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

15 December 2005

Dear Ms Kelsall

**Group 2 and 3 Exposure Drafts: ED 6/05 - 26/05**

We appreciate the opportunity to comment on the above mentioned Exposure Drafts (EDs) and to contribute to the continued improvement of the Australian auditing standards. We contributed to and support the group submission on these EDs, made on behalf of the profession, a copy of which is attached. In addition, we have attached some specific comments on particular EDs in Appendices 1 to 3.

In particular, we draw your attention to our comment and recommendation on Preamble, included in Appendix 1, as we believe this to be a fundamental issue.

We continue to support the overall approach taken by the Auditing and Assurance Standards Board (AUASB) in redrafting the auditing standards to enable them to have the force of law and commend the AUASB on the progress made to date.

We would be pleased to discuss our comments with you. Please contact me on (02) 8266 2824 for additional information.

Yours sincerely

Mark Johnson  
Assurance Leader



## 1. ED 07/05 Preamble to the AUASB Standards

Para	Issue	Recommendation
39	We do not believe the changed wording of this paragraph is appropriate – there may be circumstances where the auditor may judge it necessary to depart from a basis principle or essential procedure, even though not outside their control.	<p>Revert to the wording of ISA 230 (Revised) – “Where, in exceptional circumstances, the auditor judges it necessary to depart from a basic principle or an essential procedure that is relevant in the circumstances of the audit, the auditor should document how the alternative audit procedures performed achieve the objective of the audit, and, unless otherwise clear, the reasons for the departure.”</p> <p>We believe that this wording will be more consistent with the intentions stated in paragraphs 35 and 36 of the Preamble.</p>

## 2. ED 08/05 Objective and General Principles Governing an Audit of a Financial Report

Para	Issue	Recommendation
6	There are several paragraphs later in the standard explaining the term “applicable financial reporting framework”. Para 6 only refers to one of these - the Corporations Act (CA) framework - presumably as it is most common. However this does imply the standard is only relevant to CA audits.	Add a cross reference to para 46 onwards
6	ISA 200 makes reference to an audit being an “assurance engagement” and refers to the International Framework for Assurance Engagements. This is adopted in Australia as AUS 108. While the ISA reference is slightly confusing, it is (probably) useful to clarify that an audit is an assurance engagement, and so reference to AUS 108 should be made.	Add new text to start of para 6 which states “An audit of financial statements is an assurance engagement, as defined in AUS 108.”

Para	Issue	Recommendation
7	<p>This para introduces the term “reasonable assurance” and although cross refers to para 24, rewrites the requirements slightly:</p> <ul style="list-style-type: none"> <li>• Para 7 requires auditor “to seek to obtain reasonable assurance to enable the auditor to express a positive form of opinion as to whether the financial reporting is prepared... in accordance with ...financial reporting framework”.</li> <li>• Para 24 requires auditor “to seek to obtain reasonable assurance as to whether the financial report...is free from material misstatement...”.</li> </ul> <p>This is an example of the “pursuant to ... is required to” formulation referred to in the Group submission.</p>	Delete para 7 or reword to remove the “pursuant to ... is required to” formulation.
16	Refer issue under “Preamble” above.	Refer recommendation under “Preamble” above.
58	<p>Moved from explanation to bold letter requirement in the AUS.</p> <p>Unnecessary to make it bold letter in this standard as it is not an objective or a general principle. Rather it is an action based on audit evidence collected and so is covered in other standards.</p>	Revert back to explanatory material instead of bold letter.

### 3. ED 09/05 Terms of Audit Engagements

Para	Issue	Recommendation
8	<p>1. No mention of the responsibilities of the directors or management as would be required of any normal contract.</p> <p>2. The phrase "in some countries" is used – irrelevant in AU</p>	<p>1. Include language to describe the responsibilities of the directors and management.</p> <p>2. Remove reference to “in some countries”</p>

Para	Issue	Recommendation
13	Refer to the issue raised in the Group submission relating to the conflict between this paragraph and the Corporations Act Part 2M.4 Division 3	Refer to Recommendation 6 of the Group submission. We strongly support this recommendation.
10,17	There is currently inconsistency between para 10 and para 17 in that para 10 (c) is included as explanatory guidance, but is repeated as a mandatory requirement in para 17.	The inconsistency needs to be addressed. Consideration needs to be given to what (if any) should be mandatory inclusions in the terms of engagement.
20	The reference to general purpose financial reports seems irrelevant in the context of this para to the extent that the context is frameworks other than those that apply to GPFRs.	Revisit this para and make reference to special purpose instead.
27	The existing AUS makes good reference to situations where amendments to the terms of an engagement may be inappropriate. This is not part of the ED.	Include a statement such as “it is inappropriate to change the terms of the audit engagement in order to avoid the issue of a modified audit report.”

#### 4. ED 10/05 Quality Control for Audits of a Financial Report

Para	Issue	Recommendation
8 (j)	Change now made to refer to “professional auditing engagement” – which we support, but shouldn’t “financial” be added – otherwise potentially broader than intended.	Change to “professional financial auditing engagement”
9	Suggest that “engagement” is added “that partner” at the end of the paragraph since this term is defined in the glossary such that it isn’t necessarily a “partner” – but omitting the word engagement implies it must be a partner	Add “engagement” to the last “partner”

Para	Issue	Recommendation
Name	Whilst we understand the reason for the change in the name of this standard as a result of the wording of the “Application” paragraph, we believe that this could lead to the standard not conforming with the ISA, in that the ISA refers to the standard being applicable to the audits of “historical financial information, whereas the ED Application paragraph refers to applying “as applicable” to the audit of other financial information.	Consider impact on conformity paragraph.

### 5. ED 11/05 Audit Documentation

Para	Issue	Recommendation
7	Change of wording changes the meaning of the paragraph.	Revert to ISA wording amended for Australian terminology.
25	Do not believe the change in wording is appropriate – refer to issue included under “Preamble” issues.	Refer to recommendation included under “Preamble” recommendations.
Appendix	The Appendix included in the ISA has been removed from the ED. We believe the Appendix is useful in identifying specific documentation requirements in the standards.	The Appendix should be included.

### 6. ED 12/05 The Auditor’s Responsibility to Consider Fraud in the Audit of a Financial Report

Para	Issue	Recommendation
24,25	These paragraphs are headed “Responsibilities of the Auditor..” which may indicate a “requirement”, but are included as explanatory guidance.	Add “Guidance on the ..” to the heading.
64	This paragraph makes a rebuttable presumption that revenue recognition gives rise to a fraud risk, without linkage to the mandatory documentation requirements of para 118.	Para 118 requires the auditor to document reasons why revenue recognition might not be considered a fraud risk. The last sentence of para 64 should therefore be bold.

Para	Issue	Recommendation
79	“Pursuant to ...” is used inappropriately in this paragraph.	Para 79 mentions that the auditor is required to “consider whether there are risks of management override” whereas the mandatory paragraph (80) refers to the auditor responding to risks of management override.
86	Inappropriate use of “ordinarily” in the first line.	Remove “ordinarily” from the first line – this is a requirement of para 80

#### 7. ED 14/05 Consideration of Laws and Regulation in an Audit of a Financial Report

Para	Issue	Recommendation
5	Requirement is that the auditor “recognises” that non-compliance may affect the financial report. Guidance may be required to explain how this “recognition” is documented as it is now a legal requirement.	Additional guidance required
18	<p>Reference is made to AUS 202 professional scepticism requirements, implying that this paragraph is repeating the AUS requirement. However the bold letter requirement is different to that in AUS 202:</p> <ul style="list-style-type: none"> <li>• AUS 202 requires the auditor to recognise that circumstances may exist that may cause the financial report to be materially misstated (para 21).</li> <li>• AUS 218 requires the auditor to recognise that the audit may reveal conditions or events that question whether the entity is complying with laws and regulations.</li> </ul> <p>Whilst the relevant wording in both standards is the ISA wording, and so we do not propose it is altered, the AUASB may want to consider whether this inconsistency has a legal impact.</p>	No change to the AUS proposed

Para	Issue	Recommendation
49 & 50 and 52 to 54	These paragraphs provide extended guidance on reporting to third parties and are not in the ISA. The wording tends to be repetitive although not contentious.	
51	This requires the auditor to perform additional audit tests prior to reporting. Although not in bold, this is a requirement. It is linked in the AUS to paras 23 and 24 but these two paras relate to audit evidence directly relating to the financial report presentation and disclosure and not to other external reporting responsibilities. Hence by default this para is extending the auditors' responsibilities (and liability).	Delete this paragraph.

#### 8. ED 15/05 Planning an Audit of a Financial Report

Para	Issue	Recommendation
10	Use of required in the guidance section. This could be seen as imposing an additional obligation on an auditor.	Redrafting paragraph 9 to read "The auditor shall perform the following activities at the beginning of the current engagement <i>prior to performing other significant activities for the current audit engagement</i> ".  Or reword the guidance included at paragraph 10.
15	The paragraph does not include 'ordinarily'	Include the word 'ordinarily' between "strategy" and "sets out".
19	Incomplete word. The incomplete word is "re". Per the ISA this word is "nature".	Change "re" to "nature".
20	The paragraph does not include "ordinarily".	Include the word "ordinarily" between "plan" and "includes".
26	The paragraph does not include "ordinarily".	Redraft "it may be desirable to plan to consult" with "the auditor ordinarily plans to consult".
29	'Depend' is plural and not singular.	Change to "Depends".



Para	Issue	Recommendation
Appendix 1	There is an 'a' missing from the point made in the second last bullet point on page 18.	Insert an 'a' between "of" and "standalone".

### 9. ED 17/05 Initial Engagements

Para	Issue	Recommendation
8	The second bullet point is poorly worded.	Refer to and use the corresponding wording in the ISA.

### 10. ED 19/05 Management Representations

Para	Issue	Recommendation
Appendix	The example letter is different from that in the ISA, due in part to the Corporations Act references. However the example letter does not explicitly include reference to uncorrected financial report misstatements aggregated by the auditor. Under para 12(b) of the AUS, the auditor is required to obtain a management representation on this list (and include the summary in the written representation) and hence it should be in the example.	Add reference to uncorrected misstatements as set out in para 12(b)

### 11. ED 20/05 Auditing Fair Value Measurements and Disclosures

Para	Issue	Recommendation
23	"...and disclosures in the financial report <i>is</i> in accordance with ..." should be " <i>are</i> in accordance with ..."	Change wording

### 12. ED 22/05 Subsequent Events

Para	Issue	Recommendation
10	The equivalent paragraph in the ISA (paragraph 5) includes a reference to the 'auditor's risk assessment'. This reference is not included in the draft AUS and its inclusion would enhance the guidance.	The reference to the auditor's risk assessment included in the ISA should also be included in the AUS.

Para	Issue	Recommendation
10	The use of the word 'ordinarily' in paragraph 10 would make this paragraph consistent with the drafting guidelines issued by the AuASB.	The word 'ordinarily' should be included between the words "would" and "be".
n/a		Title of 'Facts Discovered After the Date of the Auditor's Report but Before the Financial Report is Issued' should be changed to 'Facts Discovered After the Date of the Auditor's Report but Before the Date the Financial Report is Issued'. The reason being is that this is consistent with the terminology used in the definitions section.
19	Conceptually the elevation of paragraph 19 from guidance to a mandatory requirement is acceptable, however the standard needs to include more guidance around how extensive the auditors procedures would need to be. The amount of work required to be performed is further confused by the inclusion of the phrase "shall endeavour..".	Include further guidance around how much extensive an auditors procedures would need to be with respect to preventing those people who have received a copy of the financial report and audit report from placing further reliance on both documents.
23	The elevation of paragraph 23 to mandatory is conceptually acceptable, however it needs to be made clear that the extension of the auditor's procedures will depend on the auditor's judgement.	Including the phrase "the auditor considers necessary" in the first sentence should help to address this. The sentence would then read "When management revise the financial report, the auditor shall carry out the audit procedures <i>the auditor considers</i> necessary in the circumstances,...".
25	The reference to paragraph 9 is to a non mandatory paragraph.	Remove reference to paragraph 9.
25	The last part of paragraph 25 refers to what may occur in other jurisdictions.	While this is only guidance, it does not improve the overall quality of the standard and accordingly we are recommending that it be removed.

## 13. ED 23/05 Going Concern

Para	Issue	Recommendation
14	Inappropriate use of the “pursuant to ... is required to formulation” – refer Group submission. This paragraphs goes beyond the requirements of para 5.	Remove the “pursuant to ... is required to” formulation.
14 (c)	Although consistent with the ISA, it is not reasonable to expect that an auditor should be responsible for assessing going concern where management has not already done so regardless of whether the financial reporting framework doesn’t require it.	If a financial reporting framework does not specifically require that management make an assessment of going concern, the terms of the engagement should make this a specific management responsibility.  AUS 204 would need to be amended accordingly.
20	Is not consistent with paragraph 14(c)	Need to ensure consistent wording (taking into account recommendation above).
23,30	The reference to “relevant period” in para 23 is inconsistent with para 30.	Amend para 30 to refer to “relevant period” rather than “twelve months from the balance sheet date”.
39	This para duplicates detailed discussions on matters giving rise to reporting requirements at paras 36, 40, 42 and 44.	Remove para 39.
53	There is an incorrect reference to the requirements of the Corporations Act. The Act does not require the auditor to report under s311 where it is “satisfied” that the entity is no longer a going concern, rather it states that “if the auditor has reasonable grounds to suspect...”	Make consistent with requirements of Corps Act.



### 1. ED 24/05 The Independent Auditor's Report on a General Purpose Financial Report

Para	Issue	Recommendation
Various, eg. 17, 18	<p>Examples of the issue relating to the “pursuant to ... is required to” formulation included in the Group submission. Whilst the Preamble makes it clear that the use of neither of these phrases is intended to extend the mandatory requirements, these instances it does appear to do so. For example, para 17 states “Pursuant to paragraph 15 of this Auditing Standard, in undertaking this evaluation, the auditor is required to consider whether, in the context of the applicable financial reporting framework: ..” and goes on to include 4 matters that the auditor is “required” to consider. However paragraph 15 (bold paragraph) states only: “The auditor shall evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial report.” The wording in para 17 clearly does extend the requirements of para 15.</p> <p>A similar issue arises in para 18.</p>	Remove the “pursuant to ... is required to” formulation.
39	The phrase “the auditor’s report should <i>explain...</i> ” is not inconsistent with other requirements for the auditor’s report. Normal word used is “state”	Although currently consistent with the ISA, recommend changing to “the auditor’s report should <i>state ..</i> ”
8/45	The wording (and tense) used should be consistent between these 2 paragraphs.	Change “...gives a true and fair view or <i>is presented</i> fairly ...” in para 8 to “ ...gives a true or fair view or <i>presents</i> fairly ...”. Tense should be consistent throughout.
Appendix 1	As above, the wording in the auditor’s opinion should be consistent	As above

Para	Issue	Recommendation
Appendix 2	This Appendix (Summary of Audit Reporting Requirements of the Corporations Act 2001) will need to be updated every time the Corporations Act is updated. We do not believe the Appendix is necessary.	Remove Appendix 2
Appendix 2 example auditor's report	Inclusion of the Independence paragraph – not specifically included as a mandatory requirement in the AUS.	Need to clarify in the example that auditor may include this paragraph but it is not a specific requirement, either in the AUS or the Corporations Act.

## 2. ED 25/05 Modification to the Independent Auditor's Report

Para	Issue	Recommendation
11	The ISA requires the auditor to “consider modifying” the auditor’s report if there is a significant uncertainty, other than going concern. The AUS excludes the word “consider”. Whilst this is acceptable, we believe that it should be made clear that the modification is only required if the potential future impact on the financial report could be material.	Change last line of paragraph to read “... may <i>materially</i> affect the financial report.”
Example Audit reports	Inclusion of the Independence paragraph – not specifically included as a mandatory requirement in the AUS.	Need to clarify in the examples that auditor may include this paragraph but it is not a specific requirement, either in the AUS or the Corporations Act.

## 3. ED 26/05 Related Parties

Para	Issue	Recommendation
Various	<p>Whilst we are supportive of a high quality audit, and agree to the ISA+ approach, we question the reason for increasing this standard from 16 paragraphs (ISA) to 40. Most of the changes appear to be including the requirements of other standards and making them specific to related parties.</p> <p>We do not disagree with any of the additional mandatory requirements, but do not understand the necessity for them being included – they have made the standard too long.</p> <p>We also consider that paragraphs 12 and 14 may imply a <u>rebuttable presumption</u> that related party transactions necessarily give rise to higher risk. The auditor is required by AUS 402 to assess the risk of material misstatement at the assertion level for classes of transactions, account balances, and disclosures. By specifically highlighting this requirement as it relates to related party transactions, balances and disclosures appears to imply that there is a greater risk of material misstatement in this area.</p>	Revert to ISA amended for AUS drafting principles.





**AUS 404 – Audit Considerations Relating to Entities Using Service Organisations**

We suggest that the Board consider including reference in this standard (or alternatively including guidance in AGS 1042) to circumstances when a service organisation outsources work to a subservice organisation. In such instances, the responsibility for the operation of the controls at the subservice entity will still rest with the service entity but it might be relevant for the user entity and its external auditor to know which organisation has operational responsibility for the relevant controls. This situation is becoming increasingly common in Australia, particularly in the financial services sector.

**AUS 706 – Subsequent Events**

The auditing standard does not provide auditors with any guidance as to what they should do in the event of the audit report being signed after the directors' have signed the directors' report and directors' declaration. The need for this arises because the directors' obligation with respect to subsequent events is up to the date they sign the directors' declaration and the directors' report, whereas the auditor's obligation extends to the date they sign the audit report.

We suggest developing guidance for auditors when the audit report is signed at a date later than the directors sign the directors' declaration and the directors' report and a subsequent event occurs in the intervening period.

**Table of Proposed Changes**

The table of proposed changes included at the end of each ED is useful in understanding the differences between the proposed standard and the corresponding ISA. However, it would have been useful if the Board had included the reasons for the changes in this table to assist interested parties in better understanding the differences prior to responding to the EDs.

We recommend that the Board consider including reasons for changes in any future EDs.

