



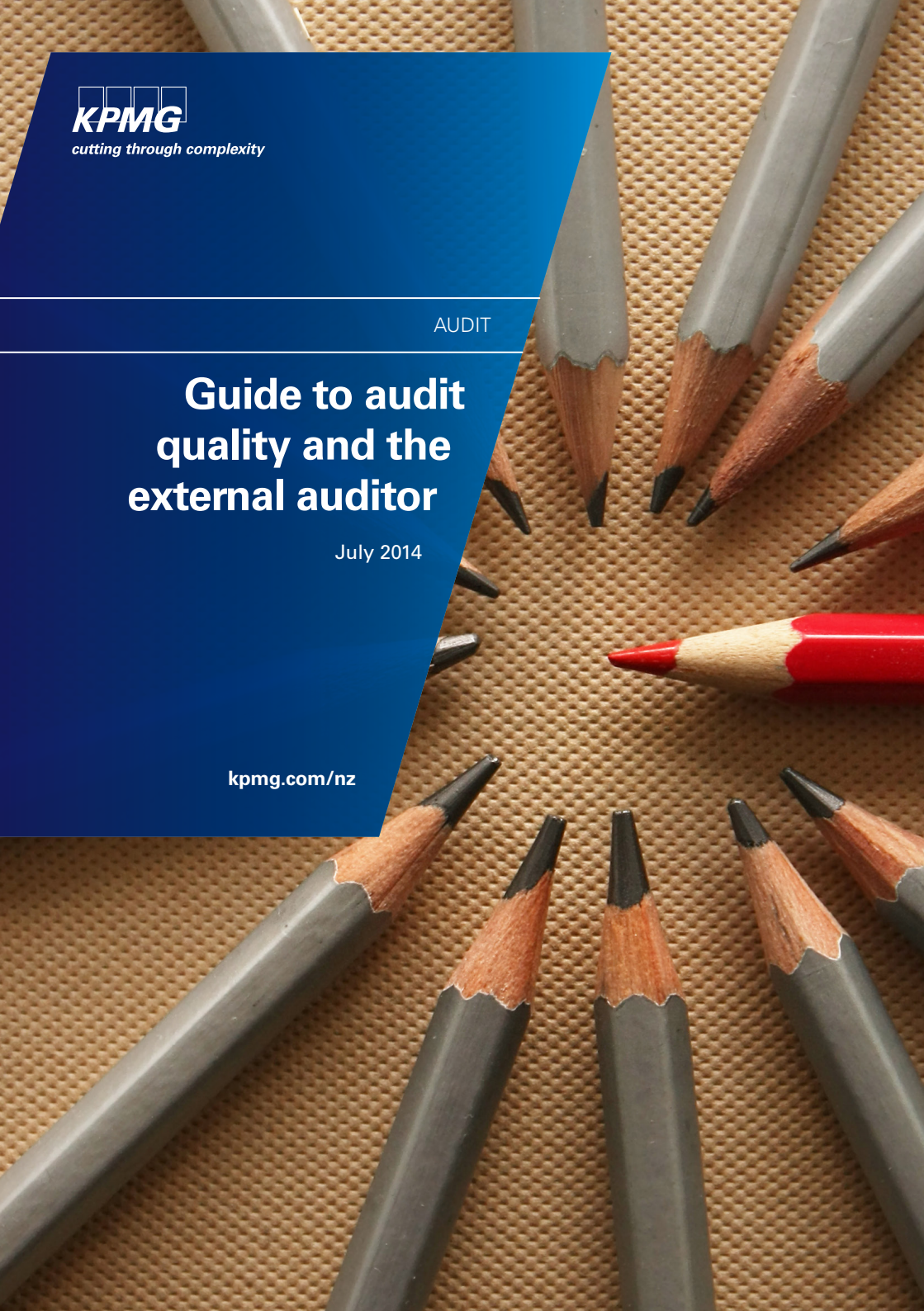
cutting through complexity

AUDIT

Guide to audit quality and the external auditor


July 2014

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**A HIGH
QUALITY,
INDEPENDENT
AUDIT IS THE
CORNERSTONE
OF INVESTOR
AND REGULATOR
CONFIDENCE.**

**CHANGES
OF AUDIT
FIRMS ARE
APPROPRIATE
TO SOLVE
A QUALITY
PROBLEM, BUT
NOT TO SOLVE
A PERCEPTION
PROBLEM.**



THE IMPORTANCE OF ASSESSING

Countries around the world are taking different approaches to address the perceived threat to independence from long tenure of audit firms. The EU have new mandatory rotation requirements restricting auditors tenure. Some countries such as the USA have publicly stated they will not adopt mandatory audit firm rotation. While others such as Canada had legislation requiring mandatory firm rotation but repealed the laws and instead support a formal assessment of the quality of the auditor.

We encourage Boards/Audit Committees to actively pursue the concept of assessing the quality of the external auditor. Steps taken to enhance external auditor quality can only improve the profession as a whole.

The key part of the assessment contains questions under four main categories:

01

Quality of service and sufficiency of resource

02

Exercise professional scepticism

03

Independence and objectivity

04

Communications with the Board/Audit Committee

The questions are intended to be completed by the Board/Audit Committee, however there may need to be input from management, internal audit, the external auditors or others. There is also a section for the Board/Audit Committee to assess their impact on audit quality. The assessment can be completed by ranking each answer or commenting on all relevant questions. There is no right or wrong score or outcome. The purpose is to identify any areas of concern, and then use that information as a starting point for discussions with the external auditors. The assessment can be conducted as frequently as is deemed necessary, however we would suggest at least every three to five years.

In the event that it is decided to put the external audit out to tender, page 11 highlights a number of items that should be considered.



GUIDE TO AUDIT QUALITY AND THE EXTERNAL AUDITOR

Review the attributes on pages 4-8 related to auditors performance and comment or rate using a five-point scale.





01 : QUALITY OF SERVICE AND SUFFICIENCY OF RESOURCES

Attribute	Rate	Comment
<p>1 The audit partner and audit team demonstrate relevant experience, technical competence and understanding of the entity and industry.</p>		
<p>2 Enough auditor resources are assigned to the audit, and continuity of audit staff is strived for.</p>		
<p>3 The audit partner is sufficiently involved in leading the audit and was accessible to management/ Board/Audit Committee.</p>		
<p>4 Evidence that the audit partner is supported by Quality Assurance processes and technical specialists.</p>		
<p>5 Audit related deadlines are met.</p>		
<p>6 The audit partner discusses the audit plan with the Board/Audit Committee and explains the approach to key areas.</p>		
<p>7 The audit plan was appropriate for the entity given risks known to the Board/Audit Committee.</p>		

Attribute	Rate	Comment
8 The engagement team maintained a respectful and professional attitude during the audit.		
9 The auditors identified opportunities and risks relevant to the entity.		
10 Where parts of the audit are performed by teams in multiple locations, the partner provided information about the technical skills, experience and objectivity of those auditors.		
11 The audit firm has the necessary geographical reach to continue to serve the entity.		
12 Management/Board/Audit Committee are kept informed about the progress of the audit and any difficulties encountered.		
13 There is an effective working relationship between the external and internal auditors, as well as other advisors (e.g. Tax).		
14 The outcome of any regulatory review is discussed with the audit committee.		

02 : EXERCISES PROFESSIONAL SCEPTICISM

Attribute	Rate	Comment
1 There is evidence that the audit team challenges, rather than rationalises significant estimates, judgements and accounting policy choices made by management.		
2 The auditors relied on external experts where necessary, and appropriately considered quality of advice received.		
3 The partner inspires confidence, and his/her opinion is valued.		
4 Discussion between the auditors and management on fraud risk, prevention and detection were led at the appropriate level and were challenging and comprehensive.		
5 The auditor discussed sensitive issues candidly and professionally.		
6 The auditor is forthright in dealing with difficult situations.		

03 | INDEPENDENCE AND OBJECTIVITY

Attribute	Rate	Comment
1 There is a robust process to obtain approval for non-audit services.		
2 The audit partner communicates the nature of non-audit services, including the safeguards put in place to protect independence.		
3 It is clear from the communications from the auditors that independence and objectivity have been achieved.		
4 The relationship between auditors and management is appropriate, such that there is no perception that the auditors may lack, or appear to lack, the required degree of objectivity.		
5 The fees charged by the auditors fairly reflect the nature and complexity of the issues of the entity.		
6 The auditor maintains a respectful but questioning approach throughout the audit.		
7 The audit firm rotates the engagement partner in line with their own firm or our specific policies.		

04 COMMUNICATIONS WITH THE BOARD/AUDIT COMMITTEE

Attribute	Rate	Comment
1 There is candid and complete dialogue between the engagement partner and the Board/Audit Committee.		
2 There is timely and informative communication about current accounting and/or other developments.		
3 The Board/Audit Committee are kept informed about progress of the audit and difficulties encountered.		
4 The engagement partner is accessible to Board/Audit Committee.		
5 Communication focuses on key risks identified, how they were addressed and the conclusions reached, as well as the reasonableness of estimates, judgements and disclosures.		
6 Comments are provided on a timely basis in relation to concerns over accounting treatment, estimates and financial reporting systems/processes.		
7 The audit plan is communicated to the Audit Committee, which reflects a clear understanding of the entity.		
8 The level of materiality applied by the auditors has been explained satisfactorily.		
9 The audit partner provides insightful comments in 'in-committee' sessions with the Board/Audit Committee.		

SELF ASSESSMENT OF THE BOARD/AUDIT COMMITTEE

Audit quality depends not only on the performance of the audit firm but also on the attitudes and performance of management and the Board/Audit Committee as they work with the auditor. There are a number of things Boards/Audit Committees can do to assist in enhancing audit quality. Take this opportunity to rate your own contribution.

Attribute	Rate	Comment
1 Board/Audit Committee members ask questions to clarify complex issues and challenge the auditors' professional scepticism in relation to accounting estimates and policies.		
2 The auditor is invited to attend all Board/Audit Committee meetings (except where auditor remuneration is discussed).		
3 The auditor is invited to meet with the Board/Audit Committee without management present.		
4 The Board/Audit Committee welcomes the candidness of the audit partner's observations in private sessions with them.		
5 The auditor has practical, open access to the Audit Committee chair.		
6 Board/Audit Committee formed their own views on complex accounting policy choices or estimates, including seeking third party advice where appropriate, rather than relying entirely on the views of the auditor.		

ADDITIONAL INFORMATION

IN RELATION TO PAGES 04-08

When performing the assessment of the external auditor, be aware that this responsibility cannot be delegated to another party. It is the role of the Board/Audit Committee to perform this assessment. Management, and others should be asked for their views, however the overall responsibility for the analysis lies with the Board/Audit Committee.

One option for completing the assessment is that each Board/Audit Committee member, along with key management personnel, complete the questions individually. The answers should then be collated. That way any gaps in understanding will be highlighted, this will stimulate additional questions or the need for additional information.

Use the boxes at the bottom of this page to address any entity specific issues which the auditors were involved in. Examples include restatements or interactions with the regulator, and how the auditor responded to these issues.

Other factors	Rate	Comment
1		
2		
3		
4		
5		

THINGS TO CONSIDER

WHEN PUTTING THE AUDIT OUT TO TENDER

Be aware that conducting a multifirm tender is often more complex and time consuming.

There will likely be several stages to the tender, plus initial meetings, evaluation of written proposals, presentation by all candidates or just a few finalists, the final assessment and decision. The process could take months.

In addition, you should not overlook the challenge for new auditors. They will have to get up to speed and build relationships quickly – which will take management’s time. Putting the audit out to tender should be a carefully thought out decision, and the following items should be taken into consideration:

Items to consider when tendering

Yes / No

1 Does the Board/Audit Committee have the time to devote to the process?

2 Is the driver of the audit tender related to audit quality and clearly understood?

3 Are the selection criteria focused on audit quality?

4 Have separate tender documents relating to audit quality and Fees been requested, and the document relating to quality been considered before reviewing the proposed fee?

5 Is audit quality likely to be compromised by reduced audit fees?

6 Does the process ensure that potential auditors are not asked for their views on contentious judgements or accounting treatments before they’re selected (opinion shopping)?

INDEPENDENCE RULES

In addition to the introduction of mandatory firm rotation overseas, there has been much debate about the non-audit services offered by the auditor.

Auditor independence rules in New Zealand are based on Professional and Ethical Standard 1 (PES 1). A summary of those rules is presented below to assist the Board/Audit Committee in making decisions about what services are allowable.

PES 1 RULES ON INDEPENDENCE

Non-Audit Service	Public Interest Entity or related	Non-Public Interest Entity
Prepare accounting records and financial statements	No ¹	Yes ²
Valuations	Yes ³	Yes ³
Tax return preparation	Yes	Yes
Tax calculation for accounting purposes	No ¹	Yes ⁴
Tax planning (effect FS)	Yes ⁵	Yes ⁵
Tax valuation for tax reporting obligations	Yes ⁶	Yes ⁶
Assistance with tax disputes	Yes ⁷	Yes ⁷
Act as advocate before public tribunal where tax is material	No	No
Internal audit	No ⁸	No ⁸
IT system services	Yes ⁹	Yes ⁹
Litigation support	Yes ¹⁰	Yes ¹⁰
Corporate finance advising or assisting with a transaction	Yes ⁵	Yes ⁵
Corporate finance as a promoter or dealer	No	No

Note: Interpretation of independence rules are very complex. The above is a summary, and the full PES 1 rules should be referred to. PES 1 can be found on the XRB website here: www.xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Professional_Ethical_Standards.aspx

CONTACT US

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- 1 The current rule allows in emergency situations. This is under review by the NZAuASB.
 - 2 No management responsibility is allowed.
 - 3 Not if valuation would have a material effect on the financial statements.
 - 4 Subject to safeguard put in place.
 - 5 Except where the advice depends on a particular accounting treatment/ presentation where there is reasonable doubt about the appropriateness of the treatment and the outcome will have a material effect on the financial statements. In these cases the audit firm should NOT provide the services.
 - 6 Allowed provided the valuation is subject to additional review or is reviewed by an external tax authority or the effect on the financial statements is not material.
 - 7 Dependent on whether: the audit firm has provided advice which is the subject of the dispute; the extent the outcome will effect the financial statements, the extent to which the matter is support by tax law. Safeguards should be implemented to address such issues.
 - 8 Certain procedures allowed, subject to restrictions.
 - 9 Except the design/ implementation of systems that form part of the ICFR or generate information significant to the accounting records of financial statements.
 - 10 Except when estimating damages or other amounts that affect the financial statements.
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Paul Herrod
Chief Executive Officer

T: + 64 (9) 367 5323
M: + 64 027 289 8448
E: pherrod@kpmg.co.nz



Graeme Edwards
Head of Audit

T: + 64 (4) 816 4522
M: + 64 027 296 5050
E: gdedwards@kpmg.co.nz



Darby Healey
Audit Quality

T: + 64 (9) 363 3663
M: + 64 027 221 1152
E: dahealey@kpmg.co.nz



Souella Cumming
Partner

T: + 64 (4) 816 4519
M: + 64 027 452 1278
E: smcumming@kpmg.co.nz



David Sutton
Partner

T: + 64 (9) 367 5844
M: + 64 027 611 1665
E: davidsutton@kpmg.co.nz



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