

PROPOSED INTERNATIONAL STANDARD ON AUDITING 260 (REVISED)**THE AUDITOR'S COMMUNICATION WITH
THOSE CHARGED WITH GOVERNANCE**

(Effective for Audits of Financial Statements for periods beginning on or after [Date])

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Appendix 1: Qualitative Aspects of Accounting Practices, Including Accounting Policies,
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Appendix 2: Other ISAs Referring to Communications with “Those Charged With Governance,”
“Management,” or Related Terms

International Standard on Auditing (ISA) 260 (Revised), “The Auditor’s Communication with Those Charged with Governance” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services,” which sets out the application and authority of ISAs.

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 in relation to an audit of financial statements. This ISA applies to all financial statement audits. However, certain requirements ordinarily require no additional action on the part of the auditor where all of those charged with governance are involved in managing an entity. The standards and guidance in this ISA are to be adapted for audits of historical financial information other than financial statements.
 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 observations arising from the audit that are relevant to their responsibilities; 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 to assist the auditor and those charged with governance to understand issues in context, and develop a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity. 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.
 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. In this ISA:
 - (a) "Those charged with governance" means the person(s) 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 and disclosure process. In some cases, those charged with governance are responsible for approving¹ the financial statements (in other cases management has this responsibility).
 - (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
- ¹ "Approving" in this context means they have the authority to conclude that the entity's complete set of financial statements, including the related notes, has been prepared – see paragraphs 55 and 56 of ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements."

charged with governance, e.g., executive directors, or owner-managers. Management is responsible for preparing the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving² the financial statements (in other cases those charged with governance have this responsibility).

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

6. The remainder of this ISA is structured as follows:

- (a) *Those charged with governance*: This section discusses the diversity of governance structures and processes, and notes that the auditor’s understanding of the entity and its environment is used to determine the relevant person(s) with whom to communicate particular matters.
- (b) *Matters of governance interest*. This section identifies the matters the auditor is required to communicate, including the auditor’s responsibilities, the planned scope and timing of the audit, matters related to the conduct of, and findings from the audit, and a statement of auditor independence.
- (c) *The communication process*. This section discusses such matters as the form and timing of communications, which vary with the engagement circumstances.
- (d) *Legal considerations*. This section notes that certain legal requirements can affect the communication process.

Those Charged with Governance

7. **The auditor should determine the relevant person(s) in the entity’s governance structure to whom to communicate particular matters.**
8. 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 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.

² “Approving” in this context means they have the authority to conclude that the entity’s complete set of financial statements, including the related notes, has been prepared – see paragraphs 55 and 56 of ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements.”

- In some cases, some or all of those charged with governance are involved in managing 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 it is not possible for this ISA to specifically identify for all audits, the person(s) with whom the auditor is to communicate particular matters. In deciding with whom to communicate 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, the auditor and the engaging party agree on the person(s) with whom the auditor will communicate particular matters. Examples are: some family owned entities where spouses and other relatives may be part of the governance structure, the management structure or both; some not-for-profit organizations; and 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:
 - The respective responsibilities of the subgroup, or individual, and the governing body as a whole.
 - The nature of the matter to be communicated.
 - Relevant legal or regulatory requirements.
 - 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.
 - 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.

Audit Committees

13. 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; and the audit committee will ordinarily meet the auditor without management present at least annually. The auditor considers whether communication with the audit committee alone adequately fulfills the auditor's responsibility to communicate with those charged with governance, taking into account the considerations referred to in paragraph 12. In some circumstances, the auditor may need to also communicate with the governing body as a whole.

Group Audits

14. When the entity being audited is a component of a group, depending on the engagement circumstances, the appropriate person(s) with whom to communicate on a particular matter may be those charged with governance of the group in addition to, or instead of (for some wholly-owned components), those charged with governance of the component. In some cases there is a legal obligation for the auditor of a component to communicate to those charged with governance of the group or the group auditor.

Communication with Management

15. Many matters are discussed with management in the ordinary course of an audit, including matters identified in this ISA as being appropriate to communicate 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.
16. Before communicating matters with 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. In addition to recognizing management's executive responsibility, 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 with 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.
17. 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 does not relieve the auditor of the responsibility to also communicate these matters with those charged with governance.

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

18. 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 to person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again to those same person(s) in their governance role. Similarly in these cases, the matters required to be communicated by paragraphs 29, which are relevant only to the oversight function of those charged with governance, ordinarily require no action on the part of the auditor because there is no oversight separate from management.
19. In such cases, the auditor nonetheless considers whether communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity. For example, in a company where all directors are family members 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). In some circumstances it may be necessary and appropriate for the auditor to communicate particular matters 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.

Matters of Governance Interest**The Auditor's Responsibilities**

20. **The auditor should communicate to those charged with governance the responsibilities of the auditor.**
21. 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.
22. In communicating the auditor's responsibilities, the auditor conveys that:
- In the absence of an agreement with the entity or additional external requirements, the auditor is responsible for communicating only significant matters required by ISAs, that arise from the audit of the financial statements of the entity or a component of the entity³, or of which the auditor otherwise becomes aware.
 - ISAs do not require the auditor to design procedures for the specific purpose of identifying matters of governance interest.

An agreement with the entity or additional external requirements may provide for broader communication with those charged with governance. For example, an agreement with the entity

³ See [proposed revised] ISA 600 "The Work of Other Auditors in the Audit of Group Financial Statements" for the definition of "component."

may provide for particular matters to be communicated when they arise from services other than the financial statement audit provided by a firm or network firm; or the mandate of a public sector auditor may provide for matters to be communicated that come to attention as a result of other work such as performance audits.

Planned Scope and Timing of the Audit

23. **The auditor should communicate an outline of the planned scope and timing of the audit to those charged with governance.**
24. 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, particularly where those charged with governance are involved in managing the entity. For example: communicating the nature and timing of detailed audit procedures could make those procedures too predictable; and communicating the materiality level could influence the approach taken to the preparation of the financial statements.
25. Matters communicated ordinarily include the following:
 - How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error, including:
 - The auditor's approach to internal control relevant to the audit.
 - 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, which is designed to obtain reasonable assurance that material misstatements will be detected, not all material misstatements may be detected.
 - Any significant limitations or additional external requirements that apply to the engagement.
 - The nature of any matters the auditor has agreed to communicate with those charged with governance.
26. Other planning matters that 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 relevant person(s) in the entity's governance structure with whom the auditor is to communicate particular matters.
 - 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 misstatement of the financial statements.
 - Particular matters those charged with governance consider should influence the auditor's materiality decisions, or may otherwise influence the audit 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, and how those charged with governance oversee the effectiveness of internal control.
 - Any matters in relation to which the auditor will perform procedures in addition to those required by ISAs and additional external requirements, in response to a request from those charged with governance or management.
 - The actions of those charged with governance in response to developments in law, accounting standards, corporate governance reporting, exchange listing rules, and other matters relevant to the entity's financial statements and annual report.
 - How those charged with governance have responded to previous communications with the auditor.
27. While communication with those charged with governance may assist the auditor in 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 obtain sufficient appropriate audit evidence.

Conduct of, and Findings From the Audit

28. **In addition to the matters required by paragraph 39 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 31-32);
 - (b) **Significant difficulties encountered during the audit** (see paragraph 33); and
 - (c) **Uncorrected misstatements, other than those the auditor believes are clearly trivial** (see paragraphs 34-36).
29. **Unless all those charged with governance are involved in managing the entity, the auditor should also communicate:**
- (a) **Material, corrected misstatements that were brought to the attention of management as a result of audit procedures.** Other corrected misstatements may also be communicated (see paragraph 37);
 - (b) **Resolved disagreements with management⁴ about matters that individually or in the aggregate could be significant to the entity's financial statements or the auditor's**

⁴ Material disagreements that have not been resolved will result in a modification to the auditor's report and will be

report. The auditor need not communicate initial differences of opinion arising from incomplete facts or preliminary information;

- (c) **A summary of representations the auditor is requesting from management.** 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
- (d) **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** (see paragraph 38).

30. The auditor considers whether the communications set out in the preceding paragraph are also appropriate when all those charged with governance are involved in managing the entity, taking into account the matters identified in paragraphs 18-19.

Qualitative Aspects of Accounting Practices

31. 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 significant accounting practices adopted by the entity. Appendix 1 provides guidance on the matters that may be included in this communication.
32. The auditor explains to those charged with governance why the auditor considers a significant accounting practice not to be 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

33. 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 evidence; and management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

Uncorrected Misstatements

34. In accordance with [proposed revised] ISA 320 "Materiality in the Identification and Evaluation of Misstatements," the auditor requests management to correct all known misstatements, other than those that the auditor believes are clearly trivial. If misstatements

communicated in accordance with ISA 701 "Modifications to the Independent Auditor's Report."

remain uncorrected, the auditor communicates to those charged with governance all known uncorrected misstatements, other than those the auditor believes are clearly trivial, again requesting their correction. The auditor addresses material misstatements individually. Where there is a large number of very small uncorrected misstatements, it may aid communication if the auditor provides those charged with governance with a summary noting the number and overall monetary effect of the misstatements, rather than communicating the details of each individual misstatement.

35. The auditor ordinarily discusses with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, having regard to qualitative as well as quantitative considerations, including possible implications in relation to future financial statements.
36. 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

37. Communication of corrected misstatements identified as a result of audit procedures is important in assisting those charged with governance to fulfill their responsibility to oversee the financial reporting and disclosure process. The auditor may consider it appropriate to also communicate other corrected misstatements to those charged with governance, in particular where they are indicative of systemic issues. 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.

Other Matters Relevant to the Financial Reporting and Disclosure Process

38. Other significant matters arising from the audit that are relevant to those charged with governance in overseeing the financial reporting and disclosure process may include such matters as:
 - 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.⁵
 - 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.

⁵ See paragraph 210.18 of the [proposed revised] IFAC Code of Ethics, or relevant ethical requirements, for ethical considerations regarding communication between the other accountant and the auditor.

Other ISAs, Additional External Requirements, and Matters Agreed with the Entity

39. The auditor should communicate to those charged with governance:

- (a) **Matters that other ISAs or additional external requirements require to be communicated; and**
- (b) **Matters that have been agreed with those charged with governance or management to be communicated.**

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

41. Appendix 2 lists the main requirements of other ISAs regarding communication with those charged with governance to complement the framework established in this ISA. These requirements relate to such matters as:

- Material weaknesses in the design or implementation of internal control relevant to the audit that have come to the auditor's attention.
- Fraud the auditor has identified that involves:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others where the fraud results in a material misstatement in the financial statements.
- Noncompliance with laws and regulations that comes to the auditor's attention.
- Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- Expected modifications to the auditor's report.

Other Matters

42. **The auditor should communicate to those charged with governance other matters of which the auditor is aware that the auditor judges to be serious and relevant to the responsibilities of those charged with governance.**

43. Such matters, which may arise from the audit of the financial statements or otherwise come to the attention of the auditor, may include:

- Inadequate governance structures or processes.
- Abuse of position by senior management.
- Financial mismanagement.

- Inadequate processes for identifying business risks or 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.
44. Unless the auditor is required by additional external requirements or by an agreement with the entity 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.

Auditor Independence

45. **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 team⁶, the firm and, when applicable, network firms are independent in accordance with relevant ethical requirements⁷ and any additional external requirements that apply to the engagement; 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, including total fees charged in the preceding 12 months for audit and for non-audit services provided by the firm and network firms to the entity and components included in its financial statements⁸, allocated to appropriate categories, and**
 - (ii) **The related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level.**
46. 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

⁶ Paragraph 290.1 of the [proposed revised] IFAC Code of Ethics requires that members of assurance teams, firms and, when applicable, network firms be independent of assurance clients. In addition to the members of the engagement team, the [proposed revised] IFAC Code of Ethics includes as part of the assurance team, "all others within a firm who can directly influence the outcome of the assurance engagement." See the definitions section of the [proposed revised] IFAC Code of Ethics for further elaboration.

⁷ Relevant ethical requirements ordinarily comprise Section 290 of the [proposed revised] IFAC Code of Ethics and relevant national ethical requirements.

⁸ See [proposed revised] ISA 600 "The Work of Other Auditors in the Audit of Group Financial Statements" for the definition of "component."

independence may be unnecessary, e.g., where all of those charged with governance have been informed 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.

47. In determining the relationships and other matters, and safeguards to communicate, the auditor refers to relevant ethical requirements such as Section 290 of the [proposed revised] IFAC Code of Ethics. The [proposed revised] 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.

The Communication Process

48. **The auditor should seek to establish with those charged with governance, a mutual understanding of the form, timing and expected general content of communications.** Difficulty in establishing such an understanding may indicate that the two-way communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraphs 62-64).
49. 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 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

50. To help establish effective two-way communication, the expectations of both the auditor and those charged with governance regarding the form, timing and general content of communications are established at an early stage of the audit. Communication of the auditor's responsibilities (paragraphs 20-22) and the planned scope and timing of the audit (paragraphs 23-27) form the basis for establishing expectations. How these expectations are established will vary, reflecting the size and governance structure of the entity and how those charged with governance operate.
51. 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 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

52. Subject to paragraphs 46 and 57, 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.
53. 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.
54. Particularly significant matters that are communicated orally are ordinarily confirmed through correspondence or recorded in minutes of the discussion. **The auditor should document in the audit working papers, matters that are particularly significant which are communicated orally but not confirmed through correspondence or recorded in minutes.** Such matters would ordinarily include only matters where communicating 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.
55. 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.
56. **The auditor should issue a written communication to those charged with governance regarding the conduct of, and findings from each audit.** This communication is issued even if its content is limited to explaining that there are no matters the auditor wishes to draw to attention in writing. 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. In some jurisdictions, an annual communication to those charged with governance regarding the conduct of, and findings from each audit is required in a prescribed form by local law.

Confidentiality

57. 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 those charged with governance and, where applicable, the group management and the group 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.
58. In certain jurisdictions, and particularly in the public sectors, the auditor may have a duty 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 law or regulation to provide a third party with a copy of the auditor's written communications to those charged with governance, the auditor may require the prior consent of those charged with governance before doing so.

Timing of Communications

59. **Communications should be made on a sufficiently timely basis to enable those charged with governance to take appropriate action.**
60. The appropriate timing for communications will vary with the circumstances, including the nature of the matter to be communicated and when the auditor becomes aware of the matter. 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 communicated before the financial statements are completed.
 - Communications regarding independence will be appropriate: before the financial statements are completed; and 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 and, for an initial engagement, may be made as part of agreeing the terms of the engagement.
 - 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.
61. The appropriate timing for communications and the actions available to those charged with governance will also depend on when the auditor identifies certain matters. For example, 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

62. **The auditor should consider whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit and, if it has not, should take appropriate action as required.**
63. Effective two-way communication assists the auditor and those charged with governance to understand issues in context, and develop a constructive working relationship. Further, 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 audit, if any, 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:
- Difficulty in establishing with those charged with governance, a mutual understanding of the form, timing and expected general content of communications.
 - 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, 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 matters raised by the auditor e.g., the extent to which those charged with governance probe issues, and question recommendations made to them.
 - Where all 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.
64. 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 actions such as:
- Modifying the auditor's report 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 small private business, or the responsible government minister or Parliament in the public sector.
- Withdrawing from the engagement where permitted in the relevant jurisdiction.

Legal Considerations

65. In some jurisdictions there may be circumstances where the auditor is required to report to a regulatory or enforcement body 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.
66. 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.

Effective Date

67. This ISA is effective for audits of financial statements for periods beginning on or after January 1, 2007.

Appendix 1

Qualitative Aspects of Accounting Practices, Including Accounting Policies, Accounting Estimates and Financial Statement Disclosures

The communication required by paragraph 28 (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. Where acceptable alternative accounting policies exist, the communication could 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 could 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 major items for which estimates are significant, issues discussed in [proposed revised] ISA 540, “Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures)” and ISA 545, “Auditing Fair Value Measurements and Disclosures” including, e.g.:
 - 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 (for example, disclosures related to revenue recognition, 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 and 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 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 summarize the main standards found in other ISAs effective as of [Date], unless noted otherwise, that refer to communications with “those charged with governance,” “management,” or related terms,⁹ 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.

[DRAFTING NOTE: NEED TO FINALIZE FOR ISAs THAT WILL BE ISSUED (FINAL OR ED) IN MARCH]

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:**

⁹ This Appendix has not been limited to “those charged with governance” because, as noted in the Explanatory Memorandum to this Exposure Draft, 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 will implement a protocol for use of “those charged with governance,” “management” and related terms when developing new documents and revising current documents.

- ... (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 ...
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.
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”

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 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.**

Proposed Conforming Amendment to ISA 570 “Going Concern”

- 39a. 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.**

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.

Proposed Revised ISA 600, “The Work of Other Auditors in the Audit of Group Financial Statements”

110. **In the case of an audit of group financial statements, the group auditor should also communicate the following to those charged with governance of the group:**
- (a) **The portion of the group financial statements on which the group auditor and related auditors will perform the work and the portion of the group financial statements on which unrelated auditors will perform the work.**
 - (b) **The components that have been identified as significant.**
 - (c) **The results of the group auditor’s evaluation of the professional qualifications, independence, and professional competence of the unrelated auditors and the effect thereof on the scope of work to be performed on the financial information of the components and on the group auditor’s and unrelated auditor’s involvement in the work to be performed by the unrelated auditors.**
 - (d) **The planned scope of work to be performed on the financial information of the components.**
 - (e) **The group auditor’s and related auditors’ planned involvement in the work to be performed by unrelated auditors on the financial information of significant components.**
 - (f) **The results of the group auditor’s evaluation whether the work of the other auditors is adequate for the group auditor’s purposes.**
 - (g) **Any limitations on the audit of the group financial statements.** For example, restrictions on the group auditor’s access to component information, component management or other auditors, including relevant parts of their audit documentation.

Proposed Conforming Amendment to ISA 701 “Modifications to the Independent Auditor’s Report”

- 21a. The auditor should communicate circumstances that lead to expected modifications to the opinion in the auditor’s report to those charged with governance.**

ISA 720 “Other Information”

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

Communication with Those Charged with Governance

- 39a **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.**
- 39b. 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.

[DRAFTING NOTE: TO BE DELETED IF THE ED OF ISA 701 IS FINALIZED AT THE MARCH MEETING]

**PROPOSED CONFORMING AMENDMENT TO INTERNATIONAL
STANDARD ON AUDITING 701**

MODIFICATIONS TO THE INDEPENDENT AUDITOR'S REPORT

Communication with those Charged with Governance

21a. The auditor should communicate circumstances that lead to expected modifications to the opinion in the auditor's report to those charged with governance. This helps to ensure that:

- (a) Those charged with governance are aware of the expected modification(s) and the reasons (or circumstances) for the modification(s) before the financial statements are finalized;**
- (b) There are no disputed facts in respect of the matter(s) giving rise to the expected modification(s), or that matters of disagreement with management 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(s).**

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