

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item **B-1**

Committee: IAASB Consultative Advisory Group

Meeting Location: Toronto

Meeting Date: September 11-12, 2006

Report Back—Communication with Those Charged with Governance

Objectives of Agenda Item

To provide a brief report back on the May 11-12, 2006 proposals of Representatives on the close off “old” format, and clarity exposure draft, of ISA 260 “Communication with Those Charged with Governance” presented at the May 22-26, 2006 IAASB meeting.

May 11-12, 2006 CAG Proposals

Below is an extract from the minutes of the May 11-12, 2006 meeting minutes¹ and an indication of how the IAASB Task Force or the IAASB responded to the Representatives’ comments.

Representatives’ comments	IAASB Task Force/IAASB response
REPORT BACK Representatives commented as follow:	
<ul style="list-style-type: none">As a general comment, Ms. Koski-Grafer noted that it would be helpful if, space permitting, the revised text could be included in the table indicating how the IAASB Task Force or IAASB has responded to the Representatives’ comments.	Agreed – relevant text included in comments below.
<ul style="list-style-type: none">Mr. Popham asked whether it was necessary to use both “significant” and “material.” Jurisdictions do not appear to interpret these terms in a similar manner. Some find significance to be greater than materiality; others find the reverse. Mr. Damant noted that the International Accounting Standards Board had a similar debate and concluded that a matter is either material or not. Another level should not be introduced. After reading the definition of significance in the	“Significance” is used throughout the ISAs to mean “the relative importance of a matter, taken in context,” and is therefore particularly appropriate where the importance of a matter is not necessarily related to error or omission in the financial statements. “Significant” is used with this broader meaning in this ISA, e.g., “significant difficulties, if any, encountered during the audit,” which are required to be communicated, include such things as “an unnecessarily brief time within which to

¹ The minutes will be approved at the September 11-12, 2006 IAASB CAG meeting.

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<p>Glossary of Terms, Ms. Koski-Grafer agreed that there should only be one term.</p>	<p>complete the audit” <i>(see paragraph 39 of “old” format in Appendix)</i>, which are not “material” in an accounting sense.</p>
<ul style="list-style-type: none"> Mr. Popham remained of the view that the guidance does not clearly indicate what the auditor does not have to communicate when management and those charged with governance are the same people. He was of the view that there is a lot that do not need to be communicated to a sole proprietor or to management / those charged with governance of a wholly-owned subsidiary. Mr. Damant was of the view that SME audit considerations could be better highlighted in the proposed ISA. 	<p>The material under the heading “When All of Those Charged with Governance are Involved in Managing the Entity” has been simplified, and the following material added with respect to wholly-owned subsidiaries: “In some cases, a number of components may be conducting the same businesses within the same system of internal control and using the same accounting practices. Where those charged with governance of those components are the same (for example, common board of directors), duplication may be avoided by dealing with these components concurrently for the purpose of communication” <i>(see paragraph 19 of “old” format in Appendix)</i>. Also, in the clarified format, the heading “Special Considerations in Audits of Smaller Entities” is used to highlight the likely difference in structure and frequency of communications <i>(see paragraph A35 of “clarified” format in Appendix)</i>.</p>
<ul style="list-style-type: none"> Referring to his comment on disclosing the communications to third parties at the previous CAG meeting, Mr. Pickeur was concerned that paragraph 61 still provided a restriction on disclosure or distribution to third parties. He believed that regulators would find this unacceptable, 	<p>The close-off version notes that “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, e.g. by stating ... any restrictions on its disclosure or distribution to third parties” <i>(see paragraph 60 of “old” format in Appendix)</i>. This wording is entirely neutral about whether there are or should be restrictions on disclosure or distribution, and its retention in the ISA is considered to be in the interests of 3rd parties (including regulators) to ensure they understand the nature of communications they receive.</p>
<ul style="list-style-type: none"> Mr. Hallqvist was of the view that, except perhaps for the companies in the United States which have broad share ownership, every 	<p>The Task Force recognizes the importance of communications with shareholders, but is of the view that unless they are also charged with a governance</p>

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<p>company has a group of key shareholders, and that it is important for the auditor to communicate with those shareholders. Mr. Damant noted that in some countries the state may be the dominant shareholder. Mr. Van Der Plaats noted that it is important that minority shareholders are equally well informed. Mr. Krantz noted that information targeted at minority shareholders will capture all shareholders, while information targeted at majority shareholders may exclude minority shareholders. Mr. Scicluna noted that shareholders do not fall within the definition of those charged with governance. Mr. Sylph agreed to ask the Task Force whether it has considered this matter.</p>	<p>role, communication with shareholders is beyond the scope of this particular ISA. This is now stated prominently (para 1 of the clarified version) in the ISA (<i>see paragraph 1 of “clarified” format in Appendix</i>).</p>
<p>OTHER MATTERS FOR CONSIDERATION BY CAG</p>	
<p>Mr. Sylph referred CAG to paragraph 43 in proposed ISA 260 (Revised), which contains additional requirements for audits of listed entities. Although the IAASB applies the principle of “an audit is an audit,” in a limited number of cases it may be necessary to go beyond this principle. Although not a new requirement, Mr. Sylph wanted to reaffirm it. He explained that the term “listed entities” is in line with that used in the IFAC <i>Code of Ethics for Professional Accountants</i>; however, the term and definition are being reviewed as part of a review of the Code and if the Code broadens its definition to include public interest entities, the same interpretation would apply within ISA 260. .</p>	<p>Noted (<i>see paragraph 42 of “old” format in Appendix</i>)</p>
<p>Mr. Sylph also noted that the Task Force will ask the IAASB whether it is necessary to re-expose the requirements and guidance because a requirement in the exposure draft is now presented as application material. The responses to the exposure did not clearly indicate where this text should be placed. He indicated that in his role as Technical Director he would advise the IAASB that this matter on its own</p>	<p>At its May 2006 meeting, the IAASB agreed that this matter on its own does not necessitate re-exposure. (<i>see paragraphs 45-48 of “old” format in Appendix</i>)</p>

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does not necessitate re-exposure. CAG did not have any views of this matter.	

The close off version of ISA 260 is available from <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=2309>.

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Appendix

Paragraphs Referred to in Report Back

Extracts from Close off Version of ISA 260

19. ISA 600 (Revised), “The Audit of Group Financial Statements” includes specific matters to be communicated by group auditors with those charged with governance. When the entity is a component of a group, the appropriate person(s) with whom the component auditor communicates depends on the engagement circumstances and the matter to be communicated. In some cases, a number of components may be conducting the same businesses within the same system of internal control and using the same accounting practices. Where those charged with governance of those components are the same (for example, common board of directors), duplication may be avoided by dealing with these components concurrently for the purpose of communication.

...

39. ISA 600 (Revised), “The Audit of Group Financial Statements” includes specific matters to be communicated by group auditors with those charged with governance. When the entity is a component of a group, the appropriate person(s) with whom the component auditor communicates depends on the engagement circumstances and the matter to be communicated. In some cases, a number of components may be conducting the same businesses within the same system of internal control and using the same accounting practices. Where those charged with governance of those components are the same (for example, common board of directors), duplication may be avoided by dealing with these components concurrently for the purpose of communication. 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 auditor by management.
- 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”).

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42. **In the case of listed entities,² the auditor should communicate with those charged with governance:**
- (a) **A statement that the engagement team and others in the firm as appropriate,³ the firm and, when applicable, network firms have complied with relevant ethical requirements⁴ regarding independence; 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.⁵ 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 identified threats to independence or reduce them to an acceptable level.**

...

Supplementary Matters

45. Those charged with governance are responsible for ensuring, 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.
46. 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 in overseeing the strategic direction of the entity or the entity's obligations related to accountability. Such matters may include, e.g., significant deficiencies in governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorization.
47. In determining whether to communicate supplementary matters with those charged with governance, the auditor may discuss matters of this kind of which the auditor has become

² 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."

³ 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.

⁴ Relevant ethical requirements ordinarily comprise the IFAC Code together with national requirements that are more restrictive.

⁵ This is a requirement of the IFAC Code.

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aware with the appropriate level of management, unless it is inappropriate to do so in the circumstances.

48. If a supplementary matter is communicated, it may be appropriate for the auditor to make 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 were carried out to determine whether other such matters exist.

...

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, e.g. by stating 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 should 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.

Extracts from Clarified Version of ISA 260

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. Although 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. This ISA does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.

...

Special Considerations in Audits of Smaller Entities

- A35. In the case of audits of smaller entities, the auditor may communicate in a less structured manner with those charged with governance than in the case of listed or larger entities and the frequency of communication may be less.