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Dear Sir/Madam

Licensing of auditors and the registration of audit firms

Thank you for providing an opportunity to submit comments on a second consultation paper that has been issued by the Financial Markets Authority (FMA) explaining how it intends to license auditors and register audit firms.

We were pleased to see an analysis of submissions that supported many of the changes you made in the second consultation paper. We noted widespread consensus on many points, particularly on the reduction of qualifying hours, but the reality is this regime is going to fundamentally change the current assurance landscape in New Zealand. There are going to be auditors that are licensed and others that are not. Our current assessment is that the vast majority of them are going to reside in the large metropolitan centres of New Zealand which means that for many issuers located in the regional centres, their audit costs will increase. We note the consultation paper is silent on this implication.

To reiterate what we said in our 16 December 2011 submission, our view is that **every entity** in New Zealand, and not just issuers, should expect a high quality audit. Overall we believe the monitoring proposals put forward in this paper should achieve its stated intention of making sure that all issuers in New Zealand are properly audited.

The role of the "accredited body"

We are aware that many discussions have taken place between the FMA and the New Zealand Institute of Chartered Accountants (NZICA) and CPA Australia (CPA). These have been followed up with consultation papers specifically addressing the role of the accredited bodies and how they will relate to the FMA.

We find it interesting that the FMA has made a decision not to delegate to the accredited body what we would describe "full responsibility" to monitor and enforce certain minimum standards.

To us there appears to be a blended role of responsibility – one that potentially could create operational issues for both NZICA and CPA in due course. For example, the FMA has clearly stipulated certain minimum experience requirements for auditors (eg 1,000 hours of

audit experience in New Zealand for auditors that will be licensed after 1 July 2014) but it appears that the accredited bodies still have some discretion around interpreting this. So if there was a newly promoted partner in Sydney that that worked almost exclusively on the audit of New Zealand subsidiaries, but that individual came up short in meeting the minimum FMA specified required hours, say 900, the accredited body appears to be left with the go/no go decision of whether to approve that individual or not.

The conundrum that is created by the FMA specifying certain minimum standards, but then providing the accredited body with the discretion to "override" these requirements in unique and valid circumstances creates some unease for us, particularly should something subsequently go wrong. Where would responsibility lie when, to follow through on the example noted above, that Sydney partner who was licensed by NZICA subsequently proves to be a rogue auditor – the FMA or the accredited body?

Given where we are currently at there is probably no quick fix, but we see the potential for a blame game given what the FMA has developed and prescribed for the accredited bodies to follow, yet still leaving them with discretion to make the final call.

Market awareness

A danger that is recognised in the initial consultation paper was that issuers may have a limited number of choice of accounting firms to undertake their audit. Our view is that implementation of this policy affects issuers in many regional centres around the country.

Our wish is that the FMA, NZICA and CPA now actively work together on bringing the change in auditor requirements to the attention of not only those in the accounting profession, but also the director community throughout the country.

Audit competency

In our previous submission we drew attention to the fact that any licensed auditor, whether resident in New Zealand or overseas, had to be able to demonstrate and evidence their current competence and knowledge of New Zealand's laws and regulations. We are pleased to see the FMA taking up this point and making changes to its second consultation paper as a result of this.

However, we think the FMA could still go one step further and provide the opportunity for a certain proportion of the minimum hours to reflect training specifically related to the audit of issuers. Our recommendation is that up to 10% of the 750 minimum hours should allocated to training provided it is targeted and focussed professional development training on the audit of issuers in New Zealand.

One of key reasons for undertaking professional development training is to compress in a structured learning environment what would otherwise be hands on experience. Our firm's rule of thumb is that 40 hours in a classroom can condense up to 1,000 hours of hands on experience in the field. Learning from "war stories" that other audit professional have had to deal with is highly effective and this is one of the reasons why we would like to see the FMA making some accommodation to recognise the huge value this type of training brings to audit practitioners.

Minimum hours

These have now changed and your current minimum of 750 hours being spent on the audit of issuers over a period of up to three years is far more reasonable. Although this will result in more licensed auditors meeting these requirements, this threshold should still prevent the "auditing enthusiast" from taking on assignments that they are clearly not prepared for and qualified to undertake.

To help meet the minimum hours we note the concept of "similar audits" being introduced, and we do not oppose this concept. However, your consultation paper refers to "full IFRS". We draw to the attention of the FMA that in light of Differential Reporting (or its future replacement the Reduced Disclosure Regime – RDR) there will be very few reporting entities that would actively elect to report under "full IFRS" when the alternatives such as RDR exist. Given this we would encourage you to consider and modify the definition of "similar audits" to recognise the reporting requirements contemplated for entities in Tier 2 of the new financial reporting framework. The audits of Tier 1 and 2 public benefit entities may also be included in the mix.

A point that we made in our original submission on auditor regulation is that a critical component to the success of the minimum audit hours regime is accurately defining in the regulations what an "audit hour" is and what an "audit hour" is not. Our view is audit hours should include any activity that is covered by standards issued the XRB's New Zealand Auditing and Assurance Standards Board (NZAAuSB). This means that time spent on interim reviews of listed companies (which is subject to review standards and not audit standards) should be included, whereas time spent on agreed-upon assurance engagements (which is not within the NZAAuSB's mandate) should be excluded.

Given the split responsibilities between the FMA and the accredited bodies, we think this is a matter requires your urgent attention.

Pre-requisite experience

The consultation paper signals that the FMA will now align its qualifying experience with Australia (ie 5 years experience, with a minimum of 3,000 hours of experience in auditing of which the last 1,000 hours in years 4 and 5 must be spent in the more complex and judgemental areas of the audit).

We make the observation that we think it would be quite extraordinary for a person within our organisation, with this level of experience, to be given this level of decision-making authority. This was the reason why we supported NZICA's viewpoint that 8 years was far more realistic – even for the most exceptional performer.

Audit report sign-off

There is a difference between the way Australian auditors sign off their audit reports and what we currently do in New Zealand.

We have considered the Australian audit opinion sign-off requirements and do not believe they are necessary or appropriate for New Zealand. The principle difference is that in Australia, the name of auditor signing the opinion (in addition to the name of the firm) needs to be provided. We think the FMA should provide some direction on this.

We are currently not aware of any issuer audit in New Zealand where an individual has been appointed in a personal capacity. What happens is that the audit firm, rather than the individual, is appointed, and this is confirmed through the audit engagement letters always being issued on audit partnership letterhead.

We note that International Standards on Auditing (which is the platform for auditing standards issued in New Zealand) do not require identification of the audit partner, only the name of the firm, so our recommendation to the FMA on this point is that New Zealand continues with its current sign-off practice. Doing this would then not create a difference between licensed auditors in the New Zealand market, and those that are not.

We believe the FMA needs to explicitly provide some direction on this issue ahead of the request for auditors to apply to become licensed auditors in this new regime, as some may not wish to be identified in this fashion.

"Fit and proper"

While have having a "fit and proper" test is most certainly in order, we think the situation of settling out of court claims requires further attention. As pointed out to the FMA at a meeting it called in Auckland on 2 March 2012, the insurance industry (rather than the audit firm) often directs the auditor to accept a settlement action/decision even though the auditor truly believes they have a supportable position and should not be sanctioned.

Given this we ask the FMA to carefully reconsider the components of "fit and proper" test.

While is it essential that investors trust licensed auditors at all times, we do believe that some of the matters noted in the consultation paper could be scaled back until it can be demonstrated that they are not providing the sanctions necessary to protect public investors. In other words, start off with an absolute minimum level of requirements, and based on experience and events, build the detailed requirements out over time.

Overseas auditors

Currently Australian auditors can sign off the financial statements of issuers in New Zealand. However, New Zealand auditors are currently not given the same right (ie allowed to sign off the financial statements of issuers in Australia). This situation needs to change.

In light of the policy principles outlined in the Single Economic Market agreement between our two countries we think as a matter of urgency the FMA should actively take steps with its counterpart in Australia to correct this situation. Simply put, it is creating unnecessary additional compliance costs on New Zealand issuers when New Zealand auditors have to involve Australian partners on the audit of any entity preparing general purpose financial statements that is incorporated in Australia.

Closing remarks

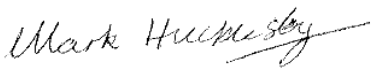
In light of the many submissions that were received from us and other audit firms around the country, we are pleased to see the FMA making so many constructive changes to its first consultation paper.

Like the FMA, we are passionate about creating and promoting trust in the audit process. We see the latest set of proposals being put forward by the FMA as sensible and genuinely believe they will work well in the New Zealand market.

You mentioned that you may wish to involve us in a "fatal flaw" review of your final requirements, as many international standard setters now ask the "large firms" to do. If you decide to do this, we would be pleased to assist.

Should you have any questions on this submission, please do not hesitate to contact the writer.

Yours sincerely



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