ASA 260
(April 2006)

Auditing Standard ASA 260 *Communication of Audit Matters with Those Charged With Governance*

Issued by the **Auditing and Assurance Standards Board**

Australian Government
Auditing and Assurance Standards Board

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PREFACE

Reasons for Issuing Auditing Standard ASA 260 *Communication of Audit Matters with Those Charged With Governance*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 260 *Communication of Audit Matters with Those Charged With Governance* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Main Features

This Auditing Standard establishes mandatory requirements and provides explanatory guidance on communication of audit matters arising from the audit of the financial report between the auditor and those charged with governance of an entity.

Operative Date

This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from AUS 710 (May 1999) *Communicating with Management on Matters Arising from an Audit*

The main differences between this Auditing Standard and the Auditing Standard issued by the Auditing & Assurance Standards Board of the Australian Accounting Research Foundation, AUS 710 (May 1999) *Communicating with Management on Matters Arising from an Audit*, are that in this Auditing Standard:

1. The word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility is described in AUS 710 by the word 'should'.

2. The explanatory guidance paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 710 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.

3. The definition of "governance", "audit matters of governance interest" and "those charged with governance" and the explanatory guidance on "relevant persons" replace the explanatory guidance on the different levels of management and the definitions of "report to management" and "operational management" in AUS 710.

4. The mandatory requirement and explanatory guidance paragraphs on "Audit Matters of Governance Interest to be Communicated" replace "Identification of Significant Matters" and "Reporting Significant Matters" in the existing AUS 710 with the following revised and/or additional requirements:

   (a) The auditor shall consider audit matters of governance interest that arise from the audit of the financial report and communicate them with those charged with governance (paragraph 15).

   (b) The auditor shall inform those charged with governance of those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial report taken as a whole (paragraph 17).

5. The following additional specific mandatory requirements are included:

   (a) The auditor shall determine the relevant persons who are charged with governance and with whom audit matters of governance interest are communicated (paragraph 9).

   (b) When the audit is conducted under Part 2M.3 of the *Corporations Act 2001,* the auditor shall communicate directly with those charged with governance:

      (i) a statement as to whether the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms are independent in accordance with relevant ethical requirements and any regulatory requirements that apply to the audit engagement; and

      (ii) - details of relationships that may reasonably have a bearing on auditor independence, as outlined in relevant ethical requirements relating to audit engagements; and

      - the related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level (paragraph 20).

6. The following mandatory requirement and related explanatory guidance paragraphs on "Format and Presentation" in AUS 710 has been removed as it is included in ASA 230 *Audit Documentation*:

   - the auditor should document the subject matter of oral reports to management regarding significant matters (paragraph .31).

7. The mandatory requirement and related explanatory guidance paragraphs on "Management Response" in AUS 710 has been included as explanatory guidance (paragraph 32).

8. Appendices 1 to 3 in AUS 710 are not included.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard ASA 260 *Communication of Audit Matters with Those Charged With Governance* as set out in paragraphs 1 to 36, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

Dated 28 April 2006

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 260

Communication of Audit Matters with Those Charged With Governance

Application

1 This Auditing Standard applies to:

(a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and

(b) an audit of a financial report for any other purpose.

2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

Operative Date

3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Introduction

4 The purpose of this Auditing Standard is to establish mandatory requirements and to provide explanatory guidance on communication of audit matters arising from the audit of the financial report between the auditor and those charged with governance of an entity. These communications relate to audit matters of governance interest as defined in this Auditing Standard. This Auditing Standard does not provide guidance on communications by the auditor to parties outside the entity, for example, external regulatory agencies.

5 The auditor shall communicate audit matters of governance interest arising from the audit of the financial report with those charged with governance of an entity.

Definitions

6 For the purposes of this Auditing Standard, "governance" means the term used to describe the role of persons entrusted with the

oversight, control and direction of an entity.[1] "Those charged with governance" includes those persons accountable for ensuring that the entity achieves its objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting to interested parties. Those charged with governance include management only when it performs such functions.

7 "Management" includes officers and others who also perform senior managerial functions. Management includes those charged with governance only in those instances when they perform such functions.

8 For the purpose of this Auditing Standard, "audit matters of governance interest" means those matters that arise from the audit of the financial report and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Audit matters of governance interest include only those matters that have come to the attention of the auditor as a result of the performance of the audit. The auditor is not required, in an audit in accordance with Auditing Standards, to design audit procedures for the specific purpose of identifying matters of governance interest.

Relevant Persons

9 The auditor shall determine the relevant persons who are charged with governance and with whom audit matters of governance interest are communicated.

10 The structures of governance vary according to the size and nature of an entity and from country to country reflecting different cultural and legal contextual backgrounds. In Australia, the governing board is responsible for the oversight function, but may establish an audit committee to assist it to fulfil its responsibilities, while senior

[1] Principles of corporate governance have generally been developed by various countries as a point of reference for the establishment of good corporate behaviour. Such principles generally focus on publicly listed companies; however, they may also serve to improve governance in other forms of entities. As board and governance structures and practices vary from country to country, there is no single model of good corporate governance. A common principle is that the entity has in place a governance structure which enables the board to exercise objective oversight over the business and management of the entity including financial reporting. Internationally, it may be appropriate to refer to the *Principles of Corporate Governance*, as issued from time to time, by the Organisation for Economic Co-operation and Development (OECD). In Australia, it may be appropriate to refer to the *Principles of Good Corporate Governance and Best Practice Recommendations*, as issued from time to time, by the Corporate Governance Council of the Australian Stock Exchange Ltd.

executives are responsible for the management function. In other countries the oversight and management function may be legally separated into different bodies, such as a supervisory (wholly or mainly non-executive) board and a management (executive) board.

11 This diversity makes it difficult to establish a universal identification of the persons who are charged with governance and with whom the auditor communicates audit matters of governance interest. The auditor uses professional judgement to determine those persons with whom audit matters of governance interest are communicated, taking into account the governance structure of the entity, the circumstances of the engagement and any relevant legislation. The auditor also ordinarily considers the legal responsibilities of those persons. For example, in entities with audit committees, the relevant persons may be members of the audit committee. However, in entities where a unitary board has established an audit committee, the auditor may decide to communicate with the audit committee, or with the whole board, depending on the importance of the audit matters of governance interest.

12 When the entity's governance structure is not well defined, or those charged with governance are not clearly identified by the circumstances of the engagement, or by legislation, the auditor ordinarily comes to an agreement with the entity about with whom audit matters of governance interest are to be communicated. Examples include some owner-managed entities, certain unincorporated associations, and some government agencies.

13 To avoid misunderstandings, an audit engagement letter may explain that the auditor will communicate only those matters of governance interest that come to the auditor's attention as a result of the performance of an audit and that the auditor is not required to design audit procedures for the specific purpose of identifying matters of governance interest. The engagement letter may also:

(a) describe the form in which any communications on audit matters of governance interest will be made;

(b) identify the relevant persons with whom such communications will be made; and

(c) identify any specific audit matters of governance interest which it has been agreed are to be communicated.

14 The effectiveness of communications is enhanced by developing a constructive working relationship between the auditor and those charged with governance. This relationship is developed while

maintaining an attitude of professional independence and objectivity.

Audit Matters of Governance Interest to be Communicated

15 The auditor shall consider audit matters of governance interest that arise from the audit of the financial report and communicate them with those charged with governance.

16 Audit matters of governance interest ordinarily include such matters as the following:[2]

- The general approach and overall scope of the audit, including any expected limitations thereon, or any additional requirements.
- The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial report.
- The potential effect on the financial report of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial report.
- Audit adjustments, whether or not recorded by the entity that have, or could have, a material effect on the entity's financial report.
- Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- Disagreements with management about matters that, individually or in aggregate, could be significant to the entity's financial report or the auditor's report. These communications include consideration of whether the matter has, or has not, been resolved and the significance of the matter.
- Expected modifications to the auditor's report.
- Any other matters agreed upon in the terms of the audit engagement.

[2] The list of matters below is not intended to be all-inclusive or exhaustive. In addition, other Auditing Standards identify specific situations where the auditor is required to communicate certain matters with those charged with governance.

17 The auditor shall inform those charged with governance of those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial report taken as a whole.

18 The uncorrected misstatements communicated to those charged with governance need not include the misstatement below a designated amount.

19 As part of the auditor's communications, those charged with governance are ordinarily informed that:

(a) the auditor's communications of matters includes only those audit matters of governance interest that have come to the attention of the auditor as a result of the performance of the audit; and

(b) an audit of a financial report is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.

Communicating Auditor Independence Requirements

20 When the audit is conducted under Part 2M.3 of the *Corporations Act 2001*, the auditor shall communicate directly with those charged with governance:

(a) a statement as to whether the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms are independent in accordance with relevant ethical requirements and any regulatory requirements that apply to the audit engagement; and

(b) (i) details of relationships that may reasonably have a bearing on auditor independence, as outlined in relevant ethical requirements relating to audit engagements;[3] and

[3] Relevant ethical requirements relating to audit engagements ordinarily comprise the applicable code of conduct of a professional accounting body. In Australia, the codes of conduct of the professional accounting bodies, as issued from time to time, are:

- CPA Australia and The Institute of Chartered Accountants in Australia, *Joint Code of Professional Conduct*; and
- National Institute of Accountants, *Pronouncements of the Board of Directors – Code of Ethics.*

(ii) the related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level.

21 The auditor ordinarily considers whether the communications set out in paragraph 20 of this Auditing Standard are also relevant in the case of other audits, particularly those of entities that may be of significant public interest because, as a result of their business, their size or their corporate status, they have a wide range of stakeholders. Examples of such entities might include public sector entities, certain unincorporated associations, and superannuation funds.

Timing of Communications

22 The auditor shall communicate audit matters of governance interest on a timely basis.

23 This enables those charged with governance to take appropriate action.

24 In order to achieve timely communications, the auditor ordinarily discusses with those charged with governance the basis and timing of such communications. In certain cases, because of the nature of the matter, the auditor may communicate that matter sooner than previously agreed.

Forms of Communications

25 The auditor's communications with those charged with governance may be made orally or in writing. Ordinarily, the auditor's decision whether to communicate orally or in writing is affected by factors such as the following:

- The size, operating structure, legal structure, and communications processes of the entity being audited.
- The nature, sensitivity and significance of the audit matters of governance interest to be communicated.
- The arrangements made with respect to periodic meetings or reporting of audit matters of governance interest.
- The amount of on-going contact and dialogue the auditor has with those charged with governance.

26 When audit matters of governance interest are communicated orally, under ASA 230 *Audit Documentation*, the auditor needs to document in the audit working papers the matters communicated and any responses to those matters. This documentation may take the form of a copy of the minutes of the auditor's discussion with those charged with governance. In certain circumstances, depending on the nature, sensitivity, and significance of the matter, it may be advisable for the auditor to confirm in writing with those charged with governance any oral communications on audit matters of governance interest.

27 Audit matters of governance interest are ordinarily reported in writing to the governing body or audit committee. The auditor ordinarily considers:

(a) attending a meeting of the governing body or audit committee, when all members are present, to discuss such matters as appropriate; and

(b) any guidelines established by the governing body for reporting issues to, for example, an audit committee, or individuals with particular responsibility for audit issues.

28 If the auditor is concerned that a written report intended for those charged with governance has not been, or may not be distributed to all members of that group, the auditor shall implement an approach whereby all members are appropriately informed of the contents of the report.

29 For example, when reporting to a particular group such as the governing body or audit committee, the auditor ordinarily considers the composition, structure and operational style of that group.

30 Ordinarily, the auditor initially discusses audit matters of governance interest with management, except where those matters relate to questions of management competence or integrity. These initial discussions with management are important in order to clarify facts and issues, and to give management an opportunity to provide further information. If management agrees to communicate a matter of governance interest with those charged with governance, the auditor may not need to repeat the communications, provided that the auditor is satisfied that such communications have effectively and appropriately been made.

Other Matters

31 If the auditor considers that a modification of the auditor's report on the financial report is required, as described in ASA 701 *Modifications to the Auditor's Report*, communications between the auditor and those charged with governance cannot be regarded as a substitute.

32 Ordinarily, the auditor considers whether audit matters of governance interest previously communicated continue to be a matter of governance interest and whether to communicate the matter again with those charged with governance.

Confidentiality

33 The requirements of a professional accounting body,[4] legislation or regulation may impose obligations of confidentiality that restrict the auditor's communications of audit matters of governance interest. Under ASA 220 *Quality Control for Audits of Historical Financial Information*, the auditor needs to refer to such requirements, laws and regulations before communicating with those charged with governance. In some circumstances, the potential conflicts with the auditor's ethical and legal obligations of confidentiality and reporting may be complex. In these cases, the auditor may wish to seek legal advice.

Laws and Regulations

34 The requirements of a professional accounting body, legislation or regulation may impose obligations on the auditor to make communications on governance related matters. For example section 311 of the *Corporations Act 2001* imposes a duty on the auditor to inform the Australian Securities and Investments Commission if certain circumstances arise during the audit. These additional communications requirements are not covered by this Auditing Standard, however, they may affect the content, form and timing of communications with those charged with governance.

35 In the public sector, obligations may be imposed on the auditor to communicate on governance related matters of a regulatory and compliance nature, which are broader than the types of matters

[4] A professional accounting body as defined in ASA 220 includes:
- The Institute of Chartered Accountants in Australia;
- CPA Australia; and
- National Institute of Accountants.

discussed in this Auditing Standard. These matters may also include considerations of economy, efficiency and effectiveness of programs, projects and activities.

In addition, the auditor's written communications may be placed on public record and distributed to a wider audience than solely those persons charged with governance of the entity being audited.

Conformity with International Standards on Auditing

36 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 260 *Communication of Audit Matters with Those Charged With Governance*, issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The main differences between this Auditing Standard and ISA 260 are:

- This Auditing Standard includes the following specific mandatory requirements and related explanatory guidance paragraphs that are not in ISA 260:
    - ♦ When the audit is conducted under Part 2M.3 of the *Corporations Act 2001*, the auditor shall communicate directly with those charged with governance:
        - ○ a statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms are independent in accordance with relevant ethical requirements and any additional external requirements that apply to the engagement; and
        - ○ (i) all relationships and other matters on auditor independence, as specified in Parts 2M.3 and 2M.4 of the *Corporations Act 2001*, which are required to be disclosed by the auditor; and

          (ii) the related safeguards that have been applied to eliminate threats to independence or reduce them to an acceptable level (paragraph 20).

- ♦ If the auditor is concerned that a written report intended for those charged with governance has not been, or may not be distributed to all members of that group, the auditor should implement an approach whereby all members are appropriately informed of the contents of the report (paragraph 28).

- This Auditing Standard contains references to the audit reporting requirements of the *Corporations Act 2001*, whereas ISA 260 does not.

- This Auditing Standard contains explanatory guidance on differential requirements in the public sector, whereas ISA 260 includes a section on Public Sector Perspective (paragraph 35).

Compliance with this Auditing Standard enables compliance with ISA 260.