

EXPOSURE DRAFT

ED 7/05

(October 2005)

Proposed Auditing Standard: Preamble to AUASB Standards

Prepared and Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

Proposed Auditing Standard: Preamble to AUASB Standards

Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by 15 December 2005. Comments should be addressed to:

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A copy of all non-confidential submissions will be placed on public record on the AUASB website: www.auasb.gov.au.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AUASB website: www.auasb.gov.au. Alternatively, any individual or organisation may obtain one printed copy of this Exposure Draft without charge until 15 December 2005 by contacting:

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PREFACE

Reasons for Issuing ED 7/05

The Auditing and Assurance Standards Board (AUASB) is proposing to issue this *Preamble to AUASB Standards* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 227B of the *Australian Securities and Investments Commission Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation, formulate auditing and assurance standards for other purposes and formulate guidance on auditing and assurance matters.

Main Proposals

This proposed Preamble to AUASB Standards sets out the AUASB's intentions on how the AUASB Standards are to be understood, interpreted and applied.

Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 1 July 2006.

Request for Comments

Comments are invited on this Exposure Draft of the proposed issuance of Auditing Standard << >> *Preamble to AUASB Standards* by 15 December 2005. The AUASB would prefer that respondents express a clear overall opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on any matter. The AUASB regards both critical and supportive comments as essential to a balanced review of the proposed Auditing Standard.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board makes Auditing Standard <<>> *Preamble to AUASB Standards* as set out in paragraphs 1 to 48 and Appendix 1, pursuant to section 227B(1) of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*

AUDITING STANDARD

Preamble to AUASB Standards

Operative Date

- 1 This Preamble to AUASB Standards is operative for financial reporting periods commencing on or after 1 July 2006.**

Introduction

- 2 The Auditing and Assurance Standards Board, the AUASB, issues AUASB Standards. The purpose of this Preamble is to set out the AUASB's intentions on how the AUASB Standards are to be understood, interpreted and applied.
- 3 An auditor shall apply the AUASB Standards in conjunction with paragraphs 1 to 47 of this Preamble.**
- 4 The AUASB derives its functions and powers under section 227B of the *Australian Securities and Investments Commission Act 2001*. The AUASB:
- (a) makes Auditing Standards under section 336 of the *Corporations Act 2001*¹ (the Act) for the purposes of the corporations legislation; and
 - (b) formulates auditing and assurance standards for other purposes¹.

Auditing Standards made under Section 336 of the Corporations Act 2001

Application

- 5 The Auditing Standards are to be applied, where applicable, in the conduct of:

¹ See diagram in Appendix 1 to this Preamble.

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- (a) an audit of a financial report for a financial year, or an audit or review² of a financial report for a half-year, prepared in accordance with Part 2M.3 of the Act; or
 - (b) an audit of a financial report prepared for any other purpose; or
 - (c) a review by the independent auditor of the entity³ of interim financial reports, prepared for any other purpose².
- 6 Although the Auditing Standards are written mainly in the context of a financial report audit, they also apply, adapted as necessary, to the audit of other financial information.

Enforcement

- 7 Section 307A of the Act requires auditors to conduct audits and reviews of the financial reports³ prepared under Part 2M.3 of the Act, in accordance with Auditing Standards.

Auditing and Assurance Standards for Other Purposes

- 8 Auditing and assurance standards for other purposes consist of standards that are designed for subject-specific areas. They include, for example, assurance engagements that relate to:
- reviews (other than a review by the independent auditor of the entity, of interim financial information, including interim financial reports, prepared for other purposes).
 - the efficiency and/or effectiveness of an entity's activities.
 - prospective financial information.
 - the effectiveness of internal controls.

Authority of the Paragraphs in AUASB Standards

- 9 AUASB Standards consist of paragraphs that are either:

² For legislative purposes, ASRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, is included in legislation as an "Auditing Standard". ASRE 2410 is to be applied in the review of a half-year financial report prepared under Part 2M.3 of the *Corporations Act 2001*, and a review by the independent auditor of the entity, of interim financial reports prepared for any other purpose.

³ Financial Reports required by Part 2M.3 of the Act are:

- the annual financial report; and
- the half-year financial report (for certain entities)

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- (a) mandatory requirements, identified in **bold-type** (black lettering); or
- (b) explanatory guidance, identified in normal-type (grey lettering).

The paragraphs in the AUASB Standards do not have equal authority.

Mandatory Requirements

- 10 Within each AUASB Standard, an auditor's obligations are stated as mandatory requirements that are identified in **bold-type**. The mandatory requirements consist of basic principles and essential procedures.
- 11 An auditor is required to comply with all mandatory requirements except when:
 - (a) application of the mandatory requirement(s) would relate to classes of transactions, account balances and disclosures that are immaterial; or
 - (b) an auditor, using professional judgement, has chosen not to adopt a particular approach or procedure where the AUASB Standard permits or requires the auditor to choose from alternative approaches or procedures; or
 - (c) a mandatory requirement(s) is conditional and the condition is not present.
- 12 When one or more of the exceptions described in paragraph 11 exist, a mandatory requirement is not relevant and the auditor is not required to document the circumstances.
- 13 In the case of an audit engagement, the mandatory requirements of each Auditing Standard are to be applied in conjunction with the mandatory requirements of other applicable Auditing Standards.
- 14 In the case of a review engagement, the auditor is required to apply the mandatory requirements contained only in the specified standard applicable to that review engagement. There is no requirement to apply the mandatory requirements of other AUASB Standards.

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Explanatory Guidance

- 15 Explanatory guidance:
- (a) is to be used to improve knowledge and understanding of the scope and application of the basic principles and essential procedures (the mandatory requirements); and
 - (b) may include practical examples to assist in the application of mandatory requirements.
- 16 Explanatory Guidance includes definitions, suggested (or typical) audit procedures, practical examples and other explanatory details and procedures that are ordinarily considered, for the purposes of understanding and fulfilling mandatory requirements.
- 17 Explanatory Guidance is not intended to limit or extend mandatory requirements or the auditor's obligations under AUASB Standards.

Other Important Elements of the AUASB Standards

- 18 In addition to mandatory requirements, see paragraphs 10 to 14 above, and explanatory guidance, see paragraphs 15 to 17 above, each AUASB Standard contains the following elements that impact on the application of the AUASB Standards:

Authority Statement

- 19 The purpose of the Authority Statement⁴ is to:
- (a) link the issuance of each individual AUASB Standard to the mandating legislation;
 - (b) identify the paragraphs that comprise the AUASB Standard;
 - (c) set out the requirement to read the AUASB Standard in conjunction with this Preamble; and
 - (d) identify the mandatory requirements of the AUASB Standard.

Application Paragraphs

- 20 Each AUASB Standard contains an application section that forms part of the mandatory requirements.

⁴ With the exception of the Authority Statement to this *Preamble to AUASB Standards*.

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- 21 The application paragraphs identify the functions of the AUASB Standard.
- 22 Auditing Standards made under section 336 of the Act⁵ contain mandatory application paragraphs relating to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and
 - (b) an audit of a financial report for any other purposes.
- 23 When an Auditing Standard may be used for the audit of financial information that is not in the form of a financial report, the application paragraph in that Auditing Standard is not included in the mandatory requirements.
- 24 Although the Auditing Standards are written mainly in the context of an external financial report audit⁶, they apply also, adapted as necessary, to the audit of other financial information.

Type of Entity

- 25 The AUASB Standards are:
- (a) neutral with respect to the audited or reviewed entity's sector and size; and
 - (b) are intended to be applied, as appropriate, to all audit, review, assurance and related service engagements in the public and private sectors conducted by external auditors.
- 26 Wherever necessary, small entity considerations are included in the body of the relevant AUASB Standard.
- 27 The AUASB Standards do not take into account any specific circumstances affecting entities that are subject to audit or review.

Operative Date

- 28 The operative date stipulates the date from which the AUASB Standard is to be applied. The operative date is stated in relation to

⁵ With the exception of ASRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*

⁶ Reference to a 'financial report' includes not only a financial report as defined under Part 2M.3 of the *Corporations Act 2001*, but also a financial report prepared for other purposes.

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the commencement date of the financial reporting period. The requirements of the AUASB Standards remain in force until:

- (a) the operative date of any amendment to those requirements; or
- (b) in relevant circumstances, the early adoption of such amendment; or
- (c) the AUASB Standard is withdrawn by the AUASB.

29 When early adoption of an AUASB Standard is allowed, a statement to that effect is included in the operative date paragraph of the AUASB Standard.

Conformity Statement

30 The conformity statement explains the relationship of the AUASB Standard with its equivalent international standard issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). The AUASB takes the position that an AUASB Standard conforms to the equivalent international standard when:

- (a) the mandatory requirements correspond with those in the relevant international standard or contain additional mandatory requirements; and
- (b) the explanatory guidance is substantially the same as the relevant international standard or contains additional explanatory guidance.

31 The explanatory guidance in the AUASB Standards commonly includes necessary differences from the equivalent international standard relating to terminology, referencing and Australian regulatory requirements.

32 When an AUASB Standard and the equivalent international standard conform, the conformity statement contains a statement to this effect. Furthermore, the conformity statement contains the following phrase:

“Compliance with this Standard enables compliance with the equivalent international standard”.

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- 33 When the AUASB Standard and the equivalent international standard are not equivalent, the conformity statement details the main differences.
- 34 The application and conformity paragraphs in each AUASB Standard assist the auditor to determine to what extent (if any) compliance with the AUASB Standards might also enable the engagement to be conducted in compliance with international standards. It is the responsibility of the auditor to determine which standards apply to the particular engagement and circumstances.

Applying the AUASB Standards

Professional Judgement

- 35 The AUASB Standards are principles-based and the auditor is expected to use professional judgement in applying the mandatory requirements in light of the given circumstances.
- 36 The use of professional judgement is required and applies in particular to:
- (a) the determination and application of materiality;
 - (b) compliance with ethical requirements relevant to audit and review engagements;
 - (c) the selection and scope of appropriate audit/review procedures;
 - (d) the assessment and evaluation of available options and results, including the persuasiveness of audit/review evidence; and
 - (e) the extent of documentation of audit/review plans, procedures, results, conclusions and communications.

Ethics

- 37 The AUASB takes the view that inclusion in the Auditing Standards of references to relevant ethical requirements is important to:
- (a) ensure a high level of public confidence in the audit function;
 - (b) enhance the rigour of the Auditing Standards; and

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- (c) ensure consistency between the Auditing Standards and the International Standards on Auditing (ISAs).

Accordingly, references to compliance with relevant ethical requirements are included in certain mandatory requirements and explanatory guidance paragraphs in the Auditing Standards.

- 38 The relevant ethical requirements relating to audit engagements referred to in the Auditing Standards are presently contained in the respective codes of professional conduct of the Professional Accounting Bodies in Australia⁷. The codes of professional conduct are aligned with the equivalent international code⁸.

Inability to Comply with Mandatory Requirements

- 39 Where, in rare and exceptional circumstances, factors outside the auditor's control prevent the auditor from complying with a relevant mandatory requirement, the auditor is required:

- (a) if possible, to perform appropriate alternative procedures; and
- (b) in accordance with AUS 208, "Audit Documentation", to document in the working papers:
- (i) the circumstances surrounding the inability to comply;
 - (ii) the reasons for the inability to comply; and
 - (iii) justification of how alternative procedures achieve the objective(s) of the mandatory requirement.

When the auditor is unable to perform appropriate alternative procedures, the auditor is required to consider the implications for the auditor's report.

⁷ In Australia, the codes of conduct of the professional accounting bodies, as issued from time to time, are:

- CPA Australia and The Institute of Chartered Accountants in Australia, *Joint Code of Professional Conduct*; and
- National Institute of Accountants, *Pronouncements of the Board of Directors – Code of Ethics*.

⁸ See IFAC Code of Ethics for Professional Accountants.

Auditing Standards Made Under Section 336 of the Corporations Act 2001

- 40 This Preamble to AUASB Standards is written in the context of the Auditing Standards issued pursuant to section 336 of the Act, however, it is relevant to understanding and applying AUASB Standards issued for other purposes.
- 41 The initial series of Auditing Standards, issued as legislative instruments, are operative for audits and reviews pertaining to financial reporting periods commencing on or after 1 July 2006.
- 42 In fulfilling its standard-setting function, the AUASB develops Auditing Standards that have a clear public interest focus and are of a high quality. Wherever possible, the AUASB uses, as appropriate, ISAs as a base from which to develop Auditing Standards. The Auditing Standards are designed to strengthen confidence in the assurance provided by an audit or review.
- 43 The AUASB has adopted certain drafting principles (see below) in making Auditing Standards under the Australian regulatory environment, wherein the Auditing Standards are legally enforceable and registered as legislative instruments under the *Legislative Instruments Act 2000*.

AUASB Drafting Approach

- 44 The following drafting principles and conventions have been adopted to implement the drafting objectives discussed above:
- (a) mandatory requirements and explanatory guidance are shown in separate paragraphs;
 - (b) paragraphs containing mandatory requirements are shown in **bold-type** text;
 - (c) the word 'shall' is used within mandatory requirements paragraphs to denote the obligations an auditor is required to comply with in the conduct of an audit;
 - (d) the present tense of verbs is used in the explanatory guidance when it is the best form of expression. Use of the present tense does not create obligations and therefore should not be interpreted as creating or implying mandatory requirements. The present tense is commonly used in

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- examples and other explanatory guidance that relate to professional judgement and professional scepticism; and
- (e) practical examples are used in explanatory guidance. Practical examples are not intended to constitute basic principles or essential procedures (mandatory requirements).
- 45 The drafting utilised in the Auditing Standards reflects the AUASB's intention that:
- (a) where mandatory requirements include statements of principle, the auditor is required to exercise judgement in applying the principle(s) according to the given circumstances; and
- (b) explanatory guidance does not limit or extend:
- (i) mandatory requirements; or
- (ii) the auditor's obligations under AUASB Standards.
- 46 The Auditing Standards, as mentioned above, are commonly based on their ISA equivalent standard. Obligations implied within the ISA explanatory guidance have been:
- (a) when appropriate, elevated to a mandatory requirement (**bold-type**); or
- (b) linked to a mandatory requirement, thereby ensuring that the explanatory guidance is clearly a duplication, or an elaboration, of a mandatory requirement, not an extension of a mandatory requirement; or
- (c) prefaced by inserting the word 'ordinarily' as a qualifier (see below).

Words and Phrases

- 47 The following words and phrases have been used in the Auditing Standards for the stated purposes (alphabetically):
- (a) *in accordance with* – is used in explanatory guidance to link the guidance with a mandatory requirement, either in the same Auditing Standard or in another Auditing Standard. The phrase is used only where the wording in the

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explanatory guidance is the same as that in the mandatory requirement.

- (b) *including* – refers to a list of items or examples but does not purport to contain all relevant items and intentionally is not exhaustive.
- (c) *is required to* – is used in the explanatory guidance to denote an elaboration of the relevant mandatory requirement to which it relates (including in the context of a practical application).
- (d) *mandatory requirements* – basic principles and essential procedures that must be applied for the audit or review engagement to comply with the relevant standard.
- (e) *ordinarily* – is used to indicate practical methods or means by which mandatory requirements may be complied with and is to be read in the following context:
 - (i) the word ‘ordinarily’ is not intended to create, or be interpreted as, a rebuttable presumption. The mandatory requirements (**bold-type**) in the Auditing Standards are the obligations that create presumptions in and of themselves; and
 - (ii) where the word ‘ordinarily’ is used, it is intended that the auditor consider:
 - whether the noted circumstances apply to the current audit or review engagement; and
 - if so, whether the suggested actions, procedures, inquiries, etc. are appropriate.
- (f) *professional judgement and professional scepticism* – are examples of the principles upon which the Auditing Standards are based and should be given their natural and ordinary meaning in light of the given context. Further discussion of these terms is contained in the re-issued Auditing Standard AUS 202 “Objective and General Principles Governing an Audit of a Financial Report”.
- (g) *pursuant to* – is used in the explanatory guidance to refer to an obligation in an Auditing Standard. The expression is used to highlight a linkage between the obligation (**bold-**

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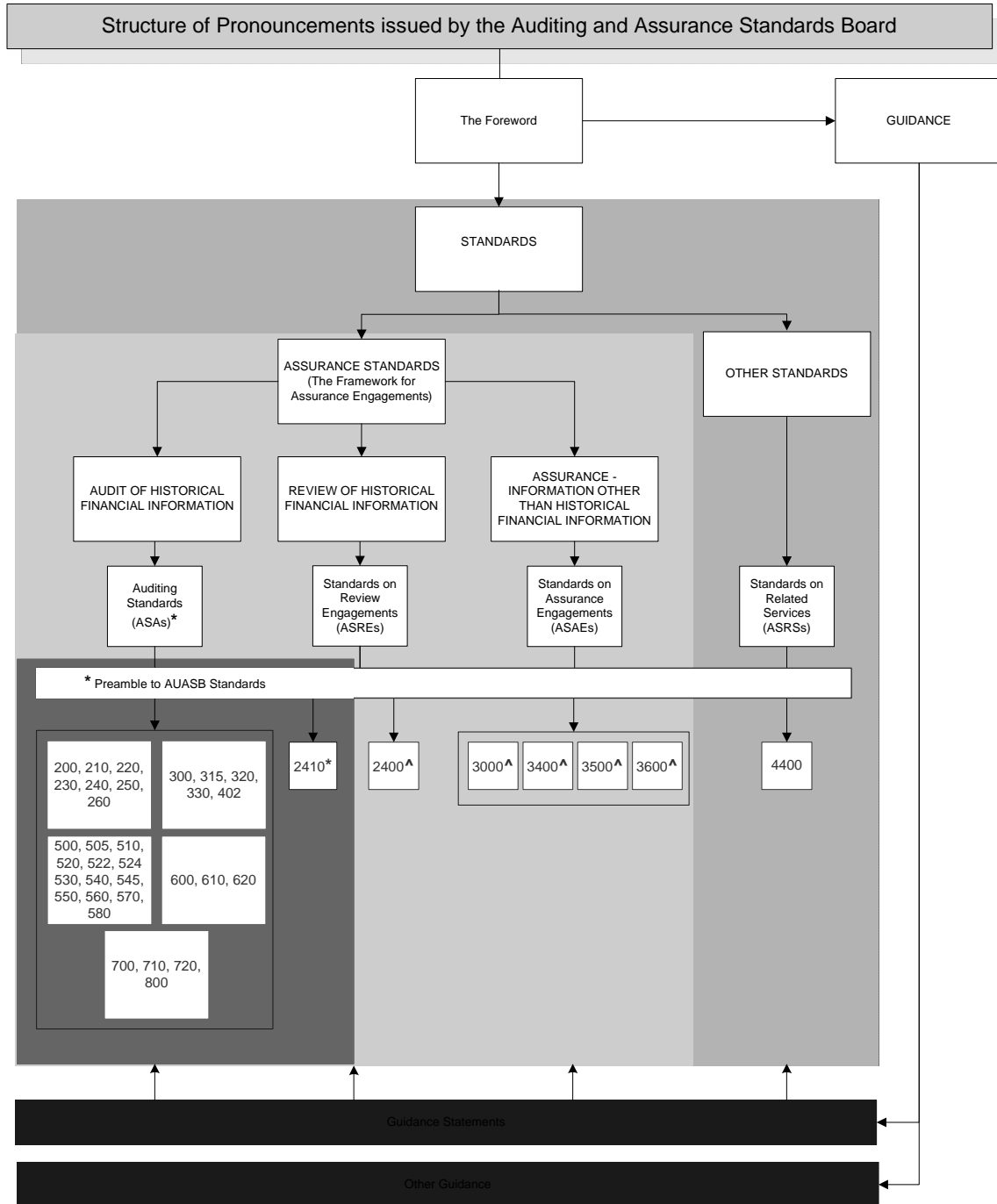
type) and the relevant explanatory guidance, which may assist in the understanding and fulfilment of the mandatory requirement(s). The expression 'pursuant to' is not intended to extend the mandatory requirement(s).

- (h) *shall* – the word 'shall', appearing in **bold-type** mandatory requirements creates an imperative, legally binding and enforceable obligation on auditors.
- (i) *understanding* – is to be given its natural and ordinary meaning in light of the given context. For example, the phrase 'the auditor shall obtain an understanding' is consistent with the notion that professional judgement is required in the given circumstances.

Conformity with International Standards on Auditing

- 48 There is no equivalent International Standard on Auditing to this *Preamble to AUASB Standards*.

APPENDIX 1



* made under section 336 of the *Corporations Act 2001*

^ auditing and assurance standards for other purposes