

**(DRAFT) EXPOSURE DRAFT OF CLARIFIED VERSION OF:
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])

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's communication with those charged with governance in relation to an audit of financial statements. 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, and for listed entities.
2. This ISA has been drafted in terms of an audit of financial statements, but is also to be applied, adapted as necessary in the circumstances of the engagement, to audits of other historical financial information.
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. Further matters may also be required to be communicated by laws or regulations, by agreement with the entity, or by additional requirements applicable to the engagement, e.g., the standards of a national professional accountancy body.

Effective Date

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

Objective to Be Achieved

5. In relation to this ISA, the objective of the auditor is to:
 - (a) Seek to establish effective two-way communication between the auditor and those charged with governance so as to understand matters related to the financial statement audit in context, and to develop a constructive working relationship; and
 - (b) Communicate with those charged with governance, in an appropriate form and on a timely basis, significant matters related to the financial statement audit that are, in the auditor's professional judgment, relevant to the responsibilities of those charged with governance.

Definitions

6. The following terms are introduced in this ISA.

- (a) “Those charged with governance” means the person(s)¹ with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include some or all management personnel, e.g., executive members of a governance board, or an owner-manager. In some cases, those charged with governance are responsible for approving² the entity’s financial statements (in other cases management has this responsibility). For discussion of the diversity of governance structures, see paragraphs A6-A13.
- (b) “Management” means the person(s)¹ who have executive responsibility for the conduct of the entity’s operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, e.g., executive members of a governance board, or an owner-manager. Management is responsible for preparing the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving² the entity’s financial statements (in other cases those charged with governance have this responsibility).
- (c) “Significant” means important when taken in context. This definition is consistent with the definition of “significance” in the Glossary of Terms, which includes examples of judging the relative importance of a matter within different contexts, in particular: “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 duties.”

Requirements

The Role of Communication

7. 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;
 - (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.

¹ “Person” in this context could be an organization, e.g., a corporate trustee, (i.e., not necessarily a “natural person”).

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.

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

Those Charged with Governance

9. The auditor shall 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. When the appropriate person(s) with whom to communicate is not clearly identifiable from the engagement circumstances, the auditor and the engaging party shall 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

11. The auditor shall consider whether communication with a subgroup of those charged with governance, e.g., an audit committee, or an individual, adequately fulfills the auditor's responsibility to communicate with those charged with governance. In some circumstances, the auditor may also need to communicate with the governing body as a whole.

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

12. 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 19 (c).
13. In such cases, the auditor shall nonetheless consider whether communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.

Matters to be Communicated

14. Communication by management with those charged with governance of matters the auditor is required to communicate does not relieve the auditor of the responsibility to also communicate them. Communication of these matters by management may, however, affect the form or timing of the auditor's communication with those charged with governance (e.g. summarized form may be appropriate when a matter has been communicated effectively by management).

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

15. The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:
- (a) The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
 - (b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
- This communication is often included in the engagement letter or other form of contract that records the agreed terms of the engagement.

Planned Scope and Timing of the Audit

16. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit.
17. 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.
18. 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

19. The auditor shall communicate with those charged with governance:
- (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice not to be appropriate and, when considered necessary, requests that changes be made.;
 - (b) Significant difficulties encountered during the audit, if any;
 - (c) Unless all of those charged with governance are involved in managing the entity:
 - (i) Material, corrected misstatements that indicate a weakness in internal control or are otherwise significant to those charged with governance in fulfilling their responsibility to oversee the financial reporting process, if any;
 - (ii) Significant matters arising from the audit that were discussed, or subject to correspondence with management, if any ; and
 - (iii) Representations the auditor is requesting from management; and

- (d) Other matters, if any, arising from the audit that are, in the auditor's professional judgment, significant to the oversight of the financial reporting process.

Auditor Independence

20. In the case of listed entities,³ the auditor shall communicate with those charged with governance:
 - (a) A statement that the engagement team and others in the firm as appropriate,⁴ the firm and, when applicable, network firms have complied with relevant ethical requirements⁵; 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.⁶ This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
 - (ii) The related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level.
21. The auditor shall consider whether the communications set out in the preceding paragraph 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.

Supplementary Matters

22. The auditor may become aware of supplementary matters that do not necessarily relate to the oversight of the financial reporting process but which are, nevertheless, likely to be significant to the responsibilities of those charged with governance for overseeing the strategic direction of the entity or the entity's obligations related to accountability. The auditor shall consider whether there are any supplementary matters of which the auditor has become aware that, in the auditor's professional judgment, are of such significance that they should be communicated with those charged with governance. If there are any such matters, the auditor shall communicate them with those charged with governance.

³ 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."

⁴ 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 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.

⁵ Relevant ethical requirements ordinarily comprise Section 290 of the IFAC Code and relevant national ethical requirements.

⁶ This is a requirement of the IFAC Code.

The Communication Process

Establishing a Mutual Understanding

23. The auditor shall seek to establish with those charged with governance a mutual understanding of the form, timing and expected general content of communications.

Forms of Communication

24. The auditor shall communicate in writing with those charged with governance regarding:
- (a) Significant findings from the audit when, in the auditor's professional judgment, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit.
 - (b) Auditor independence, when required.

Timing of Communications

25. Communications with those charged with governance shall be on a timely basis.

Adequacy of the Communication Process

26. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall take appropriate action.
27. The auditor need not design specific procedures to support the evaluation required by the preceding paragraph; rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes.
28. 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 shall consider the effect, if any, on the auditor's assessment of the risks of material misstatements, and shall seek to discuss the situation with those charged with governance.

Documentation

29. The auditor shall document matters communicated with those charged with governance that are, in the auditor's professional judgment, important in providing audit evidence to support the auditor's opinion and evidence that the audit was carried out in accordance with ISAs. The auditor may frequently communicate with those charged with governance, particularly when all of those charged with governance are involved in managing the entity, but not all matters required to be communicated are required to be documented. 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.

Application Material

The Role of Communication

- A1. 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.
- A2. This ISA focuses primarily on communications from the auditor to those charged with governance. However, effective two-way communication is also very important in assisting 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.
- A3. 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

- A4. 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.
- A5. Laws or regulations may prevent the auditor from communicating certain matters with those charged with governance, or others, within the entity. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In such circumstances, the auditor ordinarily seeks legal advice.

Those Charged with Governance

- A6. Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:
- In some jurisdictions a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a “two tier board” structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a “one tier board” structure).
 - In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, e.g., company directors. 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.

- A7. 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.
- A8. 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's 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" is relevant.

Communication with a Subgroup of Those Charged with Governance

- A9. 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. The auditor may make explicit in agreeing the terms of engagement that, unless prevented by laws or regulations, the auditor retains the right to communicate directly with the governing body as a whole.
- A10. 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.

Communication by the Auditor of a Component

A11. 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. In other cases, the permission of those charged with governance 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.

A12 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.

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

A13. In some cases, all of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognize this position. In such cases, the auditor is nonetheless required to consider 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

The Auditor’s Responsibilities in Relation to the Financial Statement Audit

A14. The auditor ordinarily 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 purpose of identifying supplementary matters to communicate with those charged with governance.
- When applicable, the auditor is also responsible for communicating particular matters required by laws or regulations, by agreement with the entity or by additional

requirements applicable to the engagement, e.g., the standards of a national professional accountancy body.

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

Planned Scope and Timing of the Audit

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

- (a) Assist those charged with governance in, e.g., understanding better the consequences of the auditor's work for their oversight activities, discussing with the auditor issues of risk and materiality, and identifying any areas in which they may request the auditor to undertake additional procedures; and
- (b) Assist the auditor to understand better the entity and its environment.

A17. 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 application of materiality, focusing on the factors considered rather than on specific thresholds or amounts.

A18. Other planning matters that it may be appropriate to discuss with those charged with governance include:

- Where the entity has an internal audit function, the extent to which the auditor will use the work of internal audit, and how the external and internal auditors can best work together in a constructive and complementary manner.
- The views of those charged with governance of:
 - The appropriate person(s) in the entity's governance structure with whom to communicate.
 - The allocation of responsibilities between those charged with governance and management.
 - The entity's objectives and strategies, and the related business risks that may result in material 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.
- The actions of those charged with governance in response to developments in accounting standards, corporate governance practices, exchange listing rules, and related matters.
- How those charged with governance have responded to previous communications with the auditor.

Findings from the Audit

Qualitative Aspects of Accounting Practices

- A19. Financial reporting frameworks ordinarily allow for the entity to make accounting estimates, and judgments about accounting policies and financial statement disclosures. The auditor ordinarily comments on the acceptability of significant accounting practices when communicating openly and constructively about significant qualitative aspects of the entity's accounting practices. The Appendix to this ISA provides guidance on the matters that may be included in this communication.
- A20. If requested changes are not made to a significant accounting practice the auditor considers to be inappropriate, those charged with governance are informed that the auditor will consider the effect of this on the financial statements of the current and future years, and on the auditor's report.

Significant Difficulties Encountered During the Audit

- A21. 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").

Corrected misstatements

- A22. Corrected misstatements that are significant to those charged with governance in fulfilling their responsibility to oversee the financial reporting process may include those that are individually material, frequently recurring, or indicative of a particular bias in the initial preparation of the financial statements.

Significant Matters Discussed, or Subject to Correspondence with Management

A23. Significant matters discussed, or subject to correspondence with management may include such matters as:

- Material weaknesses in the design or implementation of internal control.
- Concerns about management’s consultations with other accountants on accounting or auditing matters.⁷
- Discussions or correspondence in connection with the initial or recurring appointment of the auditor regarding accounting practices, the application of auditing standards, or fees for audit or other services.

Other Significant Matters Relevant to the Financial Reporting Process

A24. 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.

Auditor Independence

A25. 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 the 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.

Matters communicated would include any inadvertent violation of the IFAC Code or relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed.⁸

A26. Examples of entities that are not listed entities but where communication of auditor independence may be appropriate include public sector entities, credit institutions, insurance companies, and 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.

⁷ 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.

⁸ 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.

Supplementary Matters

- A27. It is the responsibility of those charged with governance of the entity to ensure, through oversight of management, that the entity establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.
- A28. Supplementary matters may include, e.g., significant deficiencies in governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorization.
- A29. In considering whether there are any supplementary matters to communicate with those charged with governance, the auditor ordinarily discusses matters of this kind of which the auditor has become aware with the appropriate level of management, unless it is inappropriate to do so in the circumstances.
- A30. If a supplementary matter is communicated, the auditor ordinarily makes those charged with governance aware that:
- (a) Identification and communication of such matters is incidental to the purpose of the audit, which is to form an opinion on the financial statements;
 - (b) No procedures were carried out with respect to the matter other than any that were necessary to form an opinion on the financial statements; and
 - (c) No procedures have been undertaken to determine whether other such matters exist.

The Communication Process

- A31. 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

- A32. Clear communication of the auditor's responsibilities and the planned scope and timing of the audit 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 adequate for the purpose of the audit (see paragraph A43).
- A33. 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.

Forms of Communication

A34. 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 the paragraph 24 may be oral or in writing. Written communications may include an engagement letter that is provided to those charged with governance.

A35. 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) is affected by such factors as:

- Whether the matter has been satisfactorily resolved.
- Whether management has previously communicated the matter.
- The size, operating structure, control environment, and legal structure of the entity 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.

A36. 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.

Communication with Management

A37. 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.

A38. 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.

Confidentiality

A39. 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:

- (a) That the communication has been prepared for the sole use of those charged with governance and, where applicable, the group management and the group auditor, and shall not be relied upon by third parties;
- (b) That no responsibility is assumed by the auditor to third parties; and
- (c) Any restrictions on its disclosure or distribution to third parties.

A40. 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 laws or regulations to provide a third party with a copy of the auditor's written communications with those charged with governance, the auditor may require the prior consent of those charged with governance before doing so.

Timing of Communications

A41. 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 both general purpose and special purpose financial statements, it may be appropriate to coordinate the timing of communications. .

A42. Other factors that may be relevant to the timing of communications include:

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

Adequacy of the Communication Process

A43. 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.

A44. Observations resulting from audit procedures performed for other purposes that may support the auditor's evaluation 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 ordinarily inquires 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.

A45. If the two-way communication between the auditor and those charged with governance is not adequate, and the situation cannot be resolved, the auditor considers 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.

Appendix

Qualitative Aspects of Accounting Practices

The communication required by paragraph 19 (a), and discussed in paragraphs A19 and A19, 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.

CONFORMING AMENDMENTS
INTERNATIONAL STANDARD ON AUDITING 570
GOING CONCERN

Communication with Those Charged with Governance

- 39a. The auditor should communicate events or conditions the auditor has identified 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.**

INTERNATIONAL STANDARD ON AUDITING 300
PLANNING AN AUDIT OF FINANCIAL STATEMENTS

Communication with Those Charged with Governance

- 27. ISA 260, "Communication of Audit Matters with Those Charged with Governance" requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. The auditor may discuss elements of planning with those charged with governance and the entity's management. These discussions may be a part of overall communications required to be made to those charged with governance of the entity or may be made to improve the effectiveness and efficiency of the audit. Discussions with those charged with governance ordinarily include the overall audit strategy and timing of the audit, including any limitations thereon, or any additional requirements. Discussions with management often occur to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussions of matters included in the overall audit strategy or audit plan occur, care is required in order to not compromise the effectiveness of the audit. For example, the auditor considers whether discussing the nature and timing of detailed audit procedures with management compromises the effectiveness of the audit by making the audit procedures too predictable.**