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Commerce Committee  
Select Committee Office  
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10 November 2010

Dear Committee Members

**Commerce Committee: Auditor Regulation and External Reporting Bill**

When enacted into law this Bill will have a profound impact on not only our business operations, but also on the future careers of many thousands of chartered accountants who wish to specialise in auditing.

In principle we support this Bill, however there are some aspects of it that seriously concern us.

Although not all of New Zealand's 32,000 accountants are directly involved in audit activity – our best estimate would be that approximately 10% of them currently are – a much higher percentage than this have at some point in their careers been involved in auditing a set of financial statements in accordance with professional standards.

While not wanting to over dramatise the current situation, the legislation you are considering is viewed by many audit firms as a “once in a lifetime” piece of legislation, so from our perspective it is critical that the Act that ultimately emerges is balanced, fair, and above all else, responds to the public policy issues that have been found wanting in the past.

This Bill is a complex piece of legislation that will dovetail into many other important pieces of legislation. The impression we currently have is that, unfortunately, this is a piece of legislation that is being rushed through to meet short-term political objectives. The end result may be that while the audit and financial reporting needs of “issuers” will be solved – for many other entities they might not.

This submission is from Grant Thornton New Zealand. We are an accounting firm that specialises in supporting small and medium sized enterprises, privately held businesses and not-for profit organisations. We are a national firm that has offices in Auckland, Wellington and Christchurch; we have 30 partners and 240+ staff and we have approximately 5,000 clients across the country – including a number of listed entities and issuers who will be directly impacted by the proposed legislation.

Our major comments are noted below:

### **Alignment with Australia**

The regulatory and legislative momentum behind the objective to pursue a Single Economic Market (SEM) with Australia is very apparent in this Bill. We strongly support this decision.

However, a danger that surrounds such an initiative is that the easiest solution for New Zealand is to adopt a “me to” approach to anything that is done and/or proposed by Australia.

As noted in the submission you received from the New Zealand Institute of Chartered Accountants (NZICA), we see the legislative decision to give auditing standards the force of law, and the decision to register individuals rather than firms, as two instances where it’s been easier for the New Zealand policy officials to “cut and paste” from existing legislation, rather than to pursue a more challenging “functional equivalence” approach.

Simply put, functional equivalence in a Trans-Tasman context means that policy makers must look beyond the institutions that will be put in place to deliver the outcomes; they must ask a more challenging question of what outcomes must be delivered by the legislation, and can they be delivered in any other way?

In many areas alternative solutions can often achieve the same outcome: for example registering firms rather than individuals. However, there are some circumstances where exact replication is needed – and introducing a proportionate liability regime for auditors in New Zealand is, in our view, such a case.

### **Proportionate liability**

Notwithstanding all the arguments that can be put forward by policy advisors as to why limitation of auditor liability should not be dealt with at this time, we see this as a lost opportunity. We cannot see why this issue has to be “parked” and not dealt with in the proposed legislation.

The quality of corporate reporting in New Zealand is not, in our opinion, enhanced by making auditors personally liable for all corporate losses arising from business failures. Our contention is that fairness demands some form of proportionate liability regime being enacted and now is the time for our legislators to consider this. If those authorising the issuance of financial statements (ie directors) can limit their personal liability, why are those involved in considering the assertions that went into the preparation of those same financial statements, and independently assessing the appropriateness of them (ie the auditors), not able to do likewise?

Our firm has frequently gone on record outlining the reasons why auditors in New Zealand should be more fairly treated and, like almost every other business institution – and profession, be afforded the protection of proportionate liability.

### **Criminal sanctions**

We believe the attractiveness of undertaking audit as a career will be harmed if the Bill proceeds unchanged. Imposing criminal sanctions if an individual (or firm) should fail to comply with auditing standards is a radical move. Our view is that this level of sanction is simply not necessary. We can envisage there being a shortage of people prepared to do

audits because of the risk of criminal liability with the consequential loss of freedom that this sanction would bring (eg inability to travel freely overseas due to criminal conviction).

Given the critical role that audit plays in supporting good governance, we believe it is critically important that the “brightest and best” talent coming into the accounting profession is not put off pursuing an auditing career because of a fear of being caught by the criminal sanctions that surround it.

### **Market segmentation**

Reading the Bill in isolation gives little appreciation of the vast number of entities that will not be covered by its provisions. With close to 100,000 charitable organisations, more than 500,000 companies, and close to 200,000 trusts in existence – as pointed out in NZICA’s submission, only a very small proportion of these will end up being captured and assisted by this proposed legislation.

Two important questions we believe the Select Committee members should consider are:

- when it comes to auditing, should there be two quality review regimes in place – one effectively managed and supervised by the Financial Markets Authority for issuers, and the other for all other types of entities by NZICA?
- does the fact that after this legislation is passed, a significant number of audits will still be subject to NZICA’s self-regulation, create a concern? If not, why not?

Our concern, and the reason why we wish to bring this matter to the Select Committee’s attention is that this legislation will more likely than not segment the audit market and create two different standards of audit quality: auditors (or audit firms) that are registered, and those that are not.

The non-issuer market in New Zealand is significant. Many organisations fall into this category and they include entities such as charities, not for profit entities, professional training establishments and a huge number of audits presently undertaken by the Office of the Auditor-General. What these entities all have in common is that they either handle substantial amounts of public money or they have a significant economic footprint (eg large non issuers with large work forces and local economic impacts). The policy question we believe the Select Committee members must consider is whether or not they are comfortable with having a significant number of the entities noted above audited by individuals (firms) who are not licensed and monitored by the Financial Markets Authority (FMA)? Our concern with the Bill as it is currently drafted is that we believe it will create two classes of auditors.

Contrast this with Australia, where the regulation of auditors is “across the board”, and not just restricted to issuers.

### **Reciprocity**

Currently New Zealand auditors are not allowed to sign off audit opinions in Australia, but Australian auditors (providing they satisfy the requirements noted in Section 199 of the

Companies Act 1993) are able to sign off audit opinions on New Zealand companies. We see this as unfair and in our view (notwithstanding SEM) needs to be changed.

Two policy options exist: we can take a “defensive position” (as occurs in Australia) and say that all New Zealand issuers must be audited by New Zealand registered auditors (ie audit firms) or be more accommodating and take a similar view which is currently reflected in the Bill, which is that all New Zealand issuers must be audited by licensed auditors who are subject to independent review by an independent regulatory body (FMA).

SEM is founded on “mutual recognition” principles. That said, we believe assurances need to be gained from the Australian Government that New Zealand auditors, after this Bill has been passed, will be able to conduct audits in Australia from the date of enactment of this legislation. If they are not forthcoming – our view is that New Zealand all entities subject to audit should be audited by New Zealand firms to ensure that there are crystal clear lines of accountability whenever an audit is conducted.

### **Licensing auditors**

We draw the Select Committee’s attention to the fact that the majority of audits conducted in this country are currently undertaken by members of NZICA. However, in future this may not always be the case.

Our view is that if the licensed auditor regime outlined in the Bill is to be credible, everyone conducting an audit must be regulated in a comparable way. The FMA will play a critical role in ensuring this happens.

Our concern with the Bill as it is currently drafted is this: we cannot see any provisions in the proposed legislation that would prevent members of an audit partnership resident in New Zealand joining a recognised professional accounting body overseas because of a perception that it has lesser standards imposed on its members (in terms of promoting and maintaining audit quality). Certainly if this step were to be taken it would be a radical move, but if it was it has the potential to seriously undermine one of the objectives of this Bill: that all audits on New Zealand issuers are undertaken by auditors (firms) who are subject to no lesser standards than those imposed on auditors licensed in New Zealand.

### **Transparency**

In considering “functional equivalence”, we noted in a “compare and contrast” analysis we undertook that the Bill does not clearly indicate whether or not the meetings of the External Reporting Board (XRB) – as well as its auditing and accounting operational committees- will be held in public. We think they should.

Looking to Australia we draw the Select Committee’s attention to the fact that almost all of the deliberations of both the Australian Accounting Standards Board and the Australian Auditing Standards Board are open to the public. In addition, almost all of the papers referred to in their agendas are available for download from their websites, so that interested parties can determine whether there would be benefit in observing deliberations.

The International Accounting Standards Board (IASB) in issuing its International Financial Reporting Standards (IFRS) which form the basis for many New Zealand standards issued

by our Accounting Standards Review Board opened up almost all of their deliberations to the public with considerable success. Given the significant impact that accounting changes can bring to a set of financial statements – clarification in the Bill on this right to access important material and to observe deliberations is, in our view, important.

**Other matters**

Select Committee members should note that our firm was actively involved in the deliberations that produced NZICA's submission. It is a submission we support.

We would like the opportunity to appear before the Select Committee to elaborate on the concerns that we have noted with the Bill in this letter and in the NZICA's submission. Joining us would be Brent Kennerley, an Audit Partner based in Wellington.

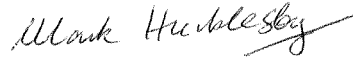
Should you have any questions in the interim, please do not hesitate to call us.

Yours sincerely



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