

Auditor Regulation Act 2011

Consultation paper #1: Licensing of auditors and registration of audit firms

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Introduction

1. The Financial Markets Authority ('FMA') has responsibilities under the Auditor Regulation Act 2011 ('the Act') to oversee the regulation of auditors and audit firms in respect of issuer audits¹.
2. The main provisions of the Act come into force on 1 July 2012. Section 32 of the Act, which comes into force before the main provisions of the Act, permits FMA to prescribe various regulatory requirements, including requirements relating to the licensing of auditors and registration of audit firms, transitional requirements, ongoing competence requirements for licensees, and requirements for accredited bodies².
3. Before FMA prescribes any of these matters FMA must consult with people who represent the views of the auditing profession, and any other organisations or groups that will be substantially affected by the proposals³. This is the first in a series of consultation papers to be published by FMA in respect of the implementation of the Act.
4. The purpose of this paper is to consult on FMA's proposed:
 - (a) minimum standards for licensing a person must meet in order to be issued with a licence to perform issuer audits;
 - (b) the kinds of conditions to which such licences must, and may, be subject;
 - (c) minimum standards an audit firm must meet in order to be registered; and
 - (d) criteria which must be met in order for individuals and firms to be eligible for the transitional arrangements of the Act.
5. FMA would appreciate your comments on the proposals in this paper. In particular, we are seeking responses to the questions set out at the end of each section of the document. FMA is interested to know whether you agree or disagree with the proposals set out in this paper, and the reasons for your views. Where you disagree with proposals set out in the paper, FMA would be particularly interested to understand whether you consider the requirement is impractical or inappropriate. FMA is also happy to receive, and will consider, any suggestions of alternative or additional requirements you believe are appropriate.

¹ Issuer audit is defined in the Act and means an audit of the financial statements, and if required, group financial statements, of an issuer, an audit of the financial statements of any scheme, fund, or retirement village referred to in section 9A of the Financial Reporting Act 1993, and any other audit or review required under the Securities Act 1978.

² An accredited body is a person that is granted accreditation, or treated as having been granted accreditation, under the Act. NZICA is deemed to be an accredited body. FMA may grant accreditation to any other appropriate organisations. The Act provides accredited bodies with the primary role in regulating licensed auditors and registered audit firms from New Zealand, as well as responsibilities for ongoing monitoring, and investigating, and taking enforcement action in respect of, any breaches of the auditing and assurance standards.

³ See section 36 of the Act.

How to make a submission

6. Please send your written submissions by using the [\[Contact Us form\]](#) on FMA's website, www.fma.govt.nz, selecting 'make a comment' and clearly labelling your attached submission document as 'Submission on the Auditor Regulation Act Consultation Paper #1'.
7. You can also send your written submission to:

Compliance Monitoring
Financial Markets Authority
Level 8, 56 The Terrace
PO Box 1179
WELLINGTON 6011
8. If you require clarification of any of the matters discussed in this paper, please contact us.
9. The final date for submissions on this paper is **Friday, 16 December 2011**.
10. Following this consultation period FMA will consider all submissions received and FMA will issue a further consultation document for a short period. FMA intends to conduct this second round of consultation, and finalise and gazette the prescribed standards and conditions, by April 2012. While this target date is some time before the 1 July 2012 commencement of the Act, FMA considers it important both the audit profession and accredited bodies are given reasonable time, after the publication of the final standards and conditions, to prepare for the licensing and registration processes.
11. Submissions will be subject to the Official Information Act 1982. FMA may also make submissions available on its website, or draw attention to submissions in internal or external reports. If you would like FMA to withhold any commercially sensitive, confidential or proprietary information included in your submission, please say so in your submission. Any request to have information withheld will be considered in accordance with the Official Information Act.

Relevant provisions of the Auditor Regulation Act 2011

12. This section outlines the relevant provisions of the Act, as they relate to licensing of auditors, registration of audit firms and transitional arrangements.

Purpose of the Auditor Regulation Act 2011

13. The Act establishes a framework for the regulation of auditors of issuers. The purpose of the Act is to regulate auditors who carry out audits in respect of issuers and to establish an independent oversight system in order to:
 - (a) promote, in respect of issuer audits, quality, expertise, and integrity in the profession of auditors; and
 - (b) promote the recognition of the professional status of New Zealand auditors in overseas jurisdictions.

The relationship between FMA and accredited bodies

14. FMA has overall responsibility for the regulation of auditors in respect of issuer audits in New Zealand. However, front line regulation of auditors is divided between:
 - (a) accredited bodies, who have primary responsibility for regulating New Zealand based auditors; and
 - (b) FMA, who has primary responsibility for regulating overseas auditors.
15. FMA also has the role of granting accreditation to accredited bodies and supervising them on an ongoing basis.

Licensing of auditors

16. The Act requires a person who acts as the auditor in respect of an issuer audit to hold a licence. A licensed auditor must also be responsible for any issuer audits undertaken by a registered audit firm.
17. The Act does not require every person involved in an audit engagement undertaken by a firm to be a licensed auditor. The Act requires that the audit partner will be a licensed auditor. FMA proposes to additionally require that the engagement quality control reviewer will also be a licensed auditor. However, FMA does not expect, and the Act does not require, that other audit staff necessarily will be licensed auditors. This paper may, however, be of interest to audit staff who are progressing towards becoming an audit partner, as the requirements for becoming licensed will involve a significant period of experience.

18. The Act provides that accredited bodies may issue licences to New Zealand based auditors if the accredited body is satisfied the person meets the prescribed minimum standards and is otherwise a fit and proper person.
19. In the case of overseas auditors, the Act provides for licences to be issued by FMA. To become licensed, the Act requires an overseas auditor to:
 - (a) be entitled to act as an auditor in one of the prescribed overseas jurisdictions⁴;
 - (b) meet prescribed minimum standards;
 - (c) be a fit and proper person;
 - (d) be subject to ongoing competency requirements that are equivalent to those under the Act;
 - (e) be subject to quality review procedures that are equivalent to those under the Act; and
 - (f) have systems, policies and procedures that are sufficient to meet the purposes of the Act.
20. The Act requires that licences issued by an accredited body or FMA:
 - (a) must be subject to any applicable conditions of the kinds prescribed by FMA;
 - (b) may be subject to any other conditions of a kind prescribed by FMA that the accredited body or FMA thinks fit; and
 - (c) must specify a condition relating to the kinds of issuer audits in respect of which the licensed auditor is authorised to act under the licence.
21. Licences must specify the date of expiry, which must not be later than 5 years from the date the licence was issued.
22. The Act provides for the relevant authority⁵ to cancel or suspend an auditor's licence in specified circumstances, including where the auditor does not satisfy or no longer satisfies the prescribed minimum standards or has failed to comply with a condition of their licence. The Act provides a procedure which must be followed before a licence is suspended or cancelled. The provisions for suspension and cancellation of licences do not preclude the use of any other remedies or sanctions in appropriate circumstances.

⁴ At this time, regulations prescribing jurisdictions have not been finalised. We expect regulations will initially prescribe the home jurisdictions of overseas professional bodies whose members are currently able to carry out audits under the Securities Act 1978.

⁵ A relevant authority is, in respect of a licence issued by an accredited body, the accredited body that issued the licence or a disciplinary body authorised by the accredited body; or is, in the case of licences issued by FMA, FMA.

Registration of audit firms

23. Under the Act an audit firm may only accept an engagement to conduct an issuer audit if it is registered. Audit firms are registered with the Companies Office following approval by either an accredited body or FMA.
24. An accredited body may authorise the Registrar to register an audit firm if the firm is a partnership (but not a limited partnership), one or more of the partners of the firm are licensed auditors and the firm meets the prescribed minimum standards.
25. FMA may authorise the Registrar to register an overseas audit firm where it is satisfied of certain matters, including that:
 - (a) the firm is a partnership (but not a limited partnership);
 - (b) one or more of the firm's partners are licensed auditors;
 - (c) the firm meets the prescribed minimum standards;
 - (d) the firm is subject to review arrangements that are equivalent to the quality review provisions under the Act; and
 - (e) the systems, policies and procedures of the firm are satisfactory in terms of promoting compliance with applicable legal requirements and auditing standards, and otherwise promoting reasonable care, diligence and skill.
26. The registration of an audit firm is subject to any conditions imposed by the accredited body or FMA, as the case may be. However, unlike conditions for auditor licences, the Act does not provide for FMA to prescribe the conditions, or the range of available conditions, which may be attached to an audit firm registration.
27. The Act provides for the registration of an audit firm to be cancelled in certain circumstances, including where the audit firm no longer meets the prescribed standards or has failed to comply with the conditions of its registration. There is no provision for the suspension of audit firm registrations. As with the provisions for cancellation of a licence, the Act provides a procedure which must be followed before a registration is cancelled.

Transitional arrangements

28. The Act provides transitional provisions to allow current auditors to continue to act while their applications are considered. To be eligible for a transitional licence, auditors must:
 - (a) have acted as the auditor in respect of an issuer audit in the past two years;
 - (b) be, immediately before the commencement of the transitional provisions, entitled to act as an auditor; and
 - (c) meet any other transitional requirements prescribed by FMA.

29. In the case of a New Zealand auditor, the person must be a chartered accountant and the holder of a certificate of public practice. For overseas auditors, the person must be a member of a professional body designated by the Registrar, and must be entitled to act as an auditor in their home jurisdiction.
30. Transitional provisions are also available for New Zealand audit firms that:
 - (a) are ordinary partnerships;
 - (b) have at least one partner who receives a transitional licence;
 - (c) have acted as the auditor in respect of an issuer audit in the past two years; and
 - (d) meet any other requirements prescribed by FMA to rely on the transitional provisions.
31. The Act does not include transitional provisions for overseas audit firms.

FMA can prescribe licensing and registration matters

32. The Act permits FMA to prescribe by notice in the Gazette various matters. Before FMA prescribes any of these matters, FMA is required to consult with people representing the views of the auditing profession, and any other organisations or groups that will be substantially affected by the proposals. By this paper, FMA is consulting on the following matters:
 - (a) the minimum standards for licensing of auditors, including standards relating to required competence, qualifications and experience that must be met in order to be licensed by an accredited body or FMA;
 - (b) the kinds of conditions to which licences must be subject, and the kinds of conditions to which the licence may be subject;
 - (c) the minimum standards an audit firm must meet in order to be registered; and
 - (d) the additional requirements that auditors and audit firms must meet in order to get a transitional licence or registration (including requirements for auditors relating to competence, qualifications and experience and, in the case of audit firms, requirements relating to the firm's systems, policies and procedures).

Policy considerations

33. The Act sets out certain principles FMA must be guided by when prescribing matters in relation to auditor licensing and audit firm registration. This section of the paper sets out the principles prescribed by the Act, and FMA's view as to how these should be taken into account in determining the standards and conditions to be prescribed.
34. The Act requires that the minimum standards, conditions, and other matters prescribed under section 32 of the Act must be necessary or desirable, directly or indirectly –
 - (a) to promote, in respect of issuer audits, the quality, expertise, and integrity of the audit profession; and
 - (b) to promote the recognition of the professional status of New Zealand auditors in overseas jurisdictions.
35. Furthermore, the Act requires the prescribed matters should not unnecessarily restrict the licensing of auditors or the registration of audit firms, and should not impose undue costs on auditors, audit firms, or issuers.

Quality, expertise, and integrity of the audit profession

36. FMA considers the objective of promoting quality, expertise and integrity reflects that users of audited financial information need to have confidence in issuer audits, and the financial information to which those audits relate. For this confidence to exist, amongst other things, licensed auditors must have the expertise to conduct high quality audits. Licensed auditors must also be persons of integrity, who will meet the standards of diligence and professionalism expected of the audit profession. Additionally, licensed auditors and registered audit firms need to be accountable for the audit opinions they issue. Specifically:

Auditors

- (a) Auditors must have the professional knowledge, technical skills and experience to perform audits with appropriate competence, expertise and reliability. The required skills and technical knowledge must be maintained on an ongoing basis, as well as demonstrated at the time of licensing. In addition to knowledge, skill and experience of audit methods and procedures, this needs to include knowledge and understanding of the client's business.
- (b) Auditors must be fit and proper persons with the integrity needed to perform the audit role with honesty, reliability and professionalism. In particular, auditors need to avoid material conflicts of interest and resist undue pressure from clients.
- (c) Auditors must be subject to appropriate scrutiny and accountability in the performance of their functions. This scrutiny needs to be from the profession, in the form of peer reviews both at the time of the engagement and after the fact, as well

as from monitoring by accredited bodies and quality reviews under the Act. Persons reviewing or supervising the performance of audit functions need to have the skills, knowledge and objectivity to effectively assess the licensed auditor's performance.

- (d) Auditors need to be held accountable for their actions. This means that auditors need to be subject to adequately stringent requirements, and to disciplinary action in the event that they fail to meet the required standards. It also means auditors should be held responsible for the audit work they perform and the opinions they express.

Audit firms

- (e) Audit firms must have the management, governance, staff, systems and controls required to perform audits with appropriate competence, expertise and reliability, including providing auditing staff with the resources and support needed to carry out their responsibilities to a high professional standard.
 - (f) Audit firms must have the policies needed, and discharge those policies, to avoid material conflicts of interest that could compromise their independence from the client and objectivity in performing the audit. These policies must, at minimum, meet the requirements of auditing and assurance standards.
 - (g) Audit firms must have the processes in place to ensure that auditors in the firm are subject to appropriate scrutiny, peer review and accountability. These processes must, at minimum, meet the requirements of auditing and assurance standards.
 - (h) Audit firms must be subject to effective scrutiny by appropriately qualified, objective persons and organisations, which are able to hold the firm to account for its compliance with applicable requirements, including registration requirements. Firms should be subject to disciplinary action in the event they fail to meet the required standards.
37. FMA considers promoting quality, expertise and integrity in the audit profession is particularly important in the current environment, where significant failures in the financial markets, both in New Zealand and internationally, have negatively affected investor confidence.

Recognition of the professional status of New Zealand auditors in overseas jurisdictions

38. FMA considers the purpose of promoting the recognition of the professional status of New Zealand auditors in overseas jurisdictions requires a set of regulatory arrangements that are, and are seen to be, credible by reference to international benchmarks⁶. This suggests

⁶ In preparing the proposal discussed in this paper, we have considered the requirements set out in the European Commission's Directive (which appears to provide a de facto benchmark for international recognition) and how that directive has been implemented in the United Kingdom, and Australia (being New Zealand's closest trading partner, and the single jurisdiction which is likely to be most relevant to auditors).

New Zealand licensing and registration arrangements for auditors and audit firms respectively should, to the extent appropriate, be broadly consistent with the requirements of overseas jurisdictions where New Zealand auditors may wish to gain recognition to perform audits. Where New Zealand requirements differ from those of key overseas jurisdictions, FMA considers the requirements should ensure equivalent outcomes to the requirements in those other jurisdictions. Additionally, FMA considers it important to ensure that our standards are seen as credible by reference to international standards, such as those issued by the International Federation of Accountants ('IFAC').

39. Where appropriate, FMA considers comparability between New Zealand's audit licensing and registration requirements and those applied in other relevant jurisdictions, is preferable. Compatibility with other key jurisdictions will significantly influence the perceived credibility of the auditing requirements in New Zealand, both in terms of formal recognition and in terms of acceptance by international investors, rating agencies and other interested organisations. These organisations are likely to prefer a regime which is broadly familiar due to its similarity with other jurisdictions they operate in.
40. However, this does not necessarily mean that New Zealand's regime should adhere to all elements of relevant international standards, or copy the regulatory arrangements of any other jurisdiction. Instead, the auditor regulation framework should be tailored to New Zealand conditions and the needs of users of audited financial statements.

Avoiding unnecessarily restrictive licensing or registration requirements

41. The Act directs FMA to ensure requirements do not unnecessarily restrict the licensing of auditors or the registration of audit firms. This recognises the need for striking a balance between setting appropriately high standards for licensing and registration to meet the purposes of the Act, while not going beyond what is necessary to achieve that outcome. It also points to the need to avoid imposing requirements that are significantly higher than those imposed in comparable jurisdictions.

Adverse consequences of an uncompetitive audit market

42. An excessively restrictive approach could have the effect of reducing the competition within the auditing profession. Reduced competition may result in an increase in costs of issuer audits by licensed auditors, as auditors will not need to compete as hard to find and retain audit clients. The decreased likelihood of audit clients leaving an auditor or audit firm will reduce the incentive for auditors to set fees at competitive rates.
43. A reduction in competition within the audit profession may also reduce the incentive for auditors to perform to a high standard. FMA considers it is preferable, where practical, to impose requirements that maintain market incentives to strive for quality, and mechanisms in the market for identifying any auditors who do not meet acceptable standards. It is inevitable

that some auditors will cease auditing issuers as a result of the new regulation, either because they do not meet the required standards or because they do not consider meeting the requirements and costs is viable for their business. However, FMA does not consider it desirable, in terms of promoting quality and expertise, to unnecessarily restrict the number of auditors who are able to perform issuer audits.

44. Another risk, particularly if requirements are very prescriptive, is auditors and audit firms come to rely on licensing and registration standards and conditions as being sufficient in all situations, as opposed to viewing these regulatory requirements as merely the minimum standards to be met. The purpose of the Act is to promote quality and expertise in the audit profession. FMA believes that self-discipline can play a significant and valuable role in maintaining and improving the standards of audits, and that this should be encouraged. As such, FMA is conscious that a regulatory regime which removes the personal incentives to maintain high standards would be undesirable, and contrary to the purposes of the Act.
45. In the extreme, an overly restrictive approach could result in too few auditors being available to meet the demand for issuer audits. This could result either in auditors taking audits they do not have the capacity to perform adequately, resulting in poorer quality audits, or in issuers not being able to find a licensed auditor to conduct their audit.

Competitive neutrality

46. FMA considers it preferable not to confer any substantial advantage or disadvantage on different categories of auditors and audit firms as regards to issuer audits, unless based on capabilities and merit. This is particularly the case between New Zealand auditors and overseas auditors. Similarly the registration requirements for New Zealand and overseas audit firms should be substantially the same.
47. Where recognised overseas jurisdictions conform to international best practice benchmarks, FMA does not consider substantial additional requirements should be imposed on auditors from those jurisdictions. In order to maintain a level playing field between New Zealand and overseas auditors and audit firms, the auditor and audit firm requirements for New Zealand auditors registered should be broadly equivalent to the requirements of overseas auditors and audit firms.
48. In addition, FMA considers New Zealand auditors performing audits that are being relied upon overseas should not generally be held to a substantially higher standard than an auditor from that jurisdiction.

Avoiding undue costs on auditors and audit firms, and on issuers

49. Regulatory initiatives usually give rise to compliance costs and other costs. The auditor oversight regime will involve some additional compliance costs for auditors and audit firms in order to become licensed or registered, and to meet conditions of that licence or registration.
50. The Act requires FMA to avoid undue costs on auditors, audit firms and issuers. This recognises the general principle in public policy-making that the costs of a regulatory requirement should be proportionate to the expected benefits from the regulatory requirement. FMA does not consider this prevents it from prescribing requirements or conditions which will impose a substantial cost on auditors or audit firms if the requirement or condition is necessary to achieve the purposes of the Act.
51. FMA is conscious costs of compliance are likely, to some extent, to be passed on to issuers (and possibly other audit clients) through increased audit fees. In turn, if the costs are significant, this may affect returns to investors of those issuers.
52. Compliance costs may relate to such matters as:
 - (a) attaining qualifications and experience specified as a requirement for licensing, complying with conditions and completing ongoing competence requirements; and
 - (b) the need for audit firms to put in place, and demonstrate that the firm has, appropriate processes and procedures for governance, systems, controls, peer review, independence, auditor rotation, indemnity insurance, etc.
53. In general, the more prescriptive and demanding the regulatory requirements, the greater the compliance costs are likely to be.
54. Currently only chartered accountants holding a certificate of public practice and certain classes of overseas auditors can conduct audits in New Zealand. NZICA already applies a number of requirements on its members, in terms of entry requirements, ongoing education requirements, and the need to comply with applicable standards. There are no additional legal requirements for auditors, and NZICA does not currently impose any additional requirements on those of its members who conduct audits, as compared with other members in public practice. As such, NZICA's requirements for membership and for obtaining a certificate of public practice form the current entry requirements into the audit profession for New Zealand based auditors. To the extent the proposed licensing requirements can be based on the existing requirements imposed by NZICA, this will avoid incurring significant additional costs for those already in the profession.
55. This paper does not discuss the fees which will be charged by the Registrar for maintaining the register of licensed auditors and registered audit firms, because these fees will be fixed by regulations and will not be affected by the minimum standards or conditions prescribed. FMA also notes that compliance costs may also be incurred by matters not discussed in this paper such as, quality reviews of auditors and audit firms by FMA, or its delegate, or by being subject to an investigation.

Auditor licences

56. Section 33 of the Act provides for FMA to prescribe minimum standards for licensing in any way FMA thinks fit, including one or more of the following ways:
- (a) by requiring a degree, diploma or certificate of a stated kind recognised by FMA;
 - (b) by requiring the successful course of a degree, course of study, or programme recognised by FMA;
 - (c) by requiring a pass in a specified examination or any other assessment;
 - (d) by reference to registration with, a licence issued by, or other authorisation from an overseas organisation;
 - (e) by requiring experience the provision of a service of a particular kind;
 - (f) by requiring a certain level of competence.
57. An accredited body may license an auditor under section 11 of the Act, and FMA may license an overseas auditor under section 12. In each case, the Act requires the relevant authority to be satisfied that the auditor meets the minimum standards and is otherwise a fit and proper person. FMA must also be satisfied that the overseas auditor:
- (a) is subject to ongoing competency requirements that are equivalent to those under the Act;
 - (b) is subject to quality review procedures that are equivalent to those under the Act; and
 - (c) has systems, policies and procedures that are sufficient to meet the purposes of the Act.
58. This indicates licensing standards should primarily be directed toward assessment of the applicant's competence to perform the role of the auditor of an issuer, and the qualifications and experience necessary to attain the required competencies.

Licences issued by accredited bodies

59. At present, to be an auditor of a company under the Companies Act 1993 or an issuer under the Securities Act 1978, a person must be a chartered accountant (except overseas qualified auditors). Under NZICA's rules, chartered accountants in public practice or providing auditing services are required to hold a certificate of public practice ('CPP'). To be issued a CPP, a member usually must meet the following requirements:
- (a) have met the entry qualifications, namely:
 - (i) four years' approved tertiary study;

- (ii) one year's general practical experience, and two years' specified practical experience with supervision by a registered mentor in an Approved Training Organisation; and
 - (iii) successful completion of the Chartered Accountants Professional Competence Programme as prescribed by the Admissions and Membership Committee; and
 - (b) have two years' acceptable practical experience as a chartered accountant; or
 - (c) if admitted to NZICA membership through membership of an overseas accounting body, have completed approved courses in New Zealand Company and Partnership Law and New Zealand Taxation; and
 - (d) in either event, have attended an NZICA approved course for new practitioners within the two years preceding first obtaining a CPP.
60. These requirements are currently the same for auditors of issuers, auditors who do not have issuers as clients, and chartered accountants in any other area of public practice. While the experience requirements can be met in different areas depending on the person's likely professional direction, chartered accountants are not prohibited from changing areas after gaining membership as a chartered accountant.
61. FMA's expectation is that persons seeking to be immediately licensed under the new regime, transitionally or otherwise, will have already met these requirements. FMA also anticipates the majority of people who are likely to apply for licences over the next few years are likely to have already completed a substantial part of these requirements. Additionally, FMA considers it likely most, if not all auditors, will prefer to continue to be chartered accountants, or hold an equivalent status with another accredited body. Accordingly, we consider NZICA's requirements provide a sensible base in setting the minimum licensing standards.
62. However, the purpose of the Act is to promote quality, expertise, and integrity of the audit profession. This recognises auditing is a specialised profession, and requires specialist skills which are not necessarily held by all chartered accountants and are not necessarily required by accountants in other areas of public practice. The Act is, in part, designed to reduce the risk of audit failures as a result of auditors not having the required skills and expertise. Accordingly, FMA considers the existing requirements for becoming a chartered accountant should not necessarily be presumed to be sufficient. Therefore, FMA proposes auditors be required to develop, and demonstrate, their audit expertise through a combination of additional audit-specific qualifications and/or experience before a person can be licensed as an auditor.
63. FMA also notes the self-regulatory regime run by NZICA does not currently include requirements equivalent to certain requirements of comparable overseas regimes. In line with ensuring international recognition of New Zealand auditors, and international harmonisation more generally, these requirements should be carefully considered and, if appropriate, similar requirements should be adopted.

64. FMA proposes the prescribed minimum standards for becoming a New Zealand licensed auditor under section 11 of the Act should be as summarised in the following table:

	Current requirements	Proposed requirements	Comparison
Academic qualification	Approved degree from NZICA accredited tertiary institution.	Approved degree from tertiary institution accredited by an accredited body.	No immediate change for NZICA members. Requirements for other accredited bodies may differ.
Pre-qualification experience	One year general experience and two years with an approved training organisation.	Not prescribed as a separate requirement but FMA expects some experience will be required to gain membership of accredited body.	No immediate change for NZICA members. Detailed requirements for other accredited bodies may differ.
Pre-qualification competency sign-off	Sign-off of pre-qualification experience includes mentor assessment of competence before person is granted CA status. This may or may not include certification of competencies in audit.	Not prescribed as a separate requirement but FMA expects applicants will be required to demonstrate a basic level of competence and obtain a sign-off in order to gain membership of accredited body.	No immediate change for NZICA members. Detailed requirements for other accredited bodies may differ.
General professional qualifications	Foundations course and PAS/PCE. Completion of new practitioners course before obtaining CPP	Not prescribed as a separate requirement but appropriate professional training courses will be required to gain membership of accredited body. Not prescribed as a separate requirement but course may be required to gain a CPP	No immediate change for NZICA members. Detailed requirements for other accredited bodies may differ. See comments on CPP below.

Professional body membership	Membership as a chartered accountant	Membership of NZICA as a chartered accountant, or equivalent status with another accredited body. This will incorporate a requirement that the applicant meets the above requirements for experience and general professional	No change for NZICA members. Alternative with other accredited body introduced.
Audit specific professional qualification	None required	Audit course (yet to be implemented)	New course required.
Post qualification experience	Two years acceptable practical experience required to gain CPP	Proposal One – 8 years Proposal Two – 5 years Experience contains further prescriptive requirements.	Under either proposal, experience will substantially increase. Additional requirements will be imposed to ensure quality and focus of experience
Advanced certification of competence	A general assessment of the applicant is completed as part of granting the CPP.	Proposal One – Introduction of a formal competency standard. Proposal Two - General sign-off by assessor (licensed auditor).	Under either proposal the requirements will be significantly enhanced. The requirements will be audit focused, as compared with the more general nature of CPPs.
Practicing certificate	CPP	CPP or equivalent practicing certificate from another accredited body.	No change for NZICA members. Alternative with other accredited body introduced.
Auditor licence	None required	Required	New under the Act.

65. FMA’s proposed minimum standards also allow for the requirements to be met in certain circumstances by demonstrating the applicant has equivalent knowledge and qualifications, so as to allow for overseas-trained auditors who immigrate to New Zealand and apply through an accredited body for a licence. This is separate from the requirements for overseas auditors who remain licensed in their home jurisdiction and can apply to FMA for a licence as an overseas auditor.

Academic qualifications

66. FMA proposes a person who seeks to be licensed as an auditor should be required to have appropriate academic qualifications relevant to accounting and auditing. FMA would require each accredited body to specify, from time to time, approved courses (including the New Zealand institutions offering those approved courses). We anticipate the approved courses will be the same as those required for professional membership.
67. These qualifications should provide the base technical knowledge required for a person to perform the role of auditor, commensurate with the purposes of the Act. The qualification should be a bachelors degree, or a course of academic study equivalent to a bachelors degree, in accounting, auditing, commercial law and related subjects from an approved university or similar tertiary institution.
68. For auditors who received an academic qualification overseas, the accredited body will be required to have a process for assessing whether the academic qualification is equivalent to a New Zealand academic qualification.
69. Where an auditor has qualified as a chartered accountant, or the equivalent designation with an overseas professional body, without a degree level academic qualification, the accredited body must be able to determine whether the person has attained a level of knowledge and expertise which is equivalent to a person who has an acceptable academic qualification.

Questions for submitters

- Q 1. Should the prescribed requirements require auditors to hold a relevant degree or equivalent academic qualification?**
- Q 2. Should FMA prescribe specific courses, or let accredited bodies specify which courses meet the requirements?**
- Q 3. Should FMA prescribe detailed requirements for the academic qualification? If so, what should these be?**

Professional qualifications

70. FMA proposes auditors should have passed a professional course in auditing, which has been approved by FMA.
71. Academic qualifications typically provide a theoretical understanding of the material, but often provide only limited insights into the practical aspects of the subject area. Further, in specialist topics like audit, academic courses tend to provide an overview of key concepts, but do not necessarily contain the required level of detailed specialist knowledge. FMA suggests the course of academic study should be supplemented by professional qualifications with a skills based, practical focus.

72. FMA proposes the professional course on auditing would be designed to be completed after a course of academic study, and generally while the prospective auditor is working in an audit related field. The course should have a practical focus on audit skills, with a view to reinforcing and building on the theoretical knowledge gained in the prospective auditor's academic study and the practical experience the auditor has gained through their work.
73. FMA is not aware of any appropriate course which is currently run in New Zealand⁷. If such a course is to be required, FMA would need to consult with accredited bodies, and other training organisations, with a view to establishing such a course.
74. In Australia courses equivalent to what FMA is proposing are run by the professional bodies as units of their courses for professional accreditation. In the case of the Institute of Chartered Accountants of Australia ('ICAA') this course forms a mandatory part of becoming a chartered accountant. For the CPA Australia Limited ('CPA'), the auditing unit is one of four optional courses, of which an applicant is required to sit and pass two. An accountant wishing to become an auditor would generally elect the auditing unit as part of their professional training.
75. We note NZICA is considering introducing an auditing course, and other technical modules, as part of a revised training programme for prospective chartered accountants from 2013. FMA understands this training programme has been designed in conjunction with ICAA, and will take substantially the same structure as ICAA's current course. It will replace the current foundations programme and the PAS/PCE course. FMA anticipates ICAA will seek to have the audit module recognised by the Australian Securities and Investments Commission ('ASIC'). FMA may, once it has had a chance to assess that module, determine it meets the requirements for the professional course proposed by this section of the paper. Similarly, the CPA auditing unit may meet the requirements.
76. FMA is considering whether a professional course on auditing should be mandatory for all auditors, or all new auditors, from the commencement of the Act.
77. FMA is considering an exception for auditors who have routinely acted as an engagement partner, including for issuer audits, prior to the commencement of the Act. In that case, the accredited body would have discretion to determine whether it was satisfied that the applicant had otherwise demonstrated that they had the competencies which would be expected of someone who has completed the course.
78. Where an applicant had completed professional training overseas, the accredited bodies would have discretion to determine that the person has completed an equivalent course, and therefore should not be required to complete the prescribed course in New Zealand.

⁷ The course discussed in this section of the paper is intended to be different to NZICA's Professional Accounting School / Professional Competency Exam course, which we are advised is not intended to teach technical skills related to specific accounting disciplines.

Questions for submitters

- Q 4. Should licensed auditors be required to complete a professional course in auditing?**
- Q 5. If so, should this apply from the commencement of the Act, or from a later date?**
- Q 6. If it is not introduced from the commencement of the Act, should it apply retrospectively to all auditors, or only to those licensed after its introduction?**
- Q 7. If it is introduced from the commencement of the Act, should there be an exemption for experienced auditors licensed during an initial licensing period?**

Membership of an accredited body

- 79. FMA proposes applicants should be required to be a member of the accredited body issuing the licence, and should be required to remain a member of that accredited body. Where an accredited body offers different classes of membership depending on the level of training and expertise, auditors would be required to be full members (for example, NZICA members should be chartered accountants, rather than associate chartered accountants or accounting technicians).
- 80. The primary reason for requiring membership of the accredited body is to ensure the accredited body has the ability to exercise all regulatory functions and powers which exist under its rules in respect of all auditors it licenses. However, as professional bodies generally seek to maintain a level of initial and ongoing professional competence within their membership, this should also provide a base level of competency and expertise. FMA will consider the entry requirements of accredited bodies in assessing whether those requirements are appropriate as base requirements for auditors as part of the accreditation process of the relevant accredited body.
- 81. FMA proposes to prescribe a requirement that applicants hold a CPP or equivalent with another accredited body. In our view, this should not cause any difficulties as it is anticipated that licensed auditors will have met all of the requirements to obtain a practicing certificate in the course of becoming licensed. FMA anticipates that licensing will involve higher training and experience requirements than a general practicing certificate for accounting. Licensed auditors will likely need to hold a CPP or equivalent practicing certificate in order to provide other accounting services under the rules of the accredited body.

Questions for submitters

- Q 8. Should licensed auditors be required to maintain membership of a professional body?**
- Q 9. Should licensed auditors be required to hold a practicing certificate (for example a CPP for NZICA members)?**

Auditing experience

82. FMA considers experience is an essential element of acquiring expertise as an auditor and, as such, proposes to require any person who seeks to be licensed as an auditor to have met a minimum level of audit experience.
83. Experience should be of an appropriate quality, and the applicant should have in fact developed the skills and expertise which the experience sought to teach or reinforce. Regardless of the minimum experience period prescribed, each applicant would be required to demonstrate that they had developed the competencies expected of a licensed auditor, or undertake any additional training or period of experience as that applicant requires to develop the expected competencies. Further details of the assessment of competence are discussed in the next section of this paper.
84. FMA has considered two proposals, one based on a preliminary submission received from NZICA and a second which more closely follows the Australian requirements⁸. However, FMA may, in settling the final requirements, adopt requirements which incorporate aspects of each proposal. The following table summarises these proposals:

	FMA proposal based on NZICA's submission	FMA proposal based on Australian requirement
Total experience	8 years.	5 years.
Audit focused experience	3000 hours over 4 years.	3000 hours over 5 years.
Experience at senior level	1000 hours over the last 2 years.	1000 hours towards the end of the required 5 years.

Time requirements for proposal based on NZICA's submissions

85. Under the proposal based on NZICA's submissions, all auditors should have completed a minimum period of eight years relevant experience after becoming a chartered accountant. Where an applicant has worked part time for a significant portion of this time, the accredited body may require the applicant to complete such additional period of time to ensure that the experience gained is equivalent to eight years full time experience. Accredited bodies will determine whether a role constitutes 'relevant experience'. Relevant experience would be broader than audit experience, but may not include all accounting and business advisory work.

⁸ While based on a proposal from NZICA and the requirements in Australia, both proposals have been modified by FMA and should be taken as FMA's proposals.

86. This experience must include at least four years, working primarily on audit and assurance related tasks under the supervision of a licensed auditor⁹. During the four years of audit related work, the applicant should complete at least 3,000 hours of audit work. The four years need not be done as a single block.
87. Included in the four years (3,000 hours), the applicant must have two years of audit focused work which includes 1,000 hours of work on issuer audits or other comparable audits. Comparable audits would be audits of companies or other entities which comply with full IFRS in the preparation of their financial statements, and where the level of complexity of the audit is similar to that of an issuer.
88. The two years (1,000 hours) experience at a senior level should generally be completed in the last two to three years before applying to become a licensed auditor. Where the experience is not recent at the time of applying to be licensed, the applicant will need to provide evidence to satisfy the accredited body the auditor has maintained the currency of their experience.

Time requirements for proposal based on Australian requirements

89. Under the proposal based on Australian requirements, applicants would be required to have at least five years relevant experience. Applicants would be expected to direct most of this time to auditing and assurance related work.
90. Applicants who only work part time or whose work is divided between audit work and work in other accounting disciplines may need additional experience in order to develop the required competencies. However, under this option, it is not proposed FMA prescribe any additional minimum period of time for these applicants. If an applicant can complete the minimum hours and gain the experience and competencies while devoting only part-time hours to auditing, the applicant will be eligible at the end of the five years.
91. During these five years of audit experience, the applicant should complete at least 3,000 hours of audit work under the supervision of a licensed auditor.
92. During the latter part of this experience, the auditor should complete 1,000 hours work on issuer audits or other similar audit engagements. Applicants should have gained at least a basic level of competence and experience in audit prior to completing these issuer audit hours.
93. Typically, the 3,000 hours requirement should be completed gradually over a period of three to five years, and the 1,000 hours should be completed over the last one to three years of the five year period. Where an applicant is not able to complete the 3,000/1,000 hours of experience within the five years, the applicant may be required to provide evidence they have maintained knowledge and skills gained in the earlier portion of their experience. This may be done by demonstrating the skill again in the course of an issuer audit or other similar audit engagement.

⁹ Provision will be made for experience before the commencement of this Act, and for some experience to be completed overseas.

94. While an applicant may have some time away from auditing work during the five years, the situation where an applicant attempts to complete all of their hours in a short period at the beginning or end of the five year period should be avoided. Where this occurs, an accredited body may determine the applicant should complete further time to ensure that quality experience has been gained.

Other features of both proposals

95. Experience may include experience gained before the commencement of this Act. FMA acknowledges that experience gained prior to the commencement of the Act will generally not have been documented in anticipation of the requirements discussed above. The accredited body will also need to consider the range of experience, and the level of responsibility the applicant has held.
96. For applicants who have gained some, but not all, of their auditing experience prior to 1 July 2012, the extent and nature of the supervision of an applicant's work pre-July 2012 will be considered by the accredited body, who will need to be satisfied the supervisor has demonstrated an appropriate degree of competence and expertise in audit.
97. For applicants who have substantial experience prior to the commencement of the Act, and have routinely acted as an engagement partner, the accredited body would not need to assess the supervision, but the accredited body would still need to assess the auditor's competence.
98. Applicants will also be able to gain part of their experience in another jurisdiction. Where this occurs, the accredited body will take account of the amount of the experience the applicant has and the jurisdiction it was gained in. Applicants will be required to complete at least the last year of experience, and 1,000 hours of audit work (which may be completed during that last year), in New Zealand under the supervision of a licensed auditor.

FMA's view

99. In the absence of any compelling submissions as to why a longer experience period is necessary, FMA prefers a five year experience period rather than an eight year period. FMA sees limited benefit in requiring any period of experience which is not focused primarily on audit and assurance work. FMA is also conscious that the overall qualification period (including academic qualifications and pre-qualification experience) is lengthy, and that some prospective auditors and audit firms may have concerns about the effect of such a long experience period on promotion and succession.

Questions for submitters

- Q 10. Should the total minimum experience period be 8 years (as per the first proposal), 5 years (as per the second proposal), or some other period?**
- Q 11. Should the requirements for experience include a period of relevant, not necessarily audit related, experience? If so, should this be prescribed as a block of general experience and a block of audit focused experience, or should it provide for a split between work areas throughout the period?**

- Q 12.** Should a longer period be prescribed (whether by a prescribed formula or by a provision for accredited bodies to set longer periods for those applicants) for applicants who work part time during their experience period? Similarly, if no provision is made for general experience, should people who split their time between audit and other accounting disciplines be required to complete an additional period to ensure that an equivalent period of audit experience is completed? Alternatively, should people who work part time in audit be subject to the same period in years, provided they can gain the required competencies?
- Q 13.** Should auditors have to complete a minimum number of audit hours (in addition to a minimum period of time)? Is 3,000 hours an appropriate number of hours? If not, how many hours should it be?
- Q 14.** Should there be a time limit for completing the required hours? If so, what should it be?
- Q 15.** If a minimum number of hours is required, should auditors also have to complete a minimum period of time (years)?
- Q 16.** Should auditors be required to complete a specified number of hours on issuer audits? Is 1,000 hours an appropriate number of hours? Should this be limited to issuer audits, or include other similar audits?
- Q 17.** Does one year (1,000 hours) of audit work in New Zealand represent a fair balance between experience in the New Zealand corporate environment and international experience?
- Q 18.** Should the New Zealand experience be required to be at the end of this period? If generally so, should there be any exceptions (for example returning auditors who have previously been licensed)?

Assessment of practical competency

100. As noted above, FMA proposes applicants must have demonstrated competence in all key aspects of an audit. In terms of this requirement, it is not intended competency be tested by way of examination or other set assessment. Rather, competence should be demonstrated in the course of the applicant's normal work.
101. FMA proposes an 'assessor' approved by the accredited body will assess the applicant. FMA anticipates that generally the assessor should be a licensed auditor who is a partner of the firm which employs the applicant. FMA will require accredited bodies to have in place systems for approving assessors in advance. In seeking approval to act as an assessor, a licensed auditor should consider, and provide information to the accredited body about, whether they, or their audit firm, have the volume and range of audit work required to give the applicant the experience required. Additionally, particularly where the proposed assessor is not the applicant's primary supervisor, the proposed assessor would need to satisfy the accredited body that they will have sufficient access to the applicant's work to form an opinion about the

quality of that work, and the level of competency demonstrated by it. FMA will expect accredited bodies to monitor the mentoring, supervision and evaluations of applicant by assessors, and to remove assessors where they are not ensuring applicants are competent before signing off on their competence.

102. Experience gained prior to the commencement of the Act will be taken into account. Similarly, experience gained through work overseas will be taken into account. Consideration of this experience will include an assessment by the accredited body of the person, or people, who supervised the applicant during that period, as well as the work undertaken by the applicant.
103. People who are experienced auditors at the time this Act comes into force will still need to provide evidence of their past experience. We anticipate this experience could be evidenced in one or more of the following ways:
 - (a) self-certification of competence supported by information about the applicant's experience:
 - (b) certification from other experienced auditors (who may not yet be a licensed auditor) supported by information about the applicant's experience. Other auditors who certify the experience of an applicant may, for example, be other partners of the same firm who have peer-reviewed audits undertaken by the applicant:
 - (c) the accredited body may review a sample of applicant's work on recent issuer audits.
104. Accredited bodies will also take into account in assessing competence any failure to adhere to acceptable standards in conducting audits in the past.
105. We note that for all experience and competence requirements, while the focus will be on work performed on issuer audit engagements, accredited bodies may take into account work performed on other audit or assurance engagements. FMA considers that taking into account work that is not specifically regulated under the Act may be appropriate for a number of reasons, including:
 - (a) There may be occasions where, while the engagement is not an issuer audit in terms of the Act, the engagement is required to be undertaken by licensed auditors. This may occur, for example, under the terms of an authorisation or licence granted to the client, or under the laws of another jurisdiction (if that jurisdiction only recognises New Zealand auditors if they are licensed).
 - (b) It is likely that users of audits will expect licensed auditors to meet the same high quality standards in respect of all engagements, even though the particular engagement may not be reserved to licensed auditors, and FMA considers it appropriate that licensed auditors should endeavour to meet this expectation.
 - (c) Where an applicant fails to comply with applicable standards in respect of an audit of an entity, whether that entity is an issuer or not, that performance will be relevant to any assessment of the auditor's competence to conduct issuer audits at that time.

Coverage of experience and competence

106. During the applicant's audit experience, the applicant should participate in all aspects of an audit. To the extent practical this should include experience in, or otherwise developing the knowledge and expertise to perform, tasks which would typically be carried out by the engagement manager, engagement partner¹⁰ and engagement quality control reviewer¹¹.
107. Applicants should have been given sufficient guidance as to how each task within an audit should be performed, and subsequently given the opportunity to independently carry out each task (subject to supervision and evaluation by their assessor). We would typically expect the applicant would have completed each task several times, with varying degrees of supervision and guidance, and in various circumstances.
108. Applicants should have gained experience with a range of audit clients. This should include various sizes, industries, risk profiles and some clients that are subject to industry specific regulatory regimes. Applicants should, particularly in the latter part of their experience period, have involvement in planning and decision making tasks in relation to more challenging audit clients¹². This may include, for example:
 - (a) involvement in making the decision whether to accept a client where the client's business represents a new industry for the firm;
 - (b) evaluating evidence and making a decision on the control testing, or planning substantive testing, where internal controls or governance structures of the client may be inadequate for the nature and scale of its business; or
 - (c) evaluating evidence and formulating the overall opinion where accounting records are not wholly adequate, potentially material misstatements may exist or there are other matters of concern to the engagement team.
109. Where such an opportunity is available and subject to such decisions being reasonable, it would provide beneficial experience for applicants to have been involved in, or able to observe, decisions to decline, or resign from, an engagement, or decisions to issue an audit report which does not provide an unqualified opinion.

¹⁰ The prospective auditor will not be able to act as an engagement partner or an engagement quality control reviewer in respect of issuer audits, but may perform most tasks normally conducted by an engagement partner under the supervision of the engagement partner, and may take a lead role in the quality control review under the supervision of an audit partner (other than the engagement partner).

¹¹ Engagement quality control reviewer means a partner, sufficiently senior staff member or appropriate consultant who undertakes an independent review of the critical judgements made during the review, where the review is undertaken prior to sign-off on the audit report.

¹² This paper should not be taken as requiring, or encouraging, any licensed auditor or audit firm to accept any audit engagement for the purpose of giving a prospective auditor experience. Licensed auditors and audit firms should form their own conclusions as to whether it is appropriate for them to accept an engagement.

110. To ensure assessors and accredited bodies apply appropriately stringent standards, and assess all key skills and areas of knowledge, FMA is considering two approaches:
- (a) prescribing in detailed areas where competencies which must be demonstrated, potentially with a general requirement to cover any areas not covered by specific requirements and to ensure overall competence; or
 - (b) prescribing general requirements, and supplement the prescribed requirements with guidance as to how compliance with the general requirements should be assessed.
111. FMA contemplates the first approach, if adopted, may take the form of a competency standard which is substantially the same as the Australian Competency Standard approved by ASIC¹³.
112. Broadly, the Australian Competency Standard requires that, before becoming a registered company auditor (Australia's equivalent to a licensed auditor), the applicant should have demonstrated competencies in all phases of an audit, including:
- (a) the acceptance or retention of a client;
 - (b) audit planning;
 - (c) control testing;
 - (d) substantive testing; and
 - (e) formulation of audit opinions.
113. For each of these areas, the Australian Competency Standard requires the auditor to have demonstrated competency in planning the phase, gathering of evidence, evaluating the evidence, and making a decision (or recommendation). In demonstrating competency, an applicant should demonstrate the ability to competently complete an entire task, and demonstrate an understanding of the impact of their performance of the task and the outcomes of their work for the overall audit.
114. If the second approach is taken, a more general certification is likely to be required, but FMA would still expect the applicant to have gained the same range of experience and to have demonstrated competence in all key areas. FMA would still expect the assessor and the accredited body to assess the applicant's competence.

¹³ The Auditing Competency Standard is a program jointly developed between ICAA and CPA. The Standard can be obtained from CPA's website at www.cpaaustralia.com.au in the 'audit and assurance' section under the 'knowledge portals' tab.

Questions for submitters

- Q 19.** Should the assessment of a competency be a formal program, similar to the Auditing Competency Standard applied in Australia, or a more general confirmation by the assessor that the applicant has completed their hours and is competent in all key aspects of auditing? Alternatively, should some other approach be taken?
- Q 20.** Are there any other key aspects of auditing, in addition to those at paragraphs 112 and 113, which should be assessed?
- Q 21.** Should the requirement for auditors to have experienced particular aspects of audits, and demonstrated competency, under a variety of circumstances form a mandatory requirement in terms of gaining experience and demonstrating competence?
- Q 22.** Are there any other factors which should be specified in relation to the range of experience an applicant should have gained or how experience should be assessed?
- Q 23.** Are there any criteria which should be applied in accepting a licensed auditor as an assessor? Alternatively should any licensed auditor be permitted to act as an assessor?
- Q 24.** Should the assessor be the applicant's supervisor, or should it be allowed to be another person within the firm? Alternatively, could it be someone outside the firm?

Fit and proper requirements

115. In addition to satisfying the minimum requirements, the Act requires auditors must be fit and proper persons. Generally FMA would expect applicants will be able to attest there are no adverse matters relevant to an assessment of their fitness to be granted a licence. Where matters exist the accredited body will consider the circumstances of the matter and the overall history of the applicant and determine whether the applicant is fit and proper.
116. FMA considers the following matters will always be relevant to the consideration of whether a person is fit and proper:
- (a) The person has been convicted of a crime involving dishonesty. A crime of dishonesty includes¹⁴:
 - (i) any offence under any of section 99 to 106, 108 to 117, and 217 to 266 of the Crimes Act 1961;
 - (ii) any offence under any of sections 15 to 20 of the Summary Offences Act 1981; or
 - (iii) any offence under any overseas law which is equivalent to one of those Crimes Act of Summary Offences Act offences.

¹⁴ Offences involving dishonesty generally involve an element of theft or fraud.

- (b) The person has been convicted of any offence under any provision of the financial markets legislation (as defined in the Financial Markets Authority Act 2011) or any offence under any provision of any overseas Act governing auditors, financial markets or financial services, corporations, financial reporting, or money laundering.
- (c) The person has been banned from acting as a director of a company or other incorporated body, or from being involved in the management of any class of incorporated or unincorporated entity.
- (d) The person has been subject to disciplinary actions against them by any professional body or disciplinary tribunal, where those actions resulted in penalties being imposed or censure.
- (e) The person has had a court ruling against them in respect of a civil case, or has reached an out of court settlement, relating to their profession.
- (f) The person has been declined membership of any professional body, or has been declined any registration, licence, authorisation, or accreditation required in relation to any profession by any public body, self-regulatory organisation or exchange, or has had any such membership, registration, licence, authorisation or accreditation revoked or withdrawn.
- (g) The person has been dismissed, or asked to resign, from a position of trust, fiduciary appointment or similar position.
- (h) The person has been placed into statutory management, or has been a director of a company which has been placed into statutory management.
- (i) The person has, in the past ten years, been made bankrupt, or has entered into a compromise agreement with creditors.
- (j) The person has, in the past ten years, been a director or senior manager of a company, or other incorporated or unincorporated entity, which has:
 - (i) been placed into liquidation, administration or receivership (or any overseas equivalent status);
 - (ii) entered into any compromise agreement, moratorium or other restructuring to avoid liquidation, administration or receivership.

For the purpose of paragraph (j), the person was a director or senior manager of the company if the person held such a position at the time of, or left the position within one year prior to, the relevant event. We note this does not include a person who was acting in their professional capacity as a receiver, liquidator or the holder of any similar office.

- (k) The person is subject to pending proceedings which, if an adverse finding is reached, will result in one or more of the matters set out in subparagraphs (a) to (j) above applying to the person.

117. If any of the matters apply to an applicant, the application would need to provide full details of the event, the applicant's conduct in relation to the event, any findings made in relation to the event, and any penalty or sanction imposed or any settlement reached. FMA expects that, in the event of a more serious event outlined in paragraph 116 applying to an applicant, it will be rare a licence will be granted. The matters identified in subparagraphs (a) to (c) will usually be serious. For other matters, the severity will depend on how recently the event occurred, and the circumstances surrounding the event. Where an accredited body determines that a matter is relatively minor, FMA would expect the accredited body to be satisfied that the applicant is unlikely to engage in similar conduct in the future before granting a licence.
118. The relevant authority may also determine an applicant is, for any other reason, not a fit and proper person to be a licensed auditor.
119. A failure or refusal to provide any declarations, or to consent, in an acceptable form, to any reasonable checks being carried out, may be considered grounds to decline an application.

Questions for submitters

Q 25. Are there any matters set out above which should not be included? Are there any matters not set out above which should be included? Should any of the matters set out above be changed (broader, narrower or given a different focus)?

Licensing of overseas auditors

120. Overseas auditors are currently able to conduct audits in respect of issuers in New Zealand provided that they meet the requirements of section 199(1) of the Companies Act 1993 and section 3A of the Securities Act 1978. In essence, this requires the overseas auditor to be a member of an approved professional association and be eligible to act as an auditor in their home country. There are currently six approved professional associations for the purpose of the Companies Act and seven for the purposes of the Securities Act, namely:
 - (a) The Institute of Chartered Accountants of Australia;
 - (b) The Association of Authorised Public Accountants (Securities Act only);
 - (c) The Australian Society of Certified Practising Accountants;
 - (d) The Institute of Chartered Accountants of England and Wales;
 - (e) The Chartered Institute of Certified Accountants;
 - (f) The Institute of Chartered Accountants of Scotland; and
 - (g) American Institute of Certified Public Accountants.

121. An 'overseas auditor' is defined in the Act as a person who is entitled to act as an auditor in a prescribed overseas jurisdiction. The Governor General, by Order in Council, will make regulations prescribing (amongst other matters) overseas jurisdictions for this purpose. Given the application of the transitional provisions, FMA expects that initially Australia, the United Kingdom and the United States will be prescribed jurisdictions, with further jurisdictions being considered as a need is identified.
122. FMA intends to assess the requirements of each prescribed overseas jurisdiction, with a focus on comparing the following areas to the requirements for New Zealand auditors:
- (a) Comparing the entry requirements to become a licensed auditor (or equivalent designation) in the prescribed jurisdiction, including any academic qualifications, professional qualifications, and minimum practical experience requirement. The requirements will be assessed with a view to ensuring overall equivalence, and may not necessarily require that each jurisdiction is comparable to FMA's requirements in every area;
 - (b) Comparing the ongoing competency requirements for licensed auditors. We note FMA is required to be satisfied the ongoing competency requirements required in the auditor's home jurisdiction are equivalent to, or at least as satisfactory as, those required of New Zealand licensed auditors¹⁵; and
 - (c) Considering any other conditions or requirements which are consistently imposed under the overseas regime (including matters which must, or may, be addressed by conditions under our regime);
 - (d) Comparing the quality review arrangements the firm is subject to. Similarly to ongoing competency requirements, FMA must be satisfied the quality review arrangements are equivalent to the quality reviews under the Act. In assessing this, FMA will consider whether all auditors within the jurisdiction are reviewed with equal frequency or whether the jurisdiction applies a risk based approach with some groups of auditors being reviewed more frequently than others. FMA will also consider whether the quality reviews cover audits of importance to other jurisdictions (including New Zealand) or only those conducted under the laws of that jurisdiction;
 - (e) Comparing the auditing standards and code of ethics which apply to auditors in the jurisdiction, and how those standards are imposed and enforced; and
 - (f) Comparing the general investigative and disciplinary procedures for failure to comply with auditing standards and ethical standards, for failing to exercise care and diligence, or otherwise for bringing the profession into disrepute. This will also involve considering the extent to which such powers are used.

¹⁵ FMA has not yet determined what ongoing competence requirements will be prescribed. This will be the subject of a future consultation paper.

123. FMA will also consider whether each jurisdiction has been assessed as equivalent to jurisdictions which have adopted the EU directive (or, in the case of EU jurisdictions, which have adopted the EU directive), and whether the jurisdiction is recognised by ASIC.
124. Assessments of these factors will be updated from time to time to take account of any changes to the requirements in prescribed overseas jurisdictions, or to the requirements prescribed by FMA.
125. FMA will, as part of its assessment of an overseas jurisdiction, consider whether any additional requirements should be prescribed for that jurisdiction. Any additional requirements may, as appropriate, be applied either to overseas auditors from one or more specified jurisdictions, or to overseas auditors generally.
126. Further, FMA may decide that consideration of how particular requirements are complied with by each applicant should be carried out on a case by case basis. For example, FMA may wish to ensure that overseas auditors, or a class of overseas auditors, have adequate experience in particular areas, without imposing requirements which are necessarily higher than those in the home jurisdiction. Additionally, where a jurisdiction uses a risk based method to determine the frequency of quality reviews for particular firms, FMA may wish to consider how the particular firm is assessed, and how frequently the firm will be reviewed as a result.
127. Following an assessment of the matters in paragraph 106(a) to (f) above, FMA will rely on that assessment, together with evidence that the candidate is a licensed auditor in that jurisdiction (including whether the applicant has met the key requirements necessary to become a licensed auditor or has relied on exemptions from the standard requirements) and an individual assessment of any other prescribed matters to determine whether the applicant has complied with the requirements for becoming licensed in New Zealand.
128. Overseas auditors will, in addition to demonstrating they are a licensed auditor in their home jurisdiction (and have met the required standards to attain that status), be required to demonstrate they are a fit and proper person (on substantially the same basis as New Zealand auditors) and will need to demonstrate that their (or their firm's) systems, policies and procedures are appropriate to meet the purposes of the Act. This latter point will be particularly important where the overseas auditor's firm does not intend to, or cannot, become a registered audit firm¹⁶. This assessment will consider substantially the same matters as discussed below for audit firms.

¹⁶ Audit firms in New Zealand must be ordinary partnerships. In contrast, some other jurisdictions allow audit firms to be companies or other limited liability entities. This is likely to mean some overseas audit firms will not be permitted to register in New Zealand, even though they are registered as such in their home jurisdiction.

Questions for submitters

- Q 26. Is the approach of assessing overseas jurisdictions requirements, then placing reliance on those requirements in assessing individual applications, appropriate? If not, how should overseas auditors be assessed? Alternatively, should greater reliance be placed on overseas regulation?**
- Q 27. Are there any other matters which should be considered in assessing overseas jurisdictions?**
- Q 28. Are there other matters which should be taken into account in assessing individual auditors?**

Proposed kinds of conditions for auditor licences

129. The Act allows FMA to specify the kinds of conditions to which a licence must be subject, and the kinds of conditions to which a licence may be subject. Authorisations must be subject to a condition relating to the kinds of audit engagements the auditor may accept.
130. Conditions of a licence are in addition to the licensed auditor remaining a fit and proper person, maintaining any minimum standards (to the extent these require maintenance), completing any ongoing competence requirements, complying with auditing and assurance standards and complying with certain other requirements of the Act.
131. The Act provides two penalties for breaches of conditions, suspension of licence or cancellation of licence¹⁷. One, or both, of these penalties are also available where an auditor fails to comply with auditing and assurance standards, ceases to be a fit and proper person or to meet the minimum standards prescribed under section 32 of the Act, or fails to complete the ongoing competence requirements. Accordingly, we see no benefit in making these matters conditions of a licence as well.
132. However, the circumstances in which a licence may be suspended or revoked are restricted to those under sections 20 and 21 of the Act. Accredited bodies may not cancel or suspend a licence for any other reason, including for a breach of the accredited body's rules (unless the licence included a condition requiring compliance with those rules or the particular rule breached). In this regard, we consider it appropriate to provide for conditions which will enable accredited bodies to suspend or cancel licences where this is appropriate in light of the auditor's conduct.
133. FMA considers conditions should focus on four areas:
- (a) the kind of issuer audits (required under the Act);
 - (b) systems and processes for auditors who take on engagements other than through a registered audit firm;

¹⁷ The availability of these remedies would not prevent an accredited body from imposing other, lesser, sanctions under its rules in appropriate cases.

- (c) self reporting of material matters; and
- (d) general conditions.

Kinds of issuers

- 134. The Act requires that all licences must specify a condition relating to the kinds of issuer audits in respect of which the licensed auditor is authorised to act under the licence.
- 135. FMA is considering whether to prescribe a set of kinds of issuer audits, or a single kind (i.e. all issuer audits). If FMA decides to prescribe more than one kind, FMA considers one of the following two approaches to kinds of issuer audits may provide the most appropriate basis:
 - (a) a split between potentially complex financial institutions such as banks, finance companies, insurance companies, fund managers, etc; and other issuers (equity issuers, participatory schemes, and issuers of corporate debt who are not non-bank deposit takers); or
 - (b) a more granular split into specific industries, for example banks and finance companies, insurance companies, telecommunications, forestry, retail, etc.
- 136. Under any of the options, FMA proposes that all licences should be subject to conditions that ensure licensed auditors are only permitted to conduct audits which they have the capabilities to undertake, and which appropriately provide for the accredited body or FMA to intervene to ensure this occurs if necessary. FMA proposes to prescribe kinds of conditions to enable such conditions to be attached to licences. FMA considers all licences should include a condition to prohibit the auditor from undertaking an audit of any issuer, or class of issuers, the accredited body or FMA directs it not to undertake. In addition, FMA considers licences should include a condition requiring auditors to assess their capability to undertake each audit before accepting an engagement. These requirements have existed under NZICA's rules, and in the latter case under auditing standards, for some time. However, FMA considers it important that obligations relevant to issuer audits sit under the Act, and therefore these matters should be included as conditions. To facilitate imposition of conditions of this nature, FMA would prescribe a kind of condition that requires an assessment of competency prior to accepting an engagement.
- 137. FMA proposes that, if more than one kind of issuer audit is adopted, kinds of issuer audits should initially be divided into financial institutions, and other issuers. This division reflects that financial institutions carry specific risk factors which are often not present in other classes of issuers, and financial institutions (especially finance companies) have, in the recent past, proved to be a problem for some auditors. FMA generally anticipates an auditor will either be licensed either for just the latter category or for both categories, reflecting that financial institutions appear to be the more complex category.
- 138. Applicants will need to demonstrate a level of knowledge, competence and experience in the categories that the auditor seeks to be licensed for. Licensed auditors may apply to have the categories they are licensed for changed on the basis of further knowledge or experience

gained after first becoming licensed. FMA expects a licensed auditor will not act as an engagement partner¹⁸ or an engagement quality control reviewer, or accept an engagement to act as an auditor or to perform an engagement quality control review personally, if the entity, or group, conducts a business which is not covered by the auditor's licence.

139. Overseas auditors will generally not be licensed to audit any classes of issuer they are not able to audit in their home jurisdiction.
140. FMA also proposes to include conditions, in appropriate cases, which restrict the overseas auditor to auditing New Zealand issuers with a connection to the auditor's home jurisdiction. This kind of condition would be used to help address any concerns about overseas auditors conducting audits of New Zealand based issuers without having sufficient resources in New Zealand during the course of the audit to perform the engagement adequately. This would also assist in ensuring that all issuer audit engagements undertaken by the overseas auditor are within the jurisdiction, and therefore covered by the monitoring and quality review processes, of the auditor's home jurisdiction regulator.
141. As a result, categories may be described differently for overseas auditors, so as to ensure the limitations on their New Zealand licence are consistent with any limitations on their licence issued in their home jurisdiction and that, where FMA relies on the home jurisdiction regulation of overseas auditors, that this regulation covers any issuer audit engagements undertaken by that overseas auditor in New Zealand.
142. FMA intends to review any division into kinds of issuers in a few years, at which time it may separate out any further industries that appear to have unique characteristics affecting an auditor's ability to effectively perform their function.

Questions for submitters

- Q 29. For New Zealand auditors, should licences generally be issued for all kinds of issuer audits, or for specified classes?**
- Q 30. If FMA prescribes a set of categories of issuer audits, should kinds of issuer audits be divided into two categories as proposed or into more specific industry based categories? Alternatively, should issuer audits be classified in some other way?**
- Q 31. Should overseas auditors be subject to a presumption that their licence will cover the same audits as their licence in their home jurisdiction?**
- Q 32. Should overseas auditors be restricted to auditing issuers with a connection to the auditor's home jurisdiction?**

¹⁸ The Act defines 'engagement partner' to include a licensed auditor who is not a partner in the audit firm engaged, but is an employee who has been approved by the partners of the firm to be responsible for the performance of that audit or a review of that audit.

Systems and processes

143. FMA considers auditors who accept audits, other than through an audit firm they are a partner or employee of, should be required to maintain systems, policies and procedures equivalent to those required of an audit firm. Additionally, they should maintain an appropriate level of professional indemnity insurance. FMA proposes that all licences should be subject to conditions which ensure that auditors who accept engagements personally have adequate systems, policies and procedures and have appropriate professional indemnity insurance cover, and proposes to prescribe kinds of conditions to facilitate this.
144. FMA expects it to be relatively uncommon that a New Zealand auditor will seek to undertake an audit in their personal capacity. Auditors should carefully consider whether it is appropriate to undertake issuer audits without the resources and support of an audit firm. However, as the Act permits this to occur, it is appropriate the prescribed conditions address this possibility.
145. FMA suggests New Zealand auditors who have not demonstrated they have the resources, systems, policies, procedures and other arrangements in place, including professional indemnity insurance, should not be permitted to accept audit engagements personally. FMA considers that prescribing a kind of condition which would require demonstration of these matters prior to engagements being accepted personally or prohibiting an auditor from accepting an engagement personally where that auditor cannot demonstrate these matters is appropriate.
146. This condition should not affect the licensed auditor's ability to act as an engagement partner or an engagement quality control reviewer in respect of an engagement accepted by their registered audit firm.
147. This issue is more complicated in the case of overseas auditors, who may have the backing of a firm that is the equivalent to a registered audit firm in the auditor's home jurisdiction, but is not able to be registered in New Zealand. This may leave the position where some overseas auditors have little choice but to accept the engagement in their own name.
148. In these circumstances it is a requirement that FMA consider the systems, policies and procedures the auditor has in place to ensure the quality of issuer audits. However, this statutory requirement does not create any ongoing obligation to maintain those systems. Accordingly, FMA would look to impose conditions requiring this.

Questions for submitters

- Q 33. For New Zealand auditors, should the regime favour audit engagements being accepted through registered audit firms, rather than by a licensed auditor?**
- Q 34. Will restrictions on licensed auditors accepting audit engagements personally create issues for any licensed auditors or their clients?**

Other conditions

149. FMA proposes that the following kinds of general conditions should be included in all notices:

Workload of auditors

150. Licensed auditors may be subject to conditions directed at ensuring that the licensed auditor carries out sufficient audit work that the auditor maintains their competencies and experience in audit practices and current issues. These conditions may address any of the following:

- (a) the number of audits, or issuer audits, the auditor conducts each year;
- (b) the amount of time the auditor spends on audit work, or issuer audits, each year;
- (c) the range of audit work performed by an auditor.

151. The conditions may also provide for mechanisms for the accredited body to monitor the level of audit work undertaken by an auditor who is subject to a condition of this type. Accredited bodies will need to have appropriate mechanisms in place to ensure audits are being undertaken properly where auditors are performing only small amounts of audit work.

152. Alternatively, licensed auditors may be subject to conditions designed to ensure that issuer audits receive sufficient attention from the engagement partner and the engagement quality control reviewer, and any other licensed auditors assigned to the engagement team. These conditions may include conditions which restrict the number of audit engagements a licensed auditor can take on at any given time, or which require the engagement partner to dedicate certain amounts of time to engagements. Again, FMA would expect accredited bodies to monitor compliance with such conditions where a condition is attached to a licence.

153. FMA does not expect that one, or both, of these conditions would be applied to all, or even most, licensed auditors. Rather, FMA considers this provides a tool for accredited bodies where the accredited body considers that maintaining currency with auditing practice or dedicating adequate time to individual audit engagements is an issue for a particular licensed auditor or licensed auditors at a particular firm. While making these matters conditions of a licence will create the ability to cancel a licence for non-compliance, FMA would expect accredited bodies will consider the range of mechanisms available to address these situations.

Compliance with conduct obligations

154. All licensed auditors must be subject to conditions which require the auditor to comply with relevant rules, such as any code of conduct or code of ethics, of the accredited body in the case of a New Zealand auditor, or of any professional body the auditor is required to maintain membership of in the case of an overseas auditor. This will include, amongst other things, requirements relating to ongoing training and professional development. For both overseas auditors and New Zealand based auditors who conduct audits in overseas jurisdictions or audits that are otherwise subject to the requirements of another jurisdiction, the auditor should be required to comply with the requirements of that overseas jurisdiction.

Reporting and notifications

155. FMA proposes that all licensed auditors should be subject to conditions requiring the auditor to provide specified reports and notifications to the accredited body or FMA, as the case may be.
156. FMA considers all licensed auditors should be subject to conditions which require the auditor to provide the accredited body or FMA, as the case may be, with information, such as the following:
- (a) If the auditor leaves an audit firm, joins an audit firm, becomes a partner in an audit firm, or ceases to be a partner in an audit firm, the auditor (or the audit firm on the auditor's behalf) must notify the relevant authority that issued the auditor's licence.
 - (b) In the case of any auditor who conducts audits outside New Zealand, the auditor must promptly notify the accredited body or FMA, as the case may be, of any investigation commenced or any action taken in respect of the auditor by any overseas authority. This condition would apply to both New Zealand auditors licensed by an accredited body and to overseas auditors.
 - (c) The auditor must promptly notify the accredited body or FMA, as the case may be, of any material matters relevant to the auditor's status as a licensed auditor, including any failure to comply with the rules of any professional body, and any matter which may adversely impact on whether the auditor would meet the fit and proper person test.
 - (d) The auditor must maintain a record of all audit engagements they undertake, including as an engagement partner, engagement quality control reviewer, or assisting with an audit, and must provide that record to the accredited body or FMA on request. That record should include details of the licensed auditor's role in the audit engagement, and the amount of time the licensed auditor spent on the engagement.
 - (e) The auditor must promptly notify the accredited body or FMA, as the case may be, if the auditor resigns from or declines any issuer audit engagement, or otherwise ceases to be the auditor of a particular issuer, for any reason. FMA considers that auditors should be required to provide reasons for their ceasing to act as the auditor of that issuer. It is not intended that this condition would require notification where an engagement partner ceases as a result of rotation, but the firm continues as the auditor (with another audit partner taking over as the engagement partner).
 - (f) The auditor must maintain a record of all relevant continuing education or professional development activities the licensed auditor undertakes, and provide that record to the accredited body or FMA on request.
157. Auditors may also be subject to any further conditions requiring an auditor to provide any specified information or certifications to the relevant authority that the relevant authority considers will assist its performance of its duties. This may include disclosure about or following an event of a specified type, requirements for periodic disclosure, or requirements to provide specified types of information on the request of the relevant authority.

Questions for submitters

- Q 35. Should accredited bodies be able to restrict, by conditions the maximum and minimum levels of work an auditor can take on?**
- Q 36. Should conditions require compliance with other relevant rules, such as the accredited body's rules?**
- Q 37. Are any of the reporting and notification obligations unreasonable or impractical? If so, why? Are there any other matters which reporting and notification obligations should cover?**
- Q 38. Are there any other kinds of conditions which you consider should be included? Should condition of that kind be mandatory for all auditors, for a prescribed class, or should its application be left to the organisation issuing the licence.**
- Q 39. Are there any conditions you consider should be included for only some auditors? What are they? Which classes of auditors should those conditions be included for? Why should those conditions be included only for some auditors?**

Registration of audit firms

158. Section 34 of the Act empowers FMA to prescribe, by notice in the Gazette, minimum standards for the registration of an audit firm in any way FMA thinks fit, including prescribing requirements relating to the firm's systems, policies, and procedures that relate to:
- (a) promoting compliance with:
 - (i) the requirements imposed by or under the Act and other enactments relating to the conduct of issuer audits; and
 - (ii) auditing and assurance standards;
 - (b) otherwise promoting reasonable care, diligence, and skill in the carrying out of issuer audits.
159. An accredited body may authorise the registration of an audit firm under section 25 of the Act, and FMA may authorise the registration of an overseas audit firm under section 26. In each case, the relevant authority must be satisfied one or more of the partners of the firm are licensed auditors and the firm meets the prescribed minimum standards. Additionally, for overseas audit firms, FMA must be satisfied the firm is subject to review arrangements equivalent to the quality review provisions under the Act, and that the systems, policies and procedures of the firm are satisfactory.
160. This indicates a focus on systems, policies and procedures for audit firms.

Proposed minimum standards for the registration of an audit firm

Membership of a professional body

161. FMA proposes 75% of all partners of an audit firm, both audit partners or partners in other areas, should be members of an approved accounting professional body and hold a practicing certificate or an auditor licence.
162. For NZICA members, this will mean being a chartered accountant and holding a certificate of public practice issued by NZICA or being a licensed auditor (with that licence issued by NZICA). If any other professional bodies become accredited, their members would need to hold an equivalent status with that accredited body or be licensed as an auditor through that professional body.
163. If any audit partner is an overseas auditor licensed in New Zealand, it will be sufficient that the partner is a member of any professional body the partner is required to be a member of either under the auditor licensing laws of its home jurisdiction, or as a condition of the partner being licensed in New Zealand.
164. Overseas qualified partners who are not licensed auditors would generally be permitted to rely on a membership of an approved overseas professional body, rather than seeking membership from NZICA or another accredited body.

Questions for submitters

- Q 40. Is 75% of partners an appropriate threshold? Alternatively, should all partners of New Zealand audit firms be required to be members of a professional body?**
- Q 41. Should all partners be members of the accredited body issuing the licence, or should the requirements permit membership of any appropriate professional body?**
- Q 42. Should 75% of partners of overseas audit firms be required to be members of a professional body?**

Partners must meet fit and proper requirements

165. FMA proposes all partners of an audit firm meet the fit and proper requirements applied to licensed auditors, whether or not they seek to be licensed as an auditor.
166. Those partners who are licensed auditors will have demonstrated they are fit and proper in the course of their licence application. Given that other partners must be members of a professional body, generally this should not cause any issues.

Questions for submitters

- Q 43. Should the fit and proper test apply to all partners, or just persons holding relevant positions? Should it be applied at the same threshold for all partners? Alternatively, should it be applied at a lower threshold for partners whose involvement in the audit business is limited to voting on matters decided collectively by all partners?**

Systems and processes for ensuring high quality audits

167. FMA proposes audit firms should adhere to all relevant requirements of *International Standard Quality Control 1 – Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Service Engagements*¹⁹ ('ISQC1') and *Professional and Ethical Standard 3 – Quality Control*²⁰ ('PES 3'). These standards require firms to have appropriate systems, policies and procedures for, amongst other things, accepting and retaining audit engagements, assigning the engagement team, confirming and preserving independence, and peer review of significant judgements in appropriate cases. PES 3 is the

¹⁹ ISQC 1 is an international standard on quality control promulgated by the International Federation of Accountants ('IFAC'). A copy of this standard is available from IFAC's website at www.ifac.org.

²⁰ PES 3 is a standard promulgated by the External Reporting Board ('XRB'). A copy of this standard is available on XRB's website at www.xrb.govt.nz.

New Zealand standard, and all firms which offer audit and assurance services, both those that conduct issuer audits and those that do not, are required to implement procedures to comply with it.

168. These standards apply to a wide range of firms, and adopt a principles based approach to setting requirements. Audit firms will be able to adopt the standard in a way that is appropriate for their business. However, audit firms should be conscious they are conducting statutory audits of issuers, and of the public interest involved in issuer audits being of a high quality, in determining how to adopt the standards for their firm. The standards should be applied in a manner which is both appropriate for the firm's whole audit and assurance business, and reflects the importance of the issuer audits undertaken by the firm. Further, the standards must be applied in a manner consistent with the broader regulatory framework in New Zealand, and with a view to implementing industry best practice. In some cases this may mean adopting policies and procedures more stringent than those set out in the standards, or which are in addition to those required by the standards.

169. Without limiting the policies and procedures which may be required, FMA considers the following matters should be addressed:

Audit firm must ensure all issuer audits are performed by appropriate licensed auditors and appropriate engagement team

170. Section 9 of the Act requires that, where an audit firm accepts an engagement to conduct an issuer audit, the engagement partner is a licensed auditor. In addition, FMA considers audit firms will need to ensure the engagement partner is permitted under the terms of their licence to conduct that audit, and has the knowledge and expertise to conduct that audit. Audit firms will also need to ensure that the engagement team collectively has the skills, knowledge and expertise to conduct the audit. The audit firm will need to demonstrate to the relevant authority it has appropriate procedures to ensure this is the case.

171. FMA also considers key decisions and judgements involved in an audit should, in addition to being made or reviewed by the engagement partner, be subject to engagement quality control review by another licensed auditor. The engagement quality control reviewer should also be permitted under the terms of their licence to conduct that audit, and have the knowledge and expertise to conduct that audit. The audit firm will need to ensure appropriate arrangements are in place, and demonstrate this to the relevant authority. This would be expected for all issuer audits in line with PES 3, even though ISQC 1 suggests the policies of the firm need not require an engagement quality control review on every audit.

Independence

172. FMA considers it critical that engagement partners, all members of the engagement team, and the engagement quality control reviewer are independent in respect of the audit engagement. Firms will need to have appropriate policies and procedures to ensure all threats to independence are addressed in respect of each engagement, and to monitor those threats throughout the engagement. Amongst other threats to independence, firms will need to address risks associated with familiarity and with fee dependence.

173. The standards require that policies should exist to minimise the risk of familiarity between clients and particular senior audit staff. The commentary to PES 3 suggests that, for issuers, this should generally be subject to rotation at least every seven years. FMA would also expect that these internal policies will address the rules of any relevant securities exchanges where the firm has clients who are listed entities or participants of an exchange²¹.
174. Firms should also have policies to address the risk of capture by management. In particular, firms should ensure that they have unrestricted ability to discuss matters directly with the audit committee and any independent directors of the client, and that this is appropriately provided for in the terms of engagement.
175. FMA also considers that firms should have policies and procedures concerning fee dependence in relation to a client. This may arise, particularly in smaller firms, through a single client or a small number of clients providing a significant portion of the audit and assurance fees earned by the firm or by a client being too important to the branding and professional reputation of the firm. It can also arise where the provision of non-audit services poses a threat to independence, either because of the relative value or total value of fees collected from those non-audit services, or because the provision of non-audit services raises the possibility of the firm auditing its own work. In addition to requiring firms to have policies and procedures to address this, FMA expects that conditions of registration will be used to facilitate monitoring of threats arising from fee dependence.

Questions for submitters

- Q 44. Does compliance with ISQC 1 and PES 3 provide a reasonable basis for the types of policies and procedures which a firm should have in place? Are there any aspects of the standard which are not relevant or appropriate?**
- Q 45. Are there any areas where FMA should prescribe higher standards than those set out in ISQC 1 or PES 3? Are there any areas where FMA should prescribe requirements as to how aspects of ISQC 1 and PES 3 should be implemented?**
- Q 46. Are there any other standards which should be specifically referenced in the prescribed minimum standards? Which ones?**
- Q 47. Are there any other policies and procedures a firm should be required to have?**

²¹ For example, NZX rules require that listed issuers rotate their auditor, or the engagement partner, at least every five years. Firms which have, or are seeking to have, listed clients should have policies which facilitate compliance with this requirement for relevant clients.

Indemnity insurance

176. All audit firms will be required to have professional indemnity insurance which is adequate and appropriate, both in terms of monetary amount available for claims (in total and per individual claim) and in terms of the scope of coverage (including any exclusions and conditions).
177. The accredited body or FMA, as the case may be, will consider the professional indemnity insurance held by each firm on a case by case basis, taking into account the size of, and risk associated with, the firm's audit and assurance client base, and any other business activities of the firm which may have the benefit of those professional indemnity insurance arrangements. A relevant authority may specify a minimum level of professional indemnity insurance the firm is required to maintain.
178. In the case of overseas audit firms, the firm will be required to maintain at least the level of professional indemnity insurance required in the firm's home country by the home licensing authority. That professional indemnity insurance must be available in respect of claims or actions brought by New Zealand resident persons.
179. Professional indemnity insurance should cover the firm (and all of its partners) in respect of the actions of all partners, employees and consultants of the firm. It is not anticipated that any partner or employee will be personally required to separately carry professional indemnity insurance in respect of audits where the firm is engaged.

Questions for submitters

- Q 48. Should FMA prescribe any more detailed requirements for what constitutes 'appropriate' professional indemnity insurance?**
- Q 49. Should FMA prescribe minimum amounts of professional indemnity insurance for classes or tiers of audit firms? If so, what should this proposal look like?**

Discussion of conditions attaching to a registration

180. Section 28 of the Act provides that the registration of an audit firm is subject to any conditions imposed by the accredited body or FMA, as the case may be. While the Act does not provide for FMA to prescribe conditions for audit firms, FMA considers it is useful to consider, in a discussion paper on auditor licensing and registration of audit firms, the kinds of conditions which accredited bodies and FMA are likely to attach to most registrations.
181. FMA suggests the following conditions should generally be included:
 - (a) Audit firms should be required to appoint a compliance officer. The compliance officer would be responsible for ensuring that the firm continues to meet minimum standards and complies with all conditions. The compliance officer would also be the contact person for any dealings with the accredited body and FMA.

- (b) A firm, or person acting on its behalf, must promptly advise the relevant authority if there is any change to any information recorded in the Register.
 - (c) A firm, or person acting on its behalf, must promptly advise the relevant authority if any partner of the firm ceases to be a partner, or any person becomes a partner of the firm. The notification must be accompanied by information to allow the relevant authority to assess whether a new partner is fit and proper, and (if included in the 75% threshold) is a member of an appropriate professional body.
 - (d) In the case of an overseas audit firm, the firm must notify FMA of any changes to the terms and conditions of the firm's registration, or any auditor licence held by any partner of the firm, in the home jurisdiction of the firm, including if any licence or registration is cancelled.
 - (e) The firm must provide to the relevant authority a report on the findings of any internal or external review of the firm's audit practice (including, if a review relates to the firm's practice more generally, all parts of that more general review relevant to the firm's audit and assurance business), together with details of the steps taken, or to be taken, to correct any adverse findings and implement any recommendations. If any recommendation will not be implemented, the firm should explain why not. Reviews include any reviews conducted by partners or employees of the firm, by other branches of the firm or associated or networked firms, by persons contracted by the firm to conduct a review, and, in the case of overseas auditors, by the audit regulator in the firm's home jurisdiction.
 - (f) The audit firm must provide, or make available through an external provider at the firm's expense, appropriate education and training to all audit staff. The education training should cover both matters related to audit practice generally and matters related to particular industries or issuers where the firm has accepted engagements. For the purpose of this condition, audit staff include both licensed auditors and any other partner, employee or contractor who is performing tasks related to audit engagements.
182. Additionally, FMA would expect that relevant authorities will impose conditions to facilitate monitoring of compliance by firms, including requiring the audit firm to provide information on request or periodically.

Questions for submitters

- Q 50. Are there any conditions which you consider to be too onerous?**
- Q 51. Would any of these conditions be better covered by an annual declaration by audit firms?**
- Q 52. Are there any other conditions which you consider should be included?**
- Q 53. Are there any conditions you consider should be included for only some auditors? What are they? Which classes of auditors should those conditions be included for? Why should those conditions be included only for some auditors?**

Transitional arrangements

Background to transitional provisions

183. Under the transitional provisions in subpart 3 of Part 3 of the Act, the following persons may continue to be an auditor in respect of an issuer audit, and are deemed to hold an auditor licence or audit firm registration, provided they also meet any prescribed transitional requirements:
- (a) chartered accountants who have, at any time within the two year period before the commencement of section 85 of the Act, acted as an auditor in respect of an issuer audit;
 - (b) an overseas auditor (as per section 199(1)(c) or (d) of the Companies Act 1993) and who has, at any time within the two year period before the commencement of section 86 of the Act, acted as an auditor in respect of an issuer audit;
 - (c) a New Zealand audit firm that is a partnership that has at least one partner who is a licensed auditor and has, at any time within two years before the commencement of section 87, been appointed or engaged to act as an auditor in respect of an issuer audit.
184. Under section 32 of the Act, FMA may prescribe transitional requirements for the purposes of subpart 3 of Part 3 of the Act. The scheme of the Act indicates these transitional requirements should largely address the same types of matters as are prescribed for standard licences or registrations²².
185. The transitional arrangements apply for up to two years following the commencement of the relevant sections of the Act, or until replaced with a standard licence or registration or revoked.
186. Transitional licences must be registered within 40 working days of the relevant provision (section 85, 86 or 87 as applicable) coming into force. The relevant authority may suspend any transitional licence that has not been registered at the end of that timeframe until such time as the licence is registered, or cancel the licence, on the basis it has not been registered. Similarly, a transitional audit firm registration may be cancelled if the firm has not provided the Registrar with details required to record the registration on the register within 40 working days.
187. Transitional licences and registrations are not automatically subject to conditions, and it is unlikely conditions will be imposed immediately or, where applications are made promptly, prior to a permanent licence or registration being granted. If conditions are included for any transitional licences, the conditions will be the same (or of the same kinds) as those prescribed for standard licences.

²² In this section of the paper, a standard licence or registration refers to any licence issued under section 11 or 12, and to any registration approved under section 25 or 26.

188. However, FMA and NZICA will be monitoring auditors who are on transitional licences, and will have the ability to take action against licensed auditors and audit firms, including suspending or cancelling licences or cancelling audit firm registrations in appropriate circumstances or exercising any of the other powers available to FMA or accredited bodies under the Act. FMA and NZICA will also be taking steps to ensure that those persons who have registered claiming to have a transitional licence or registration were in fact eligible for a transitional licence or registration. Those who were not eligible will be de-registered.

Proposal for transitional requirements

189. FMA proposes the transitional requirements be modelled as closely as practicable on the intended licensing and registration standards and conditions, as set out earlier in this paper.
190. Given the transitional licensing scheme does not require any independent verification that the auditor or audit firm meets the standards before the transitional licence or audit firm registration comes into existence, the requirements should also be objective criteria, to the extent practical, to minimise any uncertainty over whether an auditor or audit firm is entitled to a transitional licence or registration. However, particularly in the case of requirements for audit firms, it is unavoidable that audit firms will have to apply some judgement as to whether they qualify.
191. If any new, or more formalised, requirements are prescribed for licensing and registration, it will be necessary to defer the new requirements until a standard licence or registration is applied for. This will allow currently practicing auditors time to meet that requirement.
192. Bearing in mind these kinds of considerations, FMA proposes the transitional requirements should be as follows:

Transitional auditor requirements

- (a) The auditor must have completed at least eight years²³ of post qualification experience, including at least 3,000 hours of audit experience.

Transitional audit firm requirements

- (b) At least 75% of all partners of the audit firm should be members of NZICA or one of the overseas professional bodies designated by the Registrar for the purpose of section 86 of the Securities Act 1978.
- (c) The audit firm should have policies and procedures which comply with ISQC 1 and PES 3. In particular, it should have appropriate policies and procedures relating to accepting and retaining audit engagements, assigning the engagement team, confirming and preserving independence, and peer review of significant judgements.
- (d) The audit firm must at all times maintain adequate professional indemnity insurance.

²³ This requirement will be set at the same level as the final requirement. At this stage, we have assumed the higher requirement, but if the other proposal is accepted, this would be reduced to five years.

193. We accept these requirements for firms will involve a significant element of judgment, as to the adequacy of its policies and procedures, and its professional indemnity insurance. For this purpose, FMA intends that provided the firm's management have exercised reasonable judgement as to the 'appropriateness', and is able to justify its view, the firm will be entitled to a transitional licence. In these circumstances, the firm may be eligible for a transitional registration and that transitional registration would remain valid, even though an accredited body may subsequently require the firm to improve aspects of its policies and procedures, or increase their professional indemnity insurance, before a permanent registration is approved.

Questions for submitters

- Q 54. Are there any transitional requirements you consider to be too onerous?**
- Q 55. Is it reasonable to expect audit firms will have policies and procedures which comply with ISQC 1 and PES 3 already in place? Alternatively, would this requirement cause firms to implement new policies in order to obtain a transitional licence?**
- Q 56. Are firms able to self assess the adequacy of their policies and procedures, and their professional indemnity insurance arrangements objectively? Would it be preferable for FMA to prescribe, or include guidance on, what will be considered 'appropriate', in terms of the requirements for firms?**
- Q 57. Should any other transitional requirements be included? If so, what are they?**