

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 260**  
**(REVISED AND REDRAFTED) (Clean)**  
**COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE**

(Effective for audits of financial statements for periods beginning on or after [date])\*

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\* See footnote 1.

## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to communicate with those charged with governance in relation to an audit of general purpose financial statements. Although this ISA applies irrespective of an entity's governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity, and for listed entities. This ISA does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.
2. This ISA has been drafted in terms of an audit of general purpose financial statements, but may also be applicable, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation and presentation of the other historical financial information.
3. Recognizing the importance of effective two-way communication during an audit of financial statements, this ISA provides an overarching framework for the auditor's communication with those charged with governance, and identifies some specific matters to be communicated with them. Additional matters to be communicated, which complement the requirements of this ISA, are identified in other ISAs (see Appendix 1). Further matters, not required by this or other ISAs, may be required to be communicated by laws or regulations, by agreement with the entity, or by additional requirements applicable to the engagement, e.g., the standards of a national professional accountancy body. Nothing in this ISA precludes the auditor from communicating any other matters to those charged with governance. (Ref: Para. A29-A32)

### Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after [date].<sup>1</sup>

### Objectives

5. The objectives of the auditor are to:
  - (a) Communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the scope and timing of the audit;
  - (b) Obtain from those charged with governance, information relevant to the audit; and
  - (c) Provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process,in a manner that promotes effective two-way communication (Ref: Para. A1-A5)

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<sup>1</sup> This date will not be earlier than December 15, 2008.

## Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) Those charged with governance – The person(s)<sup>2</sup> with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include some or all management personnel, e.g., executive members of a governance board of a private or public sector entity, or an owner-manager. In some cases, those charged with governance are responsible for approving<sup>3</sup> the entity's financial statements (in other cases management has this responsibility). For discussion of the diversity of governance structures, see paragraphs A6-A13.
  - (b) Management – The person(s)<sup>2</sup> with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, e.g., executive members of a governance board, or an owner-manager. Management is responsible for preparing the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving<sup>3</sup> the entity's financial statements (in other cases those charged with governance have this responsibility).

## Requirements

### Those Charged with Governance

7. The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Ref: Para. A6-A9)

#### *Communication with a Subgroup of Those Charged with Governance*

8. When the auditor communicates with a subgroup of those charged with governance, e.g., an audit committee, or an individual, the auditor shall determine whether the auditor also needs to communicate with the governing body. (Ref: Para. A10-A12)

#### *When All of Those Charged with Governance are Involved in Managing the Entity*

9. In some cases, all of those charged with governance are involved in managing the entity, e.g., a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this ISA are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. These matters are noted in paragraph 12(c). The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of

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<sup>2</sup> "Person" in this context could be a natural person, or an organization, e.g., a corporate trustee.

<sup>3</sup> "Approving" in this context means they have the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

those with whom the auditor would otherwise communicate in their governance capacity. (Ref: Para. A13)

### **Matters to be Communicated**

#### *The Auditor's Responsibilities in Relation to the Financial Statement Audit*

10. The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:
  - (a) The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
  - (b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A14-A15)

#### *Planned Scope and Timing of the Audit*

11. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit. (Ref: Para. A16-A20)

#### *Significant Findings from the Audit*

12. The auditor shall communicate with those charged with governance (Ref: Para. A21):
  - (a) 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 (Ref: Para. A22-A23);
  - (b) Significant difficulties, if any, encountered during the audit (Ref: Para. A24);
  - (c) Unless all of those charged with governance are involved in managing the entity:
    - (i) Material weaknesses, if any, in the design, implementation or operating effectiveness of internal control that have come to the auditor's attention and have been communicated to management as required by ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," or ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks;"
    - (ii) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management (Ref: Para. A25); and
    - (iii) Written representations the auditor is requesting from relevant persons; and
  - (d) Other matters, if any, arising from the audit that are, in the auditor's professional judgment, significant to the oversight of the financial reporting process (Ref: Para. A26).

#### *Auditor Independence*

13. In the case of listed entities, the auditor shall communicate with those charged with governance:

- (a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements<sup>4</sup> regarding independence; and
- (b)
  - (i) 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. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
  - (ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level. (Ref: Para. A27-A28)

## **The Communication Process**

### *Establishing the Communication Process*

- 14. The auditor shall communicate with those charged with governance the form, timing and expected general content of communications. (Ref: Para. A33-A41)

### *Forms of Communication*

- 15. 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. (Ref: Para. A42-A44)

### *Timing of Communications*

- 16. The auditor shall communicate with those charged with governance on a timely basis. (Ref: Para. A45-A46)

### *Adequacy of the Communication Process*

- 17. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatements, and shall take appropriate action. (Ref: Para. A47-A49)

## **Documentation**

- 18. Where matters required by this ISA to be communicated are communicated orally, the auditor shall document them, and when, how, and to whom they were communicated. Where matters

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<sup>4</sup> Relevant ethical requirements ordinarily comprise the IFAC Code together with national requirements that are more restrictive.

have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. (Ref: Para. A50)

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## **Application and Other Explanatory Material**

### **The Role of Communication** (Ref: Para. 5)

- A1. This ISA focuses primarily on communications from the auditor to those charged with governance. Although requiring communication from those charged with governance to the auditor is beyond the authority of ISAs, effective two-way communication is important in assisting:
- (a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity;
  - (b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
  - (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.
- A2. Although the auditor is responsible for communicating matters required by this ISA, management also has a responsibility to communicate matters of governance interest to those charged with governance. Communication by the auditor does not relieve management of this responsibility. Similarly, communication by management with those charged with governance of matters that the auditor is required to communicate does not relieve the auditor of the responsibility to also communicate them. Communication of these matters by management may, however, affect the form or timing of the auditor's communication with those charged with governance.
- A3. Clear communication of specific matters required to be communicated by ISAs is an integral part of every audit. ISAs do not, however, require the auditor to perform procedures specifically to identify any other matters to communicate with those charged with governance.

### *Legal Considerations*

- A4. In some jurisdictions the auditor may be required to notify a regulatory or enforcement body of certain matters communicated with 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.
- A5. Laws or regulations may prevent the auditor from communicating certain matters with those charged with governance, or others within the entity. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by

an appropriate authority into an actual, or suspected, illegal act. In some circumstances, it may be appropriate for the auditor to seek legal advice.

**Those Charged with Governance** (Ref: Para. 7)

- A6. Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:
- In some jurisdictions a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a “two tier board” structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a “one tier board” structure).
  - In some entities, those charged with governance hold positions that are an integral part of the entity’s legal structure, e.g., company directors. In others, e.g., some government entities, a body that is not part of the entity is charged with governance.
  - In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- A7. In most entities, governance is the collective responsibility of a governing body, such as 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 in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body.
- A8. Such diversity means that it is not possible for this ISA to specify for all audits, the person(s) with whom the auditor is to communicate particular matters. Also, in some cases the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, e.g., entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. In such cases, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate. In deciding with whom to communicate, the auditor’s understanding of an entity’s governance structure and processes obtained in accordance with ISA 315 (Redrafted) is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.
- A9. ISA 600 (Revised and Redrafted), “Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)” includes specific matters to be communicated by group auditors with those charged with governance. When the entity is a component of a group, the appropriate person(s) with whom the component auditor communicates depends on the engagement circumstances and the matter to be communicated. In some cases, a number of components may be conducting the same businesses within the same system of internal control and using the same accounting practices. Where those charged

with governance of those components are the same (for example, common board of directors), duplication may be avoided by dealing with these components concurrently for the purpose of communication.

*Communication with a Subgroup of Those Charged with Governance* (Ref: Para. 8)

A10. When considering communicating with a subgroup of those charged with governance, the auditor may take into account such matters as:

- The respective responsibilities of the subgroup and the governing body.
- The nature of the matter to be communicated.
- Relevant legal or regulatory requirements.
- Whether the subgroup (a) has the authority to take action in relation to the information communicated, and (b) can provide further information and explanations the auditor may need.

A11. When deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the auditor may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor may make explicit in agreeing the terms of engagement that, unless prevented by laws or regulations, the auditor retains the right to communicate directly with the governing body.

A12. Audit committees (or similar subgroups with different names) exist in many jurisdictions. Although their specific authority and functions may differ, communication with the audit committee, where one exists, has become a key element in the auditor's communication with those charged with governance. Good governance principles suggest that:

- The auditor will be invited to regularly attend meetings of the audit committee.
- The chair of the audit committee and, when relevant, the other members of the audit committee, will liaise with the auditor periodically.
- The audit committee will meet the auditor without management present at least annually.

*When All of Those Charged with Governance are Involved in Managing the Entity* (Ref: Para. 9)

A13. In some cases, all of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognize this position. In such cases, communication with person(s) with management responsibilities may not adequately inform all of those with whom the auditor would otherwise communicate in their governance capacity. For example, in a small company where all directors are involved in managing the entity, some of those directors (e.g., one responsible for marketing) may be unaware of significant matters discussed with another director (e.g., one responsible for the preparation of the financial statements).

## Matters to be Communicated

### *The Auditor's Responsibilities in Relation to the Financial Statement Audit* (Ref: Para. 10)

A14. The auditor's responsibilities in relation to the financial statement audit is often included in the engagement letter or other form of contract that records the agreed terms of the engagement. Providing those charged with governance with a copy of that engagement letter or other form of contract may be an appropriate way to communicate with them regarding such matters as:

- The auditor's responsibility for performing the audit in accordance with ISAs, which is directed towards the expression of an opinion on the financial statements. The matters that ISAs require to be communicated, therefore, include significant matters arising from the audit of the financial statements that are relevant to those charged with governance in overseeing the financial reporting process.
- The fact that ISAs do not require the auditor to design procedures for the purpose of identifying supplementary matters to communicate with those charged with governance.
- When applicable, the auditor's responsibility for communicating particular matters required by laws or regulations, by agreement with the entity or by additional requirements applicable to the engagement, e.g., the standards of a national professional accountancy body.

A15. Laws or regulations, an agreement with the entity or additional requirements applicable to the engagement may provide for broader communication with those charged with governance. For example, (a) an agreement with the entity may provide for particular matters to be communicated when they arise from services provided by a firm or network firm other than the financial statement audit; or (b) the mandate of a public sector auditor may provide for matters to be communicated that come to the auditor's attention as a result of other work, such as performance audits.

### *Planned Scope and Timing of the Audit* (Ref: Para. 11)

A16. Communication regarding the planned scope and timing of the audit may:

- (a) Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures; and
- (b) Assist the auditor to understand better the entity and its environment.

A17. Care may be needed when communicating with those charged with governance about the scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly where some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable.

A18. Matters communicated may include the following:

- How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error.

- The auditor’s approach to internal control relevant to the audit.
- The application of materiality in the context of an audit, as discussed in [proposed] ISA 320 (Revised and Redrafted), “Materiality in Planning and Performing an Audit.”

A19. Other planning matters that it may be appropriate to discuss with those charged with governance include:

- Where the entity has an internal audit function, the extent to which the auditor will use the work of internal audit, 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 appropriate person(s) in the entity’s governance structure with whom to communicate.
  - The allocation of responsibilities between those charged with governance and management.
  - The entity’s objectives and strategies, and the related business risks that may result in material misstatements.
  - Matters those charged with governance consider warrant particular attention during the audit, and any areas where they request additional procedures to be undertaken.
  - Significant communications with regulators.
  - Other matters those charged with governance consider may influence the audit of the financial statements.
- The attitudes, awareness, and actions of those charged with governance concerning (a) the entity’s internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and (b) the detection or possibility of fraud.
- The actions of those charged with governance in response to developments in accounting standards, corporate governance practices, exchange listing rules, and related matters.
- The responses of those charged with governance to previous communications with the auditor.

A20. While communication with those charged with governance may assist the auditor to plan 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 obtain sufficient appropriate audit evidence.

*Significant Findings from the Audit* (Ref: Para. 12)

A21. The communication of findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

#### Significant Qualitative Aspects of Accounting Practices (Ref: Para. 12(a))

- A22. Financial reporting frameworks ordinarily allow for the entity to make accounting estimates, and judgments about accounting policies and financial statement disclosures. Open and constructive communication about significant qualitative aspects of the entity's accounting practices may include comment on the acceptability of significant accounting practices. Appendix 2 identifies matters that may be included in this communication.
- A23. If requested changes are not made to a significant accounting practice the auditor considers to be inappropriate, it may be appropriate to inform 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 During the Audit (Ref: Para. 12(b))

- A24. Significant difficulties encountered during the audit may include such matters as:
- Significant delays in management providing required information.
  - An unnecessarily brief time within which to complete the audit.
  - Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
  - The unavailability of expected information.
  - Restrictions imposed on the auditor by management.
  - Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion (refer to [proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report").

#### Significant Matters Discussed, or Subject to Correspondence with Management (Ref: Para. 12(c) (ii))

- A25. Significant matters discussed, or subject to correspondence with management may include such matters as:
- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
  - Concerns about management's consultations with other accountants on accounting or auditing matters.
  - Discussions or correspondence 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.

#### Other Significant Matters Relevant to the Financial Reporting Process (Ref: Para. 12(d))

- A26. Other significant matters arising from the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material

misstatements of fact or material inconsistencies in information accompanying the audited financial statements, that have been corrected.

*Auditor Independence* (Ref: Para. 13)

A27. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:

- (a) Threats to independence, which may be 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.

Matters communicated may include an inadvertent violation of relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed.

A28. The communication requirements relating to auditor independence that apply in the case of listed entities may also be relevant in the case of some other entities, particularly those that may be of significant public interest because, as a result of their business, their size or their corporate status, they have a wide range of stakeholders. Examples of entities that are not listed entities but where communication of auditor independence may be appropriate include public sector entities, credit institutions, insurance companies, and retirement benefit funds. On the other hand, there may be situations where communications regarding independence may not be relevant, e.g., where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where the entity is owner-managed, and the auditor's firm and network firms have little involvement with the entity beyond a financial statement audit.

*Supplementary Matters* (Ref: Para. 3)

A29. Those charged with governance are responsible for ensuring, through oversight of management, that the entity establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

A30. The auditor may become aware of supplementary matters that do not necessarily relate to the oversight of the financial reporting process but which are, nevertheless, likely to be significant to the responsibilities of those charged with governance in overseeing the strategic direction of the entity or the entity's obligations related to accountability. Such matters may include, e.g., significant deficiencies in governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorization.

A31. In determining whether to communicate supplementary matters with those charged with governance, the auditor may discuss matters of this kind of which the auditor has become aware with the appropriate level of management, unless it is inappropriate to do so in the circumstances.

A32. If a supplementary matter is communicated, it may be appropriate for the auditor to make those charged with governance aware that:

- (a) Identification and communication of such matters is incidental to the purpose of the audit, which is to form an opinion on the financial statements;
- (b) No procedures were carried out with respect to the matter other than any that were necessary to form an opinion on the financial statements; and
- (c) No procedures were carried out to determine whether other such matters exist.

### **The Communication Process**

#### *Establishing the Communication Process* (Ref: Para. 14)

A33. Clear communication of the auditor's responsibilities, the planned scope and timing of the audit, and the expected general content of communications helps establish the basis for effective two-way communication.

A34. Matters that may also contribute to effective two-way communication include discussion of:

- The purpose of communications. When the purpose is clear, the auditor and those charged with governance are better placed to have a mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form in which communications will be made.
- The person(s) in the audit team and amongst those charged with governance who will communicate regarding particular matters.
- The auditor's expectation that communication will be two-way, and that those charged with governance will communicate with the auditor matters they consider relevant to the audit, e.g. strategic decisions that may significantly affect the nature, timing and extent of audit procedures, the suspicion or the detection of fraud, and concerns with the integrity or competence of senior management.
- The process for taking action and reporting back on matters communicated by the auditor.
- The process for taking action and reporting back on matters communicated by those charged with governance.

A35. The communication process will vary with the circumstances, including the size and governance structure of the entity, how those charged with governance operate, and the auditor's view of the significance of matters to be communicated. Difficulty in establishing effective two-way communication may indicate that the communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraph A48).

#### Considerations Specific to Smaller Entities

A36. In the case of audits of smaller entities, the auditor may communicate in a less structured manner with those charged with governance than in the case of listed or larger entities.

### Communication with Management

- A37. Many matters may be discussed with management in the ordinary course of an audit, including matters required by this ISA to be communicated with those charged with governance. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for preparing the financial statements.
- A38. Before communicating matters with those charged with governance, the auditor may discuss them with management, unless that is inappropriate. For example, it may not be appropriate to discuss questions of management's competence or integrity with management. In addition to recognizing management's executive responsibility, these initial discussions may 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 with those charged with governance.

### Confidentiality

- A39. The requirements of national professional accountancy bodies, laws or regulations may impose obligations of confidentiality that restrict the auditor's communications with those charged with governance. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.
- A40. Those charged with governance may wish to provide third parties, e.g., bankers or certain regulatory authorities, with copies of a written communication from the auditor. In some cases, disclosure to third parties may be illegal or otherwise inappropriate. When a written communication prepared for those charged with governance is provided to third parties, it may be important in the circumstances that the third parties be informed that the communication was not prepared with them in mind, e.g. by stating in written communications with those charged with governance:
- (a) That the communication has been prepared for the sole use of those charged with governance and, where applicable, the group management and the group auditor, and should not be relied upon by third parties;
  - (b) That no responsibility is assumed by the auditor to third parties; and
  - (c) Any restrictions on its disclosure or distribution to third parties.
- A41. In certain jurisdictions, particularly in the public sector, the auditor may be required to submit copies of certain reports prepared for those charged with governance to relevant regulatory, funding or other bodies. Similarly, there may be a requirement that reports will be made public. In such circumstances, application of the preceding paragraph is modified appropriately. Further, unless required by laws or regulations to provide a third party with a copy of the auditor's written communications with those charged with governance, the auditor may need the prior consent of those charged with governance before doing so.

*Forms of Communication* (Ref: Para. 15)

- A42. Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The auditor may communicate matters other than those identified in paragraph 15 either orally or in writing. Written communications may include an engagement letter that is provided to those charged with governance.
- A43. In addition to the significance of a particular matter, the form of communication (e.g., whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:
- Whether the matter has been satisfactorily resolved.
  - Whether management has previously communicated the matter.
  - The size, operating structure, control environment, and legal structure of the entity.
  - Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.
  - The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
  - The amount of ongoing contact and dialogue the auditor has with those charged with governance.
  - Whether there have been significant changes in the membership of a governing body.
- A44. When a significant matter is discussed with an individual member of those charged with governance, e.g., the chair of an audit committee, it may be appropriate for the auditor to summarize the matter in later communications so that all of those charged with governance have full and balanced information.

*Timing of Communications* (Ref: Para. 16)

- A45. The appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by those charged with governance. For example:
- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, may be made as part of agreeing the terms of the engagement.
  - It may be appropriate to communicate a significant difficulty encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulty, or if it is likely to lead to a modified opinion. Similarly, it may be appropriate to communicate material weaknesses in the design, implementation or operating effectiveness of internal control that have come to the auditor's attention as soon as practicable.

- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards, e.g., when accepting an engagement to provide non-audit services, and at a concluding discussion. A concluding discussion may also be an appropriate time to communicate findings from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices.
- When auditing both general purpose and special purpose financial statements, it may be appropriate to coordinate the timing of communications.

A46. Other factors that may be relevant to the timing of communications include:

- The size, operating structure, control environment, and legal structure of the entity being audited.
- Any legal obligation to communicate certain matters within a specified timeframe.
- The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- The time at which the auditor identifies certain matters, e.g., the auditor may not identify a particular matter (e.g., noncompliance with a law) in time for preventive action to be taken, but communication of the matter may enable remedial action to be taken.

*Adequacy of the Communication Process* (Ref: Para. 17)

A47. The auditor's evaluation of the two-way communication between the auditor and those charged with governance may be based on observations resulting from audit procedures performed for other purposes, rather than specific procedures designed for that evaluation. Such observations may include:

- The appropriateness and timeliness of actions taken by those charged with governance in response to matters raised by the auditor. Where significant matters raised in previous communications have not been dealt with effectively, it may be appropriate for the auditor to inquire as to why appropriate action has not been taken, and to consider 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 matters raised by the auditor, e.g., the extent to which those charged with governance probe issues, and question recommendations made to them.
- Difficulty in establishing with those charged with governance a mutual understanding of the form, timing and expected general content of communications.

- Where all or some of those charged with governance are involved in managing the entity, their apparent awareness of how matters discussed with the auditor affect their broader governance responsibilities, as well as their management responsibilities.
- Whether the two-way communication between the auditor and those charged with governance meets applicable legal and regulatory requirements.

A48. As noted in paragraph A1, effective two-way communication assists both the auditor and those charged with governance. Further, ISA 315 (Redrafted) identifies participation by those charged with governance, including their interaction with internal audit, if any, and external auditors, as an element of the entity's control environment. Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained all the audit evidence required to form an opinion on the financial statements.

A49. If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take such actions as:

- Modifying the auditor's opinion on the basis of a scope limitation.
- 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 business (e.g. shareholders in a general meeting), or the responsible government minister or parliament in the public sector.
- Withdrawing from the engagement where permitted in the relevant jurisdiction.

**Documentation** (Ref: Para. 18)

A50. Documentation of oral communication may include a copy of minutes prepared by the entity retained as part of the audit documentation where those minutes are an appropriate record of the communication.

## **Requirements of ISQC 1 and Other ISAs that Refer to Communications with Those Charged With Governance**

**DRAFTING NOTE: THE CONTENTS OF THIS APPENDIX HAVE BEEN UPDATED, WITHOUT MARK-UP, FOR DOCUMENTS APPROVED UP TO THE APRIL 2007 IAASB MEETING. IT WILL ALSO BE REVISED FOR DOCUMENTS APPROVED AT THE MEETING AT WHICH THIS ISA IS APPROVED.**

The following lists paragraphs in ISQC 1 and other ISAs effective as of [date], unless noted otherwise, that contain specific requirements to communicate with “those charged with governance” (or “board of directors,” “audit committee,” “supervisory board,” or “persons ultimately responsible for the overall direction of the entity”). It does not list requirements to communicate with management. These paragraphs are to be understood and applied in the context of the accompanying material in the Standards from which they come.

### **Proposed ISQC 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements”** [Exposure Draft – July 2007]

36. The firm shall assign responsibility for each engagement to an engagement partner and shall establish policies and procedures requiring that:
- (a) The identity and role of the engagement partner are communicated to key members of client management and those charged with governance; ...

### **ISA 210, “Terms of Audit Engagements”** [Amended as a result of ISA 800 (Revised). Close off document approved October 2006]

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 the board of directors or shareholders, the circumstances necessitating the withdrawal.**

### **ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”** [Issued December 2006]

21. The auditor shall make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management.

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<sup>5</sup> **DRAFTING NOTE: THE RELEVANCE OF THIS FOOTNOTE WILL BE REVIEWED WHEN THIS ISA IS APPROVED.** Not all Standards listed in this Appendix have yet been redrafted following the new clarity drafting conventions.

38. 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 shall:
- ...
- (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 ...
40. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.
41. Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects 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 shall communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.
42. In accordance with ISA 260 (Revised), "Communication with Those Charged with Governance," the auditor shall communicate with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities.

**Proposed ISA 250 (Redrafted), "The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements" [Exposure Draft – April 2007]**

12. In addition, the auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:
- (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and ...
14. The auditor shall request management, and where appropriate, those charged with governance, to provide written representations that all known actual or possible noncompliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.
17. When the auditor believes there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance.

21. Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance:
  - (a) Any significant matters involving non-compliance with laws and regulations that have a material effect on the financial statements, and
  - (b) Any other matters involving non-compliance with laws and regulations that come to the auditor's attention, other than when the matters are clearly inconsequential.
22. If in the auditor's judgment the non-compliance referred to in paragraph 21 is believed to be intentional, the auditor shall communicate the matter to those charged with governance as soon as practicable.

**ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"** [Issued December 2006]

32. The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as required by ISA 260, "The Auditor's Communication with Those Charged with Governance," with those charged with governance (unless all of those charged with governance are involved in managing the entity).

**ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks"** [Issued December 2006]

19. The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility and, as required by ISA 260, "The Auditor's Communication with Those Charged with Governance," with those charged with governance (unless all of those charged with governance are involved in managing the entity).

**Proposed ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit"** [Exposure Draft – October 2006]

15. The auditor shall communicate with those charged with governance uncorrected misstatements and the effect that they may have on the opinion in the auditor's report, and request their correction. The written representation obtained from management in accordance with paragraph 11 shall form part of this communication. In communicating the effect that material uncorrected misstatements may have on the opinion in the auditor's report, the auditor shall address them individually.
16. The auditor shall communicate with those charged with governance the reasons for, and the implications of a failure to correct misstatements, having regard to the size and nature of the misstatement judged in the surrounding circumstances, including possible implications in relation to future financial statements.
17. The auditor shall communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

**Proposed ISA 550 (Revised and Redrafted), “Related Parties”** [Exposure Draft – February 2007]

23. If, when the applicable financial reporting framework establishes related party requirements, the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor shall:
- ...
- (e) If the non-identification or non-disclosure appears intentional, (i) communicate this information to those charged with governance (unless all of them are part of management and are aware of the information already communicated by the auditor), and (ii) evaluate the implications on the audit.
27. In addition to any specific written representations the auditor believes are necessary in relation to related parties, the auditor shall, where the applicable financial reporting framework establishes related party requirements, obtain written representations from management and, where appropriate, those charged with governance that:
- (a) They have disclosed to the auditor the identity of the entity’s related parties and all the related party relationships and transactions of which they are aware; and
- (b) They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.
28. Unless all of those charged with governance are involved in managing the entity and are aware of the matters already communicated by the auditor, the auditor shall communicate with those charged with governance significant matters identified during the audit regarding the entity’s related party relationships and transactions.

**Proposed ISA 560 (Redrafted), “Subsequent Events”** [Exposure Draft – December 2006]

12. When management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then:
- ...
- If the auditor’s report has already been issued to the entity, the auditor shall notify management or those charged with governance, as appropriate, not to issue the financial statements and the auditor’s report thereon to third parties. ...
17. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements together with the auditor’s report thereon is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need amendment, the auditor shall notify management and those charged with governance that action will be taken by the auditor to prevent future reliance on the auditor’s report. ...

**Proposed ISA 570 (Redrafted), “Going Concern”** [Exposure Draft – February 2007]

24. When there is significant delay in the approval of the financial statements by management or those charged with governance after the balance sheet date, the auditor shall inquire as to the reasons for the delay. ...
25. When the auditor has identified events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern the auditor shall communicate with those charged with governance about the matter. Such communication with those charged with governance shall include a discussion of the following:
  - (a) Whether the events or conditions constitute a material uncertainty;
  - (b) Whether the 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.

**Proposed ISA 580 (Revised and Redrafted), “Written Representations”** [Exposure Draft – December 2006]

18. When relevant parties do not provide the general or specific written representations requested by the auditor, the auditor shall (a) ask for the reasons; (b) reconsider the assessment of the integrity of management and, where appropriate, those charged with governance; and (c) take appropriate actions, including determining the possible effects on the opinion in the auditor’s report, having regard to the requirements in paragraphs 19-20.

*Proposed ISA 580 also includes a number of requirements, not repeated here, relating to communication with “relevant parties.” In some circumstances, those charged with governance are relevant parties.*

**ISA 600 (Revised and Redrafted), “Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)”** [Approved July 2007]

46. The group engagement team shall make group management aware, on a timely basis and at an appropriate level of responsibility, of:
  - (a) Material weaknesses in the design or operating effectiveness of group-wide controls;
  - (b) Material weaknesses that the group engagement team has identified in internal controls at components and judges are of significance to the group; and
  - (c) Material weaknesses that component auditors have identified in internal controls at components and brought to the attention of the group engagement team that the group engagement team judges are of significance to the group.
47. If fraud has been identified by the group engagement team or brought to its attention by a component auditor (see paragraph 41(h)), or information indicates that a fraud may exist, the group engagement team shall communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

48. A component auditor may be required by statute, regulation or for another reason, to express an audit opinion on the financial statements of a component. In that case, the group engagement team shall request group management to inform component management of any matter of which the group engagement team becomes aware that may be significant to the financial statements of the component, but of which component management may be unaware. If group management refuses to communicate the matter to component management, the group engagement team shall discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group engagement team, subject to legal and professional confidentiality considerations, shall consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the component until the matter is resolved.
49. The group engagement team shall communicate the following matters with those charged with governance of the group, in addition to those required by [proposed] ISA 260 (Revised and Redrafted), "Communication with Those Charged with Governance" and other ISAs:
- (a) An overview of the type of work to be performed on the financial information of the components.
  - (b) An overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components.
  - (c) Instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work.
  - (d) Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.
  - (e) Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements.

**Proposed ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report"** [Exposure Draft – July 2007]

14. If management refuses the auditor's request to remove a limitation that management has imposed on the scope of the audit, the auditor shall communicate the matter with those charged with governance.
16. If the auditor concludes that resignation from the audit is necessary because of a scope limitation imposed by management, before resigning, the auditor shall communicate to those charged with governance any matters of which the auditor has become aware that would have given rise to a modification of the opinion regarding misstatements identified during the audit.
30. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that lead to the expected modification and the proposed wording of the modification.

**Proposed ISA 706 (Revised and Redrafted), “Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor’s Report”** [Exposure Draft – July 2007]

10. When the auditor expects to include an Emphasis of Matter or an Other Matter(s) paragraph in the auditor’s report, the auditor shall communicate with those charged with governance regarding this expectation, and the proposed wording of this paragraph.

## Appendix 2

(Ref: Para. 12(a), and A22-A23)

### Qualitative Aspects of Accounting Practices

The communication required by paragraph 12(a), and discussed in paragraphs A22 and A23, 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. Where acceptable alternative accounting policies exist, the communication may include identification of the financial statement items that are affected by the choice of significant 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 may include: 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 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

- For items for which estimates are significant, issues discussed in [proposed] ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures" including, for example:
  - Management's identification of accounting estimates.
  - Management's process for making accounting estimates.
  - Risks of material misstatement.
  - Indicators of possible management bias.
  - Disclosure of estimation uncertainty in the financial statements.

#### Financial Statement Disclosures

- The issues involved, and related judgments made, in formulating particularly sensitive financial statement disclosures (e.g., disclosures related to revenue recognition, remuneration, going concern, subsequent events, and contingency issues).
- The overall neutrality, consistency, and clarity of the disclosures in the financial statements.

**Related Matters**

- The potential effect on the financial statements of significant risks, exposures, and uncertainties, such as pending litigation, that are 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.
- 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 may 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.