

**THE AUDITOR'S COMMUNICATION WITH  
THOSE CHARGED WITH GOVERNANCE  
AND CONFORMING AMENDMENTS TO ISAs 570 and 701**

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PROPOSED CONFORMING AMENDMENTS TO ISAs 570 and 701

## Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on the auditor's communication with those charged with governance.
2. The principal purposes of communication with those charged with governance are for the auditor to:
  - (a) Establish a mutual understanding of the scope and timing of the audit, and of the respective responsibilities of the auditor, those charged with governance and management;
  - (b) Provide those charged with governance with constructive observations arising from the audit; and
  - (c) Share other information that will assist the auditor and those charged with governance to fulfill their respective responsibilities.
3. This ISA focuses primarily on communications from the auditor to those charged with governance. Effective two-way communication is also important however. Wherever possible, the auditor discusses issues clearly and unequivocally with those charged with governance, and reasonably expects those charged with governance to discuss issues in the same manner.<sup>1</sup> These discussions assist the auditor and those charged with governance to understand issues fully, and develop a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
4. **The auditor should communicate to those charged with governance, on a timely basis, matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance.**
5. The main requirements of this ISA are summarized below:
  - (a) *Those charged with governance*: This section discusses the diversity of governance structures and processes across entities. The auditor's understanding of the entity and its environment is used to determine the relevant person(s) with whom the auditor communicates on particular matters.
  - (b) *Matters of governance interest*. This section identifies the following matters the auditor is required to communicate:
    - (i) The auditor's responsibilities;
    - (ii) The planned scope and timing of the audit;
    - (iii) The conduct of, and findings from the audit;
    - (iv) Statement of auditor independence;
    - (v) Matters that are required by other ISAs or additional external requirements to be communicated, and matters that have been agreed with the entity to be communicated; and
    - (vi) Other matters arising from the audit that the auditor judges to be serious and relevant to the responsibilities of those charged with governance.
  - (c) *The communication process*. This section acknowledges that the communication process will vary with the engagement circumstances, and requires the auditor to establish a mutual understanding with those charged with governance about the

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<sup>1</sup> This ISA does not address the manner in which those charged with governance interact with the auditor.

form, timing and expected content of communications. It explains that effective communication is ordinarily two-way, and provides guidance on establishing expectations, and the form, timing and confidentiality of communications. It also requires the auditor to assess the adequacy of the two-way communication and to take appropriate action as required.

- (d) *Legal considerations.* This section notes that in some circumstances the auditor is required to report certain matters to a regulatory or enforcement body. In rare circumstances, the auditor may be prevented by law from communicating certain matters to those charged with governance.

6. In this ISA:

- (a) “Those charged with governance” means the person(s) with responsibility for:
- (i) Overseeing the strategic direction of the entity; and
  - (ii) Discharging accountability obligations, including the obligation to oversee the financial reporting and disclosure process.

In some cases, those charged with governance are responsible for preparing and presenting the financial statements.

- (b) “Management” means the person(s) who have executive responsibility for the conduct of the entity's operations. In some entities, management includes some or all of those charged with governance, e.g., executive directors, or owner-managers. In some cases, management is responsible for preparing and presenting the financial statements, overseen by those charged with governance.

As discussed in paragraphs 8-13, governance structures vary by country and by entity, reflecting cultural and legal backgrounds.

- (c) “Additional external requirements” means requirements imposed on the auditor with respect to a particular engagement that are not included in the ISAs. Examples include: (i) the standards of national professional accountancy bodies, (ii) legislation, (iii) regulation, and (iv) listing rules.

### Those charged with governance

7. **The auditor should determine the relevant person(s) in the entity’s governance structure with whom to communicate on particular matters.**
8. Governance structures vary by country and by entity, reflecting influences such as cultural and legal backgrounds, and size and ownership characteristics. For example:
- In some countries a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board. In other countries, both the supervisory and executive functions are the legal responsibility of a single, unitary board.
  - In some entities, those charged with governance hold positions that are an integral part of the entity’s legal structure, e.g., company directors. For other entities, a body that is not part of the entity is charged with governance, e.g., as with some government agencies.
  - In some cases, some or all of those charged with governance are actively involved in the day-to-day management of the entity. In other cases, those charged with governance and management comprise different people.
9. In most entities, governance is the collective responsibility of a board of directors, a supervisory board, partners, proprietors, a committee of management, a council of

governors, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, e.g., the owner-manager where there are no other owners, or a sole trustee. When governance is a collective responsibility, a subgroup such as an audit committee, or even an individual may be charged with specific tasks to assist the governing body as a whole in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body as a whole.

10. Such diversity means universal identification of the person(s) comprising those charged with governance and with whom the auditor is to communicate on particular matters is not possible. In deciding with whom to communicate on particular matters, the auditor uses the understanding of an entity's governance structure and processes obtained in accordance with paragraph 25 of ISA, 315 "Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement."
11. When the entity's governance structure is not well defined, or those charged with governance are not clearly identified by legislation or the circumstances of the engagement, the auditor and the engaging party agree on the person(s) the auditor will communicate with on particular matters. Examples are (a) some family owned entities where spouses and other relatives may be part of the governance structure, the management structure or both, (b) some not-for-profit organizations, and (c) some government agencies.
12. When considering communicating with a subgroup of those charged with governance, or an individual, the auditor takes into account such matters as:
  - (a) The respective responsibilities of the subgroup, or individual, and the governing body as a whole;
  - (b) The nature of the matter to be communicated;
  - (c) Relevant legal or regulatory requirements;
  - (d) Whether the subgroup, or individual, (i) has the authority to act on the information conveyed by the auditor, and (ii) can provide further information and explanations the auditor may need; and
  - (e) Whether there is also a need to convey the information, in full or in summary form, to the governing body as a whole. This decision may be influenced by the auditor's assessment of how effectively and appropriately the subgroup, or individual, conveys relevant information to the governing body as a whole. Unless prevented by law, the auditor retains the right to communicate directly with the governing body as a whole, a fact the auditor may make explicit in agreeing the terms of engagement.
13. Communication with audit committees, which many entities have established, has become a key element in the auditor's communication with those charged with governance. Good governance principles suggest that (a) the auditor will be invited to regularly attend meetings of the audit committee; (b) the chair of the audit committee, and to a lesser extent the other members of the audit committee, will liaise with the auditor periodically; and (c) the audit committee will ordinarily meet the auditor without management present at least annually. However, depending on the engagement circumstances, e.g., the nature of particular matters to be communicated and relevant legal or regulatory requirements, communication with an audit committee may not

always fulfill the auditor's responsibility to communicate with those charged with governance.

#### COMMUNICATION WITH MANAGEMENT

14. Before communicating matters to those charged with governance, the auditor ordinarily discusses them with management unless it is inappropriate to do so, e.g., it may not be appropriate to discuss questions of management's competence or integrity. These initial discussions can clarify facts and issues, and give management an opportunity to provide further information and explanations. Similarly, when the entity has an internal audit function, the auditor may discuss matters with the internal auditor before communicating to those charged with governance. If doing so will aid the understanding of those charged with governance, the auditor ordinarily includes in communications, comments made by management or the internal auditor, and actions management has indicated it will take.
15. While management has a responsibility to communicate with those charged with governance regarding matters of governance interest, matters that arise from the audit are included in the auditor's communications also, unless the auditor is satisfied that such matters have been effectively and appropriately communicated by management. In addition, communication by management with those charged with governance regarding the auditor's responsibilities, the planned scope and timing of the audit, and auditor independence do not relieve the auditor of the responsibility to also communicate these matters with those charged with governance.

#### **Matters of governance interest**

#### THE AUDITOR'S RESPONSIBILITIES

16. **The auditor should communicate to those charged with governance the responsibilities of the auditor.**
17. The auditor communicates with those charged with governance that the entity is responsible for preparing and presenting the financial statements and the auditor is responsible for forming and expressing an opinion on the financial statements. The audit of the financial statements does not relieve the entity of its responsibilities.
18. In communicating the auditor's responsibilities, the auditor conveys that, in the absence of an agreement with the entity, the auditor is responsible for communicating only those matters required by ISAs and additional external requirements, and that ISAs do not require the auditor to design procedures for the specific purpose of identifying matters of governance interest.
19. The auditor's responsibilities regarding matters of governance interest that come to the attention of personnel in the firm outside the audit team, and personnel in other firms (including network firms) engaged by the entity and related entities, can vary between jurisdictions. In communicating the auditor's responsibilities, the auditor conveys that, in the absence of relevant additional external requirements, or an agreement with the entity to undertake additional work, the auditor is responsible for communicating

matters that come to the attention of such personnel only when they arise from the audit of the financial statements of a component of the entity<sup>2</sup>.

#### PLANNED SCOPE AND TIMING OF THE AUDIT

20. **The auditor should communicate an outline of the planned scope and timing of the audit to those charged with governance.**
21. The auditor communicates the following matters regarding the scope and timing of the audit:
- (a) How the auditor proposes to address the significant risks of material misstatement, including the auditor's approach to the assessment of, and reliance on, internal control;
  - (b) Any significant limitations or additional external requirements that apply to the engagement;
  - (c) Matters that have been agreed with the entity to be communicated to those charged with governance; and
  - (d) The application of materiality in the audit. The auditor explains that (i) both qualitative and quantitative factors are considered when making materiality judgments, and (ii) due to the inherent limitations of an audit, not all material misstatements may be detected.
22. Other planning matters that may be appropriate to discuss with those charged with governance include:
- The extent to which the auditor will use the work of the internal audit function, and how the external and internal auditors can best work together in a constructive and complementary manner.
  - The views of those charged with governance of the entity's objectives and strategies, and the related business risks that may result in material misstatement of the financial statements.
  - The attitudes, awareness, and actions of those charged with governance concerning the entity's internal control and its importance in the entity, how those charged with governance oversee the effectiveness of internal control.
  - The actions of those charged with governance in response to developments in law, accounting standards, corporate governance reporting, listing rules, and other matters relevant to the entity's financial statements and annual report.
  - How the entity has responded to previous communications with the auditor.
  - Any matters, in addition to those required by ISAs and additional external requirements, that the auditor has agreed with those charged with governance to pay particular attention to during the audit.
23. Care is required when communicating with those charged with governance about the scope and timing of the audit, not to compromise the effectiveness of the audit. For example, (a) communicating the nature and timing of detailed audit procedures could make those procedures too predictable, and (b) communicating the materiality level could influence the approach taken to the preparation of the financial statements. Also, although communication with those charged with governance may assist the auditor in

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<sup>2</sup> See [proposed revised] ISA 600 "The Work of Other Auditors in the Audit of Group Financial Statements" for the definition of "component."

planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing and extent of procedures necessary to provide sufficient appropriate audit evidence.

#### CONDUCT OF, AND FINDINGS FROM THE AUDIT

24. **In addition to the matters required by paragraph 35 to be communicated to those charged with governance, the auditor should communicate:**
- (a) **The auditor's views about the qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures** (see paragraphs 25-26);
  - (b) **Significant difficulties encountered during the audit** (see paragraph 27);
  - (c) **Uncorrected misstatements, other than those the auditor believes are clearly trivial.** Corrected misstatements may also be communicated (see paragraph 28-31);
  - (d) **Disagreements with management about matters that individually or in the aggregate could be significant to the entity's financial statements or the auditor's report, and any subsequent resolution.** The auditor need not communicate initial differences of opinion arising from incomplete facts or preliminary information that are later resolved to the auditor's satisfaction;
  - (e) **A summary of representations the auditor is requesting from management, specifically including any representations management may be reluctant to make.** In some cases, the auditor may request both management and those charged with governance to sign a representation letter. The auditor explains the significance of representations that have been requested relating to non-standard issues; and
  - (f) **Other significant matters arising from the audit that are relevant to those charged with governance in overseeing the financial reporting and disclosure process, including major issues that were discussed, or subject to correspondence with management.** Such matters may include:
    - Material misstatements of fact or material inconsistencies in information accompanying the audited financial statements, that have been corrected and therefore are not expected to result in a modification to auditor's report (see also ISA 720, "Other Information in Documents Containing Audited Financial Statements").
    - Concerns about management's consultations with other accountants on accounting or auditing matters. For example, the auditor may be concerned that management has sought the opinion of another accountant on the application of accounting or auditing standards to specific circumstances or transactions, with the intention of creating undue pressure on the judgment and objectivity of the auditor, particularly if the opinion was sought without giving full and proper facts.<sup>3</sup>
    - Discussions or correspondence with management in connection with the initial or recurring appointment of the auditor regarding accounting practices, the application of auditing standards, or fees for audit or other services.

<sup>3</sup> See also, paragraph 13.14 of the IFAC Code of Ethics for requirements regarding communication between the other accountant and the auditor.

*Qualitative aspects of accounting practices*

25. Financial reporting frameworks ordinarily permit the entity to choose, in some areas, the specific accounting practices it will adopt. They allow for the entity to make accounting estimates, and judgments about accounting policies and financial statement disclosures. The auditor communicates openly and constructively, the auditor's views on both the quality and the acceptability of the entity's accounting practices. Appendix 1 provides guidance on the matters that may be included in this communication.
26. The auditor explains to those charged with governance why the auditor considers an accounting practice not to be the most appropriate and, when considered necessary, requests that changes be made. If requested changes are not made, the auditor informs those charged with governance that the auditor will consider the effect of this on the financial statements of the current and future years, and on the auditor's report.

*Significant difficulties encountered*

27. Significant difficulties encountered during the audit may include such matters as (a) significant delays in management providing required information, (b) an unnecessarily brief time within which to complete the audit, (c) extensive unexpected effort required to obtain sufficient appropriate audit evidence, (d) the unavailability of expected evidence, and (e) management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

*Misstatements*

*Uncorrected misstatements*

28. The auditor communicates all known uncorrected misstatements, other than those the auditor believes are clearly trivial, requesting their correction. The auditor addresses material misstatements individually, explaining why the auditor considers them to be material. Where it aids communication, the auditor may provide only a summary of immaterial uncorrected misstatements, e.g., by informing those charged with governance of the number and overall financial effect of immaterial misstatements, rather than communicating the details of each individual misstatement.
29. The auditor ordinarily discusses with those charged with governance the reasons for, and the appropriateness of, a failure to correct misstatements, having regard to qualitative as well as quantitative considerations, including possible implications in relation to future financial statements.
30. To reduce the possibility of misunderstandings, the auditor may request a written representation from those charged with governance that explains why misstatements brought to their attention have not been corrected. Obtaining the representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements.

*Corrected misstatements*

31. Communication by the auditor of corrected misstatements may assist those charged with governance to fulfill their responsibilities. For example, frequently recurring immaterial misstatements, although corrected, may indicate weaknesses in internal control or a particular bias in the initial preparation of the financial statements.

## STATEMENT OF AUDITOR INDEPENDENCE

32. **In the case of listed entities, the auditor should communicate, at least annually, in writing to those charged with governance:**
- (a) **A statement that the assurance team, the firm and network firms are independent in accordance with relevant ethical requirements<sup>4</sup> and any additional external requirements that apply to the engagement;**
  - (b) **All relationships and other matters between the firm, network firms and the entity that in the auditor’s professional judgment may reasonably be thought to bear on independence, and the related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level; and**
  - (c) **The total fees charged for audit and for non-audit services provided by the firm and network firms to the entity and its components<sup>5</sup> in the preceding 12 months, allocated to appropriate categories. For each category, the auditor should also disclose the amounts of any future services that have been contracted for.**
33. The auditor considers whether the communications set out in the preceding paragraph are also appropriate in the case of entities that are not listed entities. Communications regarding independence may be unnecessary, e.g., where all of those charged with governance are aware of relevant facts through their management activities. This is particularly likely to be the case where the entity is owner-managed, and the auditor’s firm and network firms have little involvement with the entity beyond an annual audit.
34. In determining the relationships and other matters, and safeguards to communicate, the auditor refers to Section 8 of the IFAC Code of Ethics. The Code provides guidance, including application to specific situations, on:
- (a) Threats to independence, categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and
  - (b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm’s own systems and procedures.

## OTHER ISAS, ADDITIONAL EXTERNAL REQUIREMENTS, AND MATTERS AGREED WITH THE ENTITY

35. **The auditor should communicate to those charged with governance, matters that other ISAs or additional external requirements require to be communicated, and matters that have been agreed with the entity (including an agreement directly with those charged with governance) to be communicated.**
36. The matters referred to in the preceding paragraph may relate either to the responsibility of those charged with governance to oversee the financial reporting and disclosure process, or other responsibilities. In some cases, the auditor may be required to perform additional procedures to identify such matters; in other cases the auditor may be

<sup>4</sup> Relevant ethical requirements ordinarily comprise Section 8 of the IFAC Code of Ethics and relevant national ethical requirements.

<sup>5</sup> See [proposed revised] ISA 600 “The Work of Other Auditors in the Audit of Group Financial Statements” for the definition of “component.”

required to communicate only those matters that come to the auditor's attention as part of the audit of the financial statements.

37. Appendix 2 lists the requirements of other ISAs regarding communication with those charged with governance to complement the framework established in this ISA.

#### OTHER MATTERS OF WHICH THE AUDITOR MAY BECOME AWARE

38. **The auditor should communicate to those charged with governance other matters arising from the audit of the financial statements that the auditor judges to be serious and relevant to the responsibilities of those charged with governance.** Such matters may include:

- Inadequate governance structures or processes.
- Abuse of position by senior management.
- Financial mismanagement.
- Inadequate processes for (a) identifying business risks, other than those relevant to financial reporting objectives, including risks arising from weaknesses in the design or implementation of internal controls not related to financial reporting, and (b) deciding about actions to address those risks.
- Concerns the auditor may have about management's integrity, e.g., inconsistent or misleading responses by management to issues the auditor has raised.

39. Unless the auditor is required by additional external requirements to undertake procedures to determine whether matters such as those noted in the preceding paragraph have occurred, in reporting such matters, the auditor makes those charged with governance aware that:

- (a) The matters were identified as a by-product of the audit, and therefore no procedures were carried out in addition to those necessary to form an opinion on the financial statements;
- (b) No procedures have been undertaken to determine whether other matters of the nature of the items reported have occurred; and
- (c) When appropriate, these matters have been discussed with management.

#### The communication process

40. **The auditor should seek to establish with those charged with governance, a mutual understanding of the form, timing and expected general content of communications.**
41. The communication process will vary with the circumstances, including the size and ownership characteristics of the entity, how those charged with governance operate, and the auditor's view of the importance of matters to be communicated. For example, the auditor will often communicate more formally with those charged with governance of listed companies than small entities.

#### ESTABLISHING EXPECTATIONS

42. To help establish effective two-way communication, the expectations of both the auditor and those charged with governance regarding the content, form and timing of communications are established at an early stage of the audit. Communication of the auditor's responsibilities (paragraphs 16-19) and the planned scope and timing of the

audit (paragraphs 20-23) form the basis for establishing expectations. How these expectations are established will vary, reflecting the size and ownership characteristics of the entity and how those charged with governance operate.

43. Matters that may be discussed in establishing expectations include:
- The form in which communications will be made.
  - The person(s) with whom the auditor will communicate on particular matters.
  - The process for taking action and reporting back on matters communicated by the auditor.
  - Any agreed extension of the auditor's responsibilities beyond those established by ISAs and additional external requirements that apply to the engagement.

#### FORMS OF COMMUNICATION, AND DOCUMENTATION

44. Subject to paragraphs 32 and 48, the auditor's communications with those charged with governance may be oral or in writing. Although this ISA is generally not prescriptive regarding the form of communication, effective communication ordinarily involves informal communications, including discussions, as well as formal written reports.
45. Whether to communicate a particular matter orally or in writing is affected by such factors as:
- The size, operating structure and legal structure of the entity being audited.
  - The significance of the matter, including its nature and sensitivity.
  - Legal requirements.
  - Arrangements made for periodic meetings or reporting.
  - The amount of on-going contact and dialogue the auditor has with those charged with governance.
46. Particularly significant matters that are communicated orally are ordinarily confirmed through correspondence or recorded in minutes of the discussion. The auditor documents in the audit working papers, particularly significant matters that are communicated orally but not confirmed through correspondence or recorded in minutes, e.g. where communicating a matter in writing would be contrary to legal advice. This documentation is sufficiently detailed to enable the reader to understand the matter communicated and, where applicable, how issues were resolved and what actions were agreed.
47. When a significant matter is discussed informally with, for example the chair of an audit committee, the auditor ordinarily summarizes the matter in later formal communications so that all members of the audit committee have full and balanced information.
48. **The auditor should issue a written report to those charged with governance regarding the conduct of, and findings from each audit.** This report is issued even if its content is limited to explaining that there is nothing the auditor wishes to draw to the attention of those charged with governance. This avoids doubt by assuring those charged with governance they have been made aware of matters the auditor wishes to draw to their attention in writing. It may be appropriate to include this report with the written communication relating to auditor independence required by paragraph 32, or with the annual engagement letter, where one exists. In some jurisdictions, an annual

communication to those charged with governance regarding the conduct of, and findings from each audit is required by local law to be in a prescribed form.

#### CONFIDENTIALITY

49. On occasions, those charged with governance may wish to provide third parties, for example bankers or certain regulatory authorities, with copies of a written communication from the auditor. In some cases, that disclosure may not be appropriate. When providing to third parties a written communication prepared for those charged with governance, it is important to inform the third parties that the communication was not prepared with them in mind. The auditor therefore ordinarily states in written communications to those charged with governance that:

- (a) The communication has been prepared for the sole use of the entity and, where appropriate, the parent entity and its auditor;
- (b) It must not be disclosed to a third party, or quoted or referred to, without the auditor's prior written consent; and
- (c) No responsibility is assumed by the auditor to other persons.

Similarly, the auditor ordinarily requires the prior consent of those charged with governance before providing to a third party, a copy of the auditor's written communications to those charged with governance.

50. In certain jurisdictions, and particularly in the public or regulated sectors, the auditor may have a duty to submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies. Similarly, there may be a requirement or expectation that reports will be made public. In such circumstances, application of the preceding paragraph is modified appropriately.

#### TIMING OF COMMUNICATIONS

51. **Communications should be made on a sufficiently timely basis to enable those charged with governance to take appropriate action.**

52. The appropriate timing for communications will vary with the circumstances, including the nature of the matter to be communicated. For example:

- Findings from the audit that are relevant to the financial statements or the auditor's report, including the auditor's views about the qualitative aspects of the entity's accounting practices, are ordinarily communicated before those charged with governance approve the financial statements.
- Communications regarding independence will ordinarily be appropriate (a) before those charged with governance approve the financial statements, and (b) whenever significant judgments are made about threats to independence and related safeguards, e.g., when accepting an engagement to provide non-audit services.
- Communications regarding planning matters will ordinarily be made early in the audit engagement. In the case of a recurring annual audit of a small entity however, it may be appropriate to discuss planning issues for the next year when discussing findings at the completion of the current year's audit.
- In certain circumstances, the auditor may identify matters that need to be communicated to those charged with governance without delay, e.g. the existence of a material weakness in internal control.

## EFFECTIVENESS OF THE COMMUNICATION PROCESS

53. **The auditor should consider whether the two-way communication between the auditor and those charged with governance has been adequate for an effective audit and, if it has not, should take appropriate action as required.**
54. Paragraph 69 of ISA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement,” identifies participation by those charged with governance, including their interaction with internal and external auditors, as an element the auditor considers when evaluating the design of the entity's control environment. Inadequate two-way communication may indicate an unsatisfactory control environment, which will influence the auditor's assessment of the risks of material misstatements. Examples of evidence about the adequacy of the two-way communication process may include:
- The appropriateness and timeliness of actions taken by those charged with governance in response to the recommendations made by the auditor. Where significant matters raised in previous communications have not been dealt with effectively, the auditor enquires as to why appropriate action has not been taken and considers raising the point again. This avoids the risk of giving an impression that the auditor is satisfied that the matter has been adequately addressed or is no longer significant.
  - The apparent openness of those charged with governance in their communications with the auditor.
  - The willingness and capacity of those charged with governance to meet with the auditor without management present.
  - The apparent ability of those charged with governance to fully comprehend the recommendations made by the auditor e.g., the extent to which those charged with governance probe issues, and question recommendations made to them.
55. If the two-way communication between the auditor and those charged with governance is not adequate for an effective audit, there is a risk the auditor may not have obtained all the audit evidence required to form an opinion on the financial statements. Consequently, the auditor takes such actions as:
- Obtaining legal advice about the consequences of different courses of action.
  - Communicating with third parties (e.g., a regulator), or a higher authority in the governance structure that is outside the entity, such as the owners of a small private business, or the responsible government minister or Parliament in the public sector.
  - Withdrawing from the engagement.

**Legal considerations**

56. In some jurisdictions there may be circumstances where the auditor is required to report to a regulatory or enforcement body certain matters communicated to those charged with governance. For example, in some countries the auditor has a duty to report misstatements to authorities where management and those charged with governance fail to take corrective action.
57. In some circumstances, the auditor may be prevented by law from communicating certain matters to those charged with governance, or others, within the entity. For example, local laws may specifically prohibit a communication, or other action, that

might prejudice an investigation by an appropriate authority into an actual or suspected illegal act, e.g., where the communication, or other action, could alert the perpetrator of an illegal act to the fact that it had been detected. Local laws that prevent the auditor from applying a requirement of this ISA may constitute a scope limitation that results in a modification of the auditor's report. In such circumstances the auditor ordinarily seeks legal advice.

58. In some jurisdictions, legislation can prevent personnel within a firm, a network firm or another firm, from communicating to the auditor, matters of which they become aware while performing certain professional services, e.g.: tax consulting. In such cases, the auditor (a) communicates the existence and effect of such legislation with those charged with governance, (b) seeks to have the affected personnel released from such confidentiality restrictions to the extent possible, and (c) considers whether the situation constitutes a scope limitation that results in a modification of the auditor's report. In such circumstances the auditor ordinarily seeks legal advice.

**Effective date**

59. This ISA is effective for audits of financial statements for periods beginning on or after xx XXXX 200x

## Appendix 1

**Qualitative aspects of accounting practices, including accounting policies, accounting estimates and financial statement disclosures**

The communication required by paragraph 24 (a) may include such matters as:

*Accounting policies:*

- The appropriateness of the accounting policies to the particular circumstances of the entity, having regard to the need to balance the cost of providing information with the likely benefit to users of the entity's financial statements.
- The existence of acceptable alternative accounting policies, and the acceptability of the particular policy as applied by the entity. The communication could include identification of the financial statement amounts that are affected by the choice of policies as well as information on accounting policies used by similar entities.
- The initial selection of, and changes in significant accounting policies, including the application of new accounting pronouncements. The communication could include (a) the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity, and (b) the timing of a change in accounting policies in relation to expected new accounting pronouncements.
- The effect of significant accounting policies in controversial or emerging areas (or those unique to an industry, particularly when there is a lack of authoritative guidance or consensus).
- The effect of the timing of transactions in relation to the period in which they are recorded.

*Accounting estimates<sup>6</sup> and disclosures*

- The issues involved, and related judgments made, in formulating particularly sensitive accounting estimates and disclosures (for example, disclosures related to revenue recognition, going concern, subsequent events and contingency issues).
- Major items for which estimates are significant, including how such estimates are determined and subsequently monitored, and the consistency of assumptions.
- To the extent that estimates involve a range of possible outcomes, the communication could indicate how the recorded estimate relates to the range and how various selections within the range would affect the financial statements.
- The overall neutrality, consistency and clarity of the disclosures in the financial statement and in the annual report.

*Related matters:*

- The potential effect on the financial statements of significant risks and exposures, and uncertainties, such as pending litigation, that are required to be disclosed in the financial statements.
- The extent to which the financial statements are affected by unusual transactions including non-recurring amounts recognized during the period, and the extent to which such transactions are separately disclosed in the financial statements.

<sup>6</sup> The audit of accounting estimates is specifically addressed in ISA 540, “The Audit of Accounting Estimates and Related Disclosures (Excluding Those Involving Fair Value Measurements and Disclosures).”

- The factors affecting asset and liability carrying values, including the entity's bases for determining useful lives assigned to tangible and intangible assets. The communication could explain how factors affecting carrying values were selected and how alternative selections would have affected the financial statements.
- The selective correction of misstatements, e.g., correcting misstatements with the effect of increasing reported earnings, but not those that have the effect of decreasing reported earnings.

## Appendix 2

**Other ISAs referring to communications with  
“those charged with governance,” “management,” or related terms**

The paragraphs referred to below are found in ISAs effective as of xx, XXXX 200x unless noted otherwise, that contain basic principles and essential procedures referring to communications with “those charged with governance,” “management,” or related terms,<sup>7</sup> e.g., “the client.” Paragraphs in other ISAs that merely contain a cross-reference to substantive requirements within ISA 260 are not included in this Appendix. These paragraphs are to be understood and applied in the context of the explanatory and other material in ISAs that provide guidance for their application. It is therefore necessary to consider the whole text of a Standard to understand and apply the basic principles and essential procedures.

Note: The following ISAs are currently being revised and have not been included in this appendix at this stage. Appropriate extracts will be added as this document is finalized: **[DRAFTING NOTE: NEED TO FINALIZE FOR ISAs THAT WILL BE ISSUED (FINAL OR ED) IN DEC]**

- ISA 320 “Materiality in the Identification and Evaluation of Misstatements”
- ISA 540 “Audit of Accounting Estimates”
- ISA 600 “The Work of Other Auditors in the Audit of Group Financial Statements”
- ISA 700 “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements”

**ISA 210 “Terms of Audit Engagements”**

2. **The auditor and the client should agree on the terms of the engagement.** The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.
10. **On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.**
17. **Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.**
19. **If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as those charged with governance or shareholders, the circumstances necessitating the withdrawal.**

**ISA 240 “The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements”**

34. **When obtaining an understanding of the entity and its environment, including its internal control, the auditor should make inquiries of management regarding:**

<sup>7</sup> This Appendix has not been limited to “those charged with governance” because, as noted in the Explanatory Memorandum to this Exposure Draft, that ambiguity may exist when interpreting some ISAs in certain circumstances, e.g. when those charged with governance are the same people (person) as management, and in jurisdictions where those charged with governance, rather than management, have direct responsibility for the preparation and presentation of the financial statements. The IAASB is implementing a protocol for use of “those charged with governance,” “management” and related terms when developing new documents and revising current documents.

- (a) Management’s assessment of the risk that the financial statements may be materially misstated due to fraud;
  - (b) Management’s process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or account balances, classes of transactions or disclosures for which a risk of fraud is likely to exist;
  - (c) Management’s communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
  - (d) Management’s communication, if any, to employees regarding its views on business practices and ethical behavior.
38. The auditor should make inquiries of management, internal audit, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.
46. The auditor should make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.
90. The auditor should obtain written representations from management that:
- (a) It acknowledges its responsibility for the design and implementation of internal control to prevent and detect fraud;
  - (b) It has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud;
  - (c) It has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving:
    - (i) Management;
    - (ii) Employees who have significant roles in internal control; or
    - (iii) Others where the fraud could have a material effect on the financial statements; and
  - (d) It has disclosed to the auditor its knowledge of any allegations of fraud, or suspected fraud, affecting the entity’s financial statements communicated by employees, former employees, analysts, regulators or others.
93. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor should communicate these matters as soon as practicable to the appropriate level of management.
95. If the auditor has identified fraud involving:
- (a) Management;
  - (b) Employees who have significant roles in internal control; or
  - (c) Others where the fraud results in a material misstatement in the financial statements,
- the auditor should communicate these matters to those charged with governance as soon as practicable.
99. The auditor should make those charged with governance and management aware, as soon as practicable, and at the appropriate level of responsibility, of material weaknesses in the design or implementation of internal control to prevent and detect fraud which may have come to the auditor’s attention.
101. The auditor should consider whether there are any other matters related to fraud to be discussed with those charged with governance of the entity. Such matters may include for example: ...
103. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit the auditor should:

- (a) Consider the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (b) Consider the possibility of withdrawing from the engagement; and
- (c) If the auditor withdraws:
  - (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
  - (ii) Consider whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

**ISA 250 "Consideration of Laws and Regulations"**

- 18. After obtaining the general understanding, the auditor should perform procedures to help identify instances of noncompliance with those laws and regulations where noncompliance should be considered when preparing financial statements, specifically:
  - (a) Inquiring of management as to whether the entity is in compliance with such laws and regulations; and
  - (b) Inspecting correspondence with the relevant licensing or regulatory authorities.
- 23. The auditor should obtain written representations that management has disclosed to the auditor all known actual or possible noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
- 28. When the auditor believes there may be noncompliance, the auditor should document the findings and discuss them with management. Documentation of findings would include copies of records and documents and making minutes of conversations, if appropriate.
- 32. The auditor should, as soon as practicable, either communicate with those charged with governance, or obtain evidence that they are appropriately informed, regarding noncompliance that comes to the auditor's attention. However, the auditor need not do so for matters that are clearly inconsequential or trivial and may reach agreement in advance on the nature of such matters to be communicated.
- 33. If in the auditor's judgment the noncompliance is believed to be intentional and material, the auditor should communicate the finding without delay.
- 34. If the auditor suspects that members of senior management, including members of the board of directors, are involved in noncompliance, the auditor should report the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or a supervisory board. Where no higher authority exists, or if the auditor believes that the report may not be acted upon or is unsure as to the person to whom to report, the auditor would consider seeking legal advice.

**ISA 315 "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement"**

- 120. The auditor should make those charged with governance or management aware, as soon as practicable, and at an appropriate level of responsibility, of material weaknesses in the design or implementation of internal control which have come to the auditor's attention.

**ISA 545 “Fair Value Measurements and Disclosures”**

63. The auditor should obtain written representations from management regarding the reasonableness of significant assumptions, including whether they appropriately reflect management’s intent and ability to carry out specific courses of action on behalf of the entity where relevant to the fair value measurements or disclosures.

**ISA 550 “Related Parties”**

15. The auditor should obtain a written representation from management concerning:
  - (a) The completeness of information provided regarding the identification of related parties; and
  - (b) The adequacy of related party disclosures in the financial statements.

**ISA 560 “Subsequent Events”**

9. When, after the date of the auditor’s report but before the financial statements are issued, the auditor becomes aware of a fact which may materially affect the financial statements, the auditor should consider whether the financial statements need amendment, should discuss the matter with management, and should take the action appropriate in the circumstances.
14. When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the auditor’s report and which, if known at that date, may have caused the auditor to modify the auditor’s report, the auditor should consider whether the financial statements need revision, should discuss the matter with management, and should take the action appropriate in the circumstances.

**ISA 570 “Going Concern”**

18. The auditor should consider the same period as that used by management in making its assessment under the financial reporting framework. If management’s assessment of the entity’s ability to continue as a going concern covers less than twelve months from the balance sheet date, the auditor should ask management to extend its assessment period to twelve months from the balance sheet date.
22. The auditor should inquire of management as to its knowledge of events or conditions beyond the period of assessment used by management that may cast significant doubt on the entity’s ability to continue as a going concern
26. When events or conditions have been identified which may cast significant doubt on the entity’s ability to continue as a going concern, the auditor should:
  - (a) Review management’s plans for future actions based on its going concern assessment;
  - (b) Gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists through carrying out procedures considered necessary, including considering the effect of any plans of management and other mitigating factors; and
  - (c) Seek written representations from management regarding its plans for future action.

**ISA 580 “Management Representations”**

2. The auditor should obtain appropriate representations from management.
3. The auditor should obtain evidence that management acknowledges its responsibility for the fair presentation of the financial statements in accordance with the relevant financial reporting framework, and has approved the financial statements. The auditor can obtain evidence of

management's acknowledgment of such responsibility and approval from relevant minutes of meetings of the board of directors or similar body or by obtaining a written representation from management or a signed copy of the financial statements.

4. **The auditor should obtain written representations from management on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist.** The possibility of misunderstandings between the auditor and management is reduced when oral representations are confirmed by management in writing. Matters which might be included in a letter from management or in a confirmatory letter to management are contained in the example of a management representation letter in the Appendix to this ISA.
15. **If management refuses to provide a representation that the auditor considers necessary, this constitutes a scope limitation and the auditor should express a qualified opinion or a disclaimer of opinion.** In such circumstances, the auditor would evaluate any reliance placed on other representations made by management during the course of the audit and consider if the other implications of the refusal may have any additional effect on the auditor's report.

#### ISA 720 “Other Information”

16. **If the auditor becomes aware that the other information appears to include a material misstatement of fact, the auditor should discuss the matter with the entity's management.** When discussing the matter with the entity's management, the auditor may not be able to evaluate the validity of the other information and management's responses to the auditor's inquiries, and would need to consider whether valid differences of judgment or opinion exist.
17. **When the auditor still considers that there is an apparent misstatement of fact, the auditor should request management to consult with a qualified third party, such as the entity's legal counsel and should consider the advice received.**
18. **If the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor should consider taking further appropriate action.** The actions taken could include such steps as notifying those persons ultimately responsible for the overall direction of the entity in writing of the auditor's concern regarding the other information and obtaining legal advice

#### ISA 800 “The Auditor's Report on Special Purpose Audit Engagements”

3. The nature, timing and extent of work to be performed in a special purpose audit engagement will vary with the circumstances. **Before undertaking a special purpose audit engagement, the auditor should ensure there is agreement with the client as to the exact nature of the engagement and the form and content of the report to be issued.**

**PROPOSED CONFORMING AMENDMENT TO  
INTERNATIONAL STANDARD ON AUDITING 570  
GOING CONCERN**

*[Paragraphs 1-29 of ISA 570 would remain unchanged.]*

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

**40. The auditor should communicate events or conditions that may cast significant doubt on the entity's ability to continue as a going concern to those charged with governance.**

41. When events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor outlines those events or conditions to those charged with governance, and informs them of the auditor's conclusions, and the reasons for those conclusions, regarding:

- (a) Whether the events or conditions constitute a material uncertainty;
- (b) Whether use of the going concern assumption is appropriate in the preparation of the financial statements; and
- (c) The adequacy of related disclosures in the financial statements.

*[Paragraphs 30-40 of ISA 570 would remain unchanged but be renumbered paragraph 33-43.]*

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**PROPOSED CONFORMING AMENDMENT TO  
INTERNATIONAL STANDARD ON AUDITING 701  
MODIFICATIONS TO THE INDEPENDENT AUDITOR'S REPORT**

*[Paragraphs 1-21 of ISA 701 would remain unchanged.]*

**Communication with those charged with governance**

**22. The auditor should communicate expected modifications to the auditor's report to those charged with governance.**

23. The auditor seeks to discuss expected modifications to the auditor's report on the financial statements with those charged with governance. This helps to ensure that:

- (a) Those charged with governance are aware of the expected modification and the reasons for it before the financial statements are finalized;
- (b) There are no disputed facts in respect of the matter(s) giving rise to the proposed modification, or that matters of disagreement are confirmed as such; and
- (c) Those charged with governance have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification.

*[Paragraph 22 of ISA 701 would remain unchanged but be renumbered paragraph 24.]*