

ASA 265

(October 2009)

Explanatory Statement

ASA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

Issued by the Auditing and Assurance Standards Board



Australian Government

Auditing and Assurance Standards Board

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This Explanatory Statement is available on the Auditing and Assurance Standards Board (AUASB) website: www.auasb.gov.au

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Reasons for Issuing Auditing Standard ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001* (the Act), the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the International Auditing and Assurance Standards Board (IAASB) for the revision and enhancement of the International Standards on Auditing (ISAs) and to make appropriate consequential amendments to the Australian Auditing Standards. The IAASB has undertaken a programme to redraft, and in some cases, revise, in “clarity” format, the entire suite of ISAs. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

Operative Date

ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* is operative for financial reporting periods commencing on or after 1 January 2010.

Purpose of Auditing Standard ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

The purpose of the Auditing Standard is to establish requirements and to provide application and other explanatory material regarding the auditor’s responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of a financial report.

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This is a new Auditing Standard, which conforms with ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, issued by the IAASB, which is also a new International Auditing Standard.

The Standard aims to improve the consistency of audit practice by introducing requirements, which were previously implicit in the auditing standards, relating to the identification, assessment and reporting of deficiencies in internal control.

The standard is a companion standard to ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*. ASA 315 focuses on overall audit risks, and in particular risks that may cause material misstatements in the financial report, such as material weaknesses in internal controls. Further, ASA 330 *The Auditor's Responses to Assessed Risks* deals with responding to assessed risks and requires communication of any material weaknesses in internal control in accordance with ASA 260 *Communication with Those Charged with Governance*.

The standard covers the communication of significant deficiencies in internal control – essentially weaknesses in internal control that are not material, but which, in the auditor's professional judgement, are of sufficient importance to merit the attention of those charged with governance.

Main Features

The Auditing Standard requires the auditor to:

- (a) determine if, on the basis of the work performed, the auditor has identified any deficiencies in internal control;
- (b) assess whether identified deficiencies in internal control, individually or in combination, constitute significant deficiencies;
- (c) communicate, in writing, all significant deficiencies in internal control and their potential effects to those charged with governance, and where appropriate management;
- (d) communicate to management other identified deficiencies in internal control that the auditor considers to be of sufficient importance to merit management's attention; and
- (e) explain to those charged with governance, and where appropriate management, that any deficiencies identified and communicated

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have been identified through the process of auditing the financial report, which does not ordinarily include expressing an opinion on the effectiveness of internal control.

Preamble and Overall Objectives

ASA 265 is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. ASA 265 is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

Process of making Australian Auditing Standards

The AUASB's Strategic Direction, *inter alia*, provides that the AUASB develop Australian Auditing Standards that:

- have a clear public interest focus and are of the highest quality;
- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as the underlying standards;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

In implementing the FRC's Strategic Direction, the AUASB has undertaken a process of revision and redrafting of the Australian Auditing Standards that has:

- updated the form, layout and content of the Australian Auditing Standards;
- addressed the legal enforceability of mandatory obligations;
- maintained clarity of the auditor's obligations;
- incorporated appropriate references to Australian laws and regulations;

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- clearly identified, by use of the prefix “Aus”, AUASB additions to paragraphs in the requirements or the application and other explanatory material; and
- included other amendments as necessary.

Consultation Process prior to issuing the Auditing Standard

The AUASB has consulted publicly as part of its due process in developing the Auditing Standard. Exposure Draft ED 12/09 *Proposed Auditing Standard: Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* was issued on 17 April 2009 with a 30 day comment period.

As an integral part of its consultation with the public, the AUASB sought comments on specific questions including:

- the completeness and accuracy of references in the Auditing Standard to relevant laws and regulations;
- the significant costs, if any, and benefits, of compliance with any requirements under the Auditing Standard; and
- whether or not there exist any matters of public interest affecting the issuance of the Auditing Standard.

Submissions were received by the AUASB and these were considered as part of the development and finalisation of the Auditing Standard.

Regulation Impact Statement

A *Regulation Impact Statement* (RIS) has been prepared in connection with the redrafting of Australian Auditing Standards in “clarity” format, including ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*.

The RIS considered both expected benefits and expected costs of the introduction of clarified auditing standards, including comments provided by stakeholders during the redrafting process. It concluded that expected benefits to users of audit services, users of audit reports, auditors and the Australian economy in general are, on balance, likely to outweigh expected costs.