

December 2007

Basis for Conclusions:
ISA 260 (Revised and
Redrafted),
Communication with Those
Charged with Governance

*Prepared by the Staff of the International Auditing and
Assurance Standards Board*



**International Federation
of Accountants**

**BASIS FOR CONCLUSIONS:
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THOSE CHARGED WITH GOVERNANCE**

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance,” which was unanimously approved by the IAASB in September 2007.

Background

1. In March 2005, the IAASB issued an exposure draft of proposed ISA 260 (Revised), “The Auditor’s Communication with Those Charged with Governance.” The comment period for the proposed ISA closed on July 31, 2005. The IAASB gave due consideration to the comments received and approved a “close off” document of ISA 260 (Revised), “Communication with Those Charged with Governance,” in the “old style” (i.e., following the extant ISA’s drafting conventions for ISAs) in May 2006.¹ The IAASB’s Clarity conventions were applied to that document. An exposure draft of proposed ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance,” was approved for publication in October 2006 (“ED-ISA 260”).
2. The conventions used by the IAASB in redrafting ED-ISA 260, and the authority and obligation attaching to those conventions, are established in the amended Preface to International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface), approved by the IAASB in September 2006.²
3. The comment date for ED-ISA 260 was February 15, 2007. The IAASB received 45 comment letters from a variety of respondents, including regulators, IFAC member bodies, and firms. The IAASB revised ED-ISA 260 as a result of these comments. The following summarizes the more significant issues raised by respondents, and how the IAASB addressed them.

Objectives and Two-way Communication

4. A number of respondents commented on the objectives, the majority agreeing, or agreeing with minor qualification, with the objectives as exposed. Most of the other respondents commented on the extent to which two-way communication should be reflected in the objectives. Of these, a number considered that the objectives should give more emphasis to effective two-way communication, and provided various suggestions as

¹ The Basis for Conclusions: ISA 260 (Revised) and related close off document are available on the IAASB website at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0063>.

² The amended Preface can be accessed at http://www.ifac.org/download/IAASB_Preface.pdf. Elements of the authority and obligation attaching to the Clarity conventions are currently being exposed as part of proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing.”

to how this could be done. The IAASB agreed with this and added a specific reference to two-way communication in the objectives as paragraph 5(d).

5. Some respondents, on the other hand, considered that the proposed reference in the objectives to the auditor obtaining information from those charged with governance (paragraph 5(b)) should be moved, deleted or modified. The principal argument for this was that an auditing standard cannot impose an obligation on those charged with governance to provide information.
6. However, the IAASB continues to believe that obtaining information from those charged with governance is an important aspect of the objective of communication with them. There are many requirements that auditors have to meet that depend on the cooperation of others. Further, if the auditor concludes that the objective of obtaining information has not been achieved, the ISAs give guidance on the actions open to the auditor. This view allows for the objectives to retain the current reference to the auditor obtaining information from those charged with governance (paragraph 5(b)), and to add the reference to two-way communication (paragraph 5(d)).

Number and Type of Requirements

7. The number of requirements and the type of some requirements were of concern to several respondents. Specific issues noted by respondents included: whether some of the present tense statements in the close off document that were elevated to requirements should have been elevated; excessive explanatory material in the requirements section; the use of “shall consider;” and the inclusion of “conditional” requirements.
8. The IAASB reconsidered each of the requirements in light of these comments and in light of the fact that this ISA was one of the first to be converted to the clarity format since when the IAASB has gained further experience with, and comments on, its application of the Clarity conventions. As a result, the requirements section has been improved in response to the comments by, for example:
 - Removing most of the explanatory material in the section because it was not “essential explanatory material.”
 - Replacing each instance of “shall consider” with wording such as “shall determine,” to more clearly indicate what is required of the auditor.
 - Moving into the application material requirements that were merely the application to a specific circumstance of another requirement.
 - Moving “negative requirements” (for example, “written communications need not include all matters that arose during the course of the audit”) into the application material.
9. With respect to conditional requirements, some commentators argued that they are not appropriate unless the condition itself applies to virtually all audits. The clarity conventions do, however, allow for conditional requirements if the requirement is virtually always applicable when the stated condition exists. The IAASB reviewed each instance of a conditional requirement to assess its continued appropriateness in the

requirements section in the interests of ensuring consistent auditor action in defined circumstances.

Requesting a Change to a Significant Accounting Practice

10. ED-ISA 260 stated that: “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, shall request changes.”
11. A number of respondents suggested that this requirement should be deleted because it is either: (a) already covered by proposed ISA 450 (Redrafted),³ or, if not, it should be moved there, or (b) covered by the sentence that precedes it, i.e., the auditor shall communicate “the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures.”
12. Some respondents further suggested that, if retained, the final part of the sentence (“and, when considered necessary, shall request changes”) should be deleted because it is only appropriate if the auditor is of the view that there is a misstatement, which is already addressed in proposed ISA 450 (Redrafted).
13. The IAASB considered that the underlying thought behind this requirement should be retained to require the auditor to explain to those charged with governance why the auditor considers a significant accounting practice not to be the most appropriate in the circumstances, although it is not the cause of a misstatement. This could be, for example, when a practice is acceptable in the current year because its effect is not material but where it would be unacceptable if its effect became material. Communication of such matters is not dealt with in proposed ISA 450 (Redrafted), which deals with the communication of misstatements only. The IAASB further agreed that this sentence should not be moved to proposed ISA 450 (Redrafted) as it better fits with the discussion of the qualitative aspects of accounting practices than with the communication of misstatements. The IAASB did, however, agree that if the auditor considers it necessary to request a change, the matter must relate to a misstatement, and is, therefore covered by proposed ISA 450 (Redrafted). The wording of the sentence was, therefore, changed to reflect this.

Communication of Independence Matters

14. The communication of certain matters related to independence is required only in the case of listed entities. A number of respondents suggest that such communications should be required more broadly, for example, for all “public interest” entities. Application to public interest entities would be consistent with changes currently being considered by the International Ethics Standards Board for Accountants (IESBA) to the *Code of Ethics for Professional Accountants* (“the Code”).

³ Proposed ISA 450 (Redrafted), “Evaluation of Misstatements Identified during the Audit.”

15. The IAASB decided that to extend the requirement beyond listed entities would not be appropriate as part of the Clarity project, but would be considered again when changes to the Code have been finalized. A decision on the matter at that time would have the benefit of being informed by feedback received by the IESBA on its exposure draft.

Written Communication

16. ED-ISA 260 stated that: “The auditor shall communicate in writing with those charged with governance regarding auditor independence when required by paragraph 15, and significant findings from the audit when, in the auditor’s professional judgment, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit.”
17. A number of respondents commented that this wording does not give sufficient emphasis to the need to communicate important matters in writing, and suggested it be changed to, for example, “Significant findings from the audit should ... be in writing except when, in the auditor’s professional judgment, oral communication would be sufficient,” or “All important matters that arose during the course of the audit should be contained in a written form of communication that is provided to those charged with governance.”
18. The exposed wording is identical to the close off document (except for “should” becoming “shall” and the change of a paragraph reference). It reflects the IAASB’s decision based on responses to the 2005 exposure draft that, apart from matters regarding auditor independence, it should be left to the auditor’s professional judgment to determine which matters need to be communicated in writing and which may be communicated orally.⁴ To make the suggested change would, therefore, be beyond the scope of the Clarity project.

Timing of Oral Communications

19. ED-ISA 260 stated that: “Where matters required by this ISA to be communicated are communicated orally, the auditor shall document them, and how, and to whom they were communicated.”
20. Some respondents suggested that this requirement should also call for documenting *when* the matters were communicated. The IAASB considered this to be a reasonable addition that is consistent with ISA 230 (Redrafted) which requires the auditor to “document discussions of significant matters with management and others, including when and with whom the discussions took place.”⁵ The IAASB also agreed that it is not necessary to retain the requirement to document *how* these matters were communicated because it is clear from the requirement itself that they were communicated orally.

⁴ It should be noted, however, that where matters required by this ISA to be communicated are communicated orally, the auditor is required to document them, and when and to whom they were communicated. (ISA 260 (Revised and Redrafted), paragraph 19.)

⁵ ISA 230 (Redrafted), “Audit Documentation,” paragraph 8.



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