



Audit Quality Transparency Report 2023



Audit fees –

The cost issue



Foreword

Our purpose is fuelling the prosperity of New Zealand, **for all New Zealanders.**

Tītokona tō tātou tōnuitanga,
mō Aotearoa, mō tātou.

Stakeholder confidence in New Zealand businesses is essential to our prosperity.

High quality, independent audit is the cornerstone of that confidence.



The past year has been challenging on a number of fronts. Many of our clients have been dealing with their own unique business issues, whether it be the economic downturn, pivoting to a new business model or Covid-19 still disrupting the way we work. The auditing profession faced similar challenges with declining numbers entering the profession, immigration settings limiting the international inflow of talent and the wider industry still grappling with “the great resignation”.

Despite all these challenges the expectations of the auditor have only increased, and every opinion we issue must be backed by a robust audit. An auditor’s role is to instil trust in the capital markets, and I’m proud of the hundreds of KPMG auditors across the country who deliver on that trust every day.

Brent Manning
National Managing
Partner, Audit
KPMG New Zealand



When deciding what to write about this year, we asked a number of stakeholders what was being discussed in the industry, and the loudest common theme was rising audit fees.

We debated writing about this topic, for fear that it could be seen as self-serving or a sales pitch. However, it’s important to me that KPMG is a part of the conversation that’s occurring around audit fees. We want to be transparent, giving you clarity on what’s really been happening to the cost of your audits.

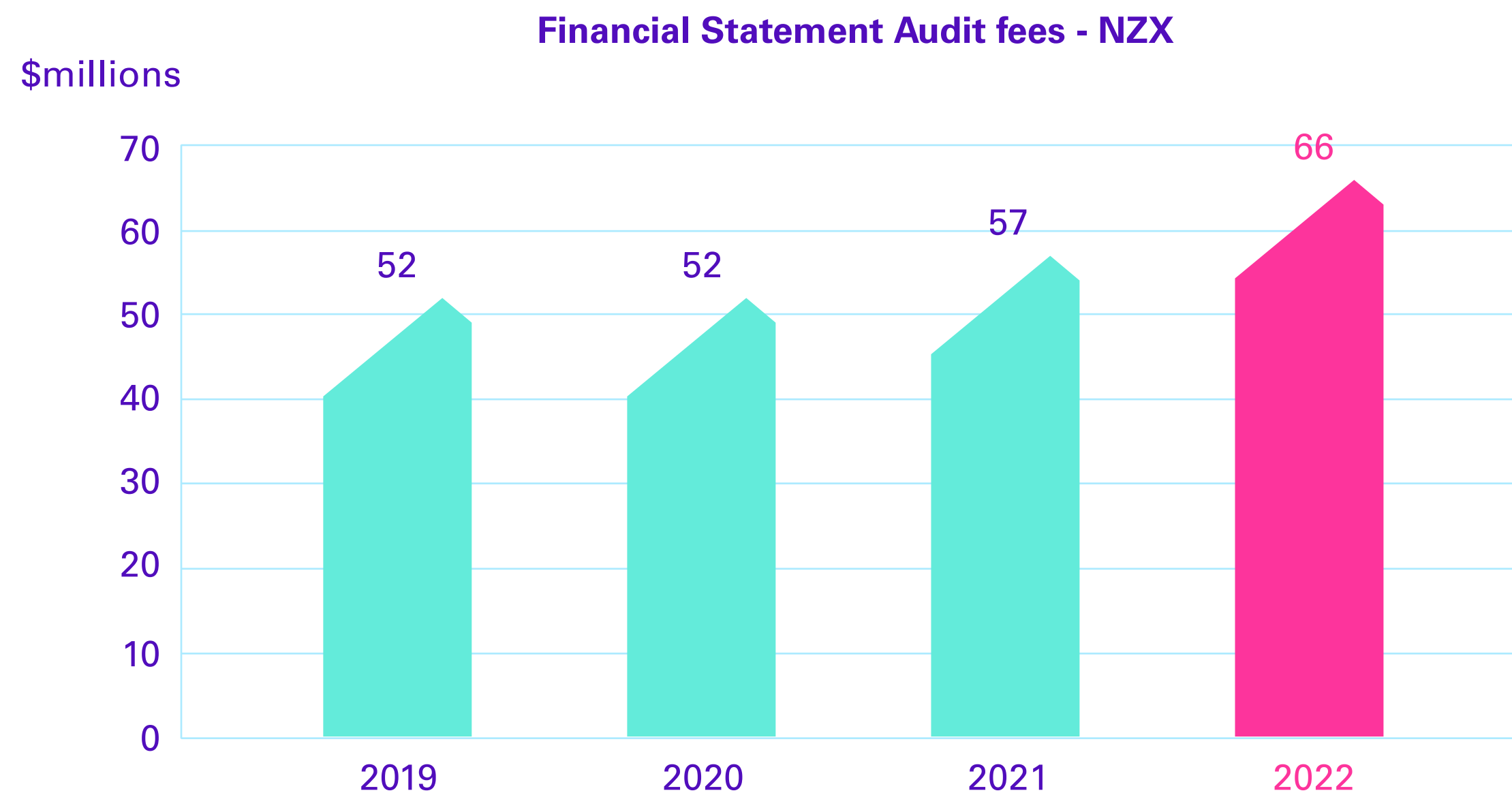
In this issue, we lay bare the ‘big five’ drivers of audit costs over recent years and how the audit profession is responding to them, to arm the director community and other stakeholders with the facts to judge the value you’re getting for your rising audit costs.

Darby Healey
Partner, Risk and
Audit Quality
KPMG New Zealand

Audit fees – the cost issue >>>

It won't have escaped most CFOs' or audit committee chairs' attention that audit fees across New Zealand have risen materially over the past four years.

The response has been complicated, with not much transparency and a concern from CFOs and directors about rising costs in uncertain economic times. **Jacco Moison, Head of Audit and Reporting at the Financial Markets Authority (FMA)** told us:



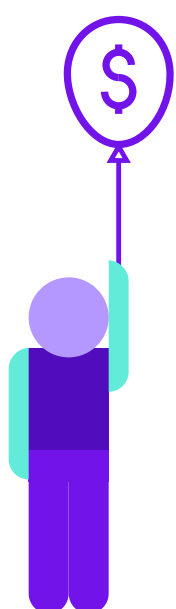
Data from KPMG analysis

>> We've done trend analysis in the past, but it's hard to know what is really happening across the industry due to the many factors impacting the audit fees. Examples include change in scope, billing of overruns and or a competitive tender which make the information unable to be compared based on the disclosures in the financial statements. >>

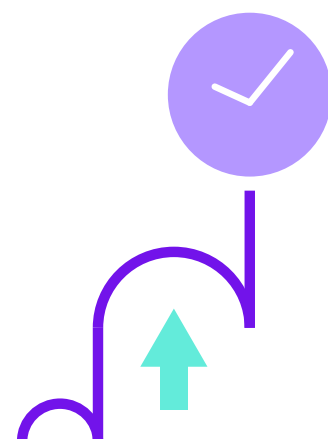
Introduction >>>

When we analysed the drivers of audit costs, we identified **'the big five'** that have combined to drive up audit costs over that period as:

Professional services salary inflation – the need to pay our people more to attract and retain talent



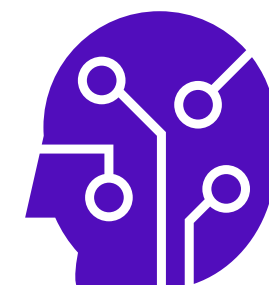
Increased total audit hours – driven mainly by new compliance requirements



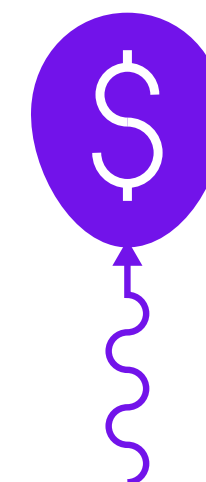
A new deal with our people – the answer can no longer be that our people just work harder



Technology – bringing about dramatic quality benefits, rather than cost reductions



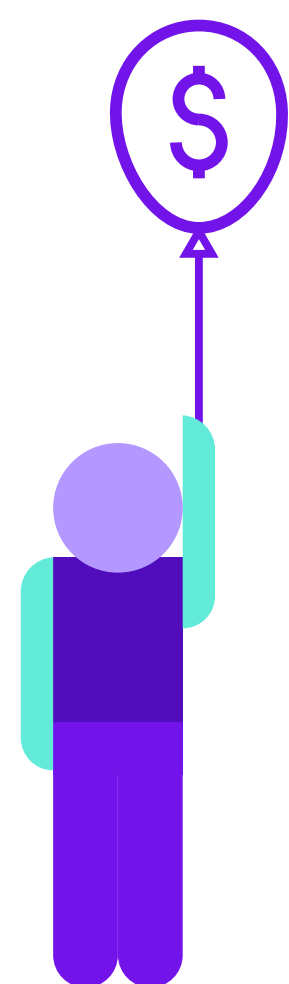
Other cost inflation – the combination of additional compliance costs, underlying inflation and a weak NZD



In this context, large multi-disciplinary firms initially saw audit margins tighten. But the degree of these cost pressures quickly reached a point where it is unsustainable and difficult 'fair fees' conversations have become the norm between audit leaders, CFOs and audit committee chairs.

>> **Whilst shareholders want management and directors to control costs, audit fees are seen as 'good costs'. They are there to serve a purpose, and an important one.** >>

Oliver Mander, CEO of the New Zealand Shareholders' Association

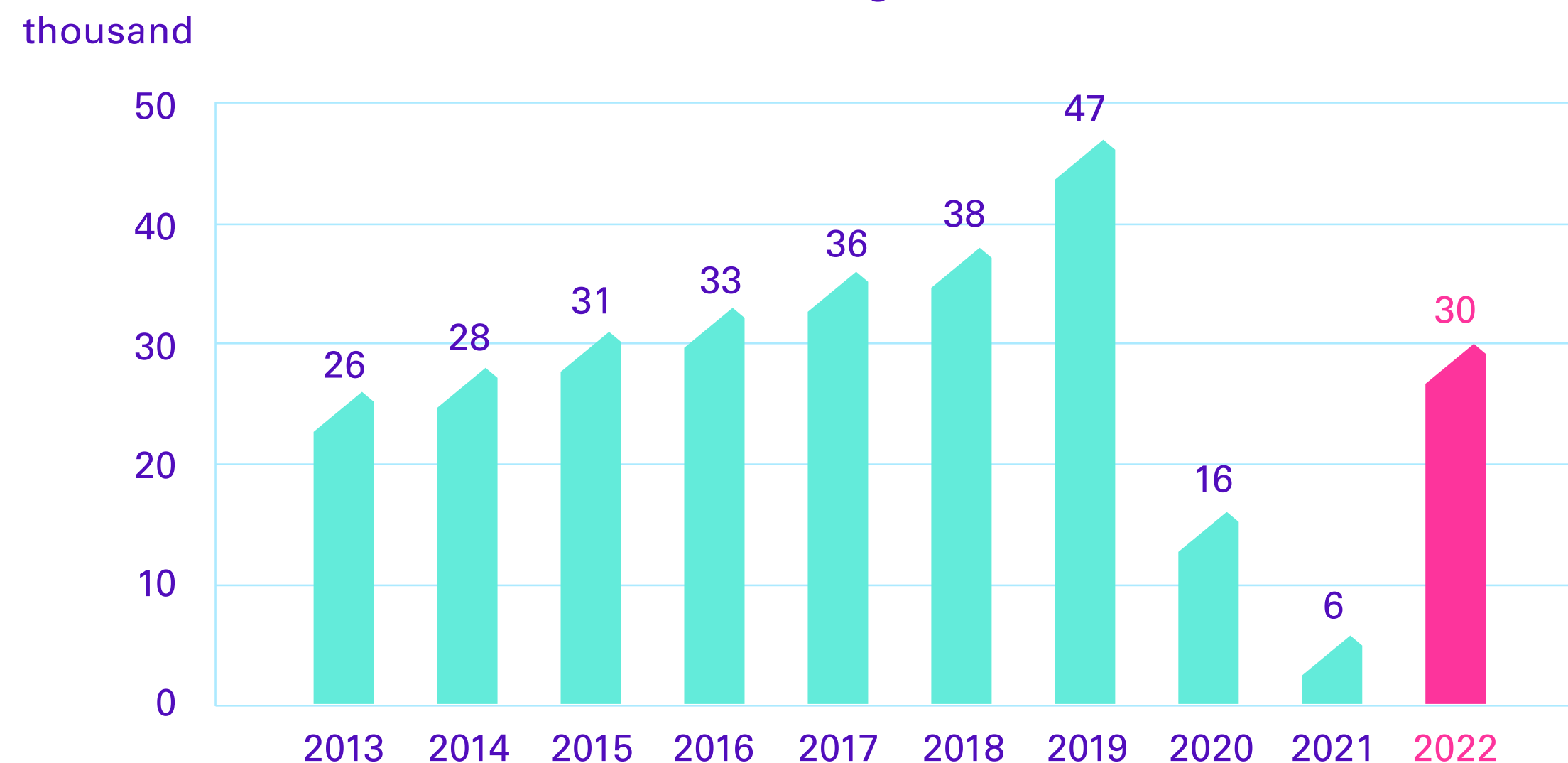


Professional services >>> salary inflation

Auditors have faced the same underlying cost of living inflation as other New Zealanders over the past four years. We've moved from an environment where inflation was largely irrelevant, to one where it dominates pricing decisions, particularly salary and wage setting.

In the same period, New Zealand first closed its borders to protect us against a global pandemic, then effectively kept them closed through immigration policies that restricted the flow of highly skilled talent into our audit and other labour markets.

Estimated migrant arrivals



Data obtained from Statistics New Zealand – Tatauranga Aotearoa

This shortage severely affected the supply of audit talent. Its impact was demonstrated most dramatically by the Auditor General reallocating

50,000

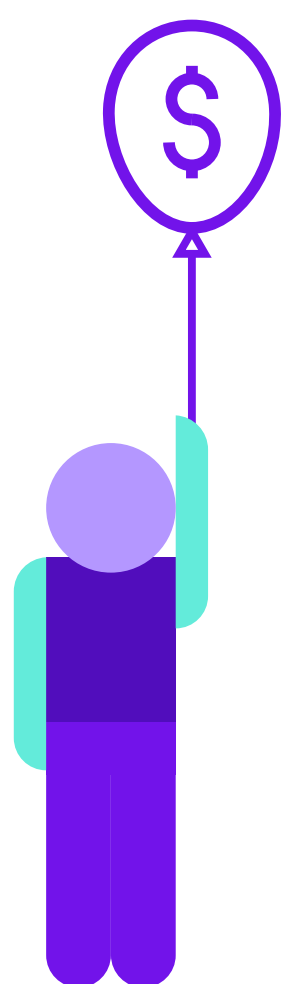
hours of audit work to other audit service providers because, despite the extension given to statutory reporting deadlines, the Auditor General's office did not have the personnel needed to complete the engagements on time.

In 2022 Chartered Accountants Australia and New Zealand successfully lobbied the New Zealand Government to add 180 audit roles to the 'green list' for preferential immigration entry.

>> **The most significant challenge facing the profession is a severe and enduring global shortage of auditors at a time when audit work is increasing in volume and complexity.¹** >>

John Ryan, Controller and Auditor-General

1. The Auditor-General's challenge to get audits done on time (www.nbr.co.nz)

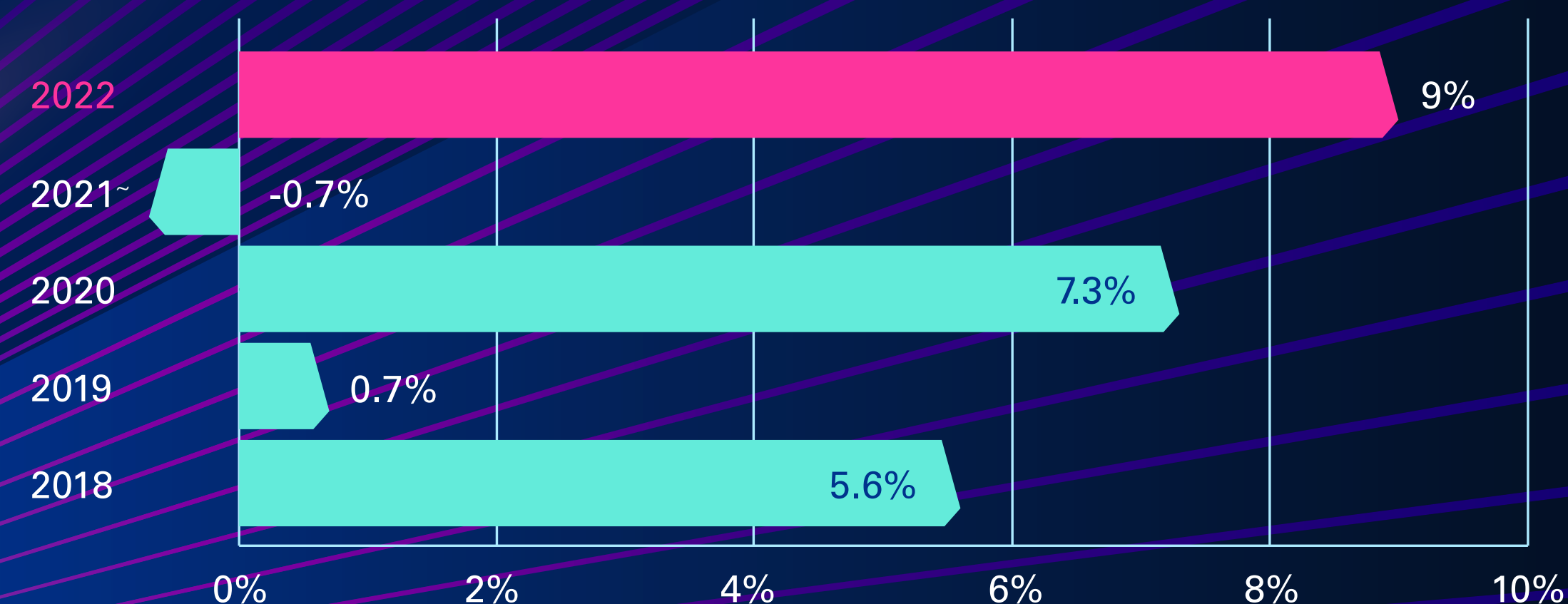


Professional services >>> salary inflation

Our New Zealand audit profession had never before operated in these circumstances. It had always been the case that our Kiwi auditors left New Zealand to gain valuable experience in other markets, and we had always been capable of attracting overseas talent through our global networks, and bring them and their families into our country and into our talent pool. As the world opened up post-pandemic, and the outflow pressure started to build, we were unable to respond with compensating inflow of global talent. The obvious result was additional salary inflation pressure.

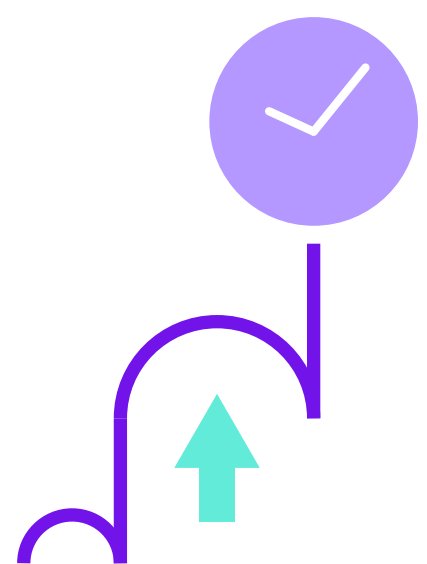
Unfortunately, with inflation, what goes up does not come down. Although we expect to see some easing of the rate of professional services salary inflation, we do not predict underlying cost of living deflation, nor do we expect audit salaries to drop, making this extraordinary period a permanent feature of the New Zealand audit industry's cost base.

**Professional and administrative services -
Average hourly earnings increase per year**



KPMG analysis of data obtained from Statistics New Zealand – Tatauranga Aotearoa

~ Covid-19 cost protection measures such as wage freezes resulted in little movement in the average hourly earnings for 2021.



Increased total >>> audit hours

The hours required to perform each audit engagement is increasing. Auditors are bound by their professional membership to adhere to standards, whether it is the auditing, accounting, professional and ethical standards, or local regulations. Changes to those standards only tend to go in one direction, being to add to audit procedures or other compliance obligations on auditors.

Recent auditing standard changes such as ISA NZ 315 (Revised) *Identifying and Assessing the Risks of Material Misstatements* require more prescriptive procedures and documentation on all audits. Upcoming changes to ISA NZ 600 *Special Considerations – Audits of Group Financial Statements* will have a significant impact to group audits from 2024. Changes to accounting standards that will be familiar to many include NZ IFRS 15 *Revenue* and NZ IFRS 16 *Leases*. The transition to these standards often impacts in the years leading up to a change in an accounting standard, as we're seeing this year with NZ IFRS 17 *Insurance Contracts*. Auditors often bear an indirect burden of lifting company understanding of the consequences of these new standards.

Every audit firm operates a System of Quality Management which underpins the delivery of quality audits. The introduction of the International Standard on Quality Management 1 (ISQM1) is a significant step-up in the requirements for all audit firms. Executives or directors who lived through the step up to Sarbanes Oxley compliance will understand the scale of change required for this regime. Over the past two years KPMG New Zealand people have spent over

35,000

hours to design, implement and and monitor compliance with the new standard.

These changes, and the increasing expectations from regulators, have contributed to an increase in the time and cost of regulatory oversight which in turn, adds additional time to the total cost of an audit.



A new deal with >>> our people

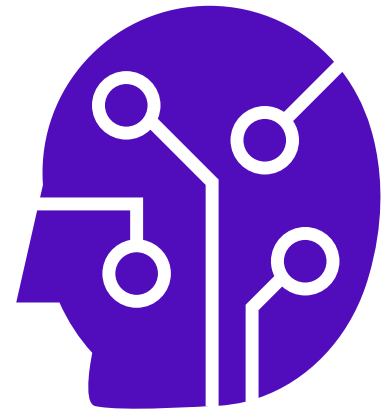
Stealthily, through the second half of the last decade, frontline auditors took on the burden of increased audit requirements by working longer hours. That had to change.

A lot had already been done to shift the timing of work, to even out the peaks and troughs of audit cycles and reduce the intensity of the final work leading up to the signing of an audit report. New Zealand's spread of balance dates already supported that distribution of work throughout the year, and most large audits have significant work undertaken prior to balance date to form the base of the assessment of the control environment and 'hard-close' some balances.

Late in the 2010s, the industry woke up to the impact of increased hours on our front-line teams. Young, intelligent students have more career options than ever before. The battle for talent crosses industry lines, and other industries have competed hard for the best people. At the same time, auditing was becoming a tougher workplace – 'work hard, play hard' wasn't an attractive sales pitch anymore (maybe it never had been). The result meant that accounting graduate numbers were declining, and still are. We needed to respond.

>> **The most meaningful response has been to recruit more auditors, and reverse the increasing weekly hours load on our people. We've done that, and it has started to work. >>**

We have more to do to protect the wellbeing of our people and make the audit profession a more attractive career choice for our most talented people.



Technology >>> driving quality

You might think that technology should have delivered efficiency to offset other cost pressures. Instead, what the audit profession and audit clients have seen is huge benefits to the quality of an audit from the use of technology.

Old-tech audits relied on statistically valid, but relatively weak testing and sampling. Selecting a pre-determined number of invoices, or manually testing the effectiveness of a control were the best we could do to identify errors or weaknesses.

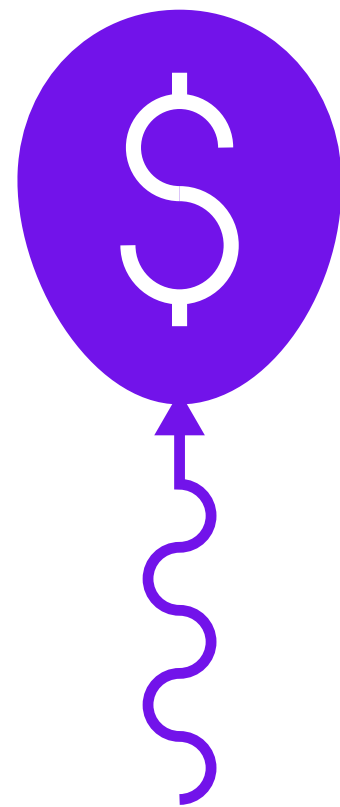
New-tech has revolutionised our approach across a range of auditing tasks. Instead of randomly selected samples, our audit tools can now ingest full populations and identify risk factors that produce a smart sample of transactions where there is an indication of fraud or error. This smarter approach dramatically enhances the quality of the audit test, however will most often result in a larger set of transactions that then need to be investigated by a human auditor.

Likewise, smart tools can now be deployed across some client systems to test the effectiveness of automated controls. Where previously an auditor may have tested a single instance or small sample of the control, these smart tools can identify all transactions that did not pass through the expected control routes. Again, this smarter approach dramatically enhances the quality of the audit test but will more often identify a weakness in controls that must be investigated, and often additional audit evidence sought to compensate for the weakness.

We've also seen big improvements in audit methodology tools. Where historically audit partners exercised broad judgement within the professional standards to determine whether sufficient audit evidence had been gathered to support an assertion, regulatory pressures and the use of these tools have driven much more global standardisation and consistency in the audit tests undertaken to support a particular balance. Inevitably, that has leaned towards more work being done.

Emerging technologies promise more of the same. Artificial intelligence and machine learning are being applied to be smarter hunters of things that might indicate fraud or error. In all but the most rigorous company control environments, this will undoubtedly identify more matters for human auditors to investigate and judge.

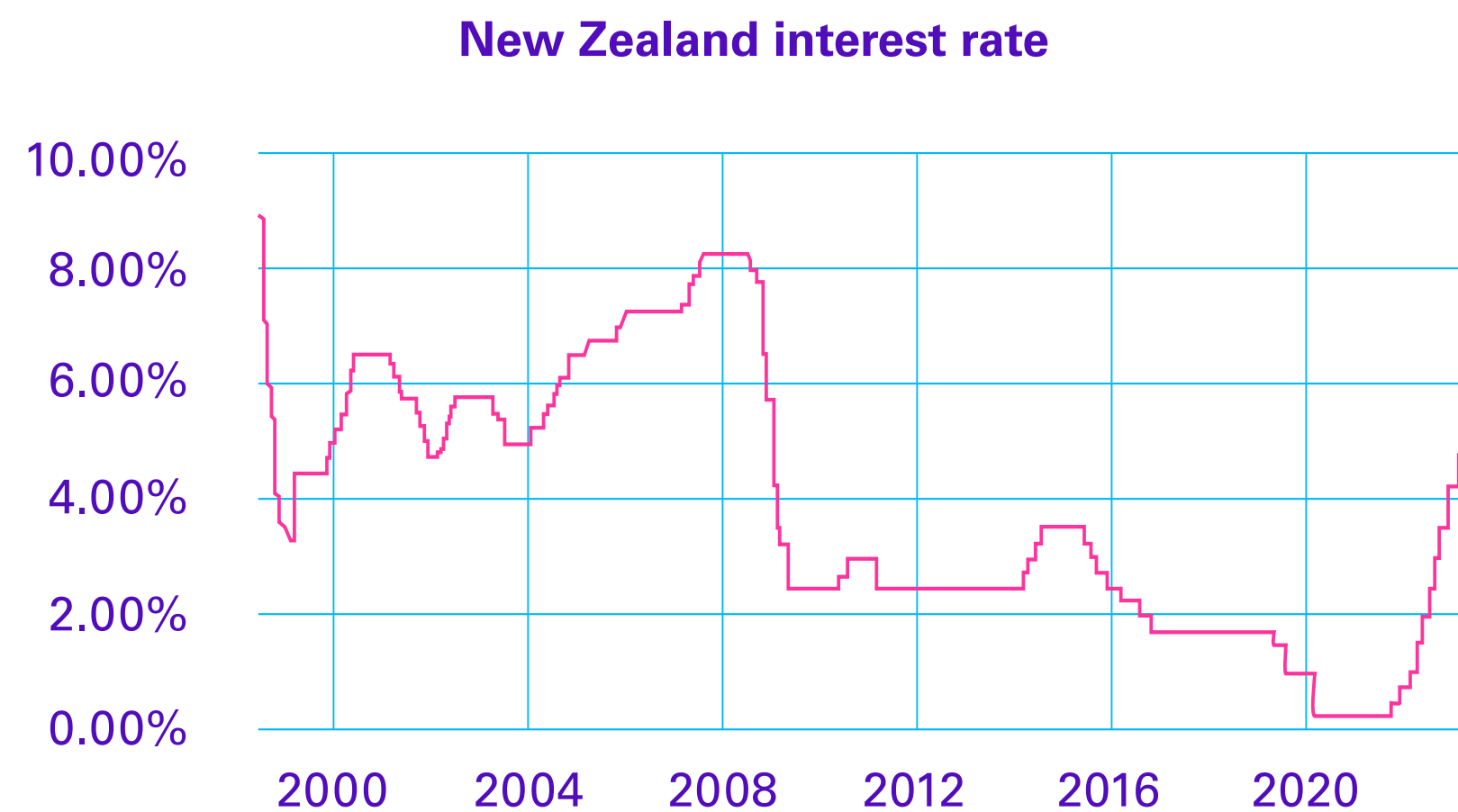
>> These technologies have driven big increases in the quality of audits, and the robustness of audit opinions. That, in turn, should drive higher confidence in company reporting and financial markets that rely on it. Inevitably though, that quality improvement has increased audit costs, not reduced them. >>



Other cost >>> inflation

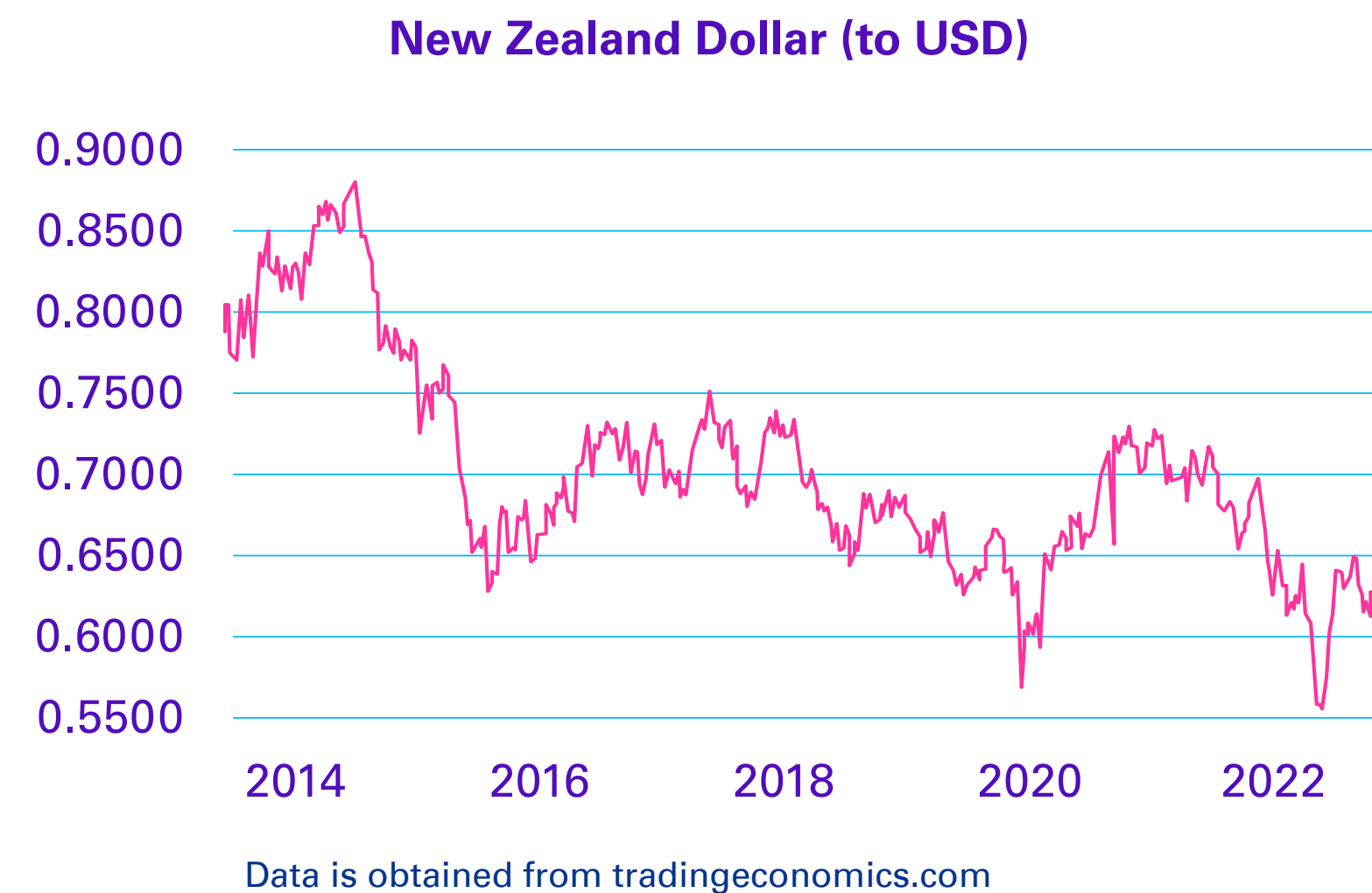
Whilst labour is the largest cost of delivering quality audits in New Zealand, other costs have also faced inflationary pressure. Most significantly affected have been the cost of capital, and the global insurance, technology and compliance costs that are subject to both underlying global inflation and the weak New Zealand Dollar.

Audit businesses require capital like every other business. With our Reserve Bank struggling to control inflation, the cost of that capital has been driven to levels not seen since the Global Financial Crisis.



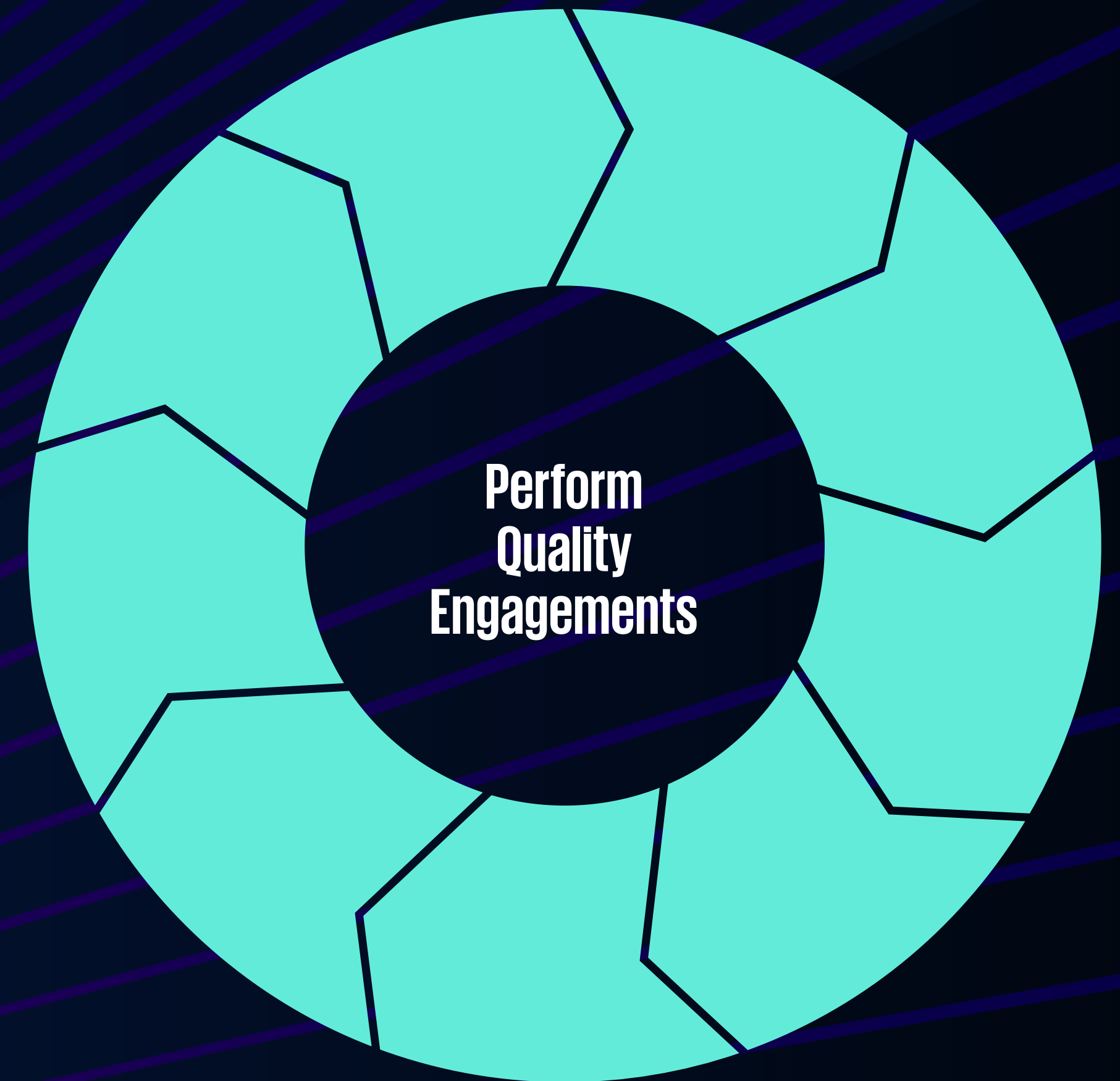
Data is obtained from tradingeconomics.com – Reserve Bank of New Zealand

Technology, insurance and compliance costs for major audit firms are largely USD denominated costs, which have been subject to both global inflationary pressures and the weakness of the New Zealand Dollar.



Combined, these global inflationary cost pressures and a New Zealand Dollar around 0.6000 rather than 0.7000 have a dramatic impact on those imported costs for the New Zealand audit industry.

Click each segment to see more



**Perform
Quality
Engagements**

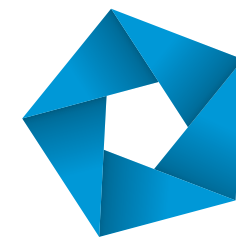


Ngā Matapono - Our Values >>>

Our values represent what we believe in and what is important to us as a firm. They guide our behaviours day-to-day, informing how we act, the decisions we make, and how we work with each other, our clients, companies that we audit, and all of our stakeholders.

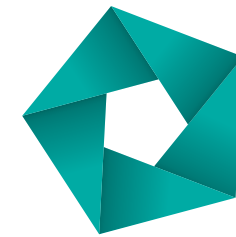
Our values are the foundation of everything we do and every action we take. They are at the heart of our [Code of Conduct](#) and are designed to work interdependently. Our values:

- guide us to do the right thing, especially when under pressure
- bind us together, across our different backgrounds and cultures, and are common to each of us
- represent the foundation of our culture and how we show up for each other and the organisations we work with.



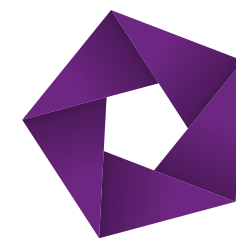
Integrity | Ngākau Tōtika

We do what is right. | Ka mahia kia tika.



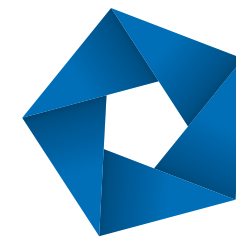
Excellence | Whai Hiranga

We never stop learning and improving. | E kore e oti te ako, te whakawhanake.



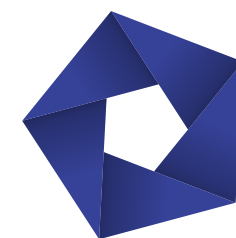
Courage | Kia Māia

We think and act boldly. | He māia te whakaaro, he māia te korero, he māia te mahi.



Together | Kotahitanga

We respect each other and draw strength from our differences. | Ka whakautea ngā rerekētanga hei painga mō te katoa.



For Better | Kaitiakitanga

We do what matters. | Ka mahia ngā mahi whai take.