

15 December 2005

The Chairman
Auditing and Assurance Standards Board
PO Box 204
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MELBOURNE VIC 8007

Dear Ms Kelsall

ED Group 2 and 3 Submissions


We are pleased to provide another group submission on the release of exposure drafts included in Group 2 and 3.

We specifically welcome the Board's proposal to make the Preamble a standard itself in ED 7/05. This, together with the link of the Preamble to the Authority Statements at the beginning of each Standard, provides an improved basis on how the Standards are to be understood, interpreted and applied.

In our first submission we suggested that "Aust" type paragraphs be used to easily identify changes to the ISA on which the proposed Australian Standards are based. If this suggestion is not adopted, the table of changes setting out the differences becomes of even more importance and should be retained in each Standard.

We have also attached some additional comments, more particularly directed at the Preamble, but including some relating to specific Exposure Drafts.

Yours faithfully



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Submissions on AUASB Exposure Drafts

1. Preamble

1.1 Paragraphs 35 and 36

1.1.1 Our submission dated 11 October 2005 discussed in some detail the possible implications of the change from "should" to "shall" in the proposed new standards, and the consequent need to clearly reflect in the Preamble the AUASB's apparent intention that professional judgment should guide the application of mandatory requirements.

1.1.2 In this regard, paragraphs 35 and 36 of the Preamble are constructive in emphasising the intention that professional judgment should inform the application of all mandatory requirements.

1.1.3 However, the ultimate objectives to which such professional judgment is directed are not stated expressly in the Preamble.

1.1.4 Proposed AUS 202 (ED 8/05) states that the essential objective of an audit of a financial report is:

- to enable the auditor to express an opinion as to whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework (paragraph 5); and
- for the auditor to seek reasonable assurance as to whether the financial report, taken as a whole, is free from material misstatements, whether due to fraud or error (paragraph 24).

1.1.5 It probably goes without saying that the professional judgment which should be exercised in the application of mandatory requirements is to be exercised with a view to achieving these essential objectives. A reference to professional judgment, of itself, would otherwise not be particularly meaningful. However, for clarity, we submit that this intention should be expressly reflected in the Preamble.

1.1.6 [**Recommendation 1**] For clarity, we recommend that the objectives stated in paragraphs 5 and 24 of proposed AUS 202 should be restated or referred to in, or in conjunction with, paragraph 35 of the Preamble. This could be achieved by adding wording along the following lines to the end of paragraph 35:

"...in order to achieve the ultimate objective of the audit or other review or assurance engagement. In the case of an audit of a financial report, those objectives are, principally:

- to enable the auditor to express an opinion as to whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework (paragraph 5 of AUS 202); and

- for the auditor to seek reasonable assurance as to whether the financial report, taken as a whole, is free from material misstatements, whether due to fraud or error (paragraph 24 of AUS 202)."

1.2 Paragraph 45

- 1.2.1 Paragraph 45(a), when read with paragraph 35, may tend to suggest that professional judgment is only to be applied to mandatory requirements "which include statements of principle". However, the criteria for determining what is a statement of principle (as opposed to, we assume, an "essential procedure" – cf paragraph 10) are not specified. It appears that all of the mandatory requirements are principles-based, as reflected in paragraph 35. Accordingly, paragraph 45(a) should not imply a distinction between mandatory requirements which include statements of principle and those that do not.
- 1.2.2 Paragraph 45(b) merely repeats paragraph 17.
- 1.2.3 Accordingly, paragraph 45 as a whole does not appear to add anything of substance to the Preamble, and at worst may tend to confuse rather than elucidate.
- 1.2.4 [*Recommendation 2*] We recommend that paragraph 45 of the Preamble be deleted.

1.3 Paragraph 11

- 1.3.1 Circumstances in which the auditor is exempted from the requirement to comply with mandatory requirements are set out in paragraph 11 of the Preamble. Those exceptions are reasonably clear. However the list of exceptions does not include the circumstance where an Auditing Standard is simply not relevant to the audit (cf paragraphs 15 and 19 of proposed AUS 202 (ED 8/05)). Perhaps this is so obvious that it goes without saying. That understanding seems to have been reflected in paragraph 5 of the Preamble, which states:

"The Auditing Standards are to be applied, where applicable..."

- 1.3.2 Nevertheless, it would be appropriate to reflect this understanding in paragraph 11 of the Preamble.
- 1.3.3 [*Recommendation 3*] For additional clarity, the basic criterion of relevance should be referred to in paragraph 11 of the Preamble.

2. Use of the "is required to" formulation in guidance

- 2.1 Paragraphs 17 and 45 of the Preamble state that the normal-type explanatory guidance "is not intended to limit or extend mandatory requirements".
- 2.2 Whilst it is stated that the grey-type does not limit the bold-type, paragraph 47(c) of the Preamble notes that where the "is required to" formulation is used in the grey-type, it denotes an "elaboration of the mandatory requirement to which it relates". On one view, there is little, if any, distinction between an "elaboration" and an "extension".
- 2.3 In order to further assist in maintaining the distinction between the grey-type and the bold-type, we suggest that the "is required to" formulation in grey-type paragraphs should

not be used in cases other than those where there is a verbatim restatement in the grey-type of the relevant bold-type paragraph. In cases where guidance uses different language to the relevant mandatory requirement, the "is required to" formulation should be replaced with the "ordinarily" formulation, which has a more appropriate import (as per paragraph 45(e) of the Preamble).

2.4 Some examples of cases where guidance uses different language to the relevant mandatory requirements, and may therefore have a tendency to extend mandatory requirements, are as follows:

- ED 10/05 (proposed AUS 206) – paragraph 31;
- ED 13/05 (proposed AUS 212) – paragraph 26;
- ED 14/05 (proposed AUS 218) – paragraphs 39, 51;
- ED15/05 (proposed AUS 302) – paragraphs 13, 28;
- ED 17/05 (proposed AUS 510) – paragraph 8;
- ED 20/05 (proposed AUS 526) – paragraphs 31, 32, 59;
- ED 21/05 (proposed AUST 606) – paragraphs 13, 20;
- ED 23/05 (proposed AUS 708) - paragraphs 14(b), 14(c), 20, 25, 28, 32;
- ED 24/05 (proposed AUS 702A) – paragraph 17.

2.5 [**Recommendation 4**] In relation to all of the proposed standards, we recommend that where a mandatory requirement is referred to in guidance, and the guidance uses language to describe the mandatory requirement which is different to that used in the mandatory requirement, the "is required to" formulation should be replaced with the "ordinarily" formulation.

3. **Conflict between proposed AUS 210 and Corporations Act Part 9.4AAA**

3.1 Paragraphs 99 and 101 of proposed AUS 210 (ED – 12/05) may give rise to a conflict with Part 9.4AAA ("**Protection for whistleblowers**") of the Corporations Act 2001 (Cth) (the "**Act**").

3.2 Part 9.4AAA provides certain protections for officers and employees of and suppliers to a company who disclose to (among others) an auditor of the company information which indicates that the company or an officer or employee of the company may have breached the Corporations legislation (a "**qualifying disclosure**"). A qualifying disclosure would include information having the effect that the company has not complied with Chapter 2M of the Act.

3.3 Under section 1317AE of the Act, an auditor is prohibited from disclosing the qualifying disclosure other than to ASIC, APRA or the Australian Federal Police; or another person with the consent of the discloser.

- 3.4 Paragraphs 99 and 101 of proposed AUS 210 may have the effect of requiring the disclosure of a qualifying disclosure to management or the board of a company, in breach of section 1317AE.
- 3.5 [**Recommendation 5**] Paragraphs 99 and 101 of proposed AUS 210 should be subject to a qualification that disclosure is not required where the auditor believes that such disclosure would breach Part 9.4AAA of the Act.
4. **Conflict between proposed AUS 204 and Corporations Act Part 2M.4 Division 3**
- 4.1 Paragraph 13 of proposed AUS 204 (ED 9/05) refers to the independence requirements of the Act. This appears to be a reference to Part 2M.4 Division 3 of the Act.
- 4.2 The Act and Professional Standards have established a comprehensive framework in relation to auditor independence. Some breaches under the Act also have defences within the Act. The requirement to include statements in relation to compliance with these independence requirements in an auditor's engagement letter would expose the auditor to actions for breach of contract in addition to the penalties already imposed by the Act and Professional Standards. In addition, the proposed requirements may be in conflict with, or additional to, the requirements of the Act, for example, the proposed requirement to report breaches immediately.
- 4.3 Further, the exposure draft provides no guidance against which to measure whether the auditor's processes are "appropriate" or not. It is likely that all auditors and audit firms will have a variety of different processes in place to achieve compliance with the Act.
- 4.4 [**Recommendation 6**] We recommend that paragraph 13 of the proposed AUS 204 be removed.