

**ISA 260 (Revised and Redrafted)  
Significant Issues**

NOTE: Paragraph references written as “(old)” are to paragraph numbers as they appeared in the Exposure Draft version of proposed ISA 260 (Revised and Redrafted), which can be seen in mark-up in Agenda Item 9-C.

**A. Objectives**

- A1. Of the 39 respondents who commented on the objectives, 21 agreed, or agreed with minor qualification, with the objectives as exposed (ACAG, Aud Com, AUASB, CIPFA, EYG, FAR, GTI, HKICPA, IAIS, ICAI, ICAP, ICAS, ICPAK, ICPAS, INTOSAI, IRBA, JICPA, KPMG, Mazars, NAO, PwC, PA for Saskatchewan, and ZICA).
- A2. Most other respondents commented on the extent to which two-way communication should be reflected in the objectives. Of these:
- (a) APB, Basel, BDO, CPAA, CEBS, IAIS, and ICAS considered that the objectives should give more emphasis to effective two way communication. Suggestions to do this included:
    - Replacing paragraph 5 with a (modified version of) the wording of paragraph 7 of the close off document, which stated the principal purposes of communication with those charged with governance.<sup>1</sup>
    - Being more outcome oriented, e.g., by specifically mentioning the objective of establishing a mutual understanding with those charged with governance.
    - Reference in the objective to the requirement at (old) paragraph 19 that the auditor evaluate the two-way communication between the auditor and those charged with governance.
    - Amalgamating paragraphs 5 (a) and 5 (c).

<sup>1</sup> Paragraph 7 of the close off document is as follows.

“The principal purposes of communication with those charged with governance are to:

- (a) Establish a mutual understanding of (i) the respective responsibilities of the auditor, those charged with governance and management in relation to the financial statement audit and (ii) the scope and timing of the audit;
- (b) Provide those charged with governance with timely observations arising from the audit that are relevant to their responsibility to oversee the financial reporting process; and
- (c) Obtain from those charged with governance, information relevant to the audit.

To achieve the principal purposes of communication, the auditor communicates matters clearly with those charged with governance, and reasonably expects those charged with governance to communicate clearly matters they consider relevant to the audit.”

This wording is similar to the wording of draft objectives discussed at the May 2006 CAG meeting, which a number of respondents also suggested be used.

- Moving some of the text of A1 (which notes the importance of effective two-way communication) into paragraph 5.
- (b) CNCC, DTI, FEE, IRE, IdW, and NIVRA considered that the proposed reference in the objectives to the auditor obtaining information from those charged with governance (paragraph 5 (b)) should be moved, deleted or modified. The principal argument for this was the one IAASB has discussed a number of times that an auditing standard cannot impose an obligation on those charged with governance to provide information, which is a precondition for the auditor to obtain that information from them. It was also noted that:
- There is no requirement in the proposed ISA that directly supports this objective.
  - It would not be possible for the auditor to determine whether this objective had been achieved or not (i.e. the auditor is not in a position to not know for sure whether TCWG are withholding information).
  - It relies on a common understanding of what information is considered “relevant to the audit,” however, the proposed standard does not provide guidance on what that phrase means in the context of the objective.

The main suggestion for modifying paragraph 5 (b) was for it to read “Seek to oObtain from those charged with governance, information relevant to the audit.”

- A3. The final wording of the auditor’s obligation to achieve the objectives stated in ISAs is currently subject to exposure. However, regardless of the final wording, it could be expected to reflect the view that “... the auditor cannot be subjected to an absolute obligation to achieve an objective, because of the inherent nature of an objective and the possibility that there may be circumstances that prevent its achievement.”<sup>2</sup> This view allows for the addition of a reference to two-way communication in the objectives, as proposed in the revised draft. It also allows for the possibility of an objective that states a desired outcome over which the auditor cannot exercise absolute control, as is the case with paragraph 5 (b), although it should be noted that the application material indicates that the auditor may confirm or discuss the views of those charged with governance on a range of matters, which will typically be the case.
- A4. The task force considers the addition of a reference to two-way communication in the objectives, as proposed in the revised draft, to be an appropriate response to the concerns expressed above. Without detracting from the primacy of the matters mentioned in paragraphs 5 (a) to (c), this reference makes it clear that two-way communication is important, as acknowledged in paragraphs 3, (old) 19, and A1.

## **B. Number of requirements**

- B1. The increase in the number of requirements due to present tense statements being elevated to a requirement was of concern to a number of respondents, e.g.:
- ACCA: *“proposed ISA 260 exhibits a substantial growth in the number and detail of specific requirements. For each new requirement we consider whether the ‘elevation’ from a*

<sup>2</sup> Explanatory Memorandum to proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing” (April 2007)

*present-tense statement in the close-off document is appropriate. Our detailed analysis concludes that hardly any of the changes are justified.”*

- ICAEW: *“There is a significant overall increase in the number of mandatory requirements in this standard through the elevation of present tense statements. In isolation, elevations may seem unobjectionable but the cumulative effect is an unnecessary burden on audit firms and represents a drift towards a box-ticking, compliance approach that will do nothing to promote audit quality.”*
- NZICA: *there has been “an increase in the number of Requirements in the Redrafted Standards (for example, a 50% increase over ISA 260). We see this as an issue in gaining acceptance of the Redrafted Standards. In our opinion, there should be a very clear reason for elevating previously grey-letter paragraphs to Requirements.”*

- B2. BDO also noted an increase in the number of requirements, and many respondents made specific suggestions on particular paragraphs, e.g., a number of respondents questioned the inclusion of “conditional” requirements. In particular ACCA, BDO, CNCC, FEE, IRE and ICAEW suggested that because (old) paragraphs 8 and 9 are conditional, they should be made a subset of paragraph 7. This is premised on the view that requirements should not be conditional because conditional requirements do not apply to virtually all audits (a view expressed in some responses to the Explanatory Memorandum’s Question 2). The clarity conventions do, however, allow for conditional requirements if the requirement is virtually always applicable when the stated condition exists. Nonetheless, the task force reviewed each instance of a conditional requirement to assess whether it was appropriately included in the requirements section.
- B3. As a result, the task force recommends the “demotion” of requirements in:
- (a) (Old) paragraphs 8 (see “Determining those charged with governance” below for further discussion of (old) paragraph 8); and
  - (b) (Old) paragraph 14(a) (see “Requesting a change to a significant accounting practice” below for further discussion of (old) paragraph 14(a)).
- B4. Removal of these requirements, coupled with removal of non-essential explanatory material (see discussion under the next heading), has led to a “slimming down” of the requirements section.

### **C. Essential explanatory material, and the use of “may”**

- C1. A number of respondents questioned the inclusion of explanatory material in the requirements section, e.g.:
- IOSCO: *“The inclusion of statements in the requirements section that appear to be guidance (i.e., statements that include the words ‘may’ or that are written in the present tense) make it unclear as to the authority of, and obligation attaching to, such statements.”*
  - ACCA: *“We do not agree with including explanatory material in the requirements section. In our experience, the first process a user carries out is to highlight all uses of the word ‘shall’ so as to discover which parts of the text are requirements. Rather than improving*

*clarity, explanatory material adds unnecessary length and detracts from the reader's understanding."*

Others who made similar comments, either in general or in relation to specific paragraphs, included ICAEW, HKICPA, BDO, DTT, GTI, IRBA, NAO, NIVRA, and NZICA.

- C2. The clarity conventions allow for the inclusion of explanatory material in the requirements section when it is considered "essential." ISA 260 was one of the first ISAs converted to the clarity format and since that time the IAASB has gained further experience with application clarity conventions. That further experience suggests less, rather than more, explanatory material being included in the requirements section.
- C3. In light of this trend and the comments received, the task force reviewed each instance of explanatory material in the requirements section, and in most cases decided it was not essential. In particular, where "may" was used in the requirements in relation to an action by the auditor, that guidance has either been:
  - (a) Moved to the application material ((old) paragraph 7 moved to A8; (old) paragraph 19 moved to (old) A46; and (old) paragraph 20 moved to A47); or
  - (b) The wording revised to remove "may" ((old) paragraph 9).

#### **D. Shall consider**

- D1. The ED used the "shall consider" formulation in three places. IOSCO, in their comment on (old) paragraph 9 note: *"In nearly every case where the term 'shall consider' has been used, we believe the more appropriate verb would be 'determine, assess, or evaluate.' We recognize that there may be occasional instances when 'shall consider' is the most appropriate term because all that is expected is for the auditor to 'think about' something; however, we think such instances should be relatively infrequent."* Others who supported replacing "shall consider" at one or more places in the ED were BDO, CEBS, HKIPA, and NZICA.
- D2. The task force has reviewed the three uses of "shall consider," and recommends that it be replaced with "determine" in (old) paragraph 9, "be satisfied" in (old) paragraph 10, and "evaluate" in (old) paragraph 19.

#### **E. Determining those charged with governance**

- E1. Paragraph 7 requires the auditor to determine the appropriate person within the entity's governance structure with whom to communicate. (Old) paragraph 8 deals with situations in which determining the appropriate person is not clear from the circumstances of the engagement; (old) paragraph 9 deals with communication with a subgroup; and (old) paragraph 10 deals with situations in which all of those charged with governance are involved in managing the entity.
- E2. A number of respondents (ACCA, BDO, CNCC, FEE, HKICPA, IRE, ICAS, ICAEW, NIVRA, NZICA and PwC) made various suggestions about moving (old) paragraphs 8 and 9, and/or 10 into the application material, or rolling them into paragraph 7. The main theme in these comments was that (old) paragraphs 8 and 9, and/or 10 are merely applications of paragraph 7 to particular situations, i.e., when paragraph 7 is properly complied with, the auditor will have met (old) paragraphs 8, 9 and/or 10. Other points raised included:

- (a) (Old) paragraphs 8, 9 and 10 are conditional (as discussed above under the heading “Number of requirements”);
  - (b) (Old) paragraph 9 has the relatively “weak” formulation of “shall consider” followed by “may”; and
  - (c) (Old) paragraph 10 contains too much explanatory material, and a negative requirement (“... matters need not be communicated ...”).
- E3. The task force agrees that (old) paragraph 8 is an application of paragraph 7 and need not be a requirement. It has been moved to the application material at paragraph A8. The task force does not agree that (old) paragraphs 9 and 10 should be either moved to the application material or rolled into paragraph 7. Although (old) paragraph 9 is conditional, it is very common for auditors to communicate with a subgroup of those charged with governance, and the task force considers that the substance of this paragraph warrants its retention as a requirement. Its wording has been strengthened accordingly.
- E4. The need for a separate requirement for those situations in which all of those charged with governance are involved in managing the entity has been well debated at IAASB during revision of this ISA and has been strongly supported by the IFAC SMP Committee. The task force believes (old) paragraph 10 is needed to properly set up the differentiation of matters to be communicated in (old) paragraph 14 (c), and should continue to be given the prominence of a requirement. The task force has also reviewed the wording of (old) paragraph 10, and is satisfied that the amount of explanatory material and the retention of the negative requirement is appropriate in the circumstances.

**F. Requesting a change to a significant accounting practice**

- F1. (Old) paragraph 14(a) requires the auditor to communicate *“The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice not to be appropriate and, when considered necessary, shall request changes.”*
- F2. ACCA, APB, FEE, HKICPA, ICAEW and PwC suggested that the second sentence of this paragraph (i.e., “When applicable ...”) be removed, arguing either that its is already covered by proposed ISA 450 (Revised and Redrafted), “Evaluation of Misstatements Identified during the Audit” (ACCA, and FEE); that it should be moved to proposed ISA 450 (Revised and Redrafted) (ICAEW); or that it is already covered by the first sentence (APB, HKICPA, and PwC).
- F3. APB and PwC further suggested that if the second sentence is retained, that at least the final part thereof (“and, when considered necessary, shall request changes”) should be deleted because it *“is only appropriate if the auditor is of the view that there is a misstatement. This is already addressed in proposed ISA 450 ... and therefore duplicative.”*
- F4. The task force considers that the second sentence of (old) paragraph 14 (a) should be kept to emphasize those circumstances in which the auditor considers a significant accounting practice

inappropriate, but not the cause of a misstatement, e.g., when a practice is aggressive but acceptable in accordance with the applicable financial reporting framework. Communication of such matters is not dealt with in proposed ISA 450 (Revised and Redrafted), which deals with the communication of misstatements only; and, in the task force's view, should not be moved to proposed ISA 450 (Revised and Redrafted) as it better fits with the discussion of the qualitative aspects of accounting practices in the first sentence of (old) paragraph 14 (a) than with the communication of misstatements. The task force does, however, agree that if the auditor considers it necessary to request a change, the matter must relate to a misstatement, and is, therefore covered by proposed ISA 450 (Revised and Redrafted). The task force therefore recommends deleting the final part of the sentence ("and, when considered necessary, shall request changes").

#### **G. Listed versus public interest entities**

- G1. (Old) paragraph 15 requires communication of certain matters related to independence. It applies only in the case of listed entities. Basel, AASB, CEBS, IAIS, Mazars, and NZICA suggest that it should apply for "public interest" entities (consistent with proposed changes to the IFAC Code of Ethics); and the Provincial Auditor for Saskatchewan suggests that it should apply for all entities.
- G2. This issue was discussed by the IAASB at its April 2007 meeting in the context of the requirement of proposed ISQC 1 (Redrafted) that listed entities have an engagement quality control review, at which time it was agreed "that to extend the requirement for reviews beyond listed entities would not be appropriate as part of the clarity project, but would be considered again when changes to the Code as a result of the IESBA exposure draft have been finalized. A decision on the matter at that time would have the benefit of being informed by feedback received by the IESBA on its exposure draft."
- G3. The task force considers this same rationale should be applied in the case of (old) paragraph 15.

#### **H. Written communication**

- H1. (Old) paragraph 17 states: *"The auditor shall communicate in writing with those charged with governance regarding auditor independence when required by paragraph 15, and significant findings from the audit when, in the auditor's professional judgment, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit."*
- H2. Basel, CEBS, ICPAK, and IOSCO commented that this wording does not give sufficient emphasis to the need to communicate important matters in writing, and suggest (old) paragraph 17 be changed to, e.g.: *"Significant findings from the audit should ... be in writing except when, in the auditor's professional judgement, oral communication would be sufficient,"* or *"All important matters that arose during the course of the audit should be contained in a written form of communication that is provided to those charged with governance."*
- H3. The exposed wording of (old) paragraph 17 is identical to the close off version of ISA 260 (except for "should" becoming "shall," and the change of a paragraph reference). It reflects the IAASB's decision based on responses to the 2006 exposure draft that, apart from matters regarding auditor independence, it should be left to the auditor's professional judgment to

determine which matters need to be communicated in writing and which may be communicated orally. It should be noted, however, that all matters required by ISA 260 to be communicated, including matters communicated orally, are required by (old) paragraph 21 to be documented. To make the suggested change would be beyond the scope of the clarity project.

## **I. Special purpose financial statements**

- I1. The task force has reviewed application of the ISA in light of the approval of [proposed] ISA 800 (Revised and Redrafted), “Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement,” at the July 2007 IAASB meeting. Proposed ISA 800.A11 states:

Communication with those charged with governance in accordance with the ISAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular whether those charged with governance are responsible for overseeing the preparation and presentation of those financial statements. In the case of special purpose financial statements prepared for a specific purpose, those charged with governance may not have such a responsibility; for example, when the special purpose financial statements are prepared solely for management’s use, or when the party engaging the auditor is not the entity responsible for the special purpose financial statements. In these cases, the requirements of [proposed] ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance” may not be relevant to the audit of the special purpose financial statements prepared for a specific purpose, except when the auditor is also responsible for the audit of the entity’s general purpose financial statements or, for example, has agreed with those charged with governance of the entity to communicate to them relevant matters identified during the audit of the special purpose financial statements prepared for a specific purpose.

- I2. To give effect to the above paragraph, the task force has amended ISA 260 (see paragraphs 1 and 2) to apply to general purpose financial statements only, thus allowing adaptation of ISA 260 when dealing with special purpose financial statements.

## **J. Timing of oral communications**

- J1. (Old) paragraph 21 states: “Where matters required by this ISA to be communicated are communicated orally, the auditor shall document them, and how, and to whom they were communicated.”
- J2. Basel, IdW and CEBS have suggested changing this to “... when, how, and to whom ...” The task force considers this to be a reasonable suggestion that is consistent with paragraph 8 of proposed ISA 230 (Redrafted), “Audit Documentation,” which requires the auditor to “document discussions of significant matters with management and others, including when and with whom the discussions took place.”

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