Due to the small number of audit files reviewed ASIC have not reported which firms have been reviewed and have not issued individual firm reports.

32 Refer ASIC Information Sheet 224 which outlines ASIC's approach to audit surveillance.

Prior Year's Approach and Results

ASIC's previous program covered the largest 6 audit firms, and a small number of other firms and they produced individual reports for the largest 6 audit firms. ASIC used a risk-based approach to select engagements and key audit areas for review.

It is not possible to compare the 2022/23 results to previous year results due to the small number of files reviewed and ASIC have not reported all the information which they have reported in prior years. The following table summarises the number and results for 2021–22 and 2020–21:

		Negative findings from reviews of key audit areas in audit files, by firm							
		Audit Firm							
		BDO	Deloitte	EY	GT	KPMG	PwC	Other	Total
FY 2021–22	Audit files reviewed	3	5	8	3	8	8	10	**45**
	Key audit areas	10	18	26	9	27	24	32	**146**
	Areas with negative findings	2	9	4	4	13	4	16	**52**
FY 2020–21	Audit files reviewed	3	5	8	3	8	8	10	**45**
	Key audit areas	10	17	30	11	27	20	34	**149**
	Areas with negative findings	2	5	2	5	8	5	20	**47**

It is worth noting that the results continued to 'worsen' despite the firm's efforts to improve audit quality, however we are aware that the results are sometimes subjective in nature and the firms do not always agree with ASIC's conclusions. Further, the more sophisticated the risk-based selection of files by ASIC, the more likely that a file selected will have a negative finding. Hence the results do not provide evidence as to the state of audit quality across the audit profession more broadly.

The FRC considers the number of audit files reviewed is small given there are over 3000 RCAs (of which over 500 audit listed entities) and 200 (of which 50 audit listed companies) authorised audit companies in Australia.[33]

External Independent Panel

As detailed in Information Sheet 224, ASIC have an external independent panel which they may choose to consult to review the method of measuring and reporting findings. ASIC may also choose to discuss the conclusions reached (including firm responses) on a small number of anonymised findings where significant judgement is required. However, ASIC makes the decisions on individual findings and the panel:

- does not review audit working papers
- does not engage with the audit firm and the audit firms are not made aware of which matters were discussed by the panel.

33 As reported in ASIC's Annual reporting and audit surveillance report 2022–23.

ASIC communicates the findings from each audit surveillance:

- to the audit firm who is asked to commit to remedial actions which are agreed to by ASIC.
- to directors of the entity[34] (from 1 July 2022)
- in a public report as detailed above.

In the past few years, the largest 6 firm individual reports were released by ASIC and the firms themselves.

The impact of a negative finding is:

- The firm may need to perform remedial actions as communicated to ASIC.
- The firm is required to perform root cause analysis as part of a continuous improvement process.[35]
- The repercussions for the partner are determined by the firm and may impact partner remuneration depending on the severity of the finding.
- ASIC may consider whether to take enforcement action, however this is not common.

ASIC assesses whether sufficient appropriate audit evidence was obtained to support the auditor's conclusions, and whether they agree with key judgements made by the auditor. Audits necessarily involve the application of professional judgement and the audit firms do not always agree with ASIC's conclusions. ASIC are of the view that they do not raise negative findings where they consider that it is due to a legitimate difference in professional judgement.

Separate Surveillances

In addition to the risk-based surveillances ASIC may review audits based on specific concerns such as complaints or other intelligence, including corporate collapses. Findings from these have resulted in enforcement outcomes, with auditors removed from practice or having their registration cancelled through enforceable undertakings and decisions of the CADB.

There have been very few court actions against RCAs for contraventions of the Corporations Act due to difficulties with proving alleged breaches and relatively low penalties however penalties have increased recently.

Refer to the FRC's Auditor Disciplinary review for further detail on ASIC's audit enforcement powers and processes.

Review of QMS and Compliance with Ethical Standards

ASIC's program focuses on key audit areas of selected audit engagements. In addition in prior years, ASIC have conducted reviews of elements of the QMS such as, processes to manage conflicts of

34 Refer RG 260 Communicating findings from audit files to directors, audit committees or senior managers.
35 ASQM 1 also requires firms to include information from external inspections when determining if there are deficiencies in their systems of quality management.

interest and approaches to firm governance and accountability for audit quality in 2019/2020, processes to manage culture and talent in 2020/2021, and root cause analysis in 2021/2022. However, ASIC do not routinely review a firm's QMS more widely, and whether it is in compliance with the Auditing Standards, or processes to manage compliance with ethical standards.
We understand that during 2022/23 ASIC had high level discussions with the firms on their implementation of the QMS, and as reported in the Annual Financial Reporting and Surveillance Report 2022–23 they did not perform any thematic reviews of QMS in 2022/23. ASIC have indicated that they will be reviewing aspects of the firms' QMS in 2024–25.

International Regulator Organisations Principles

IOSCO is an international body recognised as the global standard setter for the securities sector. IOSCO has principles that international audit regulators should comply with. The following are relevant:

- IOSCO's *Objectives and Principles of Securities Regulation* principle 19 states that Auditors should be subject to adequate levels of oversight.
- IOSCO's *Principles for Auditor Oversight* includes a list of general principles for oversight of audit firms and auditors that audit financial statements of companies whose securities are publicly traded in the capital markets. The following are relevant:
  - Principle 8 III – a mechanism should exist for a body to provide oversight over the quality and implementation of auditing, independence, and ethical standards used in the jurisdiction, as well as audit quality control environments.
  - Principle 8 IV – a mechanism should exist to require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if a professional body acts as the oversight body, is overseen by an independent body. Such an auditor oversight body must operate in the public interest, and have an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding that is not under the control of the auditing profession, to carry out those responsibilities.

IFIAR[36] is the International Organization of Independent Audit Regulators. IFIAR's *Core Principles for Independent Audit Regulators* seek to promote effective independent audit oversight globally. ASIC is a member of IFIAR. The following are relevant:

- Principle 3 – Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.
- Principle 8 – Audit regulators should establish a minimum cycle regarding the frequency of inspections, with the option of conducting ad-hoc inspections when the need arises.
- Principle 9 – Audit regulators should ensure that a risk-based inspections program is in place.
- Principle 10 – Audit regulators should ensure that inspections include effective procedures for both firm-wide and audit engagement file reviews.

36 IFIAR is a membership organisation of 54 independent audit regulators including ASIC.

Comparison with some other International Regulators

The FRC compared ASIC's surveillance program to equivalent programs of PCAOB, UK FRC, New Zealand's FMA and CPAB (refer to Appendix 1). In addition, the FRC reviewed IFIAR's 2022 Survey of Inspection Findings which details the results and scope of members' inspection program. From this the FRC noted:

- In addition to reviewing engagement files some international audit regulators review the firm's system of quality management as they serve as the foundation for executing and monitoring quality audits. As detailed above ASIC have in the past reviewed discrete elements of the firms' system of quality management and did not review any in 2022/23 and does not review the firm's system of quality management more widely. The Corporations Act s 307A requires auditors to comply with the auditing standards in the conduct of an audit and QMS are not specifically relevant in the conduct of an audit. Therefore, ASIC's scope is individual audits and not the audit firms' systems of quality management.
- Other regulators have detailed transparent plans and KPIs on how often auditors (the entire population in scope) are reviewed.

ASIC have measured their findings by reference to key audit areas on audit files reviewed whereas IFIAR measures findings by reference to audit engagements as a whole.

Small Number of Reviews

As the regulator, ASIC is the body with legislative responsibility for oversight of audit quality. The number of reviews being conducted has continued to decrease over the last few years and is now only 15 files in 2022/23. Given that there are approximately 1900[37] entities on the Australian Stock Exchange the number of files reviewed is very low. ASIC is transparent that that the small number of files reviewed does not allow them to conclude on the quality of audits in Australia. However, the FRC consider that number of reviews in both the current and recent years raises questions as to whether there is sufficient coverage of the audit market by ASIC, to enable sufficient monitoring of audit quality in Australia. The FRC also note that some overseas regulators have stated objectives of reviewing all auditors in a particular time frame, for example every year, or every 3 years. Refer to Appendix 1 for a comparison of ASIC's program to some international regulators.

Quality of the Program

Prior to the recent reduction in ASIC's audit file selections and the discontinuation of reporting of findings by firm, the FRC understands that the ASIC program provided a deterrent to poor quality as:

- there is media and Parliamentary attention to the negative findings.
- there are financial penalties for audit partners from a negative ASIC review imposed by the audit firm.
- directors are notified of negative findings (from 1 July 2022).

37 Refer ASIC Annual financial reporting and audit surveillance report 2022–23.

- firms are concerned about the possibility of losing or not winning audits based on higher levels of negative findings compared to competitors.
- the largest 6 global firms have in the past focussed on the results of local firms which affect an IFIAR target to reduce inspection findings across 25 IFIAR members and the largest 6 firms in aggregate.

The CADB

The CADB is an independent statutory body established under Part 11 of the ASIC Act. The primary role is to act as an expert disciplinary tribunal to consider applications for the cancellation or suspension of the registration of auditors under the Corporations Act.

CADB jurisdiction is limited to matters referred to it by ASIC and APRA, and to matters involving RCAs. Its functions and powers are conferred to it by sections of the ASIC Act and Corporations Act.

The functions and powers of the Board in relation to applications are to determine whether a RCA:

- has failed to carry out their duties and functions adequately and properly.
- has breached certain requirements under the Corporations Act.
- is not a fit and proper person.
- has failed to comply with a condition of their registration.
- is subject to disqualification.
- is otherwise ineligible to remain registered.

Refer to the FRC's Auditor Disciplinary review for an overview of the CADB's process when investigating a case.

When cases are referred to the CADB they evaluate the appropriateness of the auditor's work compared to professional standards without the need for expert evidence. This evaluation is valuable in contributing to understanding what appropriate standards of competency for auditors are, and how audit quality can be improved. The CADB publish its decisions which provides useful information to regulators and others.

Number of cases that have been referred the CADB since 2019/20 by nature of sanction:

Result	19–20	20–21	21–22
Registration cancelled	-	9[38]	1
Registration suspended	-	-	1
Admonition	-	-	-
Reprimand	-	-	-
Undertaking required to be given	-	-	1
Dismissed	-	-	-
Withdrawn by ASIC	-	27[39]	-
Total	**-**	**36**	**3**

Source: CADB Annual Report 2021–2022

38 These matters relate to failure to lodge annual returns. Refer to CADB decisions | CADB – Companies Auditors Disciplinary Board

39 These matters relate to failure to lodge annual reports and were withdrawn when the auditor lodged required documentation or cancelled their registration

The CADB cancelled the registration of one auditor in 2022. The number of cases referred to the CADB continues to be low due to ASIC's preference to resolve cases before referring to CADB. In addition, APRA have never referred cases to CADB as it can achieve its objectives using other tools.

As detailed in its submission to the PJC Inquiry: Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry, the CADB have noted that they are underutilised as ASIC and APRA do not refer cases to them frequently. '… the number of matters that have been considered by CADB is insufficient to fully realise either CADB's potential to meaningfully impact regulatory settings in relation to auditors or the full scope of its legislative function.' The CADB recommended there is consideration of:

- an accountability framework or a supervisory body that monitors utilisation by ASIC and APRA of CADB's jurisdiction.
- expanding the entities that may make applications to CADB regarding RCAs.

The APESB

The APESB sets professional and ethical standards with which accounting professionals who are members of the PABs must comply. The APESB is a non-statutory body that was created by the Australian PABs to develop, issue and maintain high-quality professional and ethical standards. The APESB's standards are based on the standards set by the International Ethics Standards Board for Accountants. The APESB's standards do not carry the force of law, except those which are relevant to the performance of an audit, which are legally enforceable by virtue of being referenced in auditing standards.

As a standard-setter, the APESB does not have responsibility for monitoring and enforcing compliance with their standards as this is the responsibility PABs (for their members) and ASIC. However, ASIC's audit surveillance program does not routinely focus on the firms' systems to monitor compliance with APESB's standards. Also, as detailed previously in this report ASIC does not have the powers to enforce compliance with the APESB standards. The PABs review their member firm's system of quality management which include processes to monitor compliance with the professional and ethical standards.

Compliance with the professional and ethical standards are vitally important and recent controversies indicate that more regulation is required in this area.

The AASB and AUASB

The FRC is responsible for overseeing the AASB and AUASB's standards setting processes.

The AASB and AUASB are independent non-corporate Commonwealth entities of the Australian Government responsible for setting accounting and auditing standards.

The AASB and AUASB's functions are set out in the *Australian Securities and Investments Commission Act 2001*, and both have extensive due process frameworks to ensure that their standards and guidance are developed, issued and maintained with proper regard to the public interest, are principles-based, of a high quality, clearly stated and concise and meet the needs of stakeholders. The AASB and AUASB standards are based on, and consistent with the standards set by the equivalent international standards setting bodies.

Similar to the APESB, the AASB and AUASB do not have responsibility for monitoring and enforcing compliance as this is the responsibility of ASIC and the PABs (for their members).

While audit and assurance practitioners have the primary responsibility for quality audits and assurance, the AUASB sets auditing and assurance standards that play an important role in promoting and supporting audit and assurance quality. The AUASB has a strategic objective of, in conjunction with the FRC, identifying and implementing initiatives designed to enhance audit quality in Australia. The AUASB seeks to understand from stakeholders such as regulators, auditors and accounting bodies where the auditing, assurance and quality management standards may need to be improved or enhanced.

Directors and Audit Committees

Directors have a primary responsibility for the quality of financial reporting, which is supported by high quality audits. Directors and in particular audit committees have key roles to play in supporting audit quality. The importance of their roles are emphasised in ASIC Information Sheet 196 – Audit quality – The role of directors and audit committees.

The directors' role in ensuring the independence of the auditor is governed by the requirements in the Corporations Act which requires that the directors' report include:

- the auditor's independence declaration
- for a listed company, a statement about whether the provision of non-audit services by the auditor during the financial year is compatible with the general standard of auditor independence in the Corporations Act, and whether that statement is consistent with the advice of the audit committee (section 300(11B)–(11E)).

Many entities have an audit committee whose role is to assist the board of directors to fulfill its corporate governance and oversight responsibilities in areas including annual financial reporting and oversight of the external auditor. The ASX Corporate Governance Principles also state the role of the audit committee is usually to review and make recommendations to the board in relation to:

- the appointment or removal of the external auditor
- the fees payable to the auditor for audit and non-audit work
- the rotation of the audit engagement partner
- the scope and adequacy of the external audit
- the independence and performance of the external auditor
- any proposal for the external auditor to provide non-audit services and whether it might compromise independence of the external auditor.[40]

In recognition of the integral role in the oversight of their external auditor, the FRC and the AUASB have conducted 3 separate research projects into understanding the perspectives of ACCs on audit quality. The findings[41] were that over 90 per cent of ACCs who participated rated their auditor above average or excellent. This indicates that ACCs are satisfied with audit quality. It is worth noting that the ACCs who engaged in this research were mainly from large ASX entities.

Nonetheless, some audit committees expressed concern in relation to the lack of depth of the audit market and limited choice companies have. We note that the UK also have observed this market concentration issue and recommendations have been made to address the issue in that jurisdiction.

40 Recommendation 4.1, ASX Corporate Governance Council, Corporate Governance Principles and Recommendations (4th ed.).

41 Refer to Audit Quality in Australia: The Perspective of Audit Committee Chairs 2018, Audit Quality in Australia: The Perspective of Audit Committee Chairs 2021, and Perceptions of Audit Quality by Audit Committee Chairs in Australia 2022.

We note that the size of the largest auditing firms in the Australian market may suggest a level of market concentration and may warrant a review.

In addition, the AUASB and AICD jointly prepared the Periodic Comprehensive Review of the External Auditor to provide guidance on matters where a formal review on audit quality by an incumbent auditor is prepared (which supplements ASIC Information Sheet 196).

Appendix 1 – Comparison of ASIC, PCAOB, UK FRC, NZ FMA and CPAB

	ASIC	PCAOB	UK FRC	NZ FMA	CPAB
Objective of program	To promote the improvement and maintenance of audit quality.	To assess compliance with the Sarbanes-Oxley Act, the rules of the Board, the rules of the Securities and Exchange Commission, and professional standards.	To monitor and promote improvements in the quality of auditing in the UK.	To promote and facilitate the development of fair, efficient and transparent financial markets.	To promote audit quality through proactive regulation, robust audit assessments, dialogue with domestic and international stakeholders, and practicable insights that inform capital market participants and contribute to public confidence in the integrity of financial reporting.
Scope of program	Audits of financial reports of PIEs prepared under the *Corporations Act 2001.*	Registered Public Accounting Firms (approx. 1700) i.e., auditors of public companies.	Firms that undertake statutory audits of PIEs and certain other entities.	Registered audit firms (Financial Markets Conduct Act Reporting Entities).	Registered public accounting firms.
Delegate to PABs?	No.	No. Private companies are not subject to oversight by the PCAOB. Auditors of private companies must be members of AICPA which is a	FRC is the authority with responsibility for oversight of statutory auditors, however, can delegate tasks to Recognised Supervisory Bodies (accounting bodies).	There are currently 2 accredited PAB in New Zealand: The NZICA[42], and CPA. The responsibilities of these bodies are in	There are several provincial and regional bodies that represent the Canadian Chartered Professional Accountant membership. The CPA Practice Review

42 NZICA amalgamated with the Institute of Chartered Accountants in Australia (ICAA) on 1 January 2015, to form the Chartered Accountants Australia and New Zealand. However, for the purposes of New Zealand's audit oversight regime, NZICA continues to be the accredited body.

ASIC	PCAOB	UK FRC	NZ FMA	CPAB
	PAB and conducts a Peer Review Program.	Monitoring of statutory audits outside the scope of FRC inspections of listed entity audits is delegated to the Recognised Supervisory Bodies under a series of Delegation Agreements. Link to example of agreement. The agreements are extensive, and accounting bodies must report their plans and results etc.	legislation[43] which requires the bodies to monitor registered auditors and audit firms, promote, and monitor the competence of their members and develop an investigative and disciplinary system. They are also required to report the results to the FMA for assessing their performance against their responsibilities. The FMA has the power to conduct reviews to assess that they have met their responsibilities. Refer to Accredited-body-report-2022 and NZICA_accredited_body_report_2020	program requires the review of all registered PAFs and PSPs who perform assurance, compilation and/or tax services.

43 Auditor Regulation Act 2011.

	ASIC	PCAOB	UK FRC	NZ FMA	CPAB
Frequency of reviews	Previously reviewed Big 6 firms annually. Others on a random basis but no publicly stated target for other auditors. It is not clear if the Big 6 will be reviewed annually in the new program.	If a firm provides audit opinions for more than 100 issuers, the PCAOB inspects them annually. If a firm provides audit opinions for less than 100 issuers, the PCAOB, in general, inspects them at least triennially.	Larger firms are inspected annually while other firms are generally inspected once every 3 years. In certain cases, the inspection cycle can be extended to 6 years.	Previously did each firm at least every 3 years and now starting from the 2023–2024 review cycle, every licensed firm will be reviewed each year. The FMA are transparent about their program and issue periodically their Auditor Regulation and Oversight Plan. Refer to Auditor Regulation and Oversight Plan 2023–2026. (fma.govt.nz)	All firms that audit 100 or more reporting issuers are reviewed each year and firms that audit between 50 and 99 reporting issuers are reviewed at least every 2 years. Remaining firms are inspected periodically based on CPAB's risk analysis.
How are audits selected?	Previously Audit engagements and key audit areas for review in our audit surveillances using a risk-based approach. This means that ASIC generally select some of the more complex, demanding, and challenging audits, and some more significant or higher risk areas of the financial reports. From 2022–23 the financial reporting and audit surveillance programs have been combined and ASIC now routinely select audit files for surveillance where there is a known or suspected material misstatement of the financial report. They may select other audits from other intelligence.	Selects audits for inspection using both risk-based and random methods. Most selections are based on an internal evaluation of audits believed to present a heightened risk of material misstatement. Focus is also placed on risk factors including economic trends, industry developments, market-capitalization size and/or changes, audit firm and partner, and inspection history. The remaining audits are selected randomly to provide an element of unpredictability.	In selecting individual audits to inspect, the UK FRC take account of a wide range of factors including periodic coverage of FTSE 350 constituents, the assessed level of risk in relation to individual audited entities and priority sectors for review announced by the FRC.	Audit quality reviews are risk based. This means that they may perform unscheduled reviews of audit firms and select audit firms and identify key audit areas for reviews based on specific risk factors.	Identifies and rates reporting issuers and audit firms using a risk-based approach.

	ASIC	PCAOB	UK FRC	NZ FMA	CPAB
Size of the inspection team[44]	13	460	128	Not disclosed.	37
The number of files reviewed in 2022	45[45] (15 reviewed in 2022–2023)	710[46]	148	25[47]	132[48]
What is reviewed within a file?	Key audit areas in the audit working papers for selected audit engagements. ASIC may also assess key aspects of audit firm quality control systems over audits of financial reports. This is based on direct reviews of the design and operation of those systems or evidence from audit files.	While inspections vary by firm, the PCAOB may focus on an auditor's risk assessment processes, financial reporting and audit areas affected by economic trends or pressures, audit areas that present challenges and significant risk, new accounting standards, and areas of recurring audit deficiencies.	Focus on the quality of the audit work performed in the areas selected for review, the appropriateness of key audit judgments made, and the sufficiency and appropriateness of the audit evidence obtained.	Focus is on key audit areas chosen based on common findings identified by international audit regulators and recent reviews. The reviews for the next 3 years will focus on the audit firms system of quality management, planning of the audit, execution of the audit, reporting of the audit and any significant matters.	The entire audit file is not inspected. Two to four focus areas are selected as a basis for assessing the quality of audit work in a selected file. Core areas such as materiality, risk assessment and fraud are also reviewed for each file.

44 Provided by ASIC.
45 Refer Report REP 743 Audit inspection report: 1 July 2021 to 30 June 2022 (asic.gov.au).
46 Refer staff-preview-2022-inspection-observations-spotlight.pdf (pcaobus.org).
47 Refer 2022-Audit-Quality-Monitoring-Report.pdf (fma.govt.nz).
48 Refer cpab-ccrc.ca/docs/default-source/inspections-reports/2022-annual-inspections-results-en.pdf.

	ASIC	PCAOB	UK FRC	NZ FMA	CPAB
Do they review the firm's systems of quality management?	ASIC may also assess selected aspects of audit firm quality control systems over audits of financial reports. However this is not done routinely every year.	Yes. The inspection team will review the firm's system of quality control, including areas such as the firm's management structure and processes, practices for partner management, policies and procedures for an issuer's acceptance and retention, internal inspections programs, how the firm responds to deficiencies in its audit quality, and independence policies and procedures.	Yes. They select components of the systems of quality management to identify examples of good practice.	Yes. They assess whether the audit firms' systems of quality management are appropriate.	Yes. They evaluate the effectiveness of the system of quality management, including firm implementation of the new quality management standards, firm culture and firm leadership.

Appendix 2 – How the Recommendations from the 2019 Disciplinary Review have been Addressed

ASIC

ASIC's detection, investigation, and enforcement processes

No.	Recommendations	Responses[49]
1	ASIC should adopt a more structured and consistent approach to preliminary investigations of RCA misconduct matters.	On 1 June 2018, ASIC introduced a new workflow system that better captures the existing approach to surveillance of potential RCA misconduct matters. This information is readily accessible to ASIC's Enforcement teams prior to a formal memo seeking acceptance by Enforcement. Following ASIC's recent organisation design review a new Enforcement Inquiries and Compliance Team dedicated to Financial Reporting Audit and Corporations matters was established. The team has staff with relevant experience and considers auditor misconduct referrals from stakeholder teams for possible enforcement action.
2	ASIC should improve its record keeping and data management systems to ensure key decision points in relation to RCA matters are easily tracked across the organisation.	ASIC implemented a new workflow system which is used by all ASIC teams. The progress of a matter and key decision points can be more easily tracked across the organisation.
3	ASIC should evaluate whether the criteria used for resourcing a RCA misconduct matter for enforcement action appropriately recognises the market-wide benefits of improving audit quality.	ASIC Information Sheet 151 *ASIC's approach to enforcement* publicly was reissued in November 2021. It outlines ASICs general approach to enforcement and discusses how we respond to matters taking into account considerations such as: • Strategic significance (e.g., what is the extent of harm or loss?); • Benefits of pursuing misconduct (e.g., is enforcement cost-effective?); • Issues specific to the case (e.g., what evidence is available?); and What enforcement tools are available. A new internal guide for assessing auditor related matters has been developed having regard to ASIC's experience from current audit matters under investigation. Note also that the objective under ASIC's Enforcement Strategy since 2019 has been to identity, prioritise and act quickly and decisively on the most important enforcement matters within ASIC to obtain criminal and civil court-based outcomes that discourage and punish misconduct. In order to further this priority, ASIC is pursuing several current investigations in relation to auditor misconduct, which include a focus on pursuing criminal and or civil liability for relevant auditor misconduct.

49 These responses are based on communications to the FRC in December 2021.

ASIC

ASIC's detection, investigation, and enforcement processes

No.	Recommendations	Responses[49]
4	ASIC should outline how their 'why not litigate' enforcement strategy will apply to misconduct by RCAs.	ASIC's Corporate Plan 2023–27 has dropped all mention of 'Why not litigate?' test but is committed to continuing as an 'active litigator against misconduct'. ASIC assesses the best regulatory approach to a matter having regard to all the relevant facts and circumstances, as well as the full range of regulatory tools available to ASIC. This applies to misconduct by RCAs.

ASIC

ASIC's Audit Inspection Program

No.	Recommendations	Responses[50]
10	Potential breaches of the law and failures of RCAs to meet their obligations identified in ASIC's Audit Inspection Program should be reviewed for possible enforcement action.	ASIC reviews negative findings from audit file reviews conducted as a part of our audit firm inspections for possible enforcement action, as appropriate. ASIC took criminal action against the lead auditor and audit company for the audit of Halifax Investment Services Pty Ltd, as well as referring the lead auditor to the CADB. ASIC's enforcement actions have also resulted in one auditor being convicted for failing to comply with the auditing standards and one auditor being charged with contravening the Corporations Act. In addition, 2 auditors' registrations were suspended by the CADB for deficient audits.
11	ASIC should publish the results of audit inspections in greater detail, including naming firms.	This has been adopted. For example, in October 2022, ASIC published the percentage of negative findings from reviews of key audit areas in audit files as a part of its audit firm inspections during the 12 months to 30 June 2022. ASIC Report 743 Audit inspection report for 2021–22 included individual percentages for each of the largest 6 firms by name. Under ASIC's new financial reporting and audit surveillance program they include in its public report individual audit findings for all firms reviewed in the period, providing prominence to all audit findings. Firms are no longer named. From 1 July 2022, ASIC report audit findings to the directors of companies as well as the auditor to encourage constructive dialogue between the company and auditor to improve financial reporting and audit quality.
12	ASIC be given the power to compel remediation of defective audits, alongside the power to publish notices when this occurs.	ASIC is supportive of this proposal however this requires legislative change.
13	ASIC should consider the division of resources between audit inspection and financial reporting surveillance work to ensure that ASIC's resources are being used effectively to ensure good RCA audit quality.	Audit and financial reporting surveillances are all conducted by ASIC's Companies and Small Business team. Resources continue to be dynamically allocated within the team to achieve the best outcomes for quality financial reporting supported by quality audits.
14	ASIC and the FRC will work together to implement the Parliamentary Joint Committee	In December 2019, ASIC published Report 649 Audit quality measures, indicators and other information: 2018–19. This report was partly in response to the recommendation. The report contains a broad group of audit quality

50 These responses are based on communications to the FRC.

ASIC

ASIC's Audit Inspection Program

No.	Recommendations	Responses[50]
	on Corporations and Financial Services report Oversight of ASIC, the Takeovers Panel and the Corporations Legislation No.1 of the 45th Parliament recommendation to devise a study that would track audit quality over time.	measures, indicators, and other information to supplement the findings outlined in ASIC Report 648 Audit inspection report for 2018–19. In December 2020, ASIC published Report 678 Audit quality measures, indicators and other information 2019–20, which similarly supplemented Report 677 Audit inspection report: 1 July 2019 to 30 June 2020. The output measures that appeared in Reports 648 and 678 were included in Report 709 Audit inspection report: 1 July 2020 to 30 June 2021, together with input measures on audit fees and non-audit fees. In 2022, ASIC separately reported on the effectiveness of root cause analysis at the largest 6 firms in Report 739. The results of FRC/AUASB surveys of audit committee chairs and CFOs on perceptions of audit quality were published by the FRC/AUASB in December 2022. The information required for other measures and indicators was provided by the 6 largest audit firms to ASIC and is no longer collected from the largest 6 firms. This is due to the time and effort required by the firms to collect this information and the view of the firms that the cost outweighed the benefit.

The CADB

No.	Recommendations	Responses[51]
1	CADB and ASIC should work to adopt a less formal and a more timely approach to the carriage of CADB matters. This should include a review of CADB's practice and procedures manuals.	CADB has comprehensively revised its matter conduct guidelines for parties to applications (Matter Guidelines). The Matter Guidelines introduce new hearing preparation procedures to be conducted between the parties which are designed to result in streamlined hearings and more efficient decision-making on applications to meet the FRC's 1st recommendation of adopting a less formal and more timely approach to matters once they are filed with CADB. CADB consulted with ASIC on the proposed changes before they were finalised. The Matter Guidelines may be found on the CADB website. The Matter Guidelines are designed to enable CADB to deliver decisions within a shorter timeframe and deal with more volume, to the extent applications are made.
2	The Government should consider revising provisions so that CADB may publish the commencement of proceedings including naming the RCA subject to the proceedings and his or her firm.	CADB believes that the transparency benefits need to be balanced against the potential reputational damage caused by such publication. If CADB selectively published the names of some RCAs to proceedings and not others, this might be perceived as lacking impartiality.

51 These responses are based on communications to the FRC.

The CADB

No.	Recommendations	Responses[51]
3	The Government should consider providing CADB with additional disciplinary powers, including powers to suspend registration during a CADB proceeding and impose fines against individual RCAs or the firms that employ them, if adverse findings are made.	CADB supports this recommendation in principle.
4	If a greater number of applications are made to CADB as a result of current and upcoming reforms, the Government should consider whether CADB will require additional administrative support to ensure matters are dealt with.	CADB supports this recommendation however additional resources will be necessary for the CADB to hear more applications.

The PABs

No.	Recommendations	Responses[52]
1	Professional bodies should refer to ASIC all matters relating to RCAs where there appears there may be a breach of the law.	**CPA** Due to privacy regulations CPA Australia can only refer to ASIC evidence of breaches of law or matters that have been published and/or the Disciplinary Tribunal specifies that ASIC is to be notified. Where this is the case CPA Australia's Professional Conduct Unit will notify ASIC in writing. **CA ANZ** Due to confidentiality requirements, this would need to be a specific sanction applied to the member, CA ANZ will amend the operating guidelines to facilitate this. **IPA** The IPA has not had cause to report to ASIC as we are not aware of any RCA members breaching the law. All breaches have been against professional and ethical standards and IPA by-laws. If the situation should arise, we will refer the matter to ASIC. The IPA has on the other hand, had members refer breaches of the law to ASIC relating to a range of matters. Members are obliged under Non-compliance with Laws and Regulations to report potential and actual material breaches of laws and regulations to the relevant public authority, and this obligation is consistently reinforced with all IPA members. The IPA have assisted members in this regard on numerous occasions.
2	Professional bodies should accurately record all disciplinary processes, including those that lead to no substantive action, and the reasons for the decision. They should also distinguish between lack of	**CPA** All disciplinary processes are recorded accurately and electronically by the Professional Conduct Unit of CPA, including reasons for the decisions. Outcomes of Disciplinary Tribunal hearings are recorded, including the reasons for sustaining (or dismissing) complaints/allegations and the reasons for the penalty/ies imposed. For those matters that do not proceed to a Disciplinary Tribunal for hearing due to either insufficient evidence provided by the

52 These responses are based on communications to the FRC.

The PABs

No.	Recommendations	Responses[52]
	evidence that conduct was inappropriate and lack of evidence because information was not provided.	complainant or the evidence provided does not support the allegations made, reasons for the decision are recorded in the final report and communicated to the parties involved. **CA ANZ** CA ANZ records all disciplinary processes, and will however amend the recording to distinguish between lack of evidence that conduct was inappropriate and lack of evidence because information was not provided. **IPA** This is already being done. The IPA records all disciplinary action taken against members. The IPA ensures that the information recorded includes reasons for the decision including where there is lack of evidence that conduct was inappropriate, and lack of evidence because information was not provided. IPA members who face disciplinary action can be penalised for failing to provide information requested as part of the disciplinary process. Since COVID-19, IPA has introduced enhanced record keeping and reporting through the use of digital document management systems, electronic signatures, enhanced recording, improved online public and member communications, and our Disciplinary Tribunal hearings are entirely virtual. Further digitisation is currently underway which will lead to more improvements in the overall disciplinary process. In addition to a process of continuous improvement, the IPA commenced a root and branch review of its complaints and disciplinary system and processes to ensure they are operating at best practice levels. The final tranche will be completed in early 2024.
3	Professional bodies should formalise processes for advising each other and the FRC of their disciplinary proceedings, particularly regarding RCAs.	**CPA** CPA Australia has continued to review how it may form closer ties with other statutory and professional bodies to directly advise them of disciplinary outcomes that are publicly available on CPA Australia's website. In September 2020 CPA Australia and the FRC signed a MOU to collaborate wherever possible and mutually beneficial to ensure audit quality and to promote open discussion on issues relating to audit quality. **CA ANZ** Due to confidentiality requirements, this would need to be a specific sanction applied to the member, CA ANZ will amend the operating guidelines to facilitate this. In addition in September 2020 CA ANZ and the FRC signed a MOU to collaborate wherever possible and mutually beneficial to ensure audit quality and to promote open discussion on issues relating to audit quality. As part of this CA ANZ undertakes to inform the FRC of any disciplinary action taken against any member of CA ANZ in relation to a breach of CA ANZ's audit quality requirements without necessarily identifying individual auditors. CA ANZ will also inform the FRC when it is aware that one of its members has been referred to the CADB in relation to a breach of audit quality requirements. **IPA** The outcomes of IPA's disciplinary proceedings are published, and members are required to report any disciplinary action taken by other bodies or regulators etc and can be penalised for failing to do so. The IPA has not formalised processes with the other bodies, however subject to obtaining further legal advice, the IPA may be in a position to comply with or implement the recommendations. The IPA regularly engages with the other PABs and regulatory bodies to discuss developments, trends, and concerns. The IPA adheres to its legal obligations on privacy and confidentiality and will take these into consideration. In September 2020 the IPA and the FRC signed a MOU to collaborate wherever possible to promote open discussion on issues relating to audit quality.

The PABs

No.	Recommendations	Responses[52]
4	Professional bodies should publicly report statistics on the number of complaints they receive, and the number of complaints that do not proceed.	**CPA** There has been no change in CPA's complaints reporting processes since the update of March 2020. CPA Australia's Annual Integrated Report contains statistics relating to the source of complaints received, those investigated and closed due to lack of supporting evidence and complaints brought before a disciplinary tribunal and penalties imposed. **CAANZ** CA ANZ currently publish the number of complaints and the outcome in their annual report. **IPA** The IPA publishes statistics on the number and nature of complaints received and outcomes. The IPA publishes information on the type of complaint, common causes of investigations, geographical location of members and information on the outcomes of Tribunal decisions, including reasons for determination provided by the Tribunal. With respect to the number of complaints that don't proceed (i.e., 'no case to answer'), the IPA provides this information internally for Board purposes and as part of our Professional Standards Improvement Program with the Professional Standards Councils.

Appendix 3 – Stakeholders Interviewed

We thank representatives from the following bodies who shared their views with us:

Audit Firms

Deloitte

EY

PwC

KPMG

BDO

Grant Thornton

Pitcher Partners

William Buck

Regulators

ASIC

APRA

Tax Practitioners Board

Professional Accounting Bodies

CA ANZ

CPA Australia CPA

IPA

Other

The Companies Auditor Disciplinary Board (CADB)

Accounting Professional & Ethical Standards Board (APESB)

Professional Standards Council

Glossary

AASB	Australian Accounting Standards Board.
ACC	Audit Committee Chair.
ACNC	Australian Charities and Not-for-profits Commission.
AFR	Australian Financial Review.
AICD	Australian Institute of Company Directors.
APESB	Accounting Professional and Ethical Standards Board.
APRA	Australian Prudential Regulation Authority.
ASA	Australian Auditing Standards.
ASIC	Australian Securities and Investments Commission.
ASX	Australian Securities Exchange.
ATO	Australian Taxation Office.
AUASB	Auditing and Assurance Standards Board.
CA ANZ	Chartered Accountants Australia and New Zealand.
CADB	Companies and Auditors Disciplinary Board.
CEO	Chief Executive Officer.
CPA	CPA Australia.
CPAB	Canadian Public Accountability Board.
CPD	Continuing Professional Development.
CPP	Certificate of Public Practice.
EY	Ernst & Young Australia.
FMA	Financial Markets Authority.
FRC	Financial Reporting Council.
GT	Grant Thornton Australia Limited.
IFAC	International Federation of Accountants.
IFIAR	International Forum of Independent Audit Regulators.
IOSCO	International Organization of Securities Commissions.
IPA	Institute of Public Accountants.
MOU	Memorandum of Understanding.
NZICA	New Zealand Institute of Chartered Accountants.
PABs	Professional Accounting Bodies. This consists of CA ANZ, CPA and IPA.
PAF	Professional Accounting Firm in Canada.
PCAOB	Public Company Accounting Oversight Board.
PCC	Professional Conduct Committee.
PCFR	Professional Conduct Framework Review.
PCOC	Professional Conduct Oversight Committee.
PIE	Public Interest Entity.
PJC	Parliamentary Joint Committee on Corporations and Financial Services.
PSC	Professional Standards Council.
PSP	Professional Service Provider in Canada.
PWC	PricewaterhouseCoopers Australia.
SMO	Statements of Membership Obligations.
SMSF	Self-Managed Superannuation Fund.

QMS	Quality Management Standards.
RCA	Registered Company Auditor.
UK FRC	UK Financial Reporting Council

Resources Reviewed

1. Relevant parts of *Corporations Act 200*1
2. s 225(2C) *Australian and Investments Commission Act 2001*
3. Submissions to the PJC Inquiry: Ethics and Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry
4. Submissions to the Senate Inquiry into Management and Assurance of Integrity by Consulting Services and the NSW Government's use and management of consulting services
5. Auditor registration requirements
6. IOSCO Objectives and Principles of Securities Regulation
7. IOSCO Principles for Auditor Oversight
8. IFIAR's Core Principles for Independent Audit Regulators
9. CAANZ, CPA, IPA Annual Reports
10. Relevant extracts from PAB's by-laws
11. The PAB's requirements for membership entry, CPP and CPD
12. Extracts from the PAB's quality review programs
13. Reporting on PAB quality review programs and results
14. CAANZ Professional Conduct Framework Review Final Report
15. CA ANZs Summary of Research into Statutory audit and assurance requirements and the demand for RCAs in Australia
16. ASIC Report 743 ASIC reports on audit inspection findings for 12 months to 30 June 2022
17. ASIC Report 774 Annual financial reporting and audit surveillance report 2022–23
18. ASIC's RG 260 Communicating findings from audit files to directors, audit committees or senior management
19. ASIC Information Sheet 196 Audit Quality: The role of directors and audit committees
20. ASIC Information Sheet 184 Audit transparency reports
21. ASIC Information Sheet 224 Audit surveillances
22. ASIC Information Sheet 151 ASIC's Approach to Enforcement
23. ASIC's Corporate Plan 2023–27
24. ASQM 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements*
25. ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*
26. APESB's Website and Annual Report
27. CADB Website and Annual Report

28. Transparency Reports of the largest 6 audit firms
29. IFAC's SMO 1
30. Professional Standards Council website
31. Public reporting by the PCAOB, UK FRC, NZ FMA and CPAB on their Audit Surveillance Programs

NOVEMBER 2023

Audit Quality Monitoring Report

1 July 2022 – 30 June 2023

FMA
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

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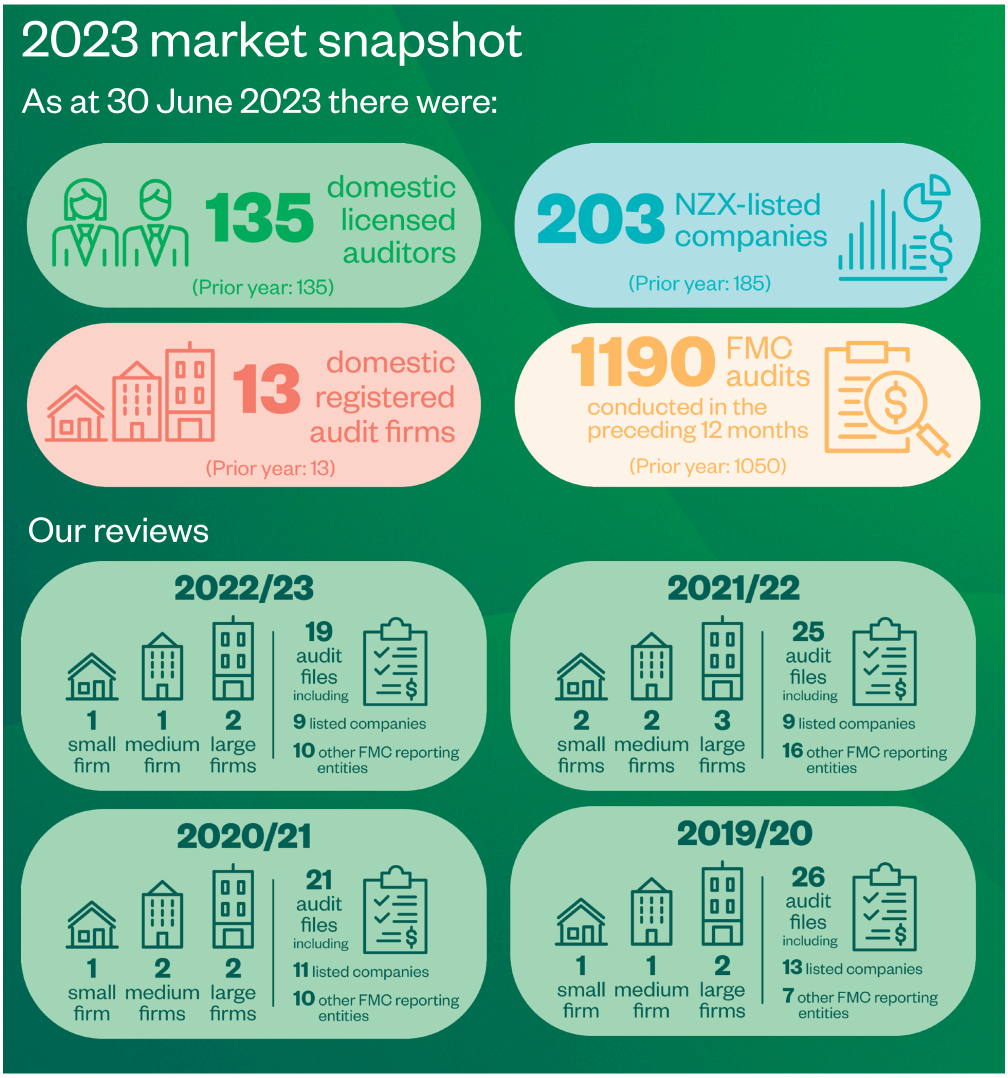
Summary of reviews



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

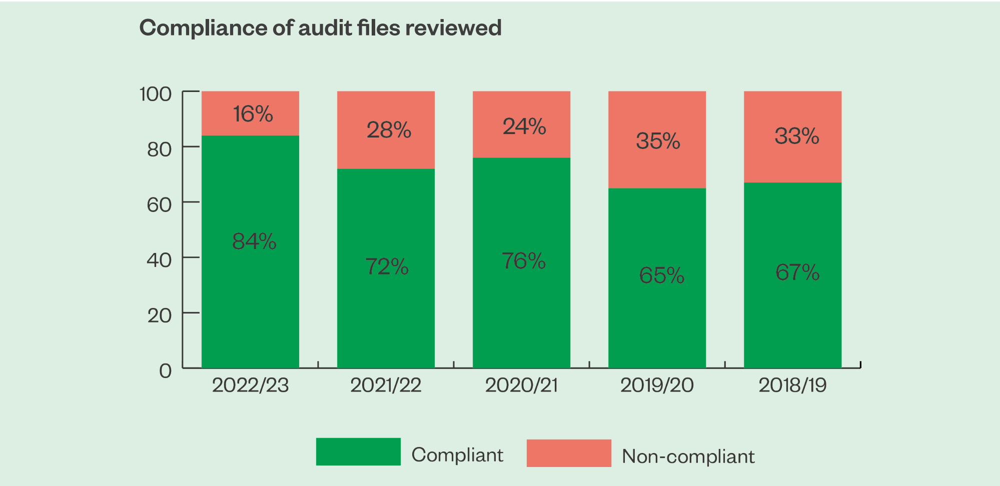
What we have seen

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.



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.

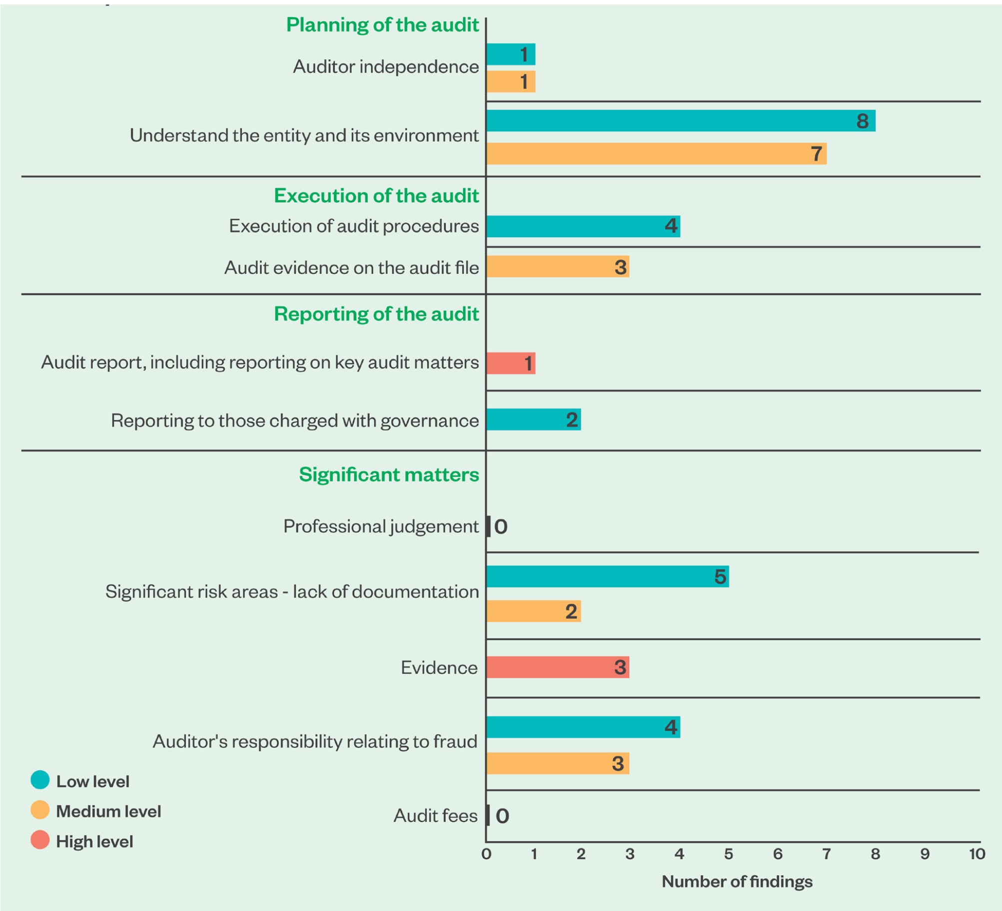
In our monitoring of audits and audit firms, we are not only focusing on compliance with audit standards, but also considering developments and trends in the audit market, such as public information on ethical breaches, that could impact the quality of audits going forward or require additional focus.

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.

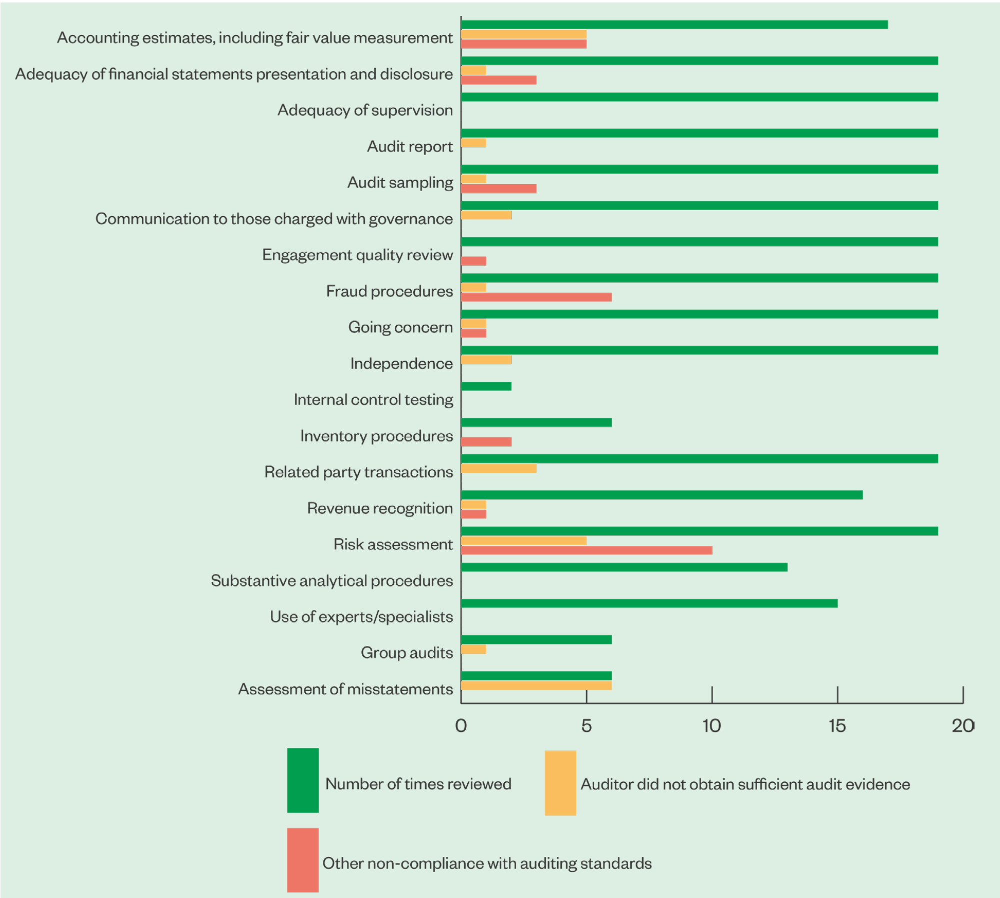
Analysis of our file reviews

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.

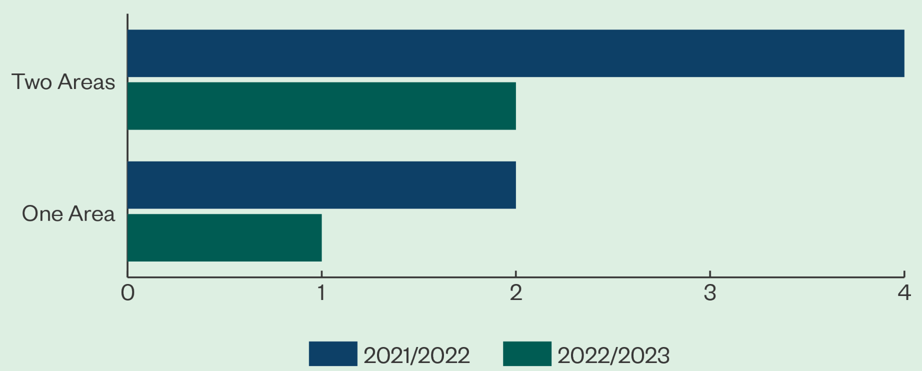
For more details on common findings and themes, see page 18.

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.

Number of areas reviewed in which files were non-compliant



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.

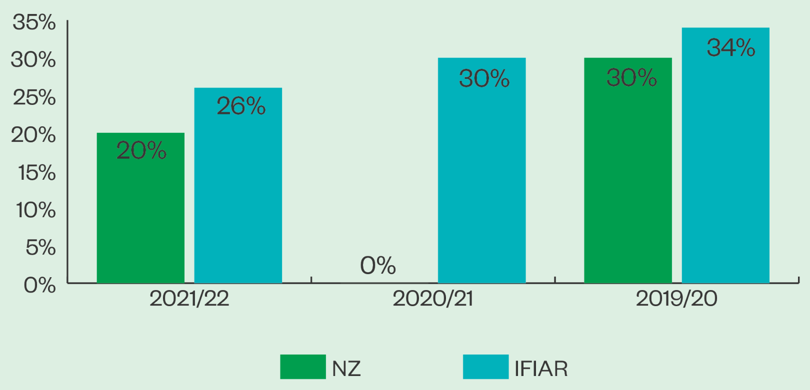
6: During the subsequent audit of an entity following our review of its audit file, the audit team had to confirm the data used in financial models to determine the insurance liability was accurate and complete, and there were no misstatements in the data that could have a material impact on the valuation 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.

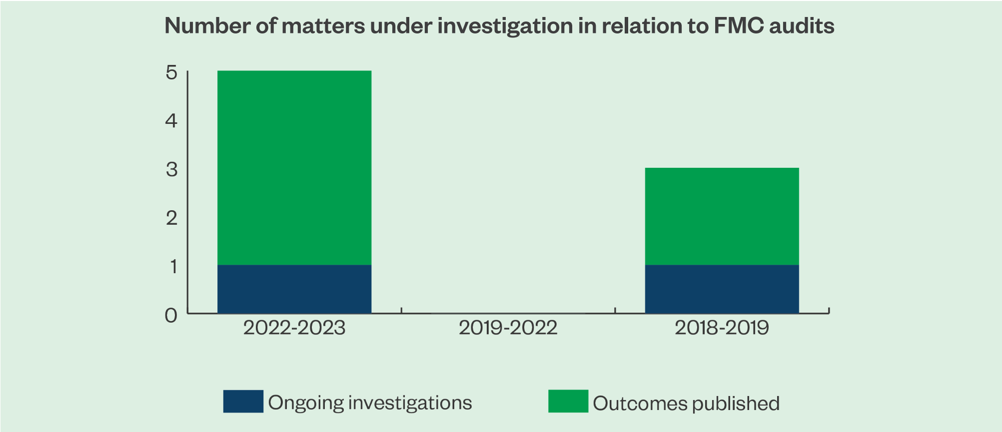
Fonterra

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.

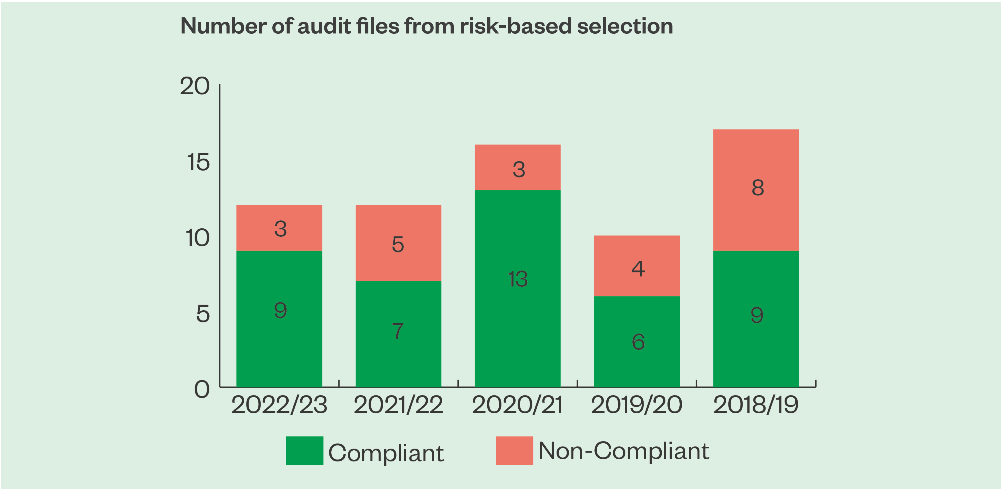
File selection and ratings for individual audit files

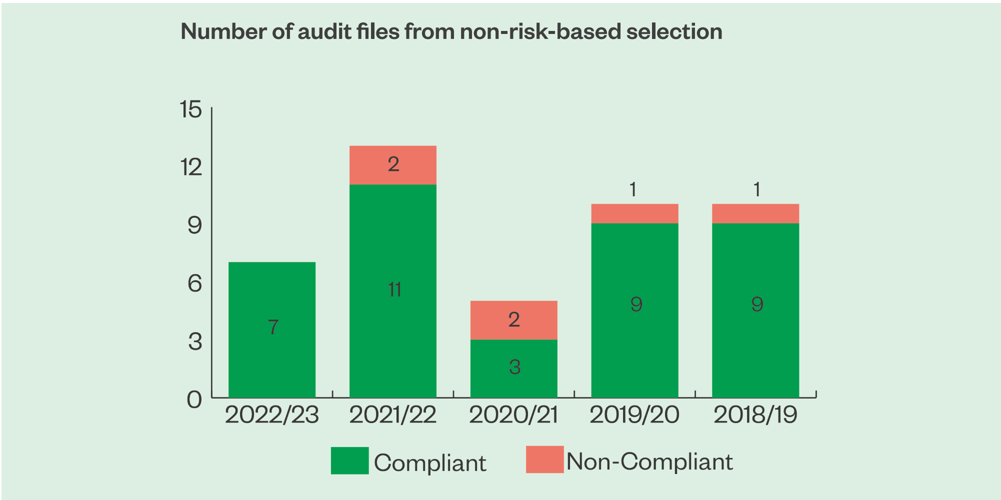
The number of audit files we select for each audit firm is determined by the number of licensed auditors at the audit firm, the number of FMC audits completed and the results of the audit firm's previous review.

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

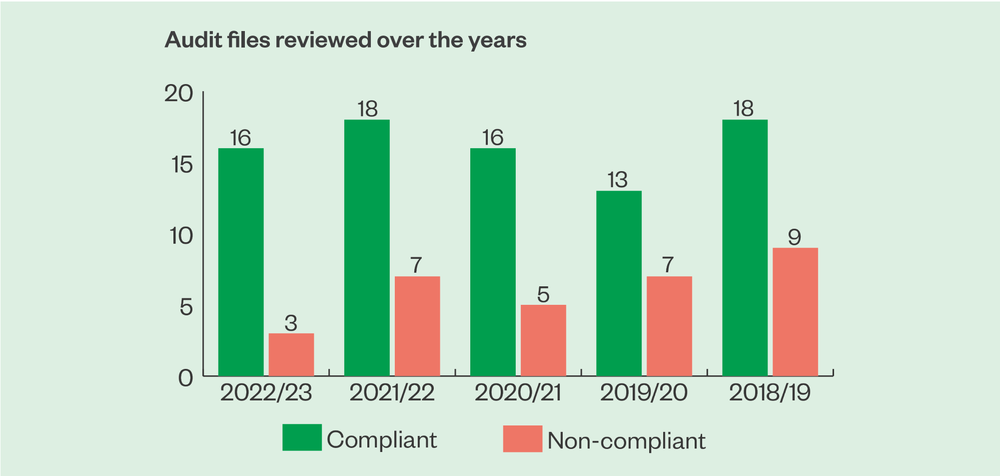
When we complete a file review, the reviewer gives each individual finding on that file a rating from low to high, and proposes a final overall file rating from the categories below:

- 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.

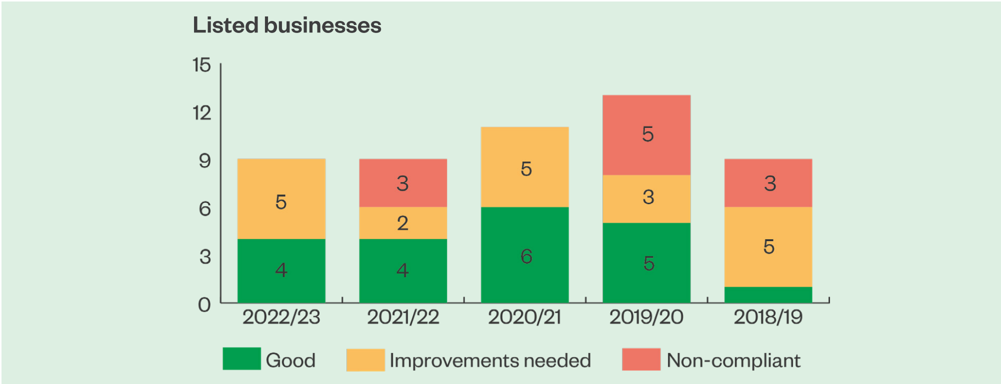
The ratings are moderated by the AOC.

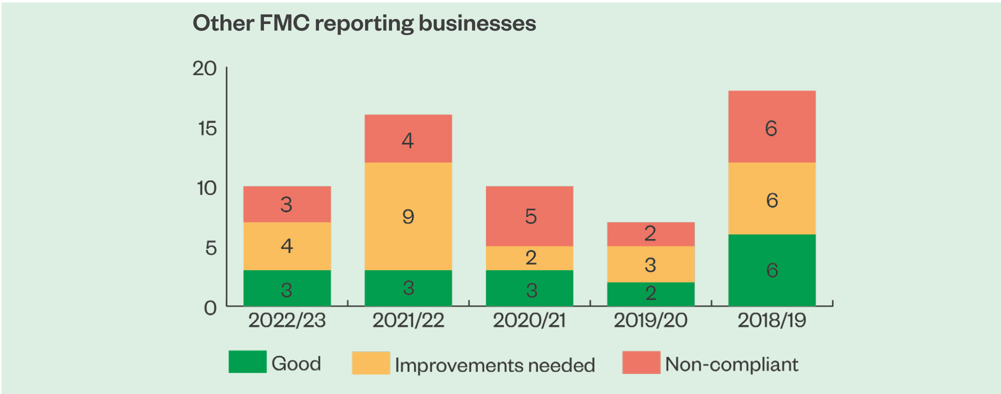
Summary of review ratings

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.

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