Audit Quality in New Zealand – Early Evidence from the Regulator

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Abstract

The results of audit quality reviews undertaken by the Financial Markets Authority (FMA) regulator are examined from 2013 to 2017. The introduction of audit regulation has reduced the number of audit firms registered to audit FMC reporting entities indicating that regulation imposes costs on firms reviewed. Initial inspections of audit files show a high proportion that require significant improvements. A comparison of New Zealand and United Kingdom audit file ratings from 2013-2015 shows the United Kingdom rated much higher in meeting audit quality standards

The analysis of audit file inspections for 2016 does not indicate a resounding improvement in audit quality but there are more positive signs in 2017. The study highlights issues with comparing audit quality internationally and raises questions about why reporting on audit quality inspections is not consistent among audit regulators to enable international comparisons to be made. The study contributes to the audit literature by giving early insights into New Zealand's experience of regulating auditors and in making cross country comparisons.

Keywords: Audit Quality, Audit Regulation, Audit quality framework.

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1 Introduction

The collapse of several private finance companies in New Zealand during 2006-2010 highlighted problems with the quality of audits and weaknesses in the self-regulatory model for auditors. During this period, the finance sector in New Zealand collapsed with around 67 finance companies put into liquidation or moratorium with debt holders (Deep freeze list, 2016). The Registrar of Companies reported that the quality of the audits contributed to the failure of the finance companies and investor losses (Harris, 2009). The finance company audits were found to lack rigour and analytical depth. Questions were raised about whether or not the auditors had the necessary skills and experience to audit some of the complex business structures and whether or not they complied with New Zealand Institute of Chartered Accountants' technical audit standards (Harris, 2009).

The purpose of this study is to examine the results of the inspections of audit quality undertaken by the FMA. The study examines the definition of audit quality from an academic and audit regulator perspective and the quality indicators which are essential for conducting good quality audits. This study contributes to the audit literature in New Zealand by giving insights of regulator reviews of audit quality. This is an area that has been researched in the United States but under researched in other jurisdictions.

The report is structured as follows: Section 2 provides the background of New Zealand audit regulation and a review of literature relating to defining audit quality. Section 3 outlines the research question and research method. Section 4 includes an analysis of the audit quality reviews and discussion of the findings. Section 5 concludes the study.

2 Literature Review

2.1 Background of audit regulation in New Zealand before 2011

Prior to 2011, New Zealand applied a self-regulatory model in which the(NZICA, now named Chartered Accountants Australia New Zealand (CAANZ), was directly responsible for regulating accountants and auditors whilst also promoting the interest of the profession to the public (Power, 2009).

The self-regulatory model of NZICA was established through the functions set out in the NZICA Act 1996. These included promoting the quality, expertise, and integrity of the accountancy profession and responsibility for training and educating members (NZICA Act, 1996, s5). These arrangements created a self-regulatory model that had an in-built conflict of interest as NZICA promoted the interests of the profession as well as regulating its members.

NZICA was required to have a code of ethics to govern the professional conduct of its members as well as a process to investigate complaints of its members relating to breaches of professional and ethical standards (NZICA Act 1996, s6 and s7).

Certificates of public practice were issued by NZICA to indicate that chartered accountants are sufficiently competent to undertake audit work. Chartered accountants under the Code of Ethics were required to undertake continuing professional development to maintain standards of practice. Additionally, under the Code of Ethics members had to determine whether they had the professional competence to undertake the audit work (NZICA Code of Ethics 2017, s 130). However, relying on a chartered accountant to self-assesses if they are expert to do an audit was considered very unreliable (Power, 2009). An independent audit monitoring system was recommended to parliament to provide a greater level of confidence in the quality of FMC reporting entities[2] audits, which include issuers. and auditors and would bring New Zealand in line with international standards. For example, New Zealand auditors were not able to carry out audits in Australia while operating under a self-regulatory system (Ministry of Business Innovation and Employment, 2010).

The self-regulatory model was identified as a contributing factor in the collapse of several private finance companies in New Zealand from 2006-2010. In response, the New Zealand government introduced a scheme to oversee the quality of audits and auditors independent of NZICA “to reduce the risk that investors will incur large audit-failure losses” (Power 2009, p. 10). The Audit Regulation Act 2011 empowers the Financial Markets Authority (FMA) to regulate auditors and audit firms of FMC reporting entities, which include issuers. (Auditor Regulation Act, 2011, s5). The Act requires the FMA to carry out quality reviews once every four years of registered audit firms and of licensed auditors that are not a member of an audit firm.[3] This review is completed to ensure that the audit systems and processes are comply with auditing and assurance standards and that reasonable care diligence and skill is demonstrated in the audit work (Audit Regulation Act, 2011, s65). The legislation gives power to the FMA to impose penalties if audits are not carried out to the specified standards. The FMA can cancel or suspend a registered audit firm or licenced auditor or prohibit them permanently or

[2] A FMC reporting entity is defined in the Financial Markets Conduct Act 2013. These entities are considered to have a greater level of public accountability and include entities specified issuers of debt and equity securities to the public, listed issuers, registered banks, insurance companies, credit unions and building societies (Financial Markets Conduct Act 2013, s 451).
[3] In practice the FMA undertakes quality reviews of audit firms every three years, except the Big 4 firms which are reviewed every 18 months (FMA, 2017)

temporarily from performing FMC audits (Audit Regulation Act 2011, s78(2)). In addition, auditors may be subject to disciplinary procedures from the professional accounting body.

The new regulatory regime focuses on audit quality. However, the concept of audit quality is multifaceted and cannot be observed or measured as a single performance indicator. Audit quality can vary depending on the perspective of the stakeholder such as an investor, government regulator, and professional body (Knechel, Krishnan, Pevzner, Shefchik, & Velury, 2013). The following section provides an overview of how academics and regulators define and measure audit quality and summarises research on the impact of audit regulator inspections.

2.2 Defining audit quality

An influential definition of audit quality originates from DeAngelo's work: audit quality is defined as "a market-assessed joint probability that a given auditor will both discover a breach in the client's accounting system, and report the breach" (DeAngelo, 1981, p.186). The definition has two components. The first component depends on auditor competence to discover a breach. The second component relies on auditor independence and objectivity to adjust or report the error (Knechel et al., 2013).

A number of regulators and standard setters have attempted to define audit quality but there is no universal agreement on a definition. An example is the International Auditing and Assurance Board (IAASB)'s definition:

"A quality audit is likely to be achieved by an engagement team that:

- Exhibited appropriate values, ethics and attitudes
- Was sufficiently knowledgeable and experienced and had sufficient time allocated to perform the audit work
- Applied a rigorous audit process and quality control procedures
- Provided valuable and timely reports and
- Interacted appropriately with a variety of stakeholders" (IAASB, 2014, p. 10).

As there is no consensus of a definition of audit quality, efforts have been made to identify the characteristics of audit quality. Academic researcher, Francis (2011), proposes six factors that influence audit quality:

i. **Audit input:** Two key inputs are identified: the quality of the audit engagement team and the audit testing procedures.

ii. **Audit processes:** The audit process involves decisions and judgements made by the engagement team in evaluating and interpreting audit evidence.
iii. **Audit firms:** Auditing is undertaken by audit firms which hire audit staff, develop the audit procedures and issue audit reports.
iv. **Audit industry and audit markets:** The provision of auditing services constitutes an industry whose structure influences market and economic behaviour.
v. **Institutions:** Each country has its institutional environment such as regulators and professional accounting bodies which can impact incentives for auditing quality.
vi. **Economic consequences of audit outcomes:** Audit opinions on financial statements have economic consequences for audit clients and capital markets.

Knechel et al. (2013) builds on Francis's (2011) framework by adding primary attributes of the audit audit process comprising of inputs, process, outcomes and context. The primary attributes are:

i. **Incentives –** audit quality can be impacted positively or negatively by individual responses to incentives such as fee pressure, client retention pressures, and reputation loss etc.
ii. **Uncertainty –** the outcome of an audit is not free of risk.
iii. **Uniqueness –** evey audit engagement is unique and the nature of the audit process has to adapt to the different circumstances.
iv. **Process –** audit is a systematic process.
v. **Judgement –** auditor knowledge and skills impact the quality of professional judgement in an audit.

Independent audit regulators have developed audit quality frameworks and the United Kingdom's Financial Reporting Council (FRC), was one of the first to do so. After a thorough consultation, the FRC (2008) identified five drivers of audit quality:

i. The culture of the audit firm
ii. The skills and personal qualities of audit partners and staff
iii. The effectiveness of the audit process
iv. The reliability and usefulness of the audit reporting
v. Factors outside the control of the auditors such as the impact of corporate governance, audit committees and shareholders on the quality of financial reporting and the audit process.

The United States audit regulator, the Public Company Accounting Oversight Body (PCAOB), in July 2015 issued a statement seeking comment on 28 probable audit quality indicators (PCAOB, 2015). The indicators are classified into three categories: audit professional, audit process and audit results. The audit professional category includes measures relating to the availability and knowledge and skills of audit staff and the focus of the audit process. The audit process category covers the culture of the audit firm –"tone at the top and leadership", audit incentives, independence, investment in infrastructure to support audit and records of monitoring and remediation. Quality indicators for audit results focus on the outcomes of the audit process including the financial statements, reporting of issues relating to internal controls and going concern, enforcement and litigation and communication between the auditors and audit committees. A summary of the categories and the indicators is presented in Appendix 1.

As a setter of international auditing standards, the IAASB has issued an audit quality framework listing a number of audit quality indicators. The framework has five key elements: (1) audit inputs, (2) process, (3) outputs, (4) interactions with stakeholders and (5) contextual factors (IAASB, 2014). These elements are very similar to those of Francis (2011). Quality indicators for each element are identified at (i) audit engagement level (ii) audit firm level, and (iii) national level, (IAASB, 2014). Table 1 gives an overview of the IAASB Framework.

[Insert Table 1]

There is similarity in the drivers of audit quality proposed by academics, regulators (FRC and PCAOB) and standard setters (IAASB). They all focus on audit inputs, the audit process and audit outcomes. However, greater variation exists as to the consideration of external factors in the audit industry and economic environment.

Given the number of audit quality indicators the next section focuses on the results of empirical research on the impact of audit regulation.

2.3 The impact of audit regulation on audit quality

Significant research on audit regulation has occurred in the United States. The PCAOB publishes the inspection reports for the audit firms. Initial results of 316 reports of small audit firms (with less than 100 audit clients) showed that 60% had audit deficiencies with the number of deficiencies decreasing from 2004 to 2005. The audit deficiencies were mostly the failure to perform and document substantive procedures most often relating to the balance sheet items. Audit firms with deficiencies were usually small, with fewer partners and staff, and were experiencing faster growth compared to other audit firms (Hermansen, Houston & Rice, 2007).

In a further study, Hermansen and Houston (2009) compared the first and second inspection reports of 116 small audit firms to evaluate if the firms had improved their audit practice. They found that after the first inspection 60% of firms had audit deficiencies. After the second inspection a large decrease occurred with only 4 out of the 116 audit firms with deficiencies. The results clearly indicate that the audit firms had improved audit quality after the results of the first inspection.

DeFond and Lennox (2011) examine the trends in registration of a sample of 1,233 small audit firms: they found that 607 (49%) exited the audit market between 2001 to 2008 with 394 of these firm exiting shortly after the PCAOB was established. A positive association with exiting firms and the total number of audit weaknesses reported by PCAOB inspection reports and AICPA peer review reports, indicated that exiting firms were of lower quality (DeFond and Lennox, 2011).

Audit firms who receive deficiencies in their inspection reports are often impacted negatively in the market. Daugherty, Dickins and Tervo (2011) find that audit firms with deficiency reports are associated with being dismissed by their clients, voluntarily resigning from audits and deregistering from the PCAOB. When an audit firm is dismissed, it is more likely to be replaced by an audit firm that has no reported deficiencies. Gunny and Zhang (2013) find that audit quality is lower for small audit firms that receive a PCAOB report with a serious deficiency. Clients of these audit firms are associated with significantly higher abnormal accruals and restatements the financial statements compared with clients of other audit firms.

Lamoreaux (2016) finds that audit firms subject to PCAOB inspections provide higher quality audits compared with firms that are not subject to review. In this research study, higher audit quality audits are measured by the greater number of going concern opinions, the greater number of disclosures of material weakness disclosure and less earnings management.

Research in audit inspections in other countries is limited. In Australia audit inspections by the Australian Securities and Investments Commission began in 2004-2005. Interviews of auditors, the auditing standard setters and the regulators are undertaken to gain their perceptions about the audit regulatory environment in Australia (Houghton, Kend & Jubb, 2013). They concluded that regulation has increased costs of documentation, however there is concern that the increased time on documentation may compromise auditors' focus on important risk areas. The increased costs are also considered to be a barrier to enter the Australia audit market diminishing competition (Houghton, Kend & Jubb, 2013).

3 Research Question & Method

This study examines the impact of regulation by the FMA on audit quality in New Zealand. Specifically, the study asks:

1 What are the results of the audit quality reviews conducted by the independent audit regulator in New Zealand?

The study attempts to answer this question by examining the results of audit quality reviews published by the FMA from 2013 to 2016[4]. The methodology used by the FMA, relating to reviewing audit firms along with the findings from the monitoring reports will be analysed to assess if the FMA reviews have affected audit quality.

The FMA does not publish which firms are subject to a review each year. The results of the reviews are collated for all firms reviewed in a year. [5] This limits the analysis of this study as the yearly results are not necessarily representative of all registered audit firms and audit engagements. However, the results of the reviews can be evaluated to indicate trends for the industry.

All registered audit firms had been subject to a quality review by the end of 2015. In 2016 the audit regulator commenced a second review of audit firms. This is still on-going with only a proportion of firms reviewed for a second time at the time of this study. It should be noted that the quality reviews for this period were undertaken by CAANZ as the FMA has the power to delegate reviews (Audit Regulation Act 2011, s66). However, from 2017 the FMA will independently conduct the reviews (Financial Market Authority, 2016).

4 Discussion & Findings

4.1 FMA audit quality reviews

As outlined in Section 2.0, the FMA is required to perform quality reviews of registered audit firms once every four years (Auditor Regulation Act 2011, s65). A quality review is specified in the legislation and is to include:

(a) an assessment of the design of the internal quality control system

(b) reasonable compliance testing of procedures, and a review of a sufficient number of audit files to verify the effectiveness of the internal quality control system;

[4] The audit quality reviews are published in the FMA's Audit Quality Monitoring Reports.

[5] This contrasts with the practice in the United States where the PCAOB releases inspection reports of audit firms

(c) a review of the systems, policies, and procedures to assess compliance with legal requirements and auditing and assurance standards,
(d) the quantity and quality of resources used, and
(e) compliance with competence programmes.
(Audit Regulation Act 2011 Section 68(1)).

A review of audit files requires evidence that legal requirements and auditing and assurance standards have been complied with and that the audit is carried out with reasonable care, diligence and skill (Audit Regulation Act 2011, s68(3)). In addition, the FMA states a quality audit has to be independent, have sufficient audit evidence and application of professional scepticism applied by the auditors, in order to give a reliable audit opinion (Financial Market Authority, 2016).

4.2 Analysis

The population of licensed auditors and registered audit firms from 2013 to 2017 is shown in Table 2. Over the five years the number of licensed auditors has dropped marginally from 150 to 141 auditors. There has been a significant 47.5% drop in the number of domestic audit firms; decreasing from 40 to 21 firms. Thus there is an increased concentration of the audit market with fewer audit firms for FMC entities. This drop is consistent with the United States experience where about 50% of small audit firms exited the SEC client market after the introduction of audit regulation (DeFond & Lennox, 2011). The introduction of the Audit Regulation Act signals a trade-off between enhancing audit quality and promoting competition in the audit market (Houghton et al., 2013).

The FMA does not provide a breakdown of the nature of the registered audit firms but drop in the number of audit firms could have been due to the following factors. A possible cause of audit firms deregistering is the increased cost of complying with quality reviews. The process imposes costs on firms of maintaining and improving: quality control systems, internal reviews of audit engagements, compliance with professional and auditing standards as well as dealing with increased regulatory scrutiny. For audit firms with a small client base, these costs may outweigh the benefits of remaining in that segment of the audit market (DeFond & Lennox, 2011). Smaller audit firms (defined by the FMA (2013) as covering one to two locations and less than four licensed auditors) may have a small portfolio of FMC reporting clients so that the costs of compliance may have outweighed the benefits of registration. The number of registered audit firms may probably decline in the future as the New Zealand Auditing and Assurance Boards (XRB, 2017) expects to adopt the revised international auditor rotation requirement which extend the cooling off periods for engagement partner and the engagement quality control reviewer from a minimum of two years to five and three years respectively.

[Insert Table 2]

Table 3 shows the number of registered audit firms inspected by the FMA for each year. The audit firms are categorised as: large national firms (which include the Big 4 audit firms), other national and network firms and small firms (firms with fewer than 4 licensed auditors). The type of audit firm reviewed each year has changed very little over time, with 17% of audit firms reviewed being large national firms, 33% small firms and 50% other national network firms. These proportions are similar to that reported by the Australian Securities & Investments Commission for the period of December 2010 to June 2016, the ASIC inspected 4 (17%) large national firms, 9 (39%) smaller firms and 10 (43%) other national and network firms (ASIC, 2017).

[Insert Table 3]

The total sample of firms inspected has varied from 9 firms in 2013 to 12 firms in 2015 and 7 firms in 2017. In 2013, 23% of the population of audit firms was inspected and in 2016, 50% of the population. However, the FMA does not indicate the percentage of issuer audits that the audit firms cover. The number of audit firms inspected compares well with the 23 firms inspected by the ASIC for the 2015-2016 period (ASIC, 2017).

The selection of audit files by the FMA is not random and stratified to include a cross-section of licensed auditors. The FMA applies a risk based approach considering entities that have had qualified audit reports, not complied with regulations, firms that operating in high risk industries and entities of significant public interest e.g. listed companies, banks and insurance companies, (FMA, 2016). This approach is similar to the PCAOB's which considers:

(1) the risk that an issuers' financial statements may be misstated,
(2) characteristics of an issuer and its industry,
(3) potential audit issues, and

(4) audit firm considerations such as a particular practice, partner and previous inspection results (PCAOB, 2011).

Table 4 records the number of audit files of listed and other issuers that have been reviewed from 2013 to 2017. On average 37 audit files are reviewed annually with 30% files of listed issuers and 70% other FMC entities.

[Insert Table 4]

The FMA applies a rating scale to assess the quality of a reviewed audit file. The ratings are:

Good or good with limited improvement required – Audit procedures have been performed around key risk areas and satisfactory audit evidence obtained.

Compliant, but need improvement – Sufficient and appropriate audit evidence has been obtained in key risk areas. However, a number areas of the file show that the audit was not performed in accordance with auditing standards.

Significant improvements required – The review has found insufficient audit evidence for at least one key risk are or the audit file showed a material misstatement which required restatement of the financial statements. There are a number of areas where audit work was not performed according to standards. (FMA, 2016, p19).

Table 5 Panel A, summarises ratings given by the FMA. Care needs to be taken in interpreting the data as the audit files reviewed differ each year. In 2013, the first year of inspections, only 42% of audit files were good or compliant, with 58% of files requiring significant improvement. The compliance rates improved to 64% in 2014. In 2015, 55% of files met the standard while 45% of audit files required improvements. In 2016, only 50% of files were compliant despite being inspected for a second time. This indicates that audit firms have not responded sufficiently to areas of weakness that were identified in the first review or that the regulators standards may be developing over time. However, 2017 has seen a marked improvement with 58% of files meeting the minimum quality threshold and 22% 6 files of a good standard.

[Insert Table 5]

The results show that on an average only 11% of the total files reviewed have been rated as good or good with limited improvements. Forty-seven per cent of files have been rated as compliant but requiring improvement and 42% requiring significant improvements. These results indicate a significant gap in audit quality between the standards of the FMA and audit practice.

The FMA reports the audit file ratings by listed entity and other FMC entity. The results are summarised in Table 5, Panel B. In general, listed entities have higher percentage of audits meeting FMA standards compared with other entities. For listed entities, compliant rates vary from a maximum of 85% in 2015 (comprising 39% good and 46% compliant audit files) to a minimum of 83% complying audit files in 2017. For other issuers, compliance rates vary from a low of 38% in 2013, (comprising 11% good and 27% compliant audit files) to a high of 62% in 2014. In all years except 2016, a greater percentage of Other FMC entities audits required significant improvements compared with listed entities. In 2016, 47% of other entities required significant improvements. This is comparable to the United Kingdom where 47% of audits requiring significant improvements over the last five years were non-listed entities

The FMA's use of ratings in their audit reviews differs from approaches from other regulators which makes international comparisons of audit inspections difficult to make. However, the United Kingdom's FRC uses a similar rating system to New Zealand– using four categories: good, limited improvements required, improvements required and significant improvements required. For the purposes of comparison in this study, the first two United Kingdom categories have been combined to compare with New Zealand's 'Good with limited improvement'. The results of the comparison are shown in Table 6 for 2013 to 2015.

[Insert Table 6]

Again there are limitations in making international comparisons as the nature of the reviews and samples may be different. Nonetheless, Table 6 shows that audit quality ratings in the United Kingdom are much higher and improving compared to New Zealand. In 2015, 91% of audit files in the United Kingdom were judged as good or only requiring limited improvement compared with 55% for New Zealand. The New Zealand ratings are much lower compared with the United Kingdom. This may be due to the fact that inspections from the United

Kingdom commenced in 2004 compared to 2013 for New Zealand (Carson, Simnett & Vanstraelen 2013)

The Australian Securities and Investments Commission (2017) and PCAOB (2013) report the results of audit engagement inspections by the audit of key areas of the financial statement items such as revenue, impairments, taxation, and fair value measurements etc. In the ASIC's audit inspection report for 2015-2016 states that for the 18 months to December 2016 (2015) 25% (19%) of 390 (463) key audit areas "did not obtain reasonable assurance that the financial report as whole was free of material restatements" (ASIC, 2017, p, 8). The International Forum of Independent Regulators (IFIAR) survey of members on the results of inspections of individual audit engagement states that "42% of the listed of public interest entities (PIE) audits had at least one least one finding[6]" (IFIAR, 2017, p. 1). This compares with a rate of 43% in 2015.

The FMA has identified 15 areas of improvement for audit firms. Table 7 summarises the number of audit firms meeting, not meeting or partially meeting the FMA standard for each of the areas. Audit evidence and documentation is a key area of improvement. The FMA has noted improvement in audit documentation but audit procedures have been poorly designed or not completed to provide the appropriate audit evidence. The FMA is concerned that there is insufficient professional scepticism demonstrated in the audit files especially significant judgements are required in the audit including assessing the risk of fraud. The FMA is encouraging continuous improvement in audit firms internal reviews of quality control functions and reviews of audit files. (Financial Markets Authority, 2016, p6).

[Insert Table 7]

5 Conclusion

In 2011 the self-regulating accounting profession in New Zealand was modified. The introduction of the Audit Regulation Act 2011 established the FMA as the regulatory body to oversee the audits of FMC reporting entities. This study examines the results from the FMA's quality reviews from 2013 to 2017 to evaluate if audit quality has improved.

[6] A finding is "related to a financial statement balance or disclosure, a deficiency is either a matter with respect to which the firm did not obtain sufficient audit evidence to support its opinion or a failure to identify or address a material, or likely potential material, error in the application of an accounting principle." (IFIAR,2016).

The number of registered audit firms has dropped by 47.5 since reviews commenced while the number of licensed auditors had remained stable. Audit firms exiting this segment of the audit industry is consistent with overseas experience as firms weigh up the costs of the quality review process.

The sample of audit firms reviewed each year has changed minimally with 17% of large national audit firms, 50% other national firms and 33% small audit firms. On average 37 audit files are reviewed annually.

The FMA assess the quality of each file by giving one of three ratings. The percentage of audit files that sufficiently met standards fluctuated between 2013 to 2015 with only 55% of audit files meeting the standard in 2015. The compliance rates are significantly lower compared with the United Kingdom where in 2015, 91% of audit files were judged as good or requiring limited improvement. However, there is an indication that audit quality is improving as auditors are now being subject to a second review. In the United States the number of audit deficiencies reduced dramatically after a second inspection from the regulator.

This initial study raises questions for future research. The study has attempted to undertake some comparison with audit regulators from other countries but the process is fraught as the regulators do not report the results of the inspections in the same way. Future research could examine a common framework for reporting such results.

The study has considered audit quality as assessed by the regulator. Future studies could consider what impact audit regulation has had on audit firms and audit committees. In addition, research can consider how the introduction of regulation has impacted audit quality as inferred by the quality of earnings.

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Appendix 1 – Public Company Accounting Oversight Board Audit Quality Indicators.

1 - Audit Professionals	
Availability	1. Staffing leverage: 2. Partners workload: 3. Workload of manager and staff: 4. Accounting and auditing technical resources: 5. Specialised skill and knowledge of personnel
Competence	6. Audit personnel experience. 7. Audit personnel industry expertise: 8. Turnover of audit personnel 9. Audit work unified at service centres 10. Training for hours of each audit professional
Focus	11. Risk areas and audit hours 12. Allotment of hours to phases of the audit
Audit Process	
Tone at the top and leadership	13. Outcome of survey of firm personnel
Incentives	14. Quality ratings and compensation 15. Audit fees and client risk
Independence	16. Compliance with requirements
Infrastructure	17. Investment supporting quality auditing
Monitoring and remediation.	18. Internal quality review outcomes 19. PCAOB inspection results 20. Technical competency testing
Audit Results	
Financial statements	21. Outcome of restatements for errors of financial statements 22. Fraud and financial reporting misconduct 23. Concluding audit quality from measures of financial reporting quality
Internal control	24. Reporting weaknesses of internal control
Going concern	25. Reporting issues of going concern:
Communication between auditors and audit committees	26. Results of independent surveys of audit committee members
Enforcement and litigation	27. Trends in enforcement proceeding of PCAOB and SEC: 28. 28. Trends in private litigations

Source - Public Company Accounting Oversight Board audit quality indicators 2015

Table 1 – Overview of IAASB Audit Quality Framework

<table>
<tr><td colspan="3">Input Factors
(1) The values, ethics and attitudes of auditors, which in turn, are influenced by the culture prevailing within the audit firm
(2) The knowledge, skills, and experience of auditors and the time allocated for them to perform the audit.</td></tr>
<tr><td colspan="3">Quality Attributes of Input Factors at:</td></tr>
<tr><td>Engagement Level</td><td>Firm Level</td><td>National Level</td></tr>
<tr><td colspan="3">Process
The rigor of the audit process and quality control procedures impact audit quality.</td></tr>
<tr><td colspan="3">Quality Attributes of Process Factors at:</td></tr>
<tr><td>Engagement Level</td><td>Firm Level</td><td>National Level</td></tr>
<tr><td colspan="3">Outputs
Outputs include reports and information that are formally prepared and presented by one party to another, as well as outputs that arise from the auditing process that are generally not visible to those outside the audited organization</td></tr>
<tr><td colspan="3">Quality Attributes of Output Factors at</td></tr>
<tr><td>Engagement Level</td><td>Firm Level</td><td>National Level</td></tr>
<tr><td colspan="3">Interactions</td></tr>
<tr><td colspan="3">The way in which the stakeholders in the financial reporting supply chain interact can have an impact on audit quality</td></tr>
<tr><td colspan="3">Contextual Factors</td></tr>
<tr><td colspan="3">There are a number of environmental – or contextual – factors, such as laws and regulations and corporate governance, which have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality.</td></tr>
</table>

Source - International Auditing and Assurance Standards Board (2014) - A Framework for Audit Quality.

Table 2 - Population of Licensed auditors and Registered Audit Firms 2013-2017

Monitoring Year	Domestic Licensed Auditors	Domestic Registered Audit Firms	Registration and Cancellation of Auditor	
			New Auditors	Cancelled Auditors
2013	150	40[1]	18	18
2014	141	30[2]	8	17
2015	150	29[2]	10	1
2016	146	24[3]	8	12
2017	141	21	7	12

Source – FMA Audit Quality Reports 2013 to 2016.

[1] includes 13 firm with separate firm registrations, but operate under two brand names.

[2] includes 9 firms with separate firm registrations, but operate under two brand names.

[3] includes 5 firms include which has separate firm registrations, although it operates under one brand names.

Table 3 - Audit Inspections by Firm Type

Monitoring Year	Large National Firms		Other national and network firms		Small firms		Total Registered Firms Sampled		% Population	
	N	%	N	%	N	%	N	%	N	%
2013	1	11%	5	56%	3	33%	9	100%	9	23%
2014	2	12%	7	41%	8	47%	17	100%	17	57%
2015	2	17%	6	50%	4	33%	12	100%	12	41%
2016	2	17%	6	50%	4	33%	12	100%	12	50%
2017	2	28%	3	43%	2	28%	7	100%	7	33%

Source – FMA Audit Quality Reports 2013 to 2017.

Table 4- Audit Files Reviewed 2013-2017

Monitoring Year	Other Issuers		Listed Issuers		Total Issuers	
	N	%	N	%	N	%
2013	26	79%	7	21%	33	100%
2014	42	75%	14	25%	56	100%
2015	25	66%	13	34%	38	100%
2016	17	57%	13	43%	30	100%
2017	15	56%	12	44%	27	100%
Total	125		59		184	
Average	25	68%	12	32%	37	100%

Source – FMA Audit Quality Reports 2013 to 2017.

Table 5 - Rating of Individual Audit Files

Panel A: By Year

Year	Good with limited improvement		Compliant but need improvement		Significant improvements		Total	
	N	%	N	%	N	%	N	%
2013	5	15%	9	27%	19	58%	33	100%
2014	3	5%	33	59%	20	36%	56	100%
2015	7	18%	14	37%	17	45%	38	100%
2016	0	0%	15	50%	15	50%	30	100%
2017	6	22%	14	52%	7	26%	27	100%
Total	21	11%	85	47%	78	42%	184	100%
Average	4	11%	17	47%	15	42%	36	100%

Source – FMA Audit Quality Reports 2013 to 2017.

Panel B: By Listed and Other Entities

	Good	Good	Comply	Comply	Sig Imp	Sig Imp	Total	Total
	N	%	N	%	N	%	N	%
Listed Entities								
2013	2	29%	2	29%	3	42%	7	100%
2014	1	7%	9	64%	4	29%	14	100%
2015	5	39%	6	46%	2	15%	13	100%
2016	0	0	6	46%	7	54%	13	100%
2017	2	17%	8	66%	2	17%	12	100%
Other								
2013	3	11%	7	27%	16	62%	26	100%
2014	2	5%	24	57%	16	38%	42	100%
2015	2	8%	8	32%	15	60%	25	100%
2016	0	0%	9	53%	8	47%	17	100%
2017	4	27%	6	40%	5	33%	15	100

Source – FMA Audit Quality Reports 2013 to 2017

Table 6 – Comparisons of NZ and Ratings of Individual Audit Files

Year	Good with limited improvement		Comply but need improvement		Significant improvements		Total	
	NZ	UK	NZ	UK	NZ	UK	NZ	UK
2013	5 (15%)	50 (59%)	9 (27%)	22 (26%)	19 (58%)	13 (15%)	33	85
2014	3 (5%)	49 (60%)	33 (59%)	20 (25%)	20 (36%)	12 (15%)	56	81
2015	7 (18%)	70 (67%)	14 (37%)	25 (24%)	17 (45%)	10 (9%)	38	105

Source – FMA Audit Quality Reports 2013 to 2015. FRC Audit Quality Inspections Annual Report 2014/1*5*

Table 7 – Audit Areas requiring Improvement

	Audit Standard:			
Description	**Met**	**Partly Met**	**Not Met**	
	No firms	**No firms**	**No firms**	**Total**
Audit evidence and documentation	-	9	3	12
The auditor's responsibility relating to fraud	-	8	4	12
Use of professional scepticism	-	8	3	11
Monitoring quality control	2	7	1	10
Engagement quality control review	-	9	1	10
Related parties	1	7	1	9
Understanding the issuer and its environment	2	-	5	7
Auditor independence (other)	2	-	5	7
Audit sampling	1	5	1	7
Acceptance and continuance procedures	2	5	1	8
Substantive and analytical procedures	-	4	1	5
Auditor independence (non-audit services)	-	3	2	5
Compliance with financial reporting framework	-	2	2	4
Forming an opinion and reporting on financial statements-evidence	1	1	2	4
Subsequent events	3	1	2	6

Source – FMA Audit Quality Report 2016