

31 January 2006

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

Dear Ms Kelsall

ED Group 4 and 5 Submissions

We are pleased to provide another group submission on the release of exposure drafts included in Group 4 and 5.

As this is probably the last Submission, we thank you for considering our input over the last few months.

Yours faithfully

A handwritten signature in cursive script, appearing to read 'Ian H Miller', is positioned above the typed name.

Ian H Miller
Partner

On behalf of the Auditing Standards Response Group

Submission on AUASB Exposure Drafts (Groups 4 and 5)

1. Conflict between proposed AUS 710 and Corporations Act Part 2M.4 Division 3

- 1.1 Our submission in relation to the exposure drafts in Groups 2 and 3 included, in section 4, a submission that paragraph 13 of proposed AUS 204 (ED 9/05) was in conflict with the independence requirements of the *Corporations Act 2001 (Cth)* (the "Act") in Part 2M.4 division 3 of the Act.
- 1.2 Our submission included the following (in sections 4.2 and 4.3):
 - "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."
- 1.3 This issue of conflict also arises under paragraphs 20 and 23 of proposed AUS 710 (ED 34/05).
- 1.4 In our submission, the detailed requirements of Part 2M.4 Division 3 of the Act constitute a comprehensive code on auditor independence and should be allowed to function as such.
- 1.5 [**Recommendation 1**] Consistently with our recommendation on paragraph 13 of the proposed AUS 204, we recommend that paragraphs 20 and 23 of the proposed AUS 710 be removed.

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

- 2.1 Our submission in relation to the exposure drafts in Groups 2 and 3 included, in section 2, a submission as follows (section 2.3):
 - "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)."

2.2 This submission applies to all exposure drafts, not just those in Groups 2 and 3. That intention was reflected in the following recommendation (section 2.5):

"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."

2.3 Some additional examples (from Groups 4 and 5) of cases where guidance use different language to the relevant mandatory requirements, and which may therefore have a tendency to extend mandatory requirements, are as follows:

- ED 29/05 (proposed AUS 516) – paragraph 16
- ED 30/05 (proposed AUS 602) – paragraphs 14
- ED 33/05 (proposed AUS 306) – paragraphs 14, 23, 29, 31

3. **Auditor Permission to Communicate with entity's Legal Counsel**

3.1 Paragraph 11 of ISA 501 states "If management refuses to give the auditor permission to communicate with the entity's legal counsel, this would be a scope limitation and should ordinarily lead to a qualified opinion or a disclaimer of opinion."

3.1 [**Recommendation**]

There is no comparable paragraph in ED 27/05.

As a result of a recent legal decision clients are becoming increasingly cautious as to the way they convey and provide access to information about current legal matters. Until there is a change to legislation or laws relating to legal professional privilege and communications with auditors this reluctance will continue and auditors are likely to be faced with this situation (i.e. the client refusing to give the auditor permission to communicate with their legal advisers) more frequently.

We recommend that the Board include this paragraph in the Australian standard so that auditors have clarity as to what should occur if and when client's refuse to grant permission.

We would also encourage the Board to work with other national bodies such as the Law Council of Australia, the ICAA, CPA Australia and the Institute of Company Directors to develop a change to the laws surrounding legal professional privilege so that an entity and its legal representatives can have full and frank exchanges with the entity's auditor about legal matters without the worry of whether they can later claim legal professional privilege on these exchanges.