

**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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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 historical financial information where those charged with governance have a responsibility to oversee the preparation and presentation of that information. While 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,<sup>1</sup> and for listed entities.<sup>2</sup>
2. In some cases, those charged with governance do not have a responsibility to oversee the preparation and presentation of the historical financial information subject to audit. For example:
  - (a) When historical financial information is prepared solely for the use of management, those charged with governance may not have a responsibility to oversee its preparation and presentation. When, however, information is prepared by management to meet accountability obligations of the entity, e.g. obligations arising from legislation or contract, those charged with governance of the entity ordinarily have a responsibility to oversee its preparation and presentation.
  - (b) The auditor may be engaged by an entity to audit historical financial information of another entity, e.g., when the auditor is engaged by a shopping centre to audit historical financial information of a retail outlet located in the shopping centre. In such a case, those charged with governance of the shopping centre (the engaging party) have no responsibility to oversee the preparation and presentation of information by the management of the retail outlet. The responsibilities of the auditor regarding communication with those charged with governance in such cases will be determined by the engagement circumstances.
3. 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. The ISA is written in the context of a financial statement audit but also applies to the audit of other historical financial information.
4. **The auditor should communicate with those charged with governance, in an appropriate form and on a timely basis, significant<sup>3</sup> matters related to the financial statement audit**

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<sup>1</sup> See paragraphs 20, 21 and 33.

<sup>2</sup> See paragraph 49.

<sup>3</sup> Significance is defined in the Glossary of Terms as: "The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner's report; or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their

**that are, in the auditor’s professional judgment, relevant to the responsibilities of those charged with governance.**

7. In this ISA:

- (a) “Those charged with governance” means the person(s)<sup>4</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<sup>5</sup>, those charged with governance may include some or all management personnel, e.g., executive members of a governance board, or an owner-manager. In some cases, those charged with governance are responsible for approving<sup>6</sup> the entity’s financial statements (in other cases management has this responsibility).
- (b) “Management” means the person(s)<sup>4</sup> who have executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions<sup>5</sup>, 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>6</sup> the entity’s 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.

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

- (a) *The role of communication*: This section notes the principal purposes of communication, and the importance of effective two-way communication.
- (b) *Legal considerations*. This section notes that certain legal requirements can affect the communication process.
- (c) *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.

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duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.”

<sup>4</sup> “Person” in this context could be an organization, e.g., a corporate trustee, (i.e., not necessarily a “natural person”).

<sup>5</sup> For discussion of the diversity of governance structures and processes, see paragraphs 9-21.

<sup>6</sup> “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.

- (d) *Matters to be communicated.* This section identifies the matters the auditor is required to communicate, including the auditor's responsibilities, the planned scope and timing of the audit, findings from the audit, and a statement of auditor independence.
- (e) *The communication process.* This section discusses such matters as the form and timing of communications, which vary with the engagement circumstances.

## **The Role of Communication**

- 8.1. The principal purposes of communication with those charged with governance are to:
  - (a) Establish a mutual understanding of the scope and timing of the audit, the respective responsibilities of the auditor, those charged with governance and management in relation to the financial statement audit, and related communications;
  - (b) Provide those charged with governance with timely observations arising from the audit that are relevant to their responsibilities; and
  - (c) Share other information that will (i) assist the auditor in obtaining the audit evidence required to form an opinion on the financial statements, and (ii) assist those charged with governance to fulfill their responsibilities.
- 8.2 Communication of specific matters required by this ISA to be communicated with those charged with governance is an integral part of every audit. The auditor is not, however, required to perform procedures specifically to identify other significant matters to communicate with those charged with governance, i.e. those identified in paragraphs 32(d) and 46.
- 8.3 This ISA focuses primarily on communications from the auditor to those charged with governance. Effective two-way communication is also very important to assist the auditor and those charged with governance in understanding matters in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity. To achieve the principal purposes of communication noted above, the auditor communicates matters clearly with those charged with governance, and reasonably expects those charged with governance to communicate clearly matters they consider relevant to the audit.
- 8.4 While 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.

## **Legal Considerations**

- 8.5. In some jurisdictions the auditor may be required to communicate with 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.
- 8.6. In some circumstances, the auditor may be prevented by law from communicating certain matters with 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 opinion. In such circumstances the auditor ordinarily seeks legal advice.

## **Those Charged with Governance**

9. **The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate.** The appropriate person(s) may vary depending on the matter to be communicated.
10. 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. For other entities, a body that is not part of the entity is charged with governance, e.g., as with some government agencies.
  - In some cases, some or all of those charged with governance are involved in managing the entity. In other cases, those charged with governance and management comprise different persons.
11. 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.
12. 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 matters, the auditor uses the understanding of an entity's governance structure and processes obtained in accordance with ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement."
13. When the appropriate person(s) with whom to communicate is not clearly identifiable from the engagement circumstances, the auditor and the engaging party agree on the person(s) within the entity's governance structure with whom the auditor will communicate. Examples include

entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government agencies.

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

14. 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, (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.
  - Whether there is also a need to communicate the information, in full or in summary form, with 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, communicates relevant information with 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.
15. Audit committees (or similar subgroups with different names) exist in many jurisdictions. While 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 ordinarily meet the auditor without management present at least annually.
- 15.1 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 the previous paragraph. In some circumstances, the auditor may also need to communicate with the governing body as a whole.

### **Group Audits**

16. When the entity being audited is a component of a group, depending on the engagement circumstances and the matter to be communicated, the appropriate person(s) with whom to communicate 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. Before communicating with those charged with governance of the group, the auditor ordinarily

communicates with the group auditor in relation to the relevant matter. Protocols for communication between the component auditor and the group auditor are ordinarily formalized through correspondence at an early stage of the audit. In some cases there is a legal right for the auditor of a component to communicate with those charged with governance of the group or the group auditor, or for the group auditor to communicate with those charged with governance of the component or the component auditor. In other cases, the permission of those charged with governance of the group or of the component is required. Where permission is required, it is often recorded in engagement letters. If permission is refused, the auditor considers whether this constitutes a limitation on the scope of the audit.

- 16.1 ISA 600 (Revised), “The Audit of Group Financial Statements” includes specific matters to be communicated with those charged with governance in the case of group audits.

### **Communication with Management**

17. 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.
18. 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.
19. Communication by management with those charged with governance of the following matters, which are required by this ISA to be communicated directly by the auditor, does not relieve the auditor of the responsibility to also communicate them.
- (a) The auditor’s responsibilities in relation to the financial statement audit (see paragraphs 23-26);
  - (b) The planned scope and timing of the audit (see paragraphs 27-31);
  - (c) Findings from the audit (see paragraphs 32-42); and
  - (d) When appropriate, auditor independence (see paragraphs 49-51.1).

Communication of these matters by management may, however, affect the form or timing of the auditor’s communication (e.g. summarized form may be appropriate when a matter has been communicated effectively by management). Effective communication by management of supplementary matters (see paragraphs 46-48) need not be repeated by the auditor.



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

- 20 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:
- (a) 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; and
  - (b) Matters that are required to be communicated but 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. These matters are noted in paragraph 33.
21. 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).

**Matters to be Communicated**

22. In addition to the matters required to be communicated directly, as noted in paragraph 19, the auditor communicates the following with those charged with governance:
- (a) Matters required by other ISAs and additional external requirements, and matters agreed with the entity (see paragraph 43); and
  - (b) Supplementary matters, if any (see paragraphs 46-48).

The matters to be communicated are discussed in the following sections.

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

23. **The auditor should communicate directly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit.** This is often included in the engagement letter or other form of contract that records the agreed terms of the engagement.
24. The auditor communicates with those charged with governance 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) That the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

25. The auditor also communicates that:

- The auditor is responsible for performing the audit in accordance with ISAs, which are 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.
- ISAs do not require the auditor to design procedures for the specific purpose of identifying supplementary matters to communicate with those charged with governance. They do, however, require the auditor to communicate such matters that have come to the attention of the auditor when they are, in the auditor's professional judgment, significant and relevant to the responsibilities of those charged with governance, and have not otherwise been communicated effectively with those charged with governance.
- When applicable, the auditor is also responsible for communicating matters required by an agreement with the entity or additional external requirements.

26. An agreement with the entity or additional external requirements 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**

27. **The auditor should communicate directly with those charged with governance an overview of the planned scope and timing of the audit.** Communication regarding the planned scope and timing can:

- (a) Assist those charged with governance to, e.g., understand better the consequences of the auditor's work for their oversight activities, discuss with the auditor issues of risk and materiality, and 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.

28. Care is required 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 could reduce the effectiveness of those procedures, e.g. by making those procedures too predictable.

29. Matters communicated ordinarily 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 concept of materiality, focusing on the factors considered rather than on specific thresholds or amounts. The auditor explains that (a) both qualitative and quantitative factors are considered when making materiality judgments, and (b) due to the inherent limitations of an audit, which is designed to provide reasonable assurance that material misstatements will be detected, not all material misstatements may be detected.
  - Limitations or additional external requirements that apply to the engagement, e.g. applicable legal considerations of the type mentioned in paragraphs 8.4 and 8.5.
  - The nature of any matters the auditor has agreed to communicate with those charged with governance.
30. 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 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 misstatement of the financial statements.
    - 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.
  - 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 financial reporting laws, accounting standards, corporate governance practices, exchange listing rules, and related matters.
  - How those charged with governance have responded to previous communications with the auditor.

31. 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.

### **Findings from the Audit**

32. **The auditor should communicate directly with those charged with governance:**
- (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 34-35);
  - (b) **Significant difficulties encountered during the audit, if any** (see paragraph 36);
  - (c) **Uncorrected misstatements, other than those the auditor believes are clearly trivial<sup>7</sup>, if any** (see paragraphs 37-39); and
  - (d) **Other matters, if any, arising from the audit that are, in the auditor's professional judgment, significant and directly related to oversight of the financial reporting process** (see paragraph 40).
33. **Unless all of those charged with governance are involved in managing the entity, the auditor should also communicate directly:**
- (a) **Representations the auditor is requesting from management that, in the auditor's professional judgment, require the attention of those charged with governance, if any.** In some cases, the auditor may request both management and those charged with governance to sign a representation letter (see paragraphs 41.1-41.2); and
  - (b) **Significant matters arising from the audit that were discussed, or subject to correspondence with management, if any** (see paragraph 42).

### *Qualitative Aspects of Accounting Practices*

34. Financial reporting frameworks ordinarily 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. The Appendix to this ISA provides guidance on the matters that may be included in this communication.
35. 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.

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<sup>7</sup> **Insert explanation of "clearly trivial" if it will not be in the Glossary.**

### *Significant Difficulties Encountered*

36. 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; restrictions imposed on the auditors by management; and 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 ISA 705, "Modifications to the Opinion in the Independent Auditor's Report").

### *Uncorrected Misstatements*

37. The auditor requests management to correct all known misstatements, other than those that the auditor believes are clearly trivial, in accordance with ISA 320 (Revised), "Materiality in the Identification and Evaluation of Misstatements". If such misstatements remain uncorrected, the auditor communicates them with those charged with governance, again requesting their correction. The auditor addresses material misstatements individually. Where there is a large number of 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.
38. 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.
39. 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 this representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements.

### *Other Significant Matters Relevant to the Financial Reporting Process*

40. Other significant matters arising from the audit that are directly related 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.

### *Representations*

- 41.1 Management representations that may require the attention of those charged with governance include matters where:
- There is little audit evidence in addition to the representations.
  - The relevant accounting treatment will vary depending on the intent of the entity.
  - Management is reluctant to make the representations requested by the auditor.
  - Other audit evidence is inconsistent with representations made by management.

- 41.2 In some cases, the auditor provides those charged with governance with a copy of the complete management representation letter. In such cases, the auditor separately identifies those matters that, in the auditor's professional judgment, require the attention of those charged with governance.

*Significant Matters Discussed, or Subject to Correspondence with Management*

42. Significant matters discussed, or subject to correspondence with management may include such matters as:
- Misstatements corrected by management. In addition to communicating uncorrected misstatements as required by paragraph 32 (c), communication of corrected misstatements may also be important in assisting those charged with governance to fulfill their responsibility to oversee the financial reporting process. The auditor may consider it appropriate to communicate corrected misstatements when they are, e.g., identified as a result of audit procedures, individually material, frequently recurring, indicative of a particular bias in the initial preparation of the financial statements, or indicative of a material weakness in internal control.
  - Concerns about management's consultations with other accountants on accounting or auditing matters.<sup>8</sup>
  - 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 ISAs and Additional External Requirements, and Matters Agreed with the Entity**

43. In addition to matters required by this ISA, the auditor communicates with those charged with governance:
- (a) Matters that other ISAs or additional external requirements require to be communicated; and
  - (b) Matters the auditor has agreed with those charged with governance or management to communicate. These matters may relate either to the responsibility of those charged with governance to oversee the financial reporting 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.

**Supplementary Matters**

46. **The auditor should communicate with those charged with governance matters, if any, not otherwise required by this or other ISAs that:**
- (a) **Have come to the attention of the auditor; and**

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<sup>8</sup> See the IFAC Code of Ethics for Professional Accountants, (the IFAC Code) or relevant ethical requirements, for ethical considerations regarding communication between the other accountant and the auditor.

(b) **In the auditor’s professional judgment:**

- (i) **Are significant to the responsibilities of those charged with governance.** Routine matters need not be communicated, but rather only matters that those charged with governance are likely to consider important to their responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. Such matters may include, e.g., significant decisions or actions by senior management that lack appropriate authorization, and significant deficiencies in governance structures or processes; and
- (ii) **Have not otherwise been communicated effectively with those charged with governance by management or others.** For example, if the auditor is satisfied through inspection of board meeting papers and subsequent minutes that management’s communication of such matters has been effective, the auditor need not communicate them directly with those charged with governance.

47. Supplementary matters may either:

- (a) Arise from the audit of the financial statements but not be directly related to oversight of the financial reporting process; or
- (b) Come to the attention of the auditor other than through performance of the audit, whether they are directly related to oversight of the financial reporting process or not.

48. Unless the auditor is required by additional external requirements or by an agreement with the entity to undertake procedures to determine whether supplementary matters have occurred, in communicating 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 communicated have occurred; and
- (c) When appropriate, these matters have been discussed with management.

**Auditor Independence**

49. **In the case of listed entities,<sup>9</sup> the auditor should communicatedirectly with those charged with governance:**

- (a) **A statement that the engagement team and others in the firm as appropriate,<sup>10</sup> the firm and, when applicable, network firms are independent in accordance with**

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<sup>9</sup> The IFAC Code defines a listed entity as: “An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.”

<sup>10</sup> The IFAC Code 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 IFAC Code includes as

**relevant ethical requirements<sup>11</sup> 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.<sup>12</sup> This should 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 should 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 threats to independence or reduce them to an acceptable level.**

50. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address the relevant matters set out in IFAC Code of Ethics for Professional Accountants (the IFAC Code), which 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.

51. The auditor considers whether the communications set out in paragraph 49 are also relevant in the case of entities that are not listed 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 such entities might include public sector entities, credit institutions, insurance companies, and pension funds. 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 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 a financial statement audit.

**51.1 If a contravention of the IFAC Code or relevant ethical requirements as they relate to auditor independence has occurred, the auditor should, at the earliest practical date, directly communicate with those charged with governance the contravention and of remedial action taken or proposed, if any.<sup>13</sup>**

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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 IFAC Code for further elaboration.

<sup>11</sup> Relevant ethical requirements ordinarily comprise Section 290 of the IFAC Code and relevant national ethical requirements.

<sup>12</sup> This is a requirement of the IFAC Code.

<sup>13</sup> The IFAC Code includes guidance on safeguards that could be applied if there has been an inadvertent violation relating to a financial interest in an assurance client.



## **The Communication Process**

53. 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. For example, the auditor will often communicate more formally with those charged with governance of listed companies than small entities.

### **Establishing a Mutual Understanding**

- 53.1. **The auditor should seek to establish with those charged with governance a mutual understanding of the form, timing and expected general content of communications.**

54. Clear communication of the auditor's responsibilities (paragraphs 23-26) and the planned scope and timing of the audit (paragraphs 27-31) are intended to form the basis of a mutual understanding, which in turn helps establish effective two-way communication. How this understanding is established will vary, reflecting such factors as the size and governance structure of the entity and how those charged with governance operate. Difficulty in establishing a mutual understanding may indicate that the two-way communication between the auditor and those charged with governance is not effective (see paragraph 66).

55. Matters that may be discussed in establishing a mutual understanding include:

- 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.
- Any agreed extension of the auditor's responsibilities beyond those established by ISAs and additional external requirements.

Some of these matters may be addressed in the engagement letter or other form of contract that records the agreed terms of the engagement.

### **Forms of Communication**

56. **The auditor should communicate in writing with those charged with governance regarding:**
- (a) **Significant findings from the audit** (paragraphs 32 and 33). This written communication need not include all matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved; and
  - (b) **Auditor independence, when required** (paragraph 49).
57. Effective communication ordinarily involves informal communications, including discussions, as well as formal presentations and written reports. The auditor's communications regarding matters other than those identified in preceding paragraph may be oral or in writing.
58. 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 formally or informally) may be affected by such factors as:
- Whether management has previously communicated the matter.
  - The size, operating structure, control environment, and legal structure of the entity being audited.
  - In the case of a special purpose financial statement audit, whether the auditor also audits the entity's general purpose financial statements.
  - 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.
59. When a significant matter is discussed informally with an individual member of those charged with governance, e.g., the chair of an audit committee, the auditor ordinarily summarizes the matter in later formal communications so that the others charged with governance have full and balanced information.

### **Confidentiality**

60. On occasions, 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 is important that the third parties be informed that the communication was not prepared with

them in mind. The auditor therefore ordinarily states in written communications with 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, and should not be relied upon by others;
- (b) No responsibility is assumed by the auditor to others; and
- (c) It is not to be disclosed to others, or quoted or referred to, without the auditor's prior written consent.

61. In certain jurisdictions, particularly in the public sector, 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 with those charged with governance, the auditor may require the prior consent of those charged with governance before doing so.

### **Timing of Communications**

62. **Communications with those charged with governance should be made on a timely basis.**

63. 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 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.
- 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.
- Material weaknesses in the design or implementation of internal control which have come to the auditor's attention are communicated to management or those charged with governance as soon as practicable.
- 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, e.g. at a concluding discussion, and whenever significant judgments are made about threats to independence and related safeguards, e.g., when accepting an engagement to provide non-audit services.

- When auditing special purpose financial statements or other historical financial information, it may be appropriate to coordinate the timing of communications with the timing of communications relevant to the general purpose financial statements.
64. 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.
  - The terms of any additional external requirements e.g. the auditor may have a 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**

65. **The auditor should 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 should take appropriate action.**
66. Effective two-way communication assists the auditor and those charged with governance to understand matters in context, and to develop a constructive working relationship. Further, ISA 315 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.
- 66.1. The auditor need not design specific procedures to obtain audit evidence to support the evaluation required by paragraph 65, rather that evaluation may be based on observations resulting from audit procedures performed for other purposes. Examples of audit evidence about the adequacy of the two-way communication between the auditor and those charged with governance 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, 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.
  - 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.
67. If the two-way communication between the auditor and those charged with governance is not adequate, there is a risk the auditor may not have obtained all the audit evidence required to form an opinion on the financial statements. The auditor considers the effect, if any, on the auditor's assessment of the risks of material misstatements, and seeks to discuss the situation with those charged with governance. If the situation cannot be resolved, the auditor takes actions such 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

69.1 **The auditor should document significant matters communicated with those charged with governance.** The auditor may frequently communicate with those charged with governance, particularly when all of those charged with governance are involved in managing the entity. Not all matters communicated are required to be documented, but only those that are, in the auditor's professional judgment, significant either to the basis for the auditor's report, or to provide evidence that the audit was performed in accordance with ISAs and additional external requirements. Where documentation is in the form of minutes prepared by the entity, the auditor is satisfied that those minutes are an appropriate record of the discussion and retains a copy of them on the audit file.

69.2 **The auditor should also document:**

- (a) **When the appropriate person(s) with whom to communicate is not clearly identifiable from the engagement circumstances, the process followed in identifying**

**the appropriate person(s) within the entity's governance structure with whom to communicate.** This may be documented in the auditor's working papers, or in an engagement letter or other form of contract that records the agreed terms of the engagement; and

- (b) **When all of those charged with governance are involved in managing the entity, the process followed regarding whether communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.**

## **Effective Date**

70. This ISA is effective for audits of financial statements for periods beginning on or after [date].

## Appendix

### Qualitative Aspects of Accounting Practices

The communication required by paragraph 32(a), and discussed in paragraphs 34 and 35, 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 items for which estimates are significant, issues discussed in ISA 540 (Revised), "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, 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 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.
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## **CONFORMING AMENDMENTS**

### **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 with 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 discusses with those charged with governance:**
- (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.**