

AUSTRALASIAN COUNCIL OF AUDITORS- GENERAL

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The Chairman
Auditing and Assurance Standards Board
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Dear Chairman,

“Proposed Foreword to AUASB Pronouncements”, “Proposed Auditing Standard: Preamble to AUASB Standards” and other audit Exposure Drafts due for comment by 15 December 2005

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the attached comments in response to the Exposure Drafts (EDs) referred to above. The attachment includes on its first two pages (which is pages 3 and 4 of this response) a schedule of the audit Exposure Drafts covered by this response.

This represents the views of the Australian members of ACAG with the exception of the Auditor-General for South Australia who reserves his right to respond separately to auditing and accounting EDs where he deems it appropriate, rather than as a member of ACAG.

Request for Comments

While ACAG supports the overall content of the Proposed Foreword, the Proposed Preamble and the other audit EDs covered by this submission, we have enclosed, as separate attachments, commentary on matters that the AUASB should consider as it finalises these EDs.

In our submission dated 14 October 2005 on EDs 1/05, 2/05, 3/05, 4/05 and 5/05 we included an attachment titled “generic matters”, which included comments on issues applying to all of those five EDs. These “generic matters” are not repeated in the attachments to this letter although we anticipate that they will have relevance to all EDs.

Thank you for providing the members of ACAG with the opportunity to comment.

Yours faithfully

A handwritten signature in black ink, appearing to read "Mike Blake". The signature is stylized with a large initial "M" and a long horizontal stroke at the end.

Mike Blake
Chairperson, ACAG Financial Reporting Group (formerly Advisory Committee)
20 December 2005

ATTACHMENT

SUBMISSION BY THE AUSTRALIAN MEMBERS (EXCEPT FOR THE AUDITOR-GENERAL FOR SOUTH AUSTRALIA) OF THE AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL ON AUDITING EXPOSURE DRAFTS:-

Exposure Draft ED 6/05, Proposed Foreword to AUASB Pronouncements

Exposure Draft ED 7/05, Proposed Auditing Standard: Preamble to AUASB Standards

Exposure Draft ED 8/05, Proposed Auditing Standard: Objective and General Principles Governing an Audit of a Financial Report (Re-issuance of AUS 202)

Exposure Draft ED 9/05, Proposed Auditing Standard: Terms of Audit Engagements (Re-issuance of AUS 204)

Exposure Draft ED 10/05, Proposed Auditing Standard: Quality Control for Audits of a Financial Report (Re-issuance of AUS 206)

Exposure Draft ED 11/05, Proposed Auditing Standard: Audit Documentation (Re-issuance of AUS 208)

Exposure Draft ED 12 /05, Proposed Auditing Standard: The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report (Re-issuance of AUS 210)

Exposure Draft ED 13/05, Proposed Auditing Standard: Other Information in Documents Containing Audited Financial Reports (Re-issuance of AUS 212)

Exposure Draft ED 14/05, Proposed Auditing Standard: Consideration of Laws and Regulations in an Audit of a Financial Report (Re-issuance of AUS 218)

Exposure Draft ED 15/05, Proposed Auditing Standard: Planning an Audit of a Financial Report (Re-issuance of AUS 302)

Exposure Draft ED 16/05, Proposed Auditing Standard: Audit Considerations Relating to Entities Using Service Organisations (Re-issuance of AUS 404)

Exposure Draft ED 17/05, Proposed Auditing Standard: Initial Engagements – Opening Balances (Re-issuance of AUS 510)

Exposure Draft ED 18/05, Proposed Auditing Standard: Analytical Procedures (Re-issuance of AUS 512)

Exposure Draft ED 19/05, Proposed Auditing Standard: Management Representations (Re-issuance of AUS 520)

Exposure Draft ED 20/05, Proposed Auditing Standard: Auditing Fair Value Measurements and Disclosures (Re-issuance of AUS 526)

Exposure Draft ED 21/05, Proposed Auditing Standard: Using the Work of an Expert (Re-issuance of AUS 606)

Exposure Draft ED 22/05, Proposed Auditing Standard: Subsequent Events (Re-issuance of AUS 706)

Exposure Draft ED 23/05, Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)

Exposure Draft ED 6/05, Proposed Foreword to AUASB Pronouncements and Exposure Draft ED 7/05, Proposed Auditing Standard: Preamble to AUASB Standards

Overall comments relating to both exposure drafts

The proposed Foreword and Preamble, as a whole, are supported.

Exposure Draft - Proposed Foreword to AUASB Pronouncements

General observations

The Foreword does not address how the AUASB will deal with consequential changes to Auditing Standards. The AUASB may wish to consider this in anticipation that necessary changes may be needed following the first time application of the new Auditing Standards. Also, the Foreword may need to include a section outlining how changes, if any, to Part 12 of the *Australian Securities and Investments Commission (ASIC) Act* will need to be reflected in Auditing Standards including the Foreword and the Preamble.

Paragraphs 23 to 28

These paragraphs deal with the types of Standards issued by the AUASB. We note that paragraph 8 of the Proposed Preamble deals with “Auditing and Assurance Standards for Other Purposes” such as audits of efficiency and effectiveness. We believe that the Foreword should include a section dealing with these Other Standards.

Paragraph 29

We note two matters relating to this paragraph for the AUASB’s consideration:

1. The Foreword and the Preamble do not state whether the Guidance Statements and Other guidance will have the force of law. While Appendix 1 implies they do not have the force of law, the AUASB should state this in the Foreword.
2. Use of the word “guidance” needs further consideration. Clearly “guidance” in paragraph 29 refers to separate Statements or Alerts issued by the AUASB. We support the need for the AUASB to issue such Statements/Alerts from time to time and we also support their inclusion on the Structure of Pronouncements as detailed in Appendix 1. However, each Auditing Standard contains mandatory (black letter) requirements and “explanatory guidance” paragraphs. To avoid any confusion, between the “guidance” in the Standards and the “guidance” outside the Standards, the AUASB may wish to consider describing its proposed Guidance Statements/Alerts in some other way.

Paragraph 31

A full stop is needed at the end of this paragraph.

Paragraph 37

We assume that the due process outlined does not apply to “Other guidance” statements. This should be explicit.

AUASB due process as outlined in paras 38 to 44

We support the due process as outlined. The AUASB may wish to consider including a more flexible due process for consequential changes to Auditing Standards.

IAASB Due Process

Whilst we support inclusion of the IAASB’s due process in an Australian Foreword to Auditing Standards, consideration should be given by the AUASB to situations where the IAASB may change its process and any consequential impact on AUASB Standards.

Appendix 1

We support the Structure of Pronouncements as outlined. Consideration could be given to changing the shading attached to Guidance Statements and Other guidance – even on the Web document the words within the shading are particularly difficult to read and are illegible on hard copies.

Exposure Draft - Proposed Auditing Standard: Preamble to AUASB Standards

General observation

Many public sector audit offices conduct performance audits as a major part of their business. Other than a passing reference in paragraph 8 to assurance engagements that relate to the efficiency and/or effectiveness of an entity's activities, there is no acknowledgement of performance auditing. In particular, paragraph 6 should link the Auditing Standards to performance audits as it currently does for audits of other financial information and as AUS 806 paragraph 9(b) does at the moment. Further, there is no reference to the performance auditing standards in Appendix 1 – we understand they will fit into the 3000 series of Assurance standards.

Paragraph 5

Paragraph 5 states “The Auditing Standards are to be applied, where applicable, in the conduct of:...” the words “where applicable” in this sentence is inappropriate if it is not explained. Given that s336 applies, the words “where applicable” are redundant and it is recommended that they be deleted.

Paragraph 5(c)

Comments such as those in footnote two should be incorporated and explained within the guidance of the Preamble rather than a footnote. The use of a footnote is inappropriate; the reader could easily miss the point.

Paragraph 6

Paragraph 6 is grey letter so it is not mandatory but indicates that the auditing standards also apply to the audit of other financial information. The use of the word “apply” in a non-mandatory paragraph is inconsistent. It is recommended that the wording in paragraph 6 is changed from “also apply” to “recommended practice”. It is also considered that this paragraph should be extended to include other assurance engagements such as performance audits (Standards of Assurance Engagements) and reviews (Standards on Review Engagements) not limited to financial information audits.

Paragraph 7 “Enforcement”

In a previous submission we sought clarity by the AUASB as to the enforcement of the Auditing Standards in the audits of financial statements of entities not incorporated under the *Corporations Act 2001*. Paragraph 7 is clear in that it applies to the *Corporations Act 2001*. Paragraph 25 (b) indicates the AUASB's intention that the Auditing Standards should apply to all audits conducted by external auditors. We support this intention but note that situations may arise where an auditor is required to conduct an audit of financial statements in accordance with other legislative requirements such as State legislation. The AUASB should state in the Preamble (after paragraph 7) that the AUASB Standards may have legal enforcement under other legislation beyond the *Corporations Act 2001*.

In addition, the Preamble does not address the professional obligation as outlined in APS 1.1 “Conformity with Auditing Standards”. The AUASB should state the auditor’s professional responsibility of complying with the Australian Auditing Standards.

Paragraph 8

The heading immediately before paragraph 8, and the first sentence in paragraph 8, includes the words “Auditing and assurance standards” which is inconsistent with the terms “AUASB Standards” used throughout the Preamble. The AUASB should ensure there is consistency in the terms used to avoid confusion.

Paragraph 9

Paragraph 9 (b) makes it clear that explanatory guidance does not have equal authority to “bold type” paragraphs. However, we assume that explanatory guidance does have the force of law. Also, clarity is needed on the distinction between “explanatory guidance, Guidance Statements and Other guidance”.

Paragraph 39

This paragraph provides that in “*rare and exceptional circumstances, factors outside the auditor’s control*” might prevent them from complying with a relevant mandatory requirement. In this instance, the auditor shall perform a series of alternative procedures to satisfy the objectives of the mandatory requirement.

We believe additional guidance clarifying what is meant by “*rare and exceptional circumstances*” and “*factors outside the auditor’s control*” would be useful to prevent possible misinterpretation.

Paragraph 43

This paragraph makes reference to the *Legislative Instruments Act 2000*. This reference is an old reference and should be replaced with most current legislation, which is the *Legislative Instruments Act 2003*.

Paragraph 47 (h) – definition of “shall”

Perhaps this definition should read “Other than in the circumstances described in paragraph 11, the word ‘shall’, appearing in **bold type** mandatory ...”

Practical Examples

Paragraphs 15(b) and 44(e) refer to the inclusion of examples to ‘assist in the application of mandatory requirements’. We do not believe these paragraphs adequately diminish implied obligations existing in the proposed Standards. We recommend that an additional sentence be added to clarify that even when an auditor encounters the example’s situation, it is not mandatory for the auditor to perform the actions specified for the auditor.

Exposure Draft 8/05 Objective and General Principles Governing an Audit of a Financial Report (Re-Issuance of AUS 202)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Preface - Main Proposals

Point (e) and (j) appear to address the same matter. Recommend the removal of point (j) from the Standard.

Headings

The heading before paragraph 10, 'General Principles Governing an Audit of a Financial Report' and 'Conduct of an Audit of a Financial Report' are the same font size signifying that the two headings are of the same importance.

Paragraph 16

This paragraph provides that in "*rare and exceptional circumstances, factors outside the auditor's control*" might that prevent them from complying with a relevant mandatory requirement, the auditor shall perform a series of alternative procedures to satisfy the objectives of the mandatory requirement.

We believe additional guidance clarifying what is meant by "*rare and exceptional circumstances*" and "*factors outside the auditor's control*" would be useful to prevent possible misinterpretation of this requirement.

Paragraph 19

This paragraph requires the auditor shall not represent compliance with the auditing standards unless the auditor has complied *fully* with *all* of the Auditing Standards relevant to the audit.

However, we believe that paragraph 16 provides an exemption from complying *fully* with *all* auditing standards in *rare and exceptional circumstances, factors outside the auditor's control* providing that the auditor conducts appropriate alternative procedures.

We believe paragraph 19 should be amended or at least further guidance provided, to clarify that where the auditor has not fully complied with an auditing standard they are able to represent compliance with the auditing standards providing they have complied with the requirements of paragraph 16.

Paragraph 60

We do not support the insertion of the 'Pursuant to...' phrase referring to paragraph 10. Paragraph 10 states the auditor shall conduct an audit in accordance with Auditing Standards. We cannot see that there is a direct link between the broad requirement in

paragraph 10 and the specific requirements in paragraph 60 to refer to AUS 702. The approach taken in this paragraph to refer to other Standards appears inconsistent to the general approach noticed in this proposed Standard and other proposed Standards. For example, paragraph 59 states, 'See AUS 204 for requirements and guidance in relation to engagement acceptance...'. This approach appears more appropriate and consistent with overall approaches taken in the proposed Standards released.

Paragraph 44

We believe the words 'For example' should be inserted at the start of the last sentence in paragraph 44 to give clarity that the definition of a financial report under the *Corporations Act 2001* is just one example and therefore not contradictory to paragraph 43.

Exposure Draft 9/05 Proposed Auditing Standard: Terms of Engagement (Re-issuance of AUS 204)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

We make no suggestions.

Exposure Draft ED 10/05 “Proposed Auditing Standard: Quality Control For Audits Of A Financial Report (Re-Issuance Of Aus 206)”

Overall comment

The proposed Auditing Standard, as a whole, is supported.

We make no suggestions.

**Exposure Draft ED 11/05 – Proposed Auditing Standard: Audit Documentation
(Re-issuance of AUS 208)**

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 17

In the first bullet point the word "Misstatement" in the reference to AUS 402 should be plural ("Misstatements").

Exposure Draft ED 12/05 – Proposed Auditing Standard: The Auditor’s Responsibility to Consider Fraud in an Audit of a Financial Report (Re-issuance of AUS 210)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

We make no suggestions.

Exposure Draft ED 13/05 – Proposed Auditing Standard: Other Information in Documents Containing Audited Financial Reports (Re-issuance of AUS 212)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

We make no suggestions.

Exposure Draft ED 14/05 – Proposed Auditing Standard: Consideration of Laws and Regulations in an Audit of a Financial Report (Re-issuance of AUS 218)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 29

This paragraph requires the auditor to endeavour to obtain written representation from management. We suggest that guidance be given which refers to AUS 520 'Management Representations' to alert the auditor of the mandatory requirements and explanatory guidance when seeking such management representations. Also paragraph 29 should be consistent with AUS 520.

Exposure Draft 15/05 Planning an Audit of a Financial Report (Re-Issuance of AUS 302)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 26

The third sentence in paragraph 26 states, 'The audit engagement partner (or sole practitioner) nevertheless needs to be satisfied that the audit has been conducted in accordance with Auditing Standards'. The phrase 'needs to be satisfied' reads like a mandatory obligation.

We believe this sentence should be qualified in some way. Perhaps it could be linked back to AUS 202 (e.g. paragraph 10 of the proposed AUS 202) applying the 'Pursuant to...' approach.

Exposure Draft 16/05 Proposed Auditing Standard: Audit Considerations Relating to Entities Using Service Organisations (Re-issuance of AUS 404)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Main Changes from existing AUS 404 (July 2002), paragraph 4 – Incorrect References

Points (a), (b) and (c) all refer to paragraphs within AUS 402. The paragraph references should be to AUS 404.

Point (a) states: in accordance with AUS 402, the user auditor should obtain audit evidence through the performance of tests of controls to support any assessment of control risk which is less than high (paragraph 21 in AUS 402);

Paragraph 21 of AUS 402 states: The nature, timing, and extent of the risk assessment procedures performed depend on the circumstances of the engagement such as the size and complexity of the entity and the auditor's experience with it. In addition, identifying significant changes in any of the above aspects of the entity from prior periods is particularly important in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.

Whereas, paragraph 21 of existing AUS 404 states: **In accordance with AUS 402, the user auditor should obtain audit evidence through the performance of tests of control to support any assessment of control risk which is less than high.**

Clearly the correct reference in Point (a) should be to AUS 404 rather than to AUS 402, which appears unrelated.

Point (b) states: the user auditor should obtain sufficient appropriate audit evidence regarding the adequacy and appropriateness of the financial information obtained from the service entity (paragraph 25 in AUS 402); and

Paragraph 25 of AUS 402 states: **The auditor should obtain an understanding of the nature of the entity.** The nature of an entity refers to the entity's operations, its ownership and governance, the types of investments that it is making and plans to make, the way that the entity is structured and how it is financed. An understanding of the nature of an entity enables the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial report.

Whereas, paragraph 25 of existing AUS 404 states: **The user auditor should obtain sufficient appropriate audit evidence regarding the adequacy and appropriateness of the financial information obtained from the service entity.** There is the possibility that the financial report of the user may be prepared from unaudited information provided by the service entity. Unaudited financial information would not constitute sufficient appropriate audit evidence on which the user auditor could form an opinion on the financial report of the user.

Clearly the correct reference in Point (b) should be to AUS 404 rather than to AUS 402, which appears unrelated.

Point (c) states: when using the work of the service entity auditor, the user auditor should refer to AUS 602 “Using the Work of Another Auditor” (paragraph 30 in AUS 402); and

Paragraph 30 of AUS 402 states: **The auditor should obtain an understanding of the entity’s objectives and strategies, and the related business risks that may result in material misstatement of the financial report.** The entity conducts its business in the context of industry, regulatory and other internal and external factors. To respond to these factors, the entity’s management or those charged with governance define objectives, which are the overall plans for the entity. Strategies are the operational approaches by which management intends to achieve its objectives. Business risks result from significant conditions, events, circumstances, actions or inactions that could adversely affect the entity’s ability to achieve its objectives and execute its strategies, or through the setting of inappropriate objectives and strategies. Just as the external environment changes, the conduct of the entity’s business is also dynamic and the entity’s strategies and objectives change over time.

Whereas, paragraph 30 of existing AUS 404 states: When using the work of the service entity auditor, the user auditor should refer to AUS 602 “Using the Work of Another Auditor”.

Clearly the correct reference in Point (c) should be to AUS 404 rather than to AUS 402, which appears unrelated.

Paragraph 6 – change from ‘client’ to ‘entity’

We note the first and last sentences refer to an ‘entity’, whereas the base standard ISA 402 refers to a ‘client’. This change was not listed in the Table of Proposed Changes.

We support this change as appropriate.

Paragraph 14 – Insufficient Guidance in respect of requirements of Paragraph 13

Paragraph 13 includes mandatory requirements to:

- Obtain an understanding of the entity and its environment, including internal control
- Identify and assess the risks of material misstatement
- Design further audit procedures in response to the assessed risk.

Paragraph 14 refers the auditor to AUS 402 ‘Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements’. However, there is no reference nor alternative guidance to the requirement to design further audit procedures in response to assessed risk.

We suggest the inclusion of a reference to AUS 406 ‘The Auditor's Procedures In Response to Assessed Risks’ as a minimum level of guidance.

Paragraph 22 – Suggestion for grammatical changes

We agree with the changes made to the content of this paragraph. However, we suggest changes to shorten a very long sentence and remove an unnecessary conjunction.

The word ‘while’ should be removed from the start of the paragraph and a full stop inserted after the words ‘internal controls’. The second sentence then starts: ‘However, pursuant...’

Paragraph 25 – location of guidance

This additional guidance has been inserted after a sub-heading ‘Service Organisation Auditor’s Reports’. The primary requirement after this sub-heading is that when using a service organisation auditor’s report, the auditor shall consider the nature and content of that report. This suggests the requirements and guidance in this section relate to the use of such audit reports, and the content of subsequent paragraphs confirm this.

New guidance on circumstances where the auditor cannot use the service organisation auditor’s work seems oddly located given the circumstances described above.

In addition, paragraphs 24 and 26 appear unrelated to auditor’s reports. We suggest paragraphs 24 – 26 be alternatively located or that an appropriate sub-heading precede paragraph 24.

Paragraph 25 – elevation to black letter

The content of the guidance is considered important enough to justify a departure from ISA 402. This being the case, we suggest it may be appropriate to elevate the guidance to black letter.

Exposure Draft ED 17/05 – Proposed Auditing Standard: Initial Engagements – Opening Balances (Re-issuance of AUS 510)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

We make no suggestions.

**Exposure Draft ED 18/05 – Proposed Auditing Standard: Analytical Procedures
(Re-issuance of AUS 512)**

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Appendix – Examples of Analytical Procedures

We believe this Auditing Standard should include an Appendix providing examples of analytical procedures similar to those contained in the existing AUS 512. These examples provide auditors with an understanding of the range and types of analytical procedures they need to consider when conducting their audits.

Exposure Draft ED 19/05 – Proposed Auditing Standard: Management Representations (Re-issuance of AUS 520)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 10

We recommend that paragraph 10 be amended so that any reference to the Appendix stipulates the number 1.

Currently, paragraph 10 makes reference to the Appendix within the Auditing Standard, when in fact reference should be made to Appendix 1.

Paragraph 12

We recommend that this paragraph be amended so that the word *control* is updated to state *controls* (plural) so that the sentence reads as follows:

“ it acknowledges its responsibility for the design and implementation of internal controls to prevent and detect error; and”.

Appendix – 3rd paragraph

Paragraph 3 of the Appendix in the proposed Auditing Standard reads awkwardly:

“Although seeking representations from management on a variety of matters, a management representation letter may serve to focus management’s attention on those matters, and thus cause management to specifically address those matters in more detail than would otherwise be the case. The limitations of management representations as audit evidence are set out in this Auditing Standard”.

Both ISA 580 and the existing AUS 520 have the following paragraph in the Appendix: ‘Example of a Management Representation Letter’:

“Although seeking representations from management on a variety of matters may serve to focus management’s attention on those matters, and thus cause management to specifically address those matters in more details than would otherwise be the case, the auditor needs to be cognizant of the limitations of management representations as audit evidence as set out in this AUS/ISA”

We recommend the wording from the existing Auditing Standard and ISA be used.

Exposure Draft ED 20/05 – Proposed Auditing Standard: Auditing Fair Value Measurements and Disclosures (Re-issuance of AUS 526)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Obligations within the Proposed Auditing Standard

We believe that there are several instances within the explanatory guidance of the proposed Auditing Standard that are implied or express obligations. These are discussed below.

Paragraph 44(b) states: ‘The auditor complies with AUS 504 ‘External Confirmations’ in this regard.’

Paragraph 63 states: ‘The auditor complies with AUS 706 ‘Subsequent Events’ when evaluating audit evidence relating to such evidence.’

Paragraphs 44(b) and 63 include direct instructions to the auditor to comply with [the requirements of] other Auditing Standards. A direct instruction is not an explanation of a black letter requirement; it is an express obligation.

If this issue were addressed via the insertion of the word ‘ordinarily’, this would mean the auditor would ordinarily comply with the requirements of other Auditing Standards. Obviously, the auditor must always comply with the requirements of other Auditing Standards, and so the insertion of the word ‘ordinarily’ is not appropriate.

We recommend that these direct instructions, if retained, should be black letter requirements.

Paragraph 17(e) states: ‘When an entity uses a service organisation, the auditor complies with the requirements of AUS 404...’

Paragraph 21 states: ‘Where the auditor has determined...the auditor follows the requirements of AUS 402.’

Paragraph 44(d) states: ‘If the collateral is an important factor in measuring the fair value of the investment or evaluating its carrying amount, the auditor obtains sufficient appropriate audit evidence...and considers whether appropriate disclosures...have been made’

Paragraph 53 states: ‘Where applicable, the auditor encourages management to use such techniques as sensitivity analysis to help identify particularly sensitive assumptions.’

Paragraph 60 states: ‘In that situation, the auditor nevertheless understands management’s assumptions.’

Paragraph 67 states: ‘If an item contains a high degree of uncertainty, the auditor assesses...’

Paragraph 67 also states: ‘Where applicable, the auditor also considers...’

Each of the preceding paragraphs is in an ‘if, then’ format. That is, if the circumstances are X, then the auditor must do Y. If the circumstances are X, and the auditor does not do Y, has the auditor complied with the Standard? The auditor has probably not. And yet, if the examples above are only guidance, there is no requirement to comply.

This confusion needs to be addressed. Just because an obligation is preceded by certain circumstances, does not mean it is not an obligation. Paragraphs 68 and 69 also contained obligations under certain circumstances, and these are proposed to be elevated. This seems inconsistent with the proposed treatment of the above paragraphs.

Paragraph 39 states: ‘The auditor often considers these matters by discussing them with the expert.’ The word ‘often’ is not a defined term and is open to broad interpretation. If an auditor determines that they will not consider the matters by discussing them with the expert, would another party determine that they should have? The word ‘often’ is not appropriate in a ‘force of law’ Standard, as it is open to interpretation. We recommend this be addressed.

Paragraph 74 states: ‘For example, the auditor considers communicating the nature of significant assumptions used in fair value measurements...’ etc. The intent of the sentence is to give examples of items of interest to those charged with governance. However, an obligation for the auditor has been inserted.

We suggest the sentence is reworded as follows: ‘Governance interest items include, for example, the nature of significant assumptions used in fair value measurements...’ etc.

Paragraph 44(b) is similar to paragraph 74. It states: ‘For example, when information is obtained through the use of external confirmations, the auditor considers...’ The intent of the sentence is to provide indicators of reliability, but the current wording suggests an obligation upon the auditor.

We suggest: ‘the respondent’s competence...[etc]... are indicators of the reliability of external confirmations.’

Whilst our suggestions in respect of paragraphs 44(b) and 74 are a departure from ISA 545, it is important to remove any suggestion of obligations upon the auditor within the explanatory guidance.

We note paragraphs 15(b) and 44(e) of the proposed Preamble (ED7/05) refer to the inclusion of examples to ‘assist in the application of mandatory requirements’. This reference does not in any way diminish the points made above on the implied obligations that we believe exist.

Greater obligation within this proposed Standard in respect of Management Representations

We note that AUS 520 'Management Representations' requires written representations 'on specific matters, material to the financial report, when other sufficient appropriate audit evidence cannot be obtained'. This requirement is far more specific than the requirement in the proposed AUS 526.

Paragraph 72 of the proposed Auditing Standard requires the auditor to endeavour to obtain **written** representations from management regarding the reasonableness of significant assumptions. We believe there should be guidance within the proposed Standard on what constitutes a significant assumption. With no guidance, what is a significant assumption is open to interpretation. Arguably, proposed AUS 526 requires representations on immaterial matters for which other evidence may exist.

We recommend that the requirements in AUS 526 with respect to management representations be amended. The requirement should be that the auditor complies with AUS 520 'Management Representations'.

Inconsistent description of other Auditing Standard

Most AUSs refer to other Standards or describe their contents. When describing the provisions of Standards, other proposed Auditing Standards state that 'AUS XXX provides mandatory requirements and explanatory guidance'. Such an example is paragraph 11 of ED16/05.

However, paragraph 10 of this proposed Auditing Standard states: 'AUS 516, 'Audit of Accounting Estimates', provides guidance...' We recommend this sentence be amended to read: 'AUS 516, 'Audit of Accounting Estimates', provides mandatory requirements and explanatory guidance...'

Our recommendation is a departure from the exact wording of ISA 545. However, this departure is consistent with other Standards and results in better guidance.

*Inconsistent References to **applicable** financial reporting framework*

Paragraphs 64 and 67 of the proposed Auditing Standard refer to an entity's 'financial reporting framework'. In similar contexts, other paragraphs refer to an entity's 'applicable financial reporting framework'. The different references are consistent with ISA 545.

Notwithstanding the consistency with ISA 545, we recommend all references within the Standard, to a financial reporting framework, should be a reference to an applicable financial reporting framework. We consider consistency within the Standard to be more important than consistency with ISA 545.

Inappropriate Substitution of the Term 'Financial Statements'

The last sentence of paragraph 65 of the proposed Auditing Standard refers to 'the notes to the financial report'. The equivalent paragraph of ISA 545 refers to 'the

notes to the financial statements.’ It is clear the substitution was made to align the Standard with Australian terminology. We agree with the intent, but disagree that the substitution is appropriate. Australian Accounting Standards clearly refer to ‘notes to the financial statements’.

Incorrect Reference to other Standard

Paragraph 8 of the proposed Auditing Standard refers to AUS 402 ‘Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement’. The correct name of the AUS includes the word ‘Misstatements’ (plural). Accordingly, the reference should be corrected.

This incorrect reference to AUS 402 also occurs within point 3 of the ‘Main changes from existing AUS 526’ on page 5 and in the Table of Proposed Changes.

Inconsistencies in Use of Bullet Points

ISA 545, the base standard, uses both dot points and lettered bullet points. The proposed Auditing Standard also uses both these varieties. However, their use in the proposed Auditing Standard is not consistent with their use in ISA 545.

Paragraphs 23, 35, 36 and 64 of ISA 545 use dot points, whereas the equivalent paragraphs in the proposed auditing standard (paragraphs 29, 43, 44 and 73) use lettered bullet points. The Appendix to ISA 545 also uses a mixture of dot points and lettered bullet points, whereas the Appendix to the proposed auditing standard only uses lettered bullet points.

We recommend the use of lettered bullet points in all instances. This will allow easier reference to specific points within the Standard and consistency within the Standard. We acknowledge this will be a slight departure from ISA 545, but believe the benefits justify the change.

At the very least, changes are required such that the use of dot points and lettered bullet points in the proposed Auditing Standard is consistent with ISA 545.

AUASB should consider applying lettered bullet points more widely throughout all Auditing Standards for the reasons outlined above.

Inconsistencies in Headings

The heading prior to paragraph 60, ‘Developing Independent Fair Value Estimates for Corroborative Purposes’ and the heading prior to paragraph 61, ‘Subsequent Events’ have the same font size as the heading prior to paragraph 64, ‘Disclosures about Fair Values’.

In ISA 545, the equivalent paragraphs have different font sizes, signifying that the first two headings are not of the same importance as the third.

For consistency with ISA 545, the headings preceding paragraphs 60 and 61 should be re-formatted.

Adverse impacts on clarity of Standard

Paragraphs 18, 27, and 32 include departures from ISA 545 in the form of the insertion of ‘pursuant to’. We agree that the departure is required to overcome an implied obligation, but the resulting sentences are clumsy and too long.

These paragraphs already included lengthy sentences. Proposed paragraph 18 includes a sentence of 58 words, proposed paragraph 27 has a 53 word sentence and proposed paragraph 34 a 66 word sentence. The original sentences cannot tolerate additional words without loss of clarity.

These three instances need to be re-worded to promote the ability of users to follow guidance.

The second sentence of paragraph 18 could be split into two sentences as follows:

“In particular, pursuant to paragraph 15 of this Auditing Standard the auditor is required to obtain a sufficient understanding of control activities related to the determination of the entity's fair value measurements and disclosures. This enables the auditor to identify and assess the risks of material misstatement and to design the nature, timing and extent of the further audit procedures”.

The last sentence of paragraph 27 could be split into two sentences as follows:

“Management may determine that it has overcome the presumption that fair value can be reliably determined. Under these circumstances, pursuant to paragraph 7 of this Auditing Standard, the auditor is required to obtain sufficient appropriate audit evidence to support such determination, and whether the item is properly accounted for under the applicable financial reporting framework”.

The first sentence of paragraph 34 could be split into two sentences as follows:

“Once management has selected a specific valuation method, the auditor, pursuant to paragraph 33 of this Auditing Standard, is required to evaluate whether the entity has consistently applied that basis in its fair value measurement, and if so, whether the consistency is appropriate. Factors affecting the appropriateness include possible changes in the environment or circumstances affecting the entity, or changes in the requirements of the entity's applicable financial reporting framework”.

Grammatical Error

Paragraph 23 of the proposed Auditing Standard states:

‘The auditor shall evaluate whether the fair value measurements and disclosures in the financial report *is* in accordance with the entity’s applicable financial reporting framework.’

The use of the word ‘is’, is both a departure from ISA 545 and grammatically incorrect. The word ‘is’ should be substituted by ‘are’.

Paragraph 18 of the proposed Auditing Standard states:

‘AUS 402, requires the auditor...’. A comma after ‘AUS 402’ is unnecessary and grammatically incorrect.

Requirement to Update References to Other Standards

Paragraph 17(e) refers to AUS 404 ‘Audit Implications Relating to Entities using a Service Entity’. The proposed name for the re-issued Standard is AUS 404 ‘Audit Considerations Relating to Entities Using a Service Organisation’. If AUS 404 is re-issued first or con-currently, the reference in this paragraph will need to change.

Exposure Draft ED 21/05 – Proposed Auditing Standard: Using the Work of an Expert (Re-issuance of AUS 606)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 26

In moves to conform AUS 606 to ISA 620, the words “or an emphasis of matter” have been removed from paragraph 26. Paragraph 26 currently reads: “*Such a reference might be misunderstood to be a qualification of the auditor’s opinion or a division of responsibility, neither of which is intended.*” Paragraph 26 explains black letter paragraph 25, which reads: “**When issuing an unmodified auditor’s report, the auditor shall not refer to the work of an expert.**”

The change to paragraph 26 from the existing equivalent AUS paragraph is shown: “*Such a reference might be misunderstood to be a qualification of the auditor’s opinion or a division of responsibility, ~~or and emphasis of matter, none~~ neither of which is intended.*”

Instead, we suggest the following wording:

“Such a reference might be misunderstood to be a modification of the auditor’s opinion or a division of responsibility, neither of which is intended.”

The term “modification” includes an auditor’s opinion with an ‘emphasis of matter paragraph’ which we think is the intention.

Exposure Draft ED 22/05 – Proposed Auditing Standard: Subsequent Events (Re-issuance of AUS 706)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 4

In the first sentence of paragraph 4, the word ‘mandatory’ should be inserted before the word ‘requirements’, and the word ‘explanatory’ before the term ‘guidance’ to ensure consistency in the terms used in the Auditing Standards,

Paragraph 15

This paragraph contains guidance that has been elevated due to an implied obligation upon the auditor. Whilst we agree with the elevation, the auditor is given insufficient guidance in complying with the obligation to ‘carry out the audit procedures necessary’. In fact, there has been no guidance on what these necessary audit procedures may be which means the obligation lacks clarity.

We believe the above concern could be addressed by rewording paragraph 15 as follows:

“When management amends the financial report, the auditor shall carry out the procedures necessary to support the material accuracy of the amendment and shall provide management with a new report on the amended financial report.”

As a result there is no further need for additional guidance within this standard as the procedures to be carried out will predominately be addressed by various Auditing Standards, dependant on the nature of the amendment.

Paragraph 22

This paragraph refers to facts that would have caused the auditor to *modify* the audit report, however the previous version of the Standard referred to facts that would have caused the auditor to *qualify* the audit report. Given an ‘Emphasis of Matter’ opinion is a modified opinion according to AUS 702, the scope of this paragraph has been expanded.

The replacement of the word ‘qualified’ with the word ‘modified’ has occurred because the ISA 560 uses ‘modified’.

Consideration is required as to whether the scope of this paragraph is intended to include an ‘Emphasis of Matter’ opinion, and the use of the terms ‘modified’ or ‘qualified’ determined accordingly.

Paragraph 23

This paragraph has been amended to include the words ‘endeavour to’. However, their insertion appears to relate to the actions of management, rather than to any mandate applying to auditors.

This paragraph instructs the auditor to review the steps taken by management, and those steps taken are designed to ensure that anyone in receipt of the previously issued financial report and audit report is informed. Whether management takes steps to ‘ensure’ or takes steps to ‘endeavour to ensure’, there is no impact upon the auditor’s obligation to review the steps.

We recommend that the words ‘endeavour to’ be removed.

In addition, paragraph 23 contains guidance that has been elevated due to an implied obligation upon the auditor. Whilst we agree with the elevation, the auditor is given insufficient guidance in complying with the obligation to ‘carry out the audit procedures necessary’. If the procedures include reviewing steps taken by management and issuing a new report (as detailed in paragraph 23) this should be stated. If there are other audit procedures, these should be included as well or further guidance provided.

Paragraph 24

This paragraph refers to a note to the financial report. The equivalent paragraph within ISA 560 refers to a note to the financial statements. To conform to Australian terminology, the term financial report has been used. However, this has created the phrase ‘note to the financial report’.

Given, the notes form part of the financial report (as per AASB 101); we recommend that the existing words be replaced with ‘note within the financial report’ or ‘note to the financial statements’.

In addition, paragraph 24 imposes an obligation on auditors to include an emphasis of matter paragraph referring to a note to the financial report. If no such note has been included, the auditor is unable to comply with this obligation. The current paragraph imposes an obligation upon auditors that is beyond their control.

Paragraph 25

This paragraph contains guidance copied from paragraph 16 of the existing ISA 560:

“Local regulations of some countries permit the auditor to restrict the audit procedures regarding the revised financial report to the effects of the subsequent event that necessitated the revision. In such cases, the new audit report would contain a statement to that effect.”

Given the proposed Auditing Standard is adopting the provisions of the existing ISA, and that the proposed standard will apply only to one country, this paragraph is unnecessary.

Paragraph 26

This paragraph has been amended in two instances to include the words ‘endeavour to’. In the first instance it is in relation to steps taken by management, and it appears the change has occurred to be consistent with the change in paragraph 23.

Consistent with the point made previously in respect of paragraph 23, we recommend the first insertion of the words ‘to endeavour’ be removed.

In the second instance, the insertion of the words reduces the obligation upon the auditor. This use of the words appears appropriate.

In addition, paragraph 26 refers to a situation whereby management does not take two actions, but the situation could arise whereby management does take action in one respect but not the other. The Standard does not provide guidance in the event that management revises the financial report, but fails to inform anyone of this fact, for example.

Further guidance may be useful to clarify the auditor’s requirement to notify those charged with governance that action shall be taken by the auditor to endeavour to prevent future reliance on the auditor’s report where management has only performed one of the two actions.

Exposure Draft ED 23/05 – Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)

Overall comment

The proposed Auditing Standard, as a whole, is supported.

Paragraph 35

This paragraph states that providing the auditor is satisfied with the going concern basis, an unmodified audit report shall be issued. This statement could be misleading, as there may be other reasons to qualify than going concern.

Paragraph 44

In paragraph 44, we believe the term “had” should be replaced by “has” for the sentence to remain present tense.

Paragraph 49

The third sentence in paragraph 49 contains 62 words. More than one sentence should be used.