



13 October 2005

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Dear Merran

Comments on the Exposure Drafts of Proposed Auditing Standards issued by the Auditing and Assurance Standards Board (AUASB)

Thank you for your letter dated 5 September 2005, and for the opportunity to comment on the following five Exposure Drafts of proposed Auditing Standards issued by the AUASB on the 31 August 2005:

- **Exposure Draft ED 1/05**, Proposed Auditing Standard: *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatements* (Re-issuance of AUS 402);
- **Exposure Draft ED 2/05**, Proposed Auditing Standard: *The Auditor's Procedures in Response to Assessed Risks* (Re-issuance of AUS 406);
- **Exposure Draft ED 3/05**, Proposed Auditing Standard: *Audit Evidence* (Re-issuance of AUS 502);
- **Exposure Draft ED 4/05**, Proposed Auditing Standard: *External Confirmations* (Re-issuance of AUS 504); and
- **Exposure Draft ED 5/05**, Proposed Auditing Standard: *Existence and Valuation of Inventory* (Re-issuance of AUS 506).

CPA Australia has considered the above Exposure Drafts and articulates its general comments in this letter. Technical and editorial comments are appended. For each comment, CPA Australia has also provided suggestions for the Board's consideration. This letter is in addition to the letter, dated 11 October 2005, submitted jointly by CPA Australia, BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG, PKF, PricewaterhouseCoopers, The Institute of Chartered Accountants in Australia and the National Institute of Accountants.

General Comments

Generally, CPA Australia is supportive of the AUASB's effort to re-draft and re-issue Auditing Standards as legally enforceable Auditing Standards for the purposes of Section 336 of the *Corporations Act 2001*. We are also in agreement with the AUASB on the following:

- Using of International Standards on Auditing (ISAs) as the basis for developing Auditing Standards.
- In view of 1 July 2006 date to which the AUASB is working towards to issue the new Auditing Standards as legislative instruments, the focus of the re-drafting exercise currently undertaken by the AUASB would focus on the clarity and enforceability of the mandatory requirements and addressing the presumptively mandatory requirements currently present in the guidance paragraphs of each Auditing Standard.

With an intended operative date of financial reporting periods commencing on or after 1 July 2006 for the new Auditing Standards, dramatic changes to the proposed Auditing Standards from the existing standards would not allow adequate time for adoption by affected entities and their auditors. Clearly, this would not be in the public interest. Given that the AUASB is adopting a two-phase strategy to the re-drafting and re-issuance of Auditing Standards as legal instruments, and that *Phase 1* is to focus on ensuring legal enforceability of the Auditing Standards, the AUASB is urged to consider deferring to *Phase 2* consideration of proposals to elevate existing guidance to mandatory requirements. This would enable constituents to be clear as to their obligations arising from *Phase 1* and *Phase 2* of the AUASB's Auditing Standards re-drafting exercise.

We commend the inclusion of tables of key proposed changes for each Exposure Draft. These tables have been useful in facilitating the understanding and consideration of the re-drafted Auditing Standards. However, CPA Australia strongly urges the AUASB to consider providing marked-up copies of the Exposure Drafts without which attempts to identify proposed changes have proven to be challenging.

CPA Australia is committed to the development of high quality Auditing Standards in Australia. We hope the comments provided will be constructive to the AUASB's development of statutory Auditing Standards in Australia. It is with anticipation that we look forward to the subsequent releases of the Exposure Drafts of proposed Auditing Standards.

If you have any questions regarding this submission, please do not hesitate to contact Dr Mark Shying, CPA's Senior Policy Adviser, Financial Reporting and Governance on +61 3 9606 3903 or by email: mark.shying@cpaustralia.com.au

Yours sincerely



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TECHNICAL COMMENTS



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Page Number	Line Number	Comment(s)	Suggestion(s)
Explanatory Guide to Exposure Drafts of Proposed Auditing Standards issued by the AUASB			
2	13	The Guide explicits that, "Where possible, proposed Auditing Standards will be based on equivalent ISAs." This is inconsistent with the AUASB's media release dated 31 August 2005, "New Proposed Auditing Standards To Enhance Credibility of Audited Financial Reports and Improve Investor Confidence", which states that, "The proposed new Auditing Standards are based on the existing standards." For reasons clearly stated in CPA Australia's earlier submission relating to the Financial Reporting Council's strategic direction to the AUASB, the AUASB is urged to use ISAs as the basis for the new Auditing Standards.	Clarification by the AUASB is required.

Paragraph Number in Proposed ED (Line Number)	Status (Requirement, Guidance, Footnote or Appendix)	Comment(s)	Suggestion(s)

Exposure Draft ED 1/05 Proposed Auditing Standard: <i>Understanding the Entity and its Environment and Assessing the Risks of Material Misstatements</i> (Re-issuance of AUS 402)		
6 (13)	Guidance	<p>Add words to ensure consistency with Authority Statement.</p> <p>Consider adding words (underlined) as follows to ensure consistency in the meaning of the sentence with the Authority Statement: “... with the requirements and guidance provided in other applicable Auditing Standards.”</p>
15 (9)	Guidance	<p>Words added not in accordance with the Table of Comments.</p> <p>Consider amending as follows to ensure consistency within the Auditing Standard: “... Pursuant to the requirements of AUS 512, ...”</p>
26 (2)	Guidance	<p>Implied obligation in the existing sentence as indicated by, “The auditor’s understanding ... consists of...”</p> <p>Consider amending as follows: “The auditor’s understanding ... <u>ordinarily</u> consists of...”</p>
60 (12)	Guidance	<p>Implied obligation in the existing sentence as indicated by, “... the auditor considers the circumstances ...”</p> <p>Consider amending as follows: “... the auditor <u>ordinarily</u> considers the circumstances ...”</p>
83 (1)	Guidance	<p>Implied obligation in the existing sentence as indicated by, “In understanding the control environment the auditor considers whether...”</p> <p>Consider amending as follows: “In understanding the control environment, the auditor <u>ordinarily</u> considers whether...”</p>
93 (3)	Guidance	<p>Although guidance relates to audits of smaller entities, implied obligation in the existing sentence as indicated below should be clarified: “For such entities, the auditor discusses with management...”</p> <p>Consider amending as follows: “For such entities, the auditor <u>ordinarily</u> discusses with management...”</p>
Exposure Draft ED 2/05 Proposed Auditing Standard: <i>The Auditor’s Procedures in Response to Assessed Risks</i> (Re-issuance of AUS 406)		
22	Requirement	<p>Reconsider appropriateness of elevating guidance to a mandatory requirement.</p> <p>The proposed elevation is similar in substance to the mandatory requirement in paragraph 79. It is hard to see how elevating the guidance to a requirement would impact on the conduct of the audit. This argument is supported by the inclusion of cross-references to the above mentioned paragraph in ISA 330. Consider aligning with ISA 330 by linking guidance to the corresponding paragraphs or inserting the qualifier “pursuant to paragraph 79 of this Auditing Standard...” If this is done, the qualifier in paragraph 23 (line 14) needs to be updated.</p>

45	Requirement	Reconsider appropriateness of elevating guidance to a mandatory requirement.	The proposed elevation imposes a similar requirement on auditors as that in AUS 710. As opposed to elevating, consider linking to AUS 710 by use of qualifier, “pursuant to AUS 710...” This would also allow greater alignment with ISA 330.
61 (16)	Guidance	Use of qualifier considered inappropriate.	According to the draft Preamble, usage of the qualifier “pursuant to” does not extend the mandatory requirement. In this instance, by linking the sentence “... the auditor is required to test... each control is tested at least every third audit.”, to bold-type paragraph 57 and 60, black-lettering guidance on the suggested frequency of testing (i.e. every third audit) by the “back-door” could result.
81 (8)	Guidance	Add words to ensure consistency within the Auditing Standard.	Consider amending as follows: “... of relevant controls are <u>required to be</u> performed , pursuant to ...”
96 (5)	Guidance	Reconsider proposed linkage to bold-type paragraph.	Implied obligation is better linked to paragraph 97 as opposed to the proposed paragraph 93.
Exposure Draft ED 3/05 Proposed Auditing Standard: <i>Audit Evidence</i> (Re-issuance of AUS 502)			
18 (7)	Guidance	Implied obligation in the existing sentence as indicated by, “The auditor uses professional judgement ...”	The existing AUS 202, paragraph .06 contains the mandatory requirement, “The auditor should plan and perform an audit with an attitude of professional scepticism ...” Consider adding qualifier to link to AUS 202: “...pursuant to AUS 202, the auditor is required to ...”
21 (4)	Guidance	Sentence is ambiguous.	If providing an exhaustive list of the Auditing Standards is not the approach to be adopted, consider providing specific examples of the Auditing Standards that describes specific situations where the auditor is required to obtain audit evidence at the assertion level.
39 (1)	Guidance	Change suggested for consistency between Auditing Standards.	Although “In respect of some matters, ...” sufficiently qualifies the implied obligation in the sentence, for consistency with the drafting conventions employed in the re-drafting of the Auditing Standards, consider re-writing the sentence with “ordinarily”.

Exposure Draft ED 4/05
Proposed Auditing Standard: *External Confirmations* (Re-issuance of AUS 504)

11 (9)	Guidance	Consider use of alternative qualifier. Note: This comment is made with reference to the draft Preamble available via the AUASB website.	Whilst the use of “pursuant to..” to address the first instance of an implied obligation in the sentence (“...the auditor is required to determine the nature, timing and extent of audit evidence...”) is appropriate, for the second implied obligation in the sentence (“...irrespective of the assessed risk of material misstatement...and disclosure”), consider using the qualifier “in accordance with...” as the implied obligation is worded the same as the requirement in ED 2/05 (AUS 406), paragraph 68. This is to comply with the drafting principles as reflected in the draft Preamble.
12 (1)	Guidance	Consider adding paragraph references.	<p>The ISA-equivalent of this proposed Auditing Standard provides paragraph reference to the ISA-equivalent of AUS 406. By choosing to exclude the paragraph reference, the level of quality of the proposed Auditing Standard, compared to its international equivalent, is lowered. As this comment is not restricted to this instance, taking Auditing Standards as a whole, it is proposed that the effect, on the quality of the standards, of excluding such cross-references be considered.</p> <p>Additional comment: It is also a general observation that without specific paragraph references, where qualifiers have been proposed to clarify implied obligations, in some instances, identifying the precise mandatory requirement that the implied obligation is intended to be linked back to can prove to be challenging. This is a major constraint for respondents in the process of drafting submissions to the Exposure Drafts as readers has to assume that they are linking the implied obligation to that mandatory requirement that the Board has intended.</p>
18 (4)	Guidance	Implied obligation in the existing sentence as indicated by, “...the auditor needs to obtain...”	Although used in the context of an example, the existing sentence still contains an implied obligation. This is especially tricky in the instance when an auditor is faced with those circumstances described. Consider re-writing sentence to clarify implied obligation.

26 (4)	Guidance	Implied obligation in the existing sentence as indicated by, "...the auditor remains aware..."	It may not be appropriate to clarify the existing implied obligation by the three qualifiers employed in the re-drafting exercise as documented in the draft Preamble. Consider re-writing the sentence to adequately clarify the implied obligation.
31 (2)	Guidance	Implied obligation in the existing sentence as indicated by, "...the auditor applies an attitude ... and considers whether..."	Consider clarifying the implied obligation by linking back to the mandatory requirement in AUS 210, paragraph .24 as follows: "... pursuant to AUS 210, the auditor is required to apply an attitude..."
31 (12)	Guidance	Consider appropriateness of the use of the proposed qualifier.	A circular reference is being created by linking the Auditing Standards back to their own requirements. Consider amending as follows: <u>Option 1</u> "...pursuant to AUS 202 (paragraph .05), the auditor is required to apply the requirements in AUS 210 and AUS 218". Or <u>Option 2</u> "If the auditor believes..., guidance is provided in AUS 210 and AUS 218."
33 (5)	Guidance	Consider use of alternative qualifier.	Existing implied obligation is in substance providing further guidance relating to the mandatory requirement in paragraph 20. Consider amending as follows: "Pursuant to paragraph 20 of this Auditing Standard.. the auditor is required to consider the effect of..."

Exposure Draft ED 5/05

Proposed Auditing Standard: Existence and Valuation of Inventory (Re-issuance of AUS 506)

18 (4)	Guidance	Consider use of alternative qualifier.	<p>Whilst the qualifier “ordinarily” is used in this circumstance when the implied obligation relates to the observation of count procedures <u>AND</u> the performance of test counts, it is hard to think of an instance when either would not be carried out when the conditions stated in the paragraph are met. Consider amending as follows:</p> <p>“... pursuant to paragraph 11 and 12 of this Auditing Standard, the auditor is required to observe count procedures or perform test counts.”</p>
27	Requirement	Consider appropriateness of elevating the implied obligation to a requirement.	<p>In the event the stocktake is not performed at year-end, the auditor would not be able to comply with this requirement. Consider retaining sentence as guidance.</p>
29 & 30	Requirements	Consider appropriateness of proposed use of “shall”.	<p>Paragraph 5 of this Auditing Standard requires the auditor to “obtain sufficient appropriate audit evidence ... of inventory <u>material</u> to the financial report”. However, paragraph 29 requires the auditor “... evaluate the bases used ... in the valuation of inventory” and paragraph 30 requires the auditor to “obtain sufficient appropriate audit evidence regarding the valuation of inventory”. Note that no consideration have been given to the materiality of the inventory in question in both paragraphs 29 & 30. This contradiction does not cause concern when in the existing AUSs, bold-type paragraphs use “should” instead of “shall”. However, now that Auditing Standards are becoming legislative instruments, a potential clarity problem may exist. Notwithstanding that this Auditing Standard should be read in conjunction with AUS 306, “Materiality and Audit Estimates”, consideration should be given to clarifying this inconsistency in the mandatory requirements especially since in this instance they are all contained within the one Auditing Standard.</p>

EDITORIAL COMMENTS



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Paragraph Number in Proposed ED (Line Number)	Status (Requirement, Guidance, Footnote or Appendix)	Comment(s)	Suggestion(s)
Exposure Draft ED 1/05			
Proposed Auditing Standard: <i>Understanding the Entity and its Environment and Assessing the Risks of Material Misstatements (Re-issuance of AUS 402)</i>			
Footnote 1	Footnote	Minor formatting error	Amend font size.
37(5), 38 (7), 92 (1), 101 (1), 107(13), 108 (1), 110 (2), 116 (6)	Guidance	Minor editorial.	Add comma after “ordinarily”.
50 (9)	Guidance	Minor formatting error.	Delete extra space between “to management’s”.
75	Guidance	Minor formatting error.	Assuming that this paragraph is not intended to constitute a mandatory requirement, paragraph number should not be bold.

75 (3)	Guidance	Minor formatting error.	Minor formatting error.	Add comma (in bold) as follows: “Therefore in understanding internal control, pursuant to ...Auditing Standard, the auditor...”
116 (12)	Guidance	Minor formatting error.	Minor formatting error.	Delete extra space between “to consider”.
Exposure Draft ED 2/05 Proposed Auditing Standard: <i>The Auditor’s Procedures in Response to Assessed Risks</i> (Re-issuance of AUS 406)				
5 (1)	Guidance	Minor editorial.	Minor editorial.	Amend as follows: “The following is an overview of this <u>Auditing Standards</u> : ...”
2 (17)	Guidance	Minor grammatical error.	Minor grammatical error.	Amend as follows: “ ... the auditor is required to design and performs ...”
16 (7)	Guidance	Minor formatting error.	Minor formatting error.	Insert comma as follows: “ ...of effective controls, it is possible...”
86 (9)	Guidance	Minor editorial.	Minor editorial.	Amend as follows: “ ... the related subject matter must not <u>have</u> fundamentally changed.”
100 (3)	Requirement	Minor formatting error.	Minor formatting error.	Delete extra space between “shall attempt”.
102 (1)	Requirement	Minor formatting error.	Minor formatting error.	Delete extra space between “shall document”.
Exposure Draft ED 3/05 Proposed Auditing Standard: <i>Audit Evidence</i> (Re-issuance of AUS 502)				
25 (6)	Guidance	Sentence is grammatically incorrect.	Sentence is grammatically incorrect.	The word “however” should be deleted.
28 (7)	Guidance	Minor formatting error.	Minor formatting error.	Delete extra space between “has performed”.

40 (11)	Guidance	Minor editorial.	Consider amending sentence as follows: “Confirmations <u>are also</u> used to obtain ...”
Exposure Draft ED 4/05 Proposed Auditing Standard: <i>External Confirmations</i> (Re-issuance of AUS 504)			
7 (6)	Guidance	Minor editorial.	Add comma (shown in brackets) as follows: “In deciding to what extent to use external confirmations(,) the auditor ordinarily ...”
After 9	Header	Minor grammatical error.	“Auditor’s Assessments” should be singular rather than plural.
15 (2)	Guidance	Minor formatting error.	Delete extra space between “to the”.
19 (4)	Guidance	Minor editorial.	Amend as follows: “...obtaining audit evidence for assertions is not adequately...”
40 (7)	Guidance	Minor editorial.	Amend as follows: “...pursuant to paragraph 39 of this <u>Auditing Ssetandard</u> ”
44 (10)	Guidance	Minor editorial.	Amend as follows: “...pursuant to AUS 406, the auditor <u>is required to</u> considers the need...”