

The Auditor-General's Code of Ethics

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Introduction

1. The Auditor-General is the auditor of every public entity in New Zealand. Under the Public Audit Act 2001 (the Act), the Auditor-General is an officer of Parliament. In carrying out their role, the Auditor-General works exclusively in the public interest.
2. The Auditor-General's Code of Ethics (the Code) reflects the ethical standards that the Auditor-General and those that carry out work on their behalf need to meet. In turn, the ethical standards provide the foundations that allow the Auditor-General to meet the Act's requirements and to maintain Parliament's and the public's trust and confidence.
3. The Code sets higher requirements than the underlying *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* issued by the New Zealand Auditing and Assurance Standards Board (the NZAuASB), to further protect the Auditor-General's independence.
4. The Code is accompanied by a *Guide to support the application of the Auditor-General's Code of Ethics*.

Application

5. The Code applies to the Auditor-General, the Deputy Auditor-General, employees of the Auditor-General, and those people and/or organisations who carry out work for the Auditor-General.
6. The Code applies from 1 April 2023.

The fundamental principles

7. The Code has five fundamental principles:
 - (a) ***Integrity***— demonstrating integrity means being straightforward and honest in all statutory and professional relationships.
 - (b) ***Objectivity***— demonstrating objectivity means not compromising professional judgements for any reason, including because of bias, conflict of interests, or the undue influence of others.
 - (c) ***Professional competence and due care***— demonstrating professional competence and taking due care means:
 - (i) attaining and maintaining professional knowledge and skills at the level required to carry out one's duties and functions; and
 - (ii) acting diligently in keeping with relevant legislation and complying with the Auditor-General's Auditing Standards.

- (d) **Confidentiality**— demonstrating this means respecting the confidentiality of information acquired as a result of statutory and professional relationships.
 - (e) **Professional behaviour**— demonstrating this means complying with relevant laws and regulations and avoiding any conduct that the Auditor-General or an individual and/or an organisation carrying out work on their behalf knows or should know might discredit the Auditor-General.
8. These principles must not only **guide** how the Auditor-General, Deputy Auditor-General, and all people working on their behalf act, but also **be seen to do so** if assessed by a reasonable and informed third party with only publicly available information.
9. In the context of auditing, **independence** is implicit in the fundamental principles of integrity and objectivity.

Independence explained

10. Independence is defined in the *International Code of Ethics for Assurance Practitioners (including International Independence Standards)* (New Zealand). The definition says:
- Independence is linked to the principles of objectivity and integrity. It comprises:*
- (a) **Independence of mind**— *the state of mind that permits a conclusion to be expressed without being affected by influences that compromise professional judgement, allowing an individual to act with integrity and exercise objectivity and professional scepticism; and*
 - (b) **Independence in appearance**— *avoiding facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an audit or review team member's integrity, objectivity, or professional scepticism has been compromised.*

How the Auditor-General applies independence

11. The Auditor-General sets a higher standard for achieving independence than is contained in the underlying Code of Ethics issued by the NZAuASB as set out in paragraph 10. This higher standard applies to the Auditor-General, Deputy Auditor-General, and to all those who carry out work on their behalf.
12. The perception of independence (independence in appearance) is a vital component of independence, which those who carry out work on behalf of the Auditor-General must consider

when assessing their independence. Such an assessment requires considering how a particular situation would look from the perspective of a reasonable and informed third party with only publicly available information.

13. The Auditor-General's standard for independence:
- (a) is **stronger in its requirements** than the description in the application guidance in the underlying *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* issued by the New Zealand Auditing and Assurance Standards Board (the NZAuASB Code); and
 - (b) **applies consistently**, regardless of an audit's topic and the public organisation's size and nature. This too differs from the the NZAuASB Code.¹

Applying the reasonable and informed third-party test to assess auditor independence

14. The Auditor-General, Deputy Auditor-General, and those who carry out work on their behalf apply a more stringent independence test than that required by other codes and standards. The Auditor-General, Deputy Auditor-General, and those who carry out work on their behalf, are required to assess *all* facts and circumstances that *might* cause a reasonable and informed third party, *informed only by publicly available information*, to conclude whether a firm's or an audit's, a review's, or an assurance team member's integrity, objectivity, or professional scepticism has been compromised.
15. The test for assessing independence in appearance means meeting stringent criteria. **Any element of doubt about independence will mean failing the reasonable and informed third-party test:**
- (a) Properly applying the reasonable and informed third-party test requires assessing *all* facts and circumstances that might influence the test's application. (The test is not limited to facts and circumstances that are "so significant"), which is wording featured in the NZAuASB Code for auditors. The term "so significant" is subjective and does not establish a high enough or rigorous enough threshold to maintain independence in appearance. The "so significant" test inappropriately discounts any facts or circumstances that have "normal" significance.)
 - (b) Assessing independence in appearance is based on whether the reasonable and informed third party *might* conclude that integrity, objectivity, or professional

¹ An exception to the Auditor-General's standard applies to the requirement to rotate "key audit partners" and certain audit staff for certain categories of public organisations. The Auditor-General has adopted the rotation requirements of the underlying *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* issued by the New Zealand Auditing and Assurance Standards Board.

scepticism has been compromised. (The NZAuASB Code uses a lower criterion of “would be likely to conclude” that integrity, objectivity, or professional scepticism has been compromised, which requires more persuasive circumstances.) When applying the reasonable and informed third-party test to assess independence in appearance, the “would be likely to” criterion is replaced with the “might” criterion.

- (c) The facts and circumstances that are relevant to the reasonable and informed third-party test ***must be publicly available***. The reason for this requirement is that, in most instances, the Auditor-General’s reports are made available to the public. If information that influences the reasonable and informed third-party test is not publicly available, then the perception that the Auditor-General is not independent will remain. In this situation, the reasonable and informed third-party test fails.
16. Any work that auditors contract to carry out for public organisations that is additional to the work they carry out on behalf of the Auditor-General is limited to “work of an assurance nature”. In essence, “work of an assurance nature” is compatible with the work an auditor carries out on behalf of the Auditor-General under statute.²
17. “Work of an assurance nature” has a plain English meaning. The *Collins English Dictionary – Essential Edition 2019* defines “assurance” as “a statement or assertion intended to inspire confidence”. The meaning of “assurance” in the context of “work of an assurance nature” implies the presence of several components. These are:
- (a) the subject matter that assurance is provided over;
 - (b) the independence of the party providing the assurance (the assurer) from the subject matter that they provide assurance over – in other words, the assurer cannot have a role in creating, developing, or otherwise taking responsibility for the subject matter;
 - (c) the presence of generally accepted or agreed criteria to benchmark the subject matter against;
 - (d) the assurer’s competence to carry out the work; and
 - (e) a report arising from that work.
18. One consequence of the Auditor-General’s application of the reasonable and informed third-party test to assess auditor independence is that those who carry out work on behalf of the Auditor-General shall not use the separation of activities in a firm to reduce the threat to independence in appearance. In this context a firm is viewed as any member of a network (including local or overseas entities that belong to a “network firm”). Firms sometimes seek to

² Two exceptions to this requirement apply to very small public organisations. They are:

- assisting them to prepare their financial statements; and
- providing advice in implementing off-the-shelf accounting software (that has not been developed or promoted by the auditing firm and where the auditor has experience in implementing the software).

rely on internal separation to permit them to carry out different (and sometimes incompatible) activities for an entity. An example of internal separation is where different partners and engagement teams in the same firm provide non-assurance services for an entity that the firm also audits. ***Internal separation can never meet the perceived independence requirement.*** It is met by applying the reasonable and informed third-party test.

19. There are additional requirements for providing “work of an assurance nature”:

(a) The relationships between different public entities or between a public entity and a non-public entity could mean that an Audit Service Provider’s (and the Auditor-General’s) independence might be threatened if the Audit Service Provider provides services to an entity that the Audit Service Provider does not audit on behalf of the Auditor-General.

An example of this situation is when an entity requests an audit firm to assist it in conducting due diligence for the possible purchase of assets from a public entity that the audit firm audits on behalf of the Auditor-General. In this example, it makes no difference whether:

- (i) the entity requesting the work is a public or non-public entity;
- (ii) the entity requesting the work is audited by the Audit Service Provider or has an existing client relationship with the Audit Service Provider;
- (iii) the work is carried out by personnel other than those involved in the audit; or
- (iv) the work is carried out by another member of “the network firm” – including local or overseas entities that belong to the “network firm”.

Acceptance of such a due diligence engagement would compromise the Auditor-General’s independence because the audit firm (and, by implication, the Auditor-General) would be perceived to have conflicting responsibilities. That is, being the auditor of the public entity would be seen to conflict with being an advisor to a third party transacting with the public entity. Such a conflict is damaging to the independence of the audit firm and of the Auditor-General, particularly if the Auditor-General decided later to investigate any issues with the transaction. No safeguards applied by the audit firm could reduce the threat to independence to an acceptable level.

(b) A pre-requisite to accepting an additional assurance engagement with a public entity is to obtain the contracting party’s acknowledgement that:

- (i) the results of the work will be made available to the Office of the Auditor-General; and
- (ii) any matters identified will be brought to the Auditor-General’s attention, who is free to report in accordance with section 30 of the Act.

- (c) On its own, additional assurance work carried out in accordance with the Code does not threaten audit independence. However, where the value of the additional assurance work becomes significant when compared to the amount of the audit fee, applying the reasonable and informed third-party test might lead to a conclusion that the amount of the additional work needs to be limited.
- (d) The nature of the additional assurance work and the fees associated with the category of the engagement need to be publicly disclosed. Public disclosure is a consequence of the proper application of the reasonable and informed third-party test.

Concluding comments

- 20. The Code specifies the fundamental principles that the Auditor-General and those who carry out work on their behalf apply. The fundamental principles provide the ethical basis to support the Auditor-General's work.
- 21. The Auditor-General's independence is critically important to the good standing of their work. The Code explains how the Auditor-General applies audit independence in a public sector context, which is governed by the reasonable and informed third-party test. The Code applying in a public sector context sets a higher standard for achieving independence than is contained in the NZAuASB Code.
- 22. Ultimately, the Code forms the basis for the Auditor-General to be able to maintain Parliament's and the public's trust and confidence.