FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

November 2019

Investors' guide to auditing

Companies listed on the share market* must have their financial statements independently audited, and present a report from the auditor to investors in their annual report

Even though the auditor is appointed by the company's board of directors and paid by the company for their work, they must comply with independence requirements as set out in their Professional and Ethical Standards.

The auditor's job is to express an opinion on the company's financial statements

The auditor expresses an opinion on whether the company's financial statements comply with generally accepted accounting principles and are free from material misstatement.

The auditor does not test every financial transaction, so they can't be expected to catch all fraud or errors. It's up to the company to design, implement and maintain internal controls to limit unauthorised transactions.

The auditor doesn't express an opinion on the effectiveness of these controls. They consider how the controls are relevant to the preparation of the financial statements, and perform procedures designed to identify fraud risks.

An audit report is not an evaluation of whether the company is a good investment

An audit focuses on the integrity of the financial statements. It does not make a judgement about the state of the company itself or whether it is a safe investment.

The company should disclose any events or conditions that cast significant doubt on its ability to continue operating normally (as a 'going concern'). The auditor assesses whether this information is accurate and appropriate – but this assessment is not a conclusion on the solvency or financial health of the company.

The type of opinion indicates the types of issues the auditor identified

If a report is clean (or **unmodified**), the auditor believes the financial statements present a true and fair view of the company's financial position and results, and are in accordance with accounting standards and relevant legislation.

A **qualified** opinion means that a specific part of the financial statements contains a material misstatement, or adequate evidence could not be obtained in a specific, material area, but the rest of the financial statements present a true and fair view.

An **adverse** opinion indicates the financial statements do not present a true and fair view, or are not prepared in accordance with accounting standards.

A **disclaimer of opinion** means the auditor was unable to complete their audit due to insufficient evidence and cannot form an opinion on the financial statements.

Key audit matters provide an insight into the work of the auditor

Key audit matters must be included in the audit reports of listed entities and other FMC reporting entities considered to have a higher level of public accountability.

Key audit matters provide an opportunity to share the matters that, in the auditor's judgement, were of most significance to the company and the audit. Common examples of key audit matters include how the company values particular assets, and the accounting treatments used for certain transactions or areas of the business. The auditor is required to identify the key audit matters, explain why they are a key audit matter, and explain what audit work was done to address them.

* This requirement applies to all FMC reporting entities, which include: listed entities; issuers of regulated financial products; registered banks or licensed insurers; credit unions and building societies.

Questions for investors to ask directors

Is the auditor sufficiently paid to perform the audit? Is this more or less than last year?

This information should be disclosed in the financial statements. A company may negotiate down the fee paid to the auditor, but there is a risk this will compromise the quality of the audit.

What other services does the auditor provide to the company? Could this affect the auditor's independence?

This information should be disclosed in the notes to the financial statements. It will help investors determine how independent an auditor is. For example, if the auditor is required to review non-assurance work done by their own firm, will they take an unbiased and thorough approach to the review?

What is the length of the relationship with the audit firm?

A close relationship with an audit firm and/or key audit staff could lead to a lack of sufficient challenge. This is not in the best interests of a company or investors.

How has the company assessed the quality of the auditor?

The FMA's Audit quality a director's guide outlines what company directors should consider when appointing and assessing their auditor. This information may also be useful to help investors understand the directors' role in the audit.

Questions for investors to ask the auditor

Was the auditor able to get all the information they asked for? If not, why?

The better the information received by an auditor, the more confident they can be in their assessments. A lack of good information can be a warning sign and may result in a disclaimer of opinion.

What were the most challenging parts of the audit and how did the auditor address these?

The key audit matters will provide investors with insight into the more challenging parts of the audit. Investors can ask for more information about these or other issues, to improve their understanding of the entity and the audit.

The company's annual general meeting should provide an opportunity to ask these questions.

Who oversees auditors of FMC reporting entities?

The accredited bodies **Chartered Accountants Australia and New Zealand** and **CPA Australia** license and monitor domestic auditors, register domestic audit firms, and take action against misconduct.

The **External Reporting Board** (XRB) issues the Accounting Standards that the financial statements must comply with, as well as the Auditing and Assurance Standards that auditors must follow.

The **Financial Markets Authority** (FMA) monitors the quality of audits of FMC reporting entities. An audit quality review involves reviewing the audit firm's systems, policies and procedures for compliance with the auditing standards and the Auditor Regulation Act. It does not include re-auditing the company.

Not every entity or audit firm is reviewed every year. The FMA reviews larger audit firms every two years, and other firms every three years.

The FMA also monitors the systems, policies and processes of the accredited bodies, and licenses and registers overseas auditors and audit firms.

fma.govt.nz
0800 434 567
questions@fma.govt.nz

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND