

# AUSTRALASIAN COUNCIL OF AUDITORS- GENERAL

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The Chairman  
Auditing and Assurance Standards Board  
PO Box 204  
Collins St West  
MELBOURNE VIC 8007  
[edcomments@auasb.gov.au](mailto:edcomments@auasb.gov.au)

Dear Chairman,

**Proposed Auditing Standard: The Independent Auditor's Report on a General Purpose Financial Report (Re-issuance of AUS 702) Part A**

**Proposed Auditing Standard: Modifications to the Independent Auditor's Report (Re-issuance of AUS 702) Part B**

**Proposed Auditing Standard: Related Parties (Re-issuance of AUS 518)**

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the attached comments in response to the Exposure Drafts referred to above.

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 Exposure Drafts where he deems it appropriate, rather than as a member of ACAG.

## **Request for Comments**

While ACAG supports the overall content of the Proposed Auditing Standards, we have enclosed, as separate attachments, commentary on matters that the AUASB should consider as it finalises these Exposure Drafts.

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 Exposure Drafts. These “generic matters” are not repeated in the attachments to this letter although we anticipate that they will have relevance to all Exposure Drafts.

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 fluid and cursive, with a long horizontal stroke extending to the right.

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

## **ATTACHMENT**

### **Generic Matters – matters raised that were common to each of these three Exposure Drafts**

None noted beyond those raised in our submission of 14 October 2005.

## MATTERS SPECIFIC TO EACH EXPOSURE DRAFT

### *Exposure Draft 24/05 Proposed Auditing Standard: The Independent Auditor's Report on a General Purpose Financial Report (Re-issuance of AUS 702) Part A*

#### Overall Comment

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

#### Detailed Comments

*Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards (AUS) and International Standards on Auditing (ISA).*

Paragraph 63 states:

*“The auditor’s report shall refer to the audit having been conducted in accordance with the Auditing Standards and ISAs **only when the auditor has complied fully with all of the Auditing Standards and ISAs relevant to the audit**”.*

Paragraph 64 provides explanatory guidance to paragraph 63 outlining instances when the AUS differ from the ISA which would prevent the auditor from certifying that an audit has been conducted in accordance with Australian Auditing Standards (AUS) and International Standards on Auditing (ISA). However, this guidance appears to be very limited as it suggests that the only instance where an auditor cannot certify that an audit has been conducted in accordance with both AUS and ISA is when the audit opinion has expressed an emphasis of matter.

We believe that the guidance provided in paragraph 64 should be broadened to cover other significant inconsistencies between the AUS and ISA which would also prevent the auditor from certifying that an audit has been conducted in accordance with AUS and ISA. To assist in addressing this matter the following wording is suggested:

*“Pursuant to paragraph 63 of this Auditing Standard, a reference to both the Auditing Standards and ISAs is not appropriate if there is a significant inconsistency between relevant Auditing Standards and the equivalent ISA as identified in the “Conformity with International Standards on Auditing” section of the applicable Auditing Standard. For example if there is a conflict between the reporting requirements ....”*

*Use of the phrases “gives a true and fair view” or “is presented fairly, in all material respects,”*

We see little value in the standard prescribing two options for required phrases to be used in an unqualified audit opinion when paragraph 10 states that the two phrases are considered equivalent. We suggest the AUASB select one phrase to be used.

However, we do support the option to use different wording where required by law or regulation (paragraph 45).

*Paragraph 33(a) and Appendix 1*

We believe the term 'internal control' within this paragraph should be stated as a plural, that is, internal controls.

***Exposure Draft 25/05 Proposed Auditing Standard: Modifications to the Independent Auditor's Report (Re-issuance of AUS 702) Part B***

**Overall Comment**

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

**Detailed Comments**

**Appendix 1 – Terminology Used In This Auditing Standard**

The re-issuance of AUS 702 Part B, introduces the terms “Modified” and “Unmodified” opinions, as well as “Unqualified” and “Other than Unqualified”. This gives rise to two issues: double negative language and also several layers of opinion variation. We recommend that the Board revise this terminology to improve clarity.

**Double Negatives Examples**

The heading above paragraph 29 currently reads “Circumstances that may Result in Other than an Unqualified Opinion”. Although ISA 701 uses this terminology, we suggest the removal of double negatives. Consider the following heading as a substitute: “*Circumstances that may Result in a Modified Opinion, excluding an emphasis of matter*”.

Double negatives also occur in paragraph 25, and in the first table in Appendix 1. Paragraph 25 could be worded as “*Whenever the auditor expresses an opinion that is ~~other than unqualified~~ modified, excluding an emphasis of matter....*”

***Exposure Draft 26/05 Proposed Auditing Standard: Related Parties (Re-issuance of AUS 518)***

**Overall Comment**

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

**Detailed Comments**

*Paragraph 11 (bullet point 1)*

This bullet point would be more reader friendly if it was amended as follows:

*“The applicable financial reporting framework may require disclosure in the financial report of certain related party relationships and transactions, such as those required by Accounting Standards AASB 124 “Related Party Disclosures” and ~~Accounting Standard~~ AASB 101 “Presentation of Financial Statements”.*

*Risk Assessment Procedures (paragraphs 12 to 17)*

This section of the proposed Auditing Standard is based upon paragraphs 8-12 of the existing AUS 518. However, modifications to the wording of the existing AUS have been made. We believe these modifications reduce the clarity of auditor obligations.

We believe the intention of the 'Risk Assessment Procedures' section is to express the auditor's obligation to assess inherent and control risks that related parties and related party transactions are materially misstated. To this end, we have several suggestions regarding the structure and wording of paragraphs in this section.

Our suggested wording for mandatory requirements in paragraphs 12 and 14 is:

*12. “Based on the auditor’s knowledge of the business and inquiries of management, the auditor shall assess the inherent risk that related parties and related party transactions will not be identified, disclosed or are materially misstated”.*

*14. “Based on the auditor’s understanding of the entity and its environment including its internal control, the auditor shall assess the control risk that related parties and related party transactions will not be identified, authorised, or are materially misstated”.*

We believe the intent of paragraph 13 is to explain the auditor’s inherent risk obligation in paragraph 12. We believe the intent of paragraph 15 is to explain the auditor’s control risk obligation in paragraph 14. Following on from mandatory requirements, the ‘pursuant to’ rule should be applied to paragraph 13 and 15. The best wording to demonstrate this is as follows:

*13. “Pursuant to paragraph 12 of this Auditing Standard, the auditor is required to assess the inherent risk of material misstatement, using professional judgement to evaluate the impact of the following relevant factors...”.*

15. “Pursuant to paragraph 14 of this Auditing Standard, the auditor is required to assess the control risk of material misstatement by considering the policies and procedures relating to matters such as....”

#### Responses to Assessed Risks

We believe there should be a mandatory obligation similar to the black letter requirement in existing AUS 518.13 that requires the auditor to consider the assessed levels of risk (inherent and control) in determining the nature, timing and extent of substantive procedures. This requirement should be inserted before explanatory guidance paragraph 18 of the proposed Auditing Standard. As it currently stands, the purpose of this explanatory guidance is unclear and does not flow well from the preceding section.

#### Paragraph 23

Rather than simply referring to the guidance provided in AASB 101, we believe it would be more appropriate for this paragraph to provide further guidance with respect to considering substance over legal form of related party relationships. AASB 101 provides only limited guidance on the need to consider the substance of a transaction in a few circumstances, none of which relate to circumstances involving related parties.

#### Paragraph 24

This paragraph states that the auditor shall “be satisfied that the disclosure is adequate”. We do not believe this phrase explains what is expected of the auditor (i.e. does it mean the auditor has obtained reasonable assurance or sufficient appropriate audit evidence?). The current obligation is too vague and is open to interpretation. We recommend the sentence be reworded to state the auditor’s actual duty and responsibility.

#### Paragraph 34

This paragraph states that the auditor shall “endeavour to obtain” a written representation from management concerning related party transactions. The proposed Auditing Standard does not include audit procedures when situations occur where the auditor cannot obtain a management representation letter. We recommend that the Board include explanatory guidance that refers the auditor to AUS 520 ‘Management Representations’. This would direct the auditor to the mandatory requirements and explanatory guidance that covers all circumstances when endeavouring to obtain management representation.

#### Conformity with International Standards on Auditing

Mandatory requirement ISA 550.10, which requires auditors to consider the adequacy of control activities over the authorisation and recording of related party transactions,



is not specifically referenced in the proposed Auditing Standard. We believe specific reference should be made to this requirement as there is no other Auditing Standard which appropriately addresses the factors to consider when understanding internal controls in respect of related party transactions. As it stands, the mandatory requirements in the proposed Auditing Standard do not adequately address this.

Grammatical errors and other minor changes

- Remove the word ‘are’ in paragraph 9 to read as follows: “...*Auditing Standard* ~~are~~ as follows”.
- Consider the removal of the words ‘then’ and ‘the’ in paragraph 28 to read as follows: “*If, the auditor has reason to suspect the existence of previously unidentified related party transaction, ~~then~~ pursuant to ~~the~~ paragraph 8 ...*”
- Remove the apostrophe in the word “paragraph’s” within paragraph 39.
- In paragraph 12 of the proposed Auditing Standard, the term “enquiries” should be replaced with “inquiries”. The term “inquiry” is used in AUS 502 ‘Audit Evidence’ (where “inquiry” is a form of obtaining audit evidence) and is used throughout the proposed Auditing Standard. This correction is also required in paragraph 40.