

February 2020

# Explanatory Memorandum

## *Exposure Draft 01/20: Proposed Standard on Related Services ASRS 4400 Agreed- Upon Procedures Engagements*

Issued by the Auditing and Assurance Standards Board



**Australian Government**

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**Auditing and Assurance Standards Board**

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**Explanatory Memorandum to Exposure Draft 01/20: Proposed Standard on Related Services  
ASRS 4400 Agreed-Upon Procedures Engagements**

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*Important Note and Disclaimer*

This Explanatory Memorandum is issued by the AUASB to provide information to auditors and practitioners about the AUASB's implementation in Australia of the International Auditing and Assurance Standards Board's (IAASB's) revised International Standard on Related Services (ISRS) 4400 *Agreed-Upon Procedures Engagements*.

This Explanatory Memorandum does not establish or extend the requirements under an existing AUASB Standard(s) and is not intended to be a substitute for compliance with the relevant AUASB Standards with which auditors and assurance practitioners are required to comply when conducting a related services engagement. No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this document or for any errors or omissions in it.

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## **EXPLANATORY MEMORANDUM**

### ***Exposure Draft 01/20: Proposed Standard on Related Services ASRS 4400 Agreed-Upon Procedures Engagements***

#### **Purpose**

1. The aim of this Explanatory Memorandum is to:
  - a) provide stakeholders with information about Exposure Draft ED 01/20, issued in February 2020, and the Auditing and Assurance Standards Board's (AUASB) approach to implementing the International Auditing and Assurance Standards Board's (IAASB) Revised International Standard on Related Services (ISRS) 4400 *Agreed-Upon Procedures Engagements* (ISRS 4400) in Australia; and
  - b) seek stakeholder feedback on the Exposure Draft.

#### **Background**

##### **IAASB**

2. Agreed-Upon Procedures (AUP) Engagements are widely used and the superseded ISRS 4400 was developed over 20 years ago. In September 2017, the IAASB approved a project proposal to revise extant ISRS 4400 to address issues relating to AUP engagements.
3. This project was completed in December 2019 with the IAASB approving a revised ISRS 4400 at the December 2019 IAASB meeting.
4. The key changes and concepts in the revised ISRS 4400 include:
  - a) Professional judgement — new requirements and application material on the role of professional judgement in an AUP engagement.
  - b) Independence — new requirements and application material on disclosures in the AUP report relating to the practitioner's independence.
  - c) Engagement acceptance and continuance considerations — new requirements and application material addressing conditions for engagement acceptance and continuance, including guidance on what constitutes appropriate (or inappropriate) terminology to describe procedures and findings in AUP reports.
  - d) Use of a practitioner's expert — new requirements and application material to address the use of the work of a practitioner's expert in an AUP engagement, including the practitioner's responsibilities when using the work of an expert.
  - e) AUP report restrictions — clarification that the AUP report is not restricted to parties that have agreed to the procedures to be performed unless the practitioner decides to do so, and new application material on the practitioner's considerations if the practitioner wishes to place restrictions on the AUP report.
  - f) ISRS 4400 also addresses non-financial subject matters and includes new definitions, requirements and application material on written representations, recommendations arising from the performance of AUP engagements, and documentation.

5. ISRS 4400 contains several paragraphs relating to quality control. The IAASB is currently undertaking a project to revise ISQC 1.<sup>1</sup> The paragraphs in ISRS 4400 relating to quality control are likely to be updated through conforming amendments arising from the finalisation of Proposed ISQM 1<sup>2</sup>.

## **AUASB**

### *Feedback to IAASB*

6. In December 2018, the AUASB issued a [Consultation Paper](#) seeking feedback on the IAASB's Exposure Draft on ISRS 4400.
7. In March 2019, the AUASB made a [written submission](#) to the IAASB in response to ED ISRS 4400. In formulating its response, the AUASB sought input from its stakeholders in three principal ways. Firstly, from hosting a webinar that was attended by over 50 stakeholders representing a broad range of backgrounds, including assurance providers from a range of audit firms, professional accounting bodies, academics, those charged with governance and preparers of financial statements. Secondly, through an open invitation to provide comments on the AUASB issued Consultation Paper on this topic via the AUASB website. Finally, formal discussions and deliberations by AUASB members at AUASB meetings. The main themes expressed by the AUASB in their submission to the IAASB included:
- (a) *Independence – Requirement:* The AUASB supported the proposed ED ISRS 4400 not including a precondition for the practitioner to be independent. Paragraph 9(a) below describes what the IAASB concluded in relation to the precondition to be independent AUP engagements.
  - (b) *Independence – Reporting Requirements:* Where independence is required by law or regulation, the AUASB considered that there should be a requirement for the practitioner to disclose the criteria/framework used by the practitioner to assess independence. Additionally, the AUASB considered that the reporting of independence proposals contained in ED ISRS 4400 were too complex; and considered that the AUP report should not contain any 'negative' statements whereby the practitioner needs to state that they are not independent when the requirements of the standard do not contain an independence precondition. Paragraph 9(b) below describes what the IAASB concluded in relation to independence reporting requirements in AUP engagements.
  - (c) *Restriction on use:* The AUASB considered that the use of an AUP report should be restricted to parties that have agreed to the procedures performed or have been identified as intended users in the report. Paragraph 9(c) below describes what the IAASB concluded in relation to restriction of use of AUP reports.
  - (d) *Professional judgement:* The AUASB recommended that the proposed ED ISRS 4400 include a clearer requirement in relation to the exercise of professional judgement than what was put forward in the exposure draft. Paragraph 9(d) below describes what the IAASB concluded in relation to the exercise of professional judgement in AUP engagements.
8. The AUASB has closely followed the activities of the IAASB in their revisions to ED ISRS 4400 and consider that most of the feedback generated by Australian stakeholders has been addressed in the final revised ISRS 4400. The IAASB's positions and the AUASB's considerations of these positions is detailed in paragraphs 9(a) – 9(e) below.

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<sup>1</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

<sup>2</sup> International Standard on Quality Management (ISQM) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

## **Main Differences between ED 01/20 (based on Revised ISRS 4400) and extant ASRS 4400**

9. ED 01/20 (based on the Revised ISRS 4400) largely aligns with the extant ASRS 4400, with the main points of difference being around independence, professional judgement, restriction on use and rational purpose.

*a. Independence – Ethical Requirements*

*i. Background*

ED 01/20 does not include a precondition for the practitioner to be independent when performing an AUP engagement nor a requirement for the practitioner to determine independence. The AUASB supported this position in the AUASB's submission to the IAASB on ED ISRS 4400 on the basis that this outcome is consistent with the APESB Code, and considering that there is no recognised framework to measure independence in the context of ASRS engagements.

ED 01/20 however recognises that while the APESB Code does not contain independence requirements for agreed-upon procedures engagements, there may nonetheless be other conditions or laws and regulations that do specify requirements pertaining to independence.

*ii. Differences between Extant ASRS 4400 and ED 01/20*

- **Extant ASRS 4400 has** a requirement for the practitioner to be independent **equivalent to the independence requirement applicable to 'other assurance engagements'**, unless the engaging party has explicitly agreed to modified independence requirements.
- **ED 01/20 does not require independence** for an AUP engagement.
- The AUASB has specifically asked stakeholders' views on this matter – refer paragraph 18, section A, questions 1-4 of this Explanatory Memorandum.

*b. Independence – Reporting Requirements*

*i. Background*

To enhance transparency, ED 01/20 contains certain reporting requirements in relation to independence depending on whether the practitioner is required to be independent (although not a precondition in ED 01/20 as explained in paragraph 9(a)(i) above).

To avoid confusion, and to avoid users assuming practitioners conducting agreed-upon procedure engagements are always independent, the IAASB agreed that there should be limited disclosure when the practitioner is not required to be independent. The agreed statement is simple and does not contain any negative statements about the practitioner not being independent.

The IAASB further agreed that where the practitioner is required to be independent, reporting requirements should address concerns regarding the lack

of generally accepted criteria for determining independence when the practitioner is not required to be independent.

*ii. Differences between Extant ASRS 4400 and ED 01/20*

- **Extant ASRS 4400** has a requirement whereby if modified independence is agreed, the level of independence applied is described in the AUP report.
- **ED 01/20** requires that the AUP report includes one of two statements addressing circumstances when the practitioner is, or is not, required to be independent:
  - If the practitioner is not required to be independent and has not otherwise agreed in the terms of engagement to comply with independence requirements, a statement that there are no independence requirements with which the practitioner is required to comply; or
  - If the practitioner is required to be independent or has agreed in the terms of engagement to comply with independence requirements, a statement that the practitioner has complied with the relevant independence requirements. The statement shall identify the relevant independence requirements.
- The AUASB has specifically asked stakeholders' views on this matter – refer paragraph 18, section A, questions 5-8 of this Explanatory Memorandum.

*c. Restriction on use*

*i. Background*

To address broad concerns that AUP reports are often required to be provided to users who are not parties to the terms of the engagement, ED 01/20 does not require the AUP report to include a statement that the report is restricted. Although no longer a requirement, there may be circumstances when the practitioner still chooses to restrict the AUP report. To provide additional guidance in this area, application material has been included in ED 01/20:

- Paragraph A53 explains why neither a restriction on use nor a restriction on distribution can be mandated - i.e. in some jurisdictions, it may be possible to restrict the use of the AUP report but not its distribution. In other jurisdictions, it may be possible to restrict the distribution of the AUP report but not its use; and
- Paragraph A54 includes the factors that the practitioner may consider in deciding whether to restrict the AUP report. Paragraph A54 also clarifies that the decision on whether to restrict the AUP report rests with the practitioner (if the restriction is permitted by law or regulation).

*ii. Differences between Extant ASRS 4400 and ED 01/20*

- **Extant ASRS 4400 restricts the use** of an AUP report to those parties that have either agreed to the procedures to be performed or have been



specifically included as users in the engagement letter. A restriction on use paragraph is required to be included in an AUP report.

- **ED 01/20 does not contain a requirement that restricts** the AUP report to parties that have agreed to the procedures to be performed, but rather the report contains a statement identifying the purpose of the report and that the report may not be suitable for another purpose.
- The AUASB has specifically asked stakeholders' views on this matter – refer paragraph 18, section A, questions 9-12 of this Explanatory Memorandum.

*d. Professional Judgement*

*i. Background*

One of the most significant attributes of an agreed-upon procedures engagement is the lack of subjectivity in both the procedures and the resultant factual findings. Applying judgement requires a level of subjectivity, accordingly in extant ASRS 4400 the practitioner may not exercise professional judgement when conducting agreed-upon procedures. To build up to what ASRS 4400 currently has in its paragraph 25 requires a complete read of paragraphs 13(b), 13(j), 18, 22(c), 22(i), A21-A23 of ED 01/20.

To clarify where, and how, professional judgement is exercised in an AUP engagement without implying that professional judgement is ever “suspended” or “prohibited”, ED 01/20 contains the following in relation to professional judgement:

- Examples and subheadings in application material to demonstrate how professional judgement may be exercised when accepting, conducting and reporting on the AUP engagement.
- Clarifying, in application material examples, that professional judgement is exercised in determining an appropriate action or response resulting from performing the procedures.
- Application material explaining why professional judgement is not expected to be exercised in the performance of the procedures.

While the extant ASRS 4400 requirement comes out with a clear statement in paragraph 25 that the assurance practitioner will not be required, during the course of the engagement, to exercise professional judgement in determining or modifying the procedures to be performed, ED 01/20 is more subtle in this respect, but eventuates in the same outcome. On this basis, the AUASB supports ED 01/20 in relation to the drafting of professional judgement.

*ii. Differences between Extant ASRS 4400 and ED 01/20*

- **Extant ASRS 4400** explicitly states that the assurance practitioner is **not required**, during the course of the engagement, **to exercise professional judgement** in determining or modifying the procedures to be performed.
- **ED 01/20** requires that **‘the practitioner shall exercise professional judgement** in accepting, conducting and reporting on an agreed-upon procedures engagement, considering the circumstances of the engagement.’ Clarity regarding where, and how, professional judgement

is exercised in an AUP engagement is provided in paragraph 9(d)(i) of this Explanatory Memorandum.

- The AUASB has specifically asked stakeholders' views on this matter – refer paragraph 18, section A, question 13 of this Explanatory Memorandum.

*e. Rational Purpose*

*i. Background*

In their submission to the IAASB on ED-ISRS 4400, the AUASB considered that it would be helpful to include a precondition to understand whether there is a rational purpose to the agreed-upon procedures engagement. Professional judgement is required in determining whether to accept the engagement. In its deliberations of the matter, the IAASB agreed with the concept underlying the term “rational purpose” in an AUP engagement. However, the IAASB observed that this term is generally associated with assurance engagements. Accordingly, ED 01/20 proposes to introduce the concept of “rational purpose” in paragraph A28 without referring to it explicitly.

Furthermore, the IAASB AUP Taskforce has committed to develop some implementation support including a comparison of AUP engagements to assurance engagements.

*ii. Differences between Extant ASRS 4400 and ED 01/20*

- Extant ASRS 4400 explicitly contains a rational purpose pre-acceptance condition.
- ED 01/20 introduces the concept of “rational purpose” in paragraph A28 without referring to it explicitly.

## **AUASB Due Process**

10. In accordance with its mandates under section 227 of the *Australian Securities and Investments Commission Act 2001* and the Financial Reporting Council's (FRC) Strategic Direction, the AUASB's policy is to adopt the IAASB's auditing standards (ISAs), unless there are compelling reasons not to do so; and to amend the ISAs only when there are compelling reasons to do so.

The AUASB's principles of convergence with the ISAs and harmonisation with the standards of the New Zealand Auditing and Assurance Standards Board (NZAuASB) can be found on the AUASB's website:

[http://www.auasb.gov.au/admin/file/content102/c3/Aug14\\_IAASB-NZAuASB\\_Principles\\_of\\_Convergence\\_and\\_Harmonisation.pdf](http://www.auasb.gov.au/admin/file/content102/c3/Aug14_IAASB-NZAuASB_Principles_of_Convergence_and_Harmonisation.pdf)

While ASRS 4400 is not an Australian Auditing Standard as described in the Foreword to AUASB Pronouncements, the AUASB considers it to be in the public interest to follow the same mandate in relation to related services engagements.

11. Compelling reasons fall broadly into two categories: legal and regulatory; and principles and practices considered appropriate in maintaining or improving audit quality in Australia. Compelling reasons are further guided by the AUASB's policy of harmonisation with the standards of the NZAuASB.
12. Based on its mandate, the AUASB intend to adopt the revised ISRS 4400, relating to AUP Engagements. Prior to implementation, the AUASB is required to consult with stakeholders and, accordingly, now issues Exposure Draft ED 01/20.

13. ED 01/20 has been compiled based on a ‘final draft’ of ISRS 4400 as agreed at the December 2019 IAASB meeting. This ISRS 4400 draft is still subject to final paragraph numbering, referencing, formatting and editorials before the IAASB submits this draft for PIOB approval. Accordingly, the AUASB expects that there may be some numbering/referencing and minor editorial amendments that are still to be processed by the IAASB. These will be updated by the AUASB after the final ISRS 4400 is approved by the PIOB. The AUASB is not expecting any changes in substance or content, and consequently considers that ED 01/20 can be issued in its current form.
14. The AUASB has historically exposed Australian versions of the finalised IAASB standard. This is the process that will be undertaken in connection with the issuance of ED 01/20. ED 01/20 is the Australian Exposure Draft of the final revised IAASB’s ISRS 4400. Feedback on ED 01/20 will be used to inform the AUASB as to any requirements and guidance that may be needed in addition to, or a clarification of, the equivalent ISRS, only when there are compelling reasons to do so. At the completion of the exposure period, the AUASB will consider stakeholders’ submissions and, where the AUASB determines that a compelling reason exists, amendments to the exposure draft will be made.

#### *Exposure Draft Protocols*

15. Under its convergence policies, the AUASB continues to include requirements and guidance that are in addition to, or a clarification of, the equivalent IAASB standards only when the compelling reason test has been met. Any such modifications will be identified in the Related Services Engagements Standard by paragraph numbering commencing with an ‘Aus’ prefix. Any such changes do not diminish the requirements of the equivalent ISRS.
16. In addition to those changes that meet the compelling reason test, the AUASB makes format and terminology changes to comply with requirements relating primarily to legislative instruments. Such changes are machinery in nature and do not change the meaning of the equivalent ISRS.

#### *AUASB Modifications to the ISRS*

17. Currently, in line with the AUASB’s policy of convergence with the standards of the IAASB (see link at paragraph 10 above), the AUASB is not proposing any modification to ISRS 4400 (Revised). However, the AUASB has asked specific questions on exposure (refer paragraph 18 of this Explanatory Memorandum) for stakeholders’ consideration and comment. After such feedback is received, the AUASB will deliberate the need for any compelling reason amendments.

### **Request for Comments**

18. The AUASB requests comments on all matters in relation to ED 01/20, but specifically in relation to the questions below. Stakeholders may address only specific questions relevant to them or raise matters not specifically addressed by a question.

**Exposure Draft Questions**

The AUASB is particularly interested in stakeholders' views on the following technical matters in the exposure draft:

*Independence – Requirement (Refer paragraph 9(a) of this Explanatory Memorandum for more information):*

1. Do stakeholders support ED 01/20 not requiring independence for an AUP engagement? If not, why not?
2. Would stakeholders prefer to maintain the approach in extant ASRS 4400 whereby there is an independence requirement for the practitioner equivalent to the independence requirement applicable to 'other assurance engagements', unless the engaging party has explicitly agreed to modified independence requirements?
3. Are there any other independence pre-condition options that stakeholders would suggest to the AUASB that are not covered by questions 1 and 2 above? Please provide details.
4. If stakeholders do not support ED 01/20 not requiring independence for an AUP engagement, do stakeholders consider there to be compelling reasons (as outlined in paragraph 10 of this EM) to modify ED 01/20 (based on revised ISRS 4400)?

*Independence – Reporting Requirements (Refer paragraph 9(b) of this Explanatory Memorandum for more information):*

5. Do stakeholders support ED 01/20 with the AUP report including statements addressing circumstances when the practitioner is or is not required to be independent? If not, why not?
6. If stakeholders support maintaining the approach adopted in extant ASRS 4400 in relation to independence (as outlined in question 2 above), do stakeholders support maintaining the approach in extant ASRS 4400 whereby the report is required to contain a statement that either ethical requirements equivalent to those applicable to Other Assurance Engagements have been complied with, including independence, or, if modified independence requirements have been agreed in the terms of the engagement, a description of the level of independence applied?
7. Are there any other independence reporting options that are not covered by questions 5 and 6 above? Please provide details.
8. If stakeholders do not support ED 01/20 with the AUP report required to include statements addressing circumstances when the practitioner is or is not required to be independent, do stakeholders consider there to be compelling reasons (as outlined in paragraph 10 of this EM) to modify ED 01/20 (based on revised ISRS 4400)?

*Restriction on use (Refer paragraph 9(c) of this Explanatory Memorandum for more information):*

9. Do stakeholders support ED 01/20 not requiring the restriction of the AUP report to parties that have agreed to the procedures to be performed, but rather the report containing a statement identifying the purpose of the report and that the report may not be suitable for another purpose? If not, why not?
10. Would stakeholders prefer to maintain the approach in extant ASRS 4400 whereby the use of an AUP report is restricted to those parties that have either agreed to the procedures to be performed or have been specifically included as users in the engagement letter. Under ASRS 4400, a restriction on use paragraph is required to be included in an AUP report.

11. Are there any other restriction on use options that stakeholders would suggest to the AUASB that are not covered by questions 9 and 10 above? Please provide details.
12. If stakeholders do not support ED 01/20 not requiring the restriction of the AUP report to parties that have agreed to the procedures to be performed, do stakeholders consider there to be compelling reasons (as outlined in paragraph 10 of this EM) to modify ED 01/20 (based on revised ISRS 4400)?

*Professional judgement (Refer paragraph 9(d) of this Explanatory Memorandum for more information):*

13. Do stakeholders support the way in which the exercise of professional judgement is dealt with in ED 01/20? If not, why not?

In addition, the AUASB is also interested in stakeholders' views on:

14. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
15. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
16. Whether there are any principles and practices considered appropriate in maintaining or improving quality of related services engagements in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
17. What, if any, are the additional significant costs to/benefits for assurance practitioners and the business community arising from compliance with the main changes to the requirements of the proposed standard? If significant costs are expected, the AUASB would like to understand:
  - a. Where those costs are likely to occur;
  - b. The estimated extent of costs, in percentage terms (relative to related services fee); and
  - c. Whether expected costs outweigh the benefits to the users of related services?
18. Are there any other significant public interest matters that stakeholders wish to raise?

### **Other Outreach Activities**

19. The AUASB intend to conduct a Webinar explaining the details of the proposed ED 01/20 in March 2020.

### **Application**

20. The revised standard will be applicable for agreed-upon procedures engagements for which the terms of engagement are agreed on or after **1 January 2022**. This application date corresponds with that of the equivalent ISRS.

### *Early Adoption*

21. Consistent with the IAASB's policy, all AUASB Standards may be early adopted.

### **Comment Date**

22. ED 01/20 will be open to stakeholders for a **60-day comment period, closing 20 April 2020**.

23. At the completion of the exposure period, the AUASB will consider stakeholders' submissions and, where the AUASB determines that compelling reasons exist, amendments to the exposure draft will be made.

### **Website Resources**

24. The AUASB welcomes stakeholders input to the development of Australian Auditing Standards and regards both supportive and critical comments as essential to a balanced review of the proposed standards. Stakeholders are encouraged to access the websites of the [AUASB](#) and the [IAASB](#) to obtain further information.

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