



International Federation of Accountants

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Agenda Item

6

Committee: IAASB

Meeting Location: Lima

Meeting Date: March 7-11, 2005

Communication with Those Charged with Governance

Objectives of Agenda Item

To review and approve for exposure the proposed revised ISA 260, *The Auditor's Communication with Those Charged with Governance*, and conforming amendments to ISA 570, *Going Concern*, and ISA 701, *Modifications to the Independent Auditor's Report*.

Background

The Task Force is joint with the Australian AuASB, and also has representation from INTOSAI, the Transnational Auditing Committee (TAC) and the Institute of Internal Auditors (IIA).

The IAASB provided comments to the Task Force during a "second read" of this document at the December (New Orleans) meeting. The issues identified below relate to the major matters raised in December.

Issues

A. "Those Charged with Governance" versus "Management"

- A1. Extract from draft December minutes: *"The IAASB discussed the draft protocol for use of "those charged with governance," "management" and related terms ... (and agreed that it) ... should refer specifically to either or both (as appropriate) management or those charged with governance when discussing responsibilities within the entity."*
- A2. The attention of the IAASB is drawn to the revised approach to using "those charged with governance," "management" and related terms as outlined in the Explanatory Memorandum (Agenda Item 6-C), where the change requested at the December meeting has been made

B. Application of the ISA

- B1. Extract from draft December minutes: *"The IAASB ... concluded that communicating with those charged with governance is an essential part of the audit process, and that the ISA should be applicable to all financial statement audits. The IAASB further agreed, however, that certain requirements need not be applied when all of those charged with governance are actively involved in the day-to-day management of the entity, and asked the Task Force to consider how such an exemption could be applied."*
- B2. The Task Force considered this issue in light of the IAASB's discussion in December and the call in the Wong report for standard setters to "ensure that the needs of small- and medium-sized entities and accounting firms are addressed in the development of the international standards." As a result it has inserted new paragraphs 18-19 to introduce this

issue. Paragraph 18 notes that where those charged with governance are the same as management:

- (a) Matters communicated to management need not be communicated again to the same people in their role as those charged with governance; and
- (b) Matters that relate solely to the oversight of management are not relevant because there is no separate oversight. It refers specifically to the requirements of paragraph 29, which require no action in these circumstances. Paragraph 29 carries a footnote to this effect. The Task Force considered whether any other paragraphs should be entitled to the exemption, in particular paragraph 62, but concluded the rationale did not apply to any other requirements.

Paragraph 19 contains some additional considerations for when the provisions of paragraph 18 are invoked.

- B3. Other changes related to this issue include moving the “warning” previously part of old paragraph 23, to become paragraph 24 (i.e. immediately following the black letter requirement to which it relates), and adding to it a specific reference to situations when those charged with governance are involved in the management of the entity. The Task Force consider that this change, coupled with inserting the word “ordinarily” into the first line of paragraph 25, adequately addresses the following concern noted in the draft December minutes: “It was questioned whether it is appropriate for the ISA to require the auditor to communicate an outline of the planned scope and timing of the audit to those charged with governance when these individuals were also members of management. It was noted that the purpose of such a communication is to assist those charged with governance in discharging their oversight responsibilities, and therefore such communication would not be necessary, and may be inappropriate, when those charged with governance and management are the same individuals.”
- B4. The Task Force has consulted with IFAC’s Small and Medium Permanent Task Force (SMP PTF) on this matter. The SMP PTF are comfortable with the approach taken in the attached draft, and in particular, agree that paragraph 62 is not entitled to the exemption afforded to paragraph 29, and agree with the approach to communications regarding planned scope and timing of the audit as outlined in B3 above.

C. The Auditor’s Responsibilities

- C1. Extract from draft December minutes: *“It was noted that proposed guidance regarding the auditor’s responsibility to communicate matters that come to the attention of personnel outside the audit team only when those matters arise from the audit of a component of the entity, had too narrow a focus. The CAG had also raised a similar question. The IAASB asked the task force to reconsider this issue...”*
- C2. The Task Force has simplified the content of old paragraphs 18 and 19 (now new paragraph 22), and has also removed the narrowness of the previous draft, which had implied that auditors would not have a responsibility to communicate matters that had come to their attention unless they arose from the audit of the financial statements. The revised wording also avoids inadvertently imposing obligations on experts engaged by the auditor that would conflict with confidentiality requirements and clarifies that ISAs do not require the proactive seeking out matters of governance interest.

D. Statement of Auditor Independence

- D1. Extract from draft December minutes: *“The purpose of the requirement to communicate fees was also debated, and it was noted that because fees are perceived by some segments of the public to be associated with threats to independence, the drafting should better reflect this if the requirement is to be retained.”*
- D2. This change has been made in paragraph 45.

E. Conforming Amendments

- E1. Conforming amendments to ISA 570, “Going Concern”, and ISA 701, “Modifications to the Independent Auditor’s Report” are included in the attached. Appropriate changes will be made depending on whether the draft EDs of ISA 701 and ISA 600, “The Work of Other Auditors in the Audit of Group Financial Statements” are approved at the March meeting.

Material Presented

Agenda Item 6-A (Pages 181 – 208)	Draft ED of revised ISA 260 – Clean
Agenda Item 6-B (Pages 209 – 240)	Draft ED of revised ISA 260 – Mark-up from September meeting
Agenda Item 6-C (Pages 241 – 244)	Draft Explanatory Memorandum (<i>this draft will not be discussed in the meeting, however, members’ written or oral comments directed to the Task Force chair or staff out-of-session would be welcome</i>)

Action Requested

The IAASB is asked to consider the above issues and to approve the draft revised ISA 260 for public exposure.

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