

14 October 2005

The Chairman  
Auditing and Assurance Standards Board  
Level 4  
530 Collins Street  
MELBOURNE VIC 3000

Dear Ms Kelsall,

## **Exposure Drafts ED 1/05, 2/05, 3/05, 4/05 and 5/05**

We acknowledge and confirm our support of the group submission made by the Auditing Standards Response Group ("ASRG") in respect of the above captioned exposure drafts of proposed Australian Auditing Standards.

This response highlighted a number of critical matters that we believe requires the Auditing and Assurance Standards Board's (AUASB's) consideration in order for the industry to facilitate an efficient and effective implementation and subsequent application of the revised Auditing Standards. One such key element was the development of the Preamble. We believe this Preamble, its contents and legal standing are critical to the clarity, understanding and application of Auditing Standards as a whole and we would like to request the opportunity to comment again on the above exposure drafts once that Preamble is finalised.

The majority of our paragraph specific points arising from our examination of the exposure drafts are linked to the matters raised in the ASRG's submission and/or in the Preamble for this reason we have not included them in this response. We attach our other comments in relation to the exposure drafts as Appendices A-E.

We would be pleased to discuss our comments with members of the AUASB or its staff. If you wish to do so, please do not hesitate to contact me on 02 9322 7288.

Yours sincerely,

DELOITTE TOUCHE TOHMATSU



Greg Couttas  
Partner

**Appendix A – Comments on ED 1/05 – Proposed Auditing Standard: Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Re-issuance of AUS 402)**

<i>Paragraph/s</i>	<i>Comments</i>	<i>Recommendation/s</i>
<p><i>Paragraph 11</i></p> <p>“The auditor shall perform the following risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control:</p> <p>(a) inquiries of management and others within the entity;</p> <p>(b) analytical procedures; and</p> <p>(c) observation and inspection.”</p> <p><i>Paragraph 32</i></p> <p>“The auditor shall obtain an understanding of the nature of the entity.”</p> <p><i>Paragraph 109</i></p> <p>“The auditor shall obtain an understanding of how the entity has responded to risks arising from IT.”</p>	<p>These paragraphs, unlike others in the proposed auditing standard, when read in isolation, do not limit the auditors’ obligation to gain an understanding of the client for the purpose of performing the audit. Without any such qualifier the level of understanding the auditor shall obtain is uncertain.</p>	<p>We recommend the paragraphs be amended as follows;</p> <p><i>Paragraph 11</i></p> <p>The auditor shall perform the following risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control relevant to the audit:</p> <p>(a) inquiries of management and others within the entity;</p> <p>(b) analytical procedures; and</p> <p>(c) observation and inspection.”</p> <p><i>Paragraph 32</i></p> <p>The auditor shall obtain an understanding of the nature of the entity <u>relevant to the audit.</u></p> <p><i>Paragraph 109</i></p> <p>The auditor shall obtain an understanding of how the entity has responded to risks <u>that may result in a material misstatement of the financial report arising from IT.</u></p>

<b>Paragraph/s</b>	<b>Comments</b>	<b>Recommendation/s</b>
<p><b>Paragraph 36</b>            “The auditor shall obtain an understanding of the entity’s selection and application of accounting policies and consider whether they are appropriate for its business and consistent with the applicable financial reporting framework and accounting polices used in the relevant industry.”</p>	<p>This proposed Auditing Standard will apply to an audit of a financial report prepared in accordance with the <i>Corporations Act 2001</i> and an audit of a financial report for any other purpose. This proposed Auditing Standard will therefore be applied to audits of both general purpose and special purpose financial reports.</p> <p>When expressing an audit opinion on a special purpose financial report, and in line with the example audit report in AUS 802 “The Audit Report on Financial Information other than a General Purpose Financial Report” the auditor makes the following disclaimer as to the appropriateness of the accounting policies used “No opinion is expressed as to whether the accounting policies used, and described in Note 1, are appropriate to the needs of the members.”</p> <p>Paragraph 36 as currently drafted is unaligned with the concept of special purpose financial reports and may curtail an entity’s flexibility in relation to the preparation of special purpose financial reports.</p>	<p>We recommend this paragraph be amended as follows,            “The auditor shall obtain an understanding of the entity’s selection and application of accounting policies and for audits of <u>general purpose financial reports</u> consider whether they are appropriate for its business and consistent with the applicable financial reporting framework and accounting polices used in the relevant industry.”</p>

**Appendix B – Comments on ED 2/05 – Proposed Auditing Standard: The Auditor’s Procedures in Response to Assessed Risks (Re-issuance of AUS 406)**

<i>Paragraph/s</i>	<i>Comments</i>	<i>Recommendation/s</i>
<p><i>Paragraph 7</i>                      “The overall responses and the nature, timing, and extent of the further audit procedures are matters for the professional judgement of the auditor. In addition to the requirements of this Auditing Standard, the auditor is required to comply with the requirements in AUS 210, “The Auditor’s Responsibility to Consider Fraud and Error in an Audit of a Financial Report”, in responding to assessed risks of material misstatement due to fraud.”</p>	<p>The name of AUS 210 is incorrect.</p>	<p>The paragraph should be amended as follows, The overall responses and the nature, timing, and extent of the further audit procedures are matters for the professional judgement of the auditor. In addition to the requirements of this Auditing Standard, the auditor is required to comply with the requirements in AUS 210, “The Auditor’s Responsibility to Consider Fraud and Error in an Audit of a Financial Report”, in responding to assessed risks of material misstatement due to fraud.</p>
<p>Paragraphs 14, 22, 45, 53, 74, 85, 89</p>	<p>These paragraphs have been elevated to black letter and in doing so the AUASB has made the requirements of this standard greater than ISA 330.</p>	<p>Whilst the procedures included in these paragraphs are, in the relevant circumstances, commonly performed by an auditor, in order to maintain international harmonisation between this standard and ISA330 we recommend the AUASB reverse this proposed elevation.</p>

<b>Paragraph/s</b>	<b>Comments</b>	<b>Recommendation/s</b>
<p><i>Paragraph 12</i> The auditor shall design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the assertion level.</p>	<p>It is unclear from this paragraph what is meant by “further audit procedures”. We understand it to mean those procedures in addition to the overall responses determined in accordance with paragraph 8.</p>	<p>We would recommend the paragraph be amended as follows; <u>In addition to the procedures determined in accordance with paragraph 8 of this standard the auditor shall design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the assertion level.</u></p>
<p><i>Paragraph 45</i> If the auditor’s procedures detect a material misstatement that was not identified by the entity and that is indicative of a material weakness in internal control, the auditor shall communicate that weakness to management and those charged with governance on a timely basis.</p>	<p>Elevating this to a black letter requirement in this standard is a duplication with AUS 710.20 which requires an auditor to report significant matters to management (this includes the audit committee) on a timely basis. AUS 710 also contains guidance as to what is a timely basis whilst this is not included in this proposed standard.</p>	<p>This item should be retained as guidance only and there should be a cross reference included to AUS 710.</p>
<p><i>Paragraph 89</i> In designing substantive analytical procedures, the auditor shall determine the amount of difference from the expectation that can be accepted without further investigation.</p>	<p>Elevating this to a black letter requirement in this standard is a duplication with AUS 512.17 which requires an auditor to “investigate and obtain adequate explanations and appropriate corroborative evidence” when the analytical procedures identify significant fluctuations or relationships from the predicted outcomes.</p>	<p>This item should be retained as guidance only and there should be a cross reference included to AUS 512.</p>

**Appendix C – Comments on ED 3/05 – Proposed Auditing Standard: Audit Evidence (Re-issuance of AUS 502)**

<i>Paragraph/s</i>	<i>Comments</i>	<i>Recommendation/s</i>
Nil		

**Appendix D – Comments on ED 4/05 – Proposed Auditing Standard: External Confirmations (Re-issuance of AUS 504)**

<b>Paragraph/s</b>	<b>Comments</b>	<b>Recommendation/s</b>
<p><i>Paragraph 34</i> When performing confirmation procedures, the auditor shall maintain control over the process of selecting those to whom a request will be sent, the preparation and sending of confirmation requests, and the responses to those requests.</p>	<p>There is insufficient guidance as to what is meant by the phrase “shall maintain control”. Usually the client’s staff will assist with the preparation of confirmation requests using data (including addresses) sourced from the client’s records or systems.</p>	<p>Greater guidance should be provided to clarify what the auditor is responsible for if they conduct and external confirmation procedure.</p>
<p><i>Paragraph 35</i> Control is maintained over communication between the intended recipient and the auditor to minimise the possibility that the results of the confirmation process will be biased because of the interception and alteration of confirmation requests or responses. Pursuant to paragraph 34 of this standard, the auditor is required to ensure that it is the auditor who sends out the confirmation requests, that the requests are properly addressed, and that it is requested that all replies are sent directly to the auditor. The auditor ordinarily considers whether replies have come from the purported sender.</p>		

**Appendix E – Comments on ED 5/05 – Proposed Auditing Standard: Existence and Valuation of Inventory (Re-issuance of AUS 506)**

<i>Paragraph/s</i>	<i>Comments</i>	<i>Recommendation/s</i>
<p><i>Paragraph 11</i> When inventory is material to the financial report, the auditor shall obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting unless impracticable.</p> <p><i>Paragraph 14</i> Where attendance is impracticable, due to factors such as the nature and location of the inventory, the auditor shall consider whether alternative procedures provide sufficient appropriate audit evidence of existence and condition to conclude that the auditor need not make reference to a scope limitation.</p>	<p>There is insufficient guidance as to what is meant by the phrase “unless impracticable”. Paragraph 14 infers that the nature and location of inventory are the only factors that contribute to the implacability of attending the stock count.</p> <p>We acknowledge that there would be very few circumstances where an auditor did not attend a client’s inventory count (other than audit appointments being made after the count date) and it is therefore unlikely that this phrase would be applied in practice.</p> <p>Paragraph 4 in the main changes sections uses the phrase exceptional circumstances. This is not used in the standard.</p> <p>This paragraph indicates an auditor must attend a stock count. Other paragraphs in the standard would indicate there are situations where an auditor would not – this appears to be inconsistent. Examples are paragraphs 15 and 18.</p>	<p>Greater guidance should be provided to clarify what unless impracticable means.</p> <p>Terminology between the main changes and the standard should be aligned as to “exceptional circumstances” and “unless impracticable”.</p>



<b>Paragraph/s</b>	<b>Comments</b>	<b>Recommendation/s</b>
<p><i>Paragraphs, 19, 27, 29-31</i></p>	<p>These paragraphs have been elevated to black letter and in doing so the AUASB has made the requirements of this standard greater than ISA 501 Part A.</p>	<p>Whilst the procedures included in these paragraphs are, in the relevant circumstances, commonly performed by an auditor, in order to maintain international harmonisation between this standard and ISA 501 Part A we recommend the AUASB reverse this proposed elevation.</p>
<p><i>Paragraph 27</i> The auditor shall perform audit procedures over the final inventory listing to determine whether it accurately reflects actual inventory counts made by the entity.</p>	<p>Whilst this is a procedure commonly performed by auditors what if the client doesn't prepare a final inventory listing, does this result in a limitation of scope?</p>	<p>This paragraph should be amended to guidance or amended as follows The auditor shall perform audit procedures over the final inventory listing quantities recorded to determine whether it accurately reflects actual inventory counts made by the entity.</p>