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Basis for Conclusions ***ASRS 4450 Comfort Letter*** ***Engagements***

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



Australian Government

Auditing and Assurance Standards Board

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Contact Details

Auditing and Assurance Standards Board Phone: (03) 8080 7400
Level 7, 600 Bourke Street Fax: (03) 8080 7450
Melbourne Victoria 3000 E-mail: enquiries@auasb.gov.au
AUSTRALIA

Postal Address:
PO Box 204
Collins Street West
Melbourne Victoria 8007
AUSTRALIA

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Basis for Conclusions ASRS 4450 *Comfort Letter Engagements*

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BASIS FOR CONCLUSIONS

ASRS 4450 Comfort Letter Engagements

This Basis for Conclusions is issued by the Auditing and Assurance Standards Board (AUASB) to assist auditors in understanding the background to the issuance of Standard on Related Services ASRS 4450 *Comfort Letter Engagements* (ASRS 4450).

The Basis for Conclusions does not form part of ASRS 4450 and is not a substitute for reading the Standard.

Background

1. The AUASB has issued a new Standard on Related Services, ASRS 4450 *Comfort Letter Engagements* (ASRS 4450), which will be operative for engagements commencing on or after 1 July 2013, with early adoption permitted, as appropriate. ASRS 4450 sets out mandatory requirements and related application and other explanatory material (“guidance”) for an Australian auditor of an entity to apply when planning, performing and reporting on comfort letter engagements in respect of financial information related to, and/or included in, an offering document. There is no Australian applicable law or regulation or other AUASB pronouncement that requires the auditor to accept an engagement to prepare and issue a comfort letter, and the auditor does so only when certain preconditions are met by both the responsible party of the entity (entity) and certain requesting parties. No assurance is expressed in the comfort letter as the auditor’s procedures on the particular financial information are limited to those specified by the requesting parties.
2. The AUASB issued an exposure draft of the proposed standard (ED 03/11) in September 2011, with a comment deadline of 15 November 2011 (45 day exposure period). Submissions were received from professional accounting and banking bodies, accounting and legal firms, and banks. The AUASB considered all submissions received and in response made a number of changes to the proposed Standard. ASRS 4450 was subsequently approved for issue, subject to minor editorial changes, on 27 February 2012, with 11 votes in favour, one abstention, and one against.

Scope

3. ASRS 4450 is specifically non-jurisdictional in scope and covers both comfort letters issued in respect of an offering document to requesting parties in Australia and other jurisdictions.

Major Issues raised by Respondents on Exposure

The following summarises major issues raised by respondents to Exposure Draft ED 03/11 *Comfort Letter Engagements* (ED 03/11) issued on 30 September 2011 and how the AUASB has addressed them.

Domestic Offerings in the scope of the Standard (Paragraphs 6 and A2)

4. One respondent suggested that ED 03/11 should specifically exclude domestic (Australian) offerings from the application on the basis that it may conflict, and cause confusion with, existing standards in the area. These included, in particular, Australian Professional and Ethical Standard APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document* issued by the Accounting Professional & Ethical Standards Board and proposed standard ASAE 3450 *Assurance Engagements involving Corporate Fundraisings and/or Prospective Financial Information* (issued as Exposure Draft ED 02/11 by the AUASB on 30 September 2011).
5. In response, the AUASB considers it inappropriate for an Australian standard not to be applicable to comfort letters provided to Australian requesting parties, whilst being applicable, in certain circumstances, to comfort letters being provided to requesting parties in overseas jurisdictions. ED 03/11 already contained guidance that recognised (refer paragraph A2) current Australian market practice does not ordinarily request auditors' comfort letters for domestic offerings. It was noted that if this were to change, or an individual engagement require, then ASRS 4450 would apply. Further, the AUASB does not consider the ASRS 4450 to conflict with, or cause confusion in relation to the existing APES 350 or proposed ASAE 3450, given comfort letter engagements are not included within the scope of either Standard, as issued.

Relationship with applicable Standards of other jurisdictions (Paragraph 8)

6. The majority of respondents raised significant concerns with the practical application of paragraph 8 in the Exposure Draft, given that the requirements in ED 03/11 are not strictly equivalent to, and in

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some cases conflict with, Statement on Auditing Standard SAS 72 *Letters for Underwriters and Certain Other Requesting Parties* (Redrafted).¹ Respondents generally interpreted paragraph 8 to mean that auditors would be required to comply with both the requirements of ASRS 4450 and an equivalent (overseas) Standard, such as SAS 72, and include a reference to both in the comfort letter. Respondents raised strong concerns with auditors being able to comply with this paragraph as they noted ED 03/11 is not strictly equivalent to any other jurisdiction's issued standard or guidance. An example of this cited by some respondents is the inclusion of a requirement for the auditor to endeavour to obtain the responsible party of the entity and the requesting parties' signatures in the engagement letter, which is not included in SAS 72. The flow on effect of this inconsistency was that some respondents felt this would adversely impact the ability of auditors to be able to issue a comfort letter on a timely basis, if at all, and consequently affect the issuing entity's ability to access capital raising on a timely basis. Respondents generally suggested the following two options could clarify this issue:

- (a) Option one - paragraph 8 be amended to clarify that auditors may apply ASRS 4450 when there is no applicable standard in force in another jurisdiction, or auditors may choose to apply the standard in force of another jurisdiction (for example SAS 72) (this option was preferred by most respondents); or
 - (b) Option two - paragraph 8 be removed.
7. The AUASB reconsidered the intent of paragraph 8, and the applicability of the overall Standard within the context of existing jurisdictions' standards and guidance in this area and the AUASB accepted that inherent differences in requirements resulting from different jurisdictions' applicable law, regulation and market practice, make it difficult for comfort letter standards to be completely equivalent. Consequently, the AUASB agreed that the option one suggestion was both practical and appropriate, as it provides auditors (in conjunction with the requesting parties and the entity) the choice in the engagement circumstances of either applying ASRS 4450 or the existing jurisdiction's standard, where it is issued by a national auditing standards setting body.
 8. Option two was not considered appropriate as the AUASB believes it is critical for ASRS 4450 to explain its applicability in situations where overseas requesting parties request the auditor perform the

¹ Issued by American Institute of Certified Public Accountants (AICPA).

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engagement in accordance with that jurisdiction's existing standard on comfort letters. The AUASB has therefore reworded paragraph 8, consistent with respondents' option one suggestion.

Change Period definition (Paragraph 10(f))

9. Two respondents to ED 03/11 recommended that the "change period" definition (Paragraph 10(f)) be amended, for consistency, to align it with the definition in the widely used "default" comfort letter standard, SAS 72. On this basis, the change period definition would relate to the timeframe covered by financial information prepared after the latest balance sheet or profit and loss statement. The AUASB considered this suggestion and agreed that consistency with SAS 72's generally accepted market definition was important in this area, whilst noting the suggested wording did not alter the AUASB's intended meaning of the change period, and accordingly agreed to amend the definition.

Agreeing on the Terms of Engagement (Paragraph 17)

10. Some respondents commented that ED 03/11 includes a requirement for the auditor to endeavour to obtain the signature of the responsible party of the entity and the requesting parties on the auditor's engagement letter, which is inconsistent with SAS 72. This was listed as an example of a requirement which made the application of paragraph 8 (discussed above) very difficult for auditors, and other comfort letter parties. Respondents suggested that this requirement be removed to ensure consistency with SAS 72, which does not contain this requirement. The AUASB considered, in light of paragraph 8 changes discussed above, that the inclusion of this requirement in ASRS 4450 is appropriate, and wholly consistent with existing requirements for agreeing the terms of engagement within the AUASB's suite of auditing and assurance standards.

Performing the Engagement

11. Some respondents suggested the "auditor's statement" terminology (used to describe the results of the auditor's procedures on change period financial information), be changed to "negative assurance" to align with SAS 72. The AUASB noted the underlying wording used in "auditor's statement" is equivalent to "negative assurance". The AUASB reconsidered the use of "negative assurance" for change period financial information and again agreed it was inappropriate to use as it is incompatible with the agreed-upon procedures nature of the auditor's work (i.e. no assurance), and the AUASB's overarching *Framework for Assurance Engagements*. Further "negative assurance" is already associated in Australia with an

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auditor performing a review engagement (i.e. provision of limited assurance). If it were used in ASRS 4450 to explain non-assurance results, it would most likely cause confusion to comfort letter users in interpreting the nature of the auditor's work performed and in understanding that no assurance is expressed in the comfort letter. The AUASB therefore retained the use of the "auditor's statement" terminology.

Conclusion

Approval by the AUASB

12. The AUASB voted to approve and issue ASRS 4450, subject to minor editorial changes, at its board meeting on 27 February 2012, with 11 votes in favour, one abstention and one against. The AUASB subsequently agreed to revise its application date to engagements commencing on or after 1 July 2013, by way of an out of session vote which concluded on 29 May 2013.

Dissenting view

13. There was one dissenting view expressed by an AUASB Board member, for the reasons summarised below:
 - (a) *"The member did not believe the AUASB should issue a Standard that is not an assurance or auditing standard.*
 - (b) *In addition, the member did not agree that a comfort letter engagement is not an assurance engagement on the basis that:*
 - (i) *The distinction that a comfort letter provides 'comfort' to the addressee who will use and rely on that letter in the context of their decision-making, but no assurance is provided by the auditor issuing that letter is artificial. The comfort letter adds credibility to the subject matter to which it relates, and in fact includes statements that the letter can be relied upon by the addressee (requesting party) for the purpose for which it is provided, thereby proving assurance; and*
 - (ii) *The auditor issuing the comfort letter is ordinarily the appointed auditor of the entity, and as such the work undertaken is supported by a base knowledge of audit/review. Furthermore, some of the requirements in the Standard require the auditor*

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to perform procedures beyond the scope of agreed-upon procedures engagements, taking the issuing auditor further into providing assurance and providing comfort letter users with a reasonable expectation that the comfort letter can be relied on.

- (c) *The member was concerned that the ‘auditor’s statement’ wording used to report results for change period financial information is very similar to that used for review engagements (designated as assurance engagements). Using the same form of reporting in standards dealing with assurance engagements where it has a defined meaning, and in the proposed comfort letter standard which is designated as proving no assurance, is not conducive to narrowing the expectation gap.”*

Abstention from voting

14. There was one board member who was not in attendance at the meeting at the time of the vote who had previously indicated an intention to abstain from voting. The reasons given were that the member was not comfortable with the nature of comfort provided in comfort letters and that the AUASB appeared to be codifying practice for comfort letter engagements.

Post Implementation Review

15. The AUASB will conduct a post implementation review after the ASRS 4450 has been operative for one year, in order to assess its impact on auditors’ comfort letter engagements.

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