

29 July 2005

Mr. James M. Sylph
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017
USA

Dear Mr. Sylph:

Proposed International Standard on Auditing 260 (Revised): The Auditor's Communication with Those Charged with Governance

The global organization of Ernst & Young is pleased to comment on the above-referenced proposed standard. We support the revision of the existing International Standard on Auditing 260 to provide more guidance on both the communication process and the communication requirements. We have, however, a number of concerns with the proposed standard as drafted which are discussed below.

1. Definitions of “Those Charged with Governance” and “Management”

We understand that one of the objectives of the proposed standard was to clarify the definitions of those charged with governance and of management. We do not believe that the proposed definitions fully achieve that objective. For example, the inclusion of the reference to approval of the financial statements in both definitions makes it unclear who should ultimately be responsible for that function and is not helpful.

We suggest the following definitions, for your consideration:

“Those charged with governance” means the person or persons or governing body that have retained the oversight responsibility for the strategic direction of the entity, including the oversight responsibility for the financial reporting and disclosure process.

“Management” means the person or persons that have retained responsibility for the conduct of the entity’s operations, including the preparation and fair presentation of the financial statements.

2. Nature, Form and Timing of Communications

Nature of Communications

The proposed standard should clarify the nature of the required communications (for example, they are a by-product of the audit process or they are a part of the process of obtaining sufficient appropriate audit evidence in support of the auditor’s report on the financial statements). As a result, the auditor will be able to determine which communications need to be made before the auditor’s report on the financial statements can be issued.

Form of Communications

Paragraph 56 of the proposed standard, as presently drafted, requires the auditor to issue a written communication to those charged with governance regarding significant matters arising from the conduct of, and findings from the audit. This would include the matters covered in paragraphs 32, 33 and 43, but would exclude the auditor's responsibilities and the planned scope and timing of the audit, as well as other serious matters relevant to the responsibilities of those charged with governance. It would be preferable for paragraph 56 to specifically cover the form of communications for all matters.

Timing of Communications

The proposed standard should provide more guidance on the timing of the communications. For example, matters such as the auditor's responsibilities and the planned scope and timing of the audit would ordinarily be communicated prior to the completion of the audit and the statement of auditor independence prior to the issuance of the auditor's report on the financial statements.

3. Responsibilities of Those Charged with Governance

Paragraph 4 of the proposed standard requires the communication of matters relevant to the financial statement audit that are relevant to the responsibilities of those charged with governance. Except for a reference in paragraphs 25 (first bullet), 40 and 45 to the responsibility of those charged with governance to oversee the financial reporting and disclosure process, the responsibilities of those charged with governance are not defined in the proposed standard. The scope of the proposed standard should be restricted to the communication of matters relevant to the financial statement audit that are relevant to the oversight responsibility of those charged with governance for the financial reporting process.

4. Communication of Additional External Requirements and Matters Agreed with the Entity

Paragraph 43 includes a requirement for the auditor to communicate to those charged with governance, matters required to be communicated by additional external requirements. We question why the proposed standard includes a requirement to comply with another requirement. We recognize that the auditor has a responsibility to be aware of, and comply with, those external requirements but a failure of the auditor to comply should not result in the audit not having been conducted in accordance with ISAs. We therefore recommend that the proposed standard expressly exclude any such additional legal, regulatory or other reporting requirements that may affect the entity, although the auditor may refer to the guidance in the standard in determining the manner in which to communicate such matters.

Paragraph 43 also includes a requirement for the auditor to communicate to those charged with governance matters that have been agreed with those charged with governance or management to be communicated. We fully support an open communication process between the auditor and those charged with governance and the communication of agreed-upon matters not expressly covered by the proposed standard. However, the communication of such matters should form part of the terms of engagement between the entity and the auditor. We recommend that the proposed standard be amended to provide guidance to the effect that when those charged with governance request that matters not covered by ISAs be communicated, that the communication of such matters be included in the terms of engagement.

5. Communication of Auditor Independence

Auditor independence is paramount to the integrity of the financial reporting process for listed and non-listed entities alike. We believe that the requirement to communicate auditor independence to those charged with governance should apply to every audit engagement but that the form of communication for non-listed entities could be more flexible to reflect the circumstances of the engagement (for example, by combining the confirmation of independence with the communication of the terms of engagement). However, the requirement to communicate total fees should be restricted to listed entities only. This would require splitting paragraph 49 (b) (i) into two paragraphs.

Paragraph 49 (b) (ii) should indicate that the requirement to communicate the related safeguards that have been applied relate to identified threats to independence.

The requirement for the auditor to communicate total fees allocated to appropriate categories provides no guidance as to what would constitute appropriate categories. We suggest that the proposed standard include a statement that the components of such fees should be sufficiently detailed to meet the needs of those charged with governance.

It would also be useful for the proposed standard to include in an Appendix an example of a communication of auditor independence.

6. Communication of Other Matters

Paragraph 46 of the proposed standard requires the auditor to communicate to those charged with governance other matters which the auditor is aware that, in the auditor's professional judgment, are serious and relevant to the responsibilities of those charged with governance. There are no criteria provided to assist the auditor in making the determination of whether a matter is serious and relevant, other than two examples in paragraph 47. In addition, such matters relate to the responsibilities of those charged with governance generally, as opposed to being linked to those responsibilities to oversee the financial reporting and disclosure process. We believe that the requirement in paragraph 46 is already covered in paragraph 32(d) and therefore paragraph 46 should be deleted along with paragraph 47 and the last section of the second bullet in paragraph 25. The guidance in paragraph 48 (a) to (c) should be added to paragraph 40.

7. Adequacy of the Communication Process

Paragraph 65 requires the auditor to evaluate whether the two-way communication process between the auditor and those charged with governance has been adequate for the purpose of the audit and if it has not, to take appropriate action as required. Examples of evidence about the adequacy of the two-way communication process include the appropriateness and timeliness of actions taken by those charged with governance in response to matters raised by the auditor and the apparent openness of those charged with governance in their communications with the auditor.

We agree that an adequate communication process contributes to the effectiveness of the audit and this concept should be retained in the standard. We question however how the proposed requirement can be met, in light of the examples provided as evidence. For example, the auditor should not be required to assess the appropriateness of the actions taken by those charged with governance, except to the extent that it affects his or her report on the financial statements. Also, the openness of those charged with governance can be difficult to evaluate, absent corroborative evidence.

8. Other matters

It would also be useful if the proposed standard addressed the following situations:

- Whether the auditor has to communicate to those charged with governance that a matter or matters required to be communicated is not applicable or has not been identified;
- Whether matters communicated as a result of the previous audit, if not addressed by those charged with governance, need to be recommunicated or, where appropriate, communicated to the board of directors or equivalent.

We would be pleased to discuss our comments with members of the International Auditing and Assurance Standards Board or its staff. If you wish to do so, please contact Denise Esdon (+44 207 980 0125).

Yours sincerely,

Ernst & Young

Appendix 1 – Detailed Comments

We have some detailed comments on the proposed standard which are outlined below:

- Paragraph 5 (b) refers to “observations” arising from the audit. This term is not used anywhere else in the proposed standard. We suggest that it be replaced either by “matters” or “findings” from the audit.
- Paragraphs 9, 12, 13 and 30 refer to “particular” matters to be communicated. That term is unclear. Similarly, paragraph 25 (first and second bullets) refer to “significant” and “serious” matters. These terms should be clearly explained. The use of one phrase should be considered to avoid any ambiguity.
- Paragraph 13: It would be useful to suggest in this paragraph that the agreement between the auditor and the engaging party on the person(s) to whom the auditor communicates forms part of the terms of engagement.
- Paragraphs 14 and 25 refer to information “conveyed” by the auditor. It is unclear whether this is different than information communicated by the auditor.
- Paragraph 14 (third bullet) indicates that the decision of communicating information, in full or summary form, to the governing body as a whole, may be influenced by the auditor’s assessment of how effectively and appropriately the subgroup, or individual, conveys relevant information to the governing body as a whole. This assessment may be difficult to make and, consequently, it would be useful to indicate that the auditor should include, in his or her communication, a statement to the effect that it is the responsibility of the subgroup, or individual, to communicate those matters to those charged with governance.
- Paragraphs 22 (a) and 23 should refer to the responsibilities of the auditor under International Standards on Auditing.
- Paragraph 27: In line with paragraph 29, the reference to materiality should be to the concept of materiality.
- Paragraph 34: The related Appendix should be moved back to the body of the standard.
- Paragraph 39: It is unclear why obtaining a written representation from those charged with governance as to why misstatements brought to their attention have not been corrected will serve to reduce the possibility of misunderstandings. We suggest that this paragraph be reconsidered or deleted.