Compiled Auditing Standard **ASA 260**
(June 2011)

Auditing Standard ASA 260 *Communication with Those Charged with Governance*

This compilation was prepared on 27 June 2011 taking into account amendments made by ASA 2011-1

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

Australian Government
Auditing and Assurance Standards Board

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COMPILATION DETAILS

Auditing Standard ASA 260 *Communication with Those Charged with Governance* as Amended

This compilation takes into account amendments made up to and including 27 June 2011 and was prepared on 27 June 2011 by the Auditing and Assurance Standards Board (AUASB).

This compilation is not a separate Auditing Standard made by the AUASB. Instead, it is a representation of ASA 260 (October 2009) as amended by another Auditing Standard which is listed in the Table below.

Table of Standards

Standard	Date made	Operative date
ASA 260	27 October 2009	1 January 2010
ASA 2011-1	27 June 2011	1 July 2011

Table of Amendments

Paragraph affected	How affected	By … [paragraph]
Aus 0.1(a)	Amended	ASA 2011-1 [25]
Aus 17.1 Footnote *	Amended	ASA 2011-1 [26]

AUTHORITY STATEMENT

Auditing Standard ASA 260 *Communication with Those Charged with Governance* (as amended at 27 June 2011) is set out in paragraphs 1 to A45 and Appendices 1 and 2.

This Auditing Standard is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. This Auditing Standard is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

Dated: 27 June 2011

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 260

The Auditing and Assurance Standards Board (AUASB) made Auditing Standard ASA 260 *Communication with Those Charged with Governance*, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*, on 27 October 2009.

This compiled version of ASA 260 incorporates subsequent amendments contained in another Auditing Standard made by the AUASB up to and including 27 June 2011 (see Compilation Details).

AUDITING STANDARD ASA 260

Communication with Those Charged with Governance

Application

Aus 0.1 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 the *Corporations Act 2001*; and

(b) an audit of a financial report, or a complete set of financial statements, for any other purpose.

Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

Operative Date

Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010. [Note: For operative dates of paragraphs changed or added by an amending Standard, see Compilation Details.]

Introduction

Scope of this Auditing Standard

1. This Auditing Standard deals with the auditor's responsibility to communicate with those charged with governance in an audit of a financial report. Although this Auditing Standard 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 entities whose audit is conducted under the *Corporations Act 2001*. This Auditing Standard 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.

2. This Auditing Standard is written in the context of an audit of a financial report, but may also be applicable, adjusted as necessary in

the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation of other historical financial information.

3. Recognising the importance of effective two-way communication in an audit of a financial report, this Auditing Standard 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 Auditing Standard, are identified in other Auditing Standards (see Appendix 1). In addition, ASA 265[1] establishes specific requirements regarding the communication of significant deficiencies in internal control the auditor has identified during the audit to those charged with governance. Further matters, not required by this or other Auditing Standards, may be required to be communicated by laws or regulations, by agreement with the entity, or by additional requirements applicable to the engagement, for example, the standards of a professional accountancy body. Nothing in this Auditing Standard precludes the auditor from communicating any other matters to those charged with governance. (Ref: Para. A24-A27)

The Role of Communication

4. This Auditing Standard focuses primarily on communications from the auditor to those charged with governance. Nevertheless, effective two-way communication is important in assisting:

   (a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity;

   (b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and

   (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process,

[1] See ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management.*

thereby reducing the risks of material misstatement of the financial report.

5. Although the auditor is responsible for communicating matters required by this Auditing Standard, 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. Similarly, communication by management with those charged with governance of matters that 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.

6. Clear communication of specific matters required to be communicated by Australian Auditing Standards is an integral part of every audit. Australian Auditing Standards do not, however, require the auditor to perform procedures specifically to identify any other matters to communicate with those charged with governance.

7. Law or regulation may restrict the auditor's communication of certain matters with those charged with governance. For example, law or regulation 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 some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.

Effective Date

8. [Deleted by the AUASB. Refer Aus 0.3]

Objectives

9. The objectives of the auditor are:

   (a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial report audit, and an overview of the planned scope and timing of the audit;

   (b) To obtain from those charged with governance information relevant to the audit;

(c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and

(d) To promote effective two-way communication between the auditor and those charged with governance.

Definitions

10. For purposes of the Australian Auditing Standards, the following terms have the meanings attributed below:

    (a) Those charged with governance means the person(s) or organisation(s) (for example, a corporate trustee) 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 management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. For discussion of the diversity of governance structures, see paragraphs A1-A8.

    (b) Management means the person(s) with 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, for example, executive members of a governance board, or an owner-manager.

Requirements

Those Charged with Governance

11. The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Ref: Para. A1-A4)

Communication with a Subgroup of Those Charged with Governance

12. If the auditor communicates with a subgroup of those charged with governance, for example, an audit committee, or an individual, the

auditor shall determine whether the auditor also needs to communicate with the governing body. (Ref: Para. A5-A7)

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

13. In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this Auditing Standard 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. These matters are noted in paragraph 16(c) of this Auditing Standard. The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity. (Ref: Para. A8)

Matters to Be Communicated

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

14. The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial report audit, including that:

    (a) The auditor is responsible for forming and expressing an opinion on the financial report that has been prepared by management with the oversight of those charged with governance; and

    (b) The audit of the financial report does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A9-A10)

Planned Scope and Timing of the Audit

15. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit. (Ref: Para. A11-A15)

Significant Findings from the Audit

16. The auditor shall communicate with those charged with governance: (Ref: Para. A16)

    (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial report disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity; (Ref: Para. A17)

    (b) Significant difficulties, if any, encountered during the audit; (Ref: Para. A18)

    (c) Unless all of those charged with governance are involved in managing the entity:

        (i) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and (Ref: Para. A19)

        (ii) Written representations the auditor is requesting; and

    (d) Other matters, if any, arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process. (Ref: Para. A20)

Auditor Independence

17. In the case of listed entities the auditor shall communicate with those charged with governance:

    (a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence;[*] and

[*] See ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements.*

(b) (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgement, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial report 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 identified threats to independence or reduce them to an acceptable level. (Ref: Para. A21-A23)

Aus 17.1 In the case of entities[*] audited in accordance with the *Corporations Act 2001*, the auditor shall communicate 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, have complied with the independence requirements of section 307C of the *Corporations Act 2001.*

The Communication Process

Establishing the Communication Process

18. The auditor shall communicate with those charged with governance the form, timing and expected general content of communications. (Ref: Para. A28-A36)

Forms of Communication

19. The auditor shall communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgement, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit. (Ref: Para. A37-A39)

[*] See, for example, section 292 of the *Corporations Act 2001* for types of entities.

Aus 19.1 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 endeavour to ensure all members are appropriately informed of the contents of the report.

20. The auditor shall communicate in writing with those charged with governance regarding auditor independence when required by paragraph 17 and Aus 17.1 of this Auditing Standard.

Timing of Communications

21. The auditor shall communicate with those charged with governance on a timely basis. (Ref: Para. A40-A41)

Adequacy of the Communication Process

22. 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 evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action. (Ref: Para. A42-A44)

Documentation

23. Where matters required by this Auditing Standard to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.[2] (Ref: Para. A45)

* * *

[2] See ASA 230 *Audit Documentation*, paragraphs 8-11 and paragraph A6.

Application and Other Explanatory Material

Those Charged with Governance (Ref: Para. 11)

A1. Governance structures vary by entity, reflecting influences such as 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, for example, company directors. In others, for example, some public sector entities, a body that is not part of the entity is charged with governance.
- In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- In some cases, those charged with governance are responsible for approving[3] the entity's financial report (in other cases management has this responsibility).

A2. In most entities, governance is the collective responsibility of a governing body, such as 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, for example, 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 in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body.

[3] See ASA 700 *Forming an Opinion and Reporting on a Financial Report*, paragraph A40.

A3. Such diversity means that it is not possible for this Auditing Standard to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some owner-managed entities, some not-for-profit organisations, and some public sector entities. In such cases, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with ASA 315[4] is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

A4. ASA 600 includes specific matters to be communicated by group auditors with those charged with governance[35]. 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.

Communication with a Subgroup of Those Charged with Governance
(Ref: Para. 12)

A5. When considering communicating with a subgroup of those charged with governance, the auditor may take into account such matters as:

- The respective responsibilities of the subgroup and the governing body.
- The nature of the matter to be communicated.
- Relevant legal or regulatory requirements.

[4] See ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.
[5] See ASA 600 *Special Considerations—Audits of a Group Financial Report (Including the Work of Component Auditors)*, paragraphs 46-49.

- Whether the subgroup has the authority to take action in relation to the information communicated, and can provide further information and explanations the auditor may need.

A6. When deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the auditor may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor may make explicit in agreeing the terms of engagement that, unless prohibited by law or regulation, the auditor retains the right to communicate directly with the governing body.

A7. Audit committees (or similar subgroups with different names) exist in many jurisdictions. Although 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 meet the auditor without management present at least annually.

When All of Those Charged with Governance Are Involved in Managing the Entity (Ref: Para. 13)

A8. In some cases, all of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognise this position. In such cases, communication with person(s) with management responsibilities may not adequately inform all of those with whom the auditor would otherwise communicate in their governance capacity. For example, in a company where all directors are involved in managing the entity, some of those directors (for example, one responsible for marketing) may be unaware of significant matters discussed with another director (for example, one responsible for the preparation of the financial report).

Matters to Be Communicated

The Auditor's Responsibilities in Relation to the Financial Report Audit (Ref: Para. 14)

A9. The auditor's responsibilities in relation to the financial report audit are often included in the engagement letter or other suitable form of written agreement that records the agreed terms of the engagement. Providing those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them regarding such matters as:

- The auditor's responsibility for performing the audit in accordance with Australian Auditing Standards, which is directed towards the expression of an opinion on the financial report. The matters that Australian Auditing Standards require to be communicated, therefore, include significant matters arising from the audit of the financial report that are relevant to those charged with governance in taking responsibility for, or overseeing, the financial reporting process.
- The fact that Australian Auditing Standards 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's responsibility for communicating particular matters required by law or regulation, by agreement with the entity or by additional requirements applicable to the engagement, for example, the standards of a professional accountancy body.

A10. Law or regulation, 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 report 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 (Ref: Para. 15)

A11. Communication regarding the planned scope and timing of the audit may:

(a) Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify 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.

A12. Care is required when communicating with those charged with governance about the planned 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 may reduce the effectiveness of those procedures by making them too predictable.

A13. Matters communicated may include:

- 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 the concept of materiality in the context of an audit.[6]

A14. 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.

[6] See ASA 320 *Materiality in Planning and Performing an Audit*.

- 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 misstatements.
  - 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 report.
- 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.
- The responses of those charged with governance to previous communications with the auditor.

A15. While communication with those charged with governance may assist the auditor to plan the scope and timing of the audit, it does not change the auditor's sole responsibility to establish the overall audit strategy and the audit plan, including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.

Significant Findings from the Audit (Ref: Para. 16)

A16. The communication of findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

Significant Qualitative Aspects of Accounting Practices (Ref: Para. 16(a))

A17. The Financial reporting framework ordinarily allows the entity to make accounting estimates, and judgements about accounting policies and financial report disclosures. Open and constructive communication about significant qualitative aspects of the entity's accounting practices may include comment on the acceptability of significant accounting practices. Appendix 2 identifies matters that may be included in this communication.

Significant Difficulties Encountered During the Audit (Ref: Para. 16(b))

A18. Significant difficulties encountered during the audit may include such matters as:

- Significant delays in management, or those charged with governance 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 information.
- Restrictions imposed on the auditor by management or those charged with governance.
- Management's, or where appropriate, those charged with governance'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.[7]

Significant Matters Discussed, or Subject to Correspondence with Management (Ref: Para. 16(c) (i))

A19. Significant matters discussed, or subject to correspondence with management may include such matters as:

- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- Concerns about management's consultations with other accountants on accounting or auditing matters.
- 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 (Ref: Para. 16(d))

A20. Other significant matters arising from the audit that are directly relevant to those charged with governance in their responsibility for, or overseeing, the financial reporting process may include such matters as material misstatements of fact or material inconsistencies in information accompanying the audited financial report that have been corrected.

Auditor Independence (Ref: Para. 17)

A21. The auditor is required to comply with relevant ethical requirements, including those pertaining to independence, relating to an audit of a financial report.[8]

A22. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:

7 See ASA 705 *Modifications to the Opinion in the Independent Auditor's Report.*
8 See ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards,* paragraph 14.

(a) Threats to independence, which may be categorised 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.

The communication required by paragraph 17(a) may include an inadvertent violation of relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed.

A23. The communication requirements relating to auditor independence that apply in the case of listed entities under paragraph 17 and other entities under paragraph Aus 17.1, may also be relevant in the case of some other 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. Examples of such entities, where the communication of auditor independence may be appropriate or required, include public sector entities, credit institutions, insurance companies, and superannuation funds. On the other hand, there may be situations where communications regarding independence may not be relevant, for example, where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where the entity is owner-managed, and the auditor's firm and network firms have little involvement with the entity beyond a financial report audit.

Supplementary Matters (Ref: Para. 3)

A24. The oversight of management by those charged with governance includes ensuring that the entity designs, implements and maintains appropriate internal control with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

A25. 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, for example, significant

* For example, entities which do not have reporting requirements under the *Corporations Act 2001*.

issues regarding governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorisation.

A26. 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 aware with the appropriate level of management, unless it is inappropriate to do so in the circumstances.

A27. 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 report;

(b) No procedures were carried out with respect to the matter other than any that were necessary to form an opinion on the financial report; and

(c) No procedures were carried out to determine whether other such matters exist.

The Communication Process

Establishing the Communication Process (Ref: Para. 18)

A28. Clear communication of the auditor's responsibilities, the planned scope and timing of the audit, and the expected general content of communications helps establish the basis for effective two-way communication.

A29. Matters that may also contribute to effective two-way communication include discussion of:

- 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, for example, 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.

A30. 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. Difficulty in establishing effective two-way communication may indicate that the communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraph A44).

Considerations Specific to Smaller Entities

A31. 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 larger entities.

Communication with Management

A32. Many matters may be discussed with management in the ordinary course of an audit, including matters required by this Auditing Standard to be communicated with those charged with governance. Such discussions recognise management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the preparation of the financial report.

A33. Before communicating matters with those charged with governance, the auditor may discuss them with management, unless that is inappropriate. For example, it may not be appropriate to discuss questions of management's competence or integrity with management. In addition to recognising management's executive responsibility, these initial discussions may 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.

Communication with Third Parties

A34. Those charged with governance may wish to provide third parties, for example, 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 may be important in the circumstances that the third parties be informed that the communication was not prepared with them in mind, for example, 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 disclosure or distribution to third parties.

A35. In some jurisdictions, the auditor may be required by law or regulation to, for example:

- Notify a regulatory or enforcement body of certain matters communicated with those charged with governance. For example, in some cases the auditor has a duty to report misstatements to authorities where management and those charged with governance fail to take corrective action;

Aus A35.1 An auditor is required under the *Corporations Act 2001* to notify the Australian Securities and Investments

Commission (ASIC) if the auditor is aware of certain circumstances;[*]

- Submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies, or other bodies such as a central authority in the case of some public sector entities; or

- Make reports prepared for those charged with governance publicly available.

A36. Unless required by law or regulation to provide a third party with a copy of the auditor's written communications with those charged with governance, the auditor may need the prior consent of those charged with governance before doing so.

Forms of Communication (Ref: Para. 19-20)

A37. Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The auditor may communicate matters other than those identified in paragraphs 19 and 20 either orally or in writing. Written communications may include an engagement letter that is provided to those charged with governance.

A38. In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarisation in the communication, and whether to communicate in a structured or unstructured manner) may be 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.

[*] See ASIC Regulatory Guide 34 *Auditors' Obligations: Reporting to ASIC* (December 2007), which provides guidance to help auditors comply with their obligations under sections 311, 601HG and 990K of the *Corporations Act 2001* to report contraventions and suspected contraventions to ASIC.

- In the case of an audit of a special purpose financial report, whether the auditor also audits the entity's general purpose financial report.

- Legal requirements. In some jurisdictions, a written communication with those charged with governance may be required in a prescribed form by 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.

A39. When a significant matter is discussed with an individual member of those charged with governance, for example, the chair of an audit committee, it may be appropriate for the auditor to summarise the matter in later communications so that all of those charged with governance have full and balanced information.

Timing of Communications (Ref: Para. 21)

A40. 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 may often 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. Similarly, the auditor may communicate orally to those charged with governance as soon as practicable significant deficiencies in internal control that the auditor has identified, prior to communicating these in writing as required by ASA 265.[9] Communications regarding independence may be appropriate whenever significant judgements are made about threats to independence and related safeguards, for example, when accepting an engagement to provide non-audit services, and at a concluding discussion. A concluding discussion may also be an appropriate time to communicate findings from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices.

- When auditing both general purpose and special purpose financial reports, it may be appropriate to coordinate the timing of communications.

A41. 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, for example, the auditor may not identify a particular matter (for example, non-compliance 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 (Ref: Para. 22)

A42. The auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and those charged with governance; rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include:

- The appropriateness and timeliness of actions taken by those charged with governance in response to matters raised

[9] See ASA 265, paragraphs 9 and A14.

by the auditor. Where significant matters raised in previous communications have not been dealt with effectively, it may be appropriate for the auditor to enquire as to why appropriate action has not been taken, and to consider 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, for example, 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.

A43. As noted in paragraph 4, effective two-way communication assists both the auditor and those charged with governance. Further, ASA 315 identifies participation by those charged with governance, including their interaction with internal audit, if any, and external auditors, as an element of the entity's control environment.[10] Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor

[10] See ASA 315, paragraph A70.

may not have obtained sufficient appropriate audit evidence to form an opinion on the financial report.

A44. If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take such actions 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 (for example, a regulator), or a higher authority in the governance structure that is outside the entity, such as the owners of a business (for example, shareholders in a general meeting), or the responsible government minister or parliament in the public sector.
- Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.

Documentation (Ref: Para. 23)

A45. Documentation of oral communication may include a copy of minutes prepared by the entity retained as part of the audit documentation where those minutes are an appropriate record of the communication.

Conformity with International Standards on Auditing

This Auditing Standard conforms with International Standard on Auditing ISA 260 *Communication with Those Charged with Governance*, issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix "Aus".

The following requirements are additional to ISA 260:

- In the case of entities audited in accordance with the *Corporations Act 2001*, the auditor shall communicate 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, have complied with the independence requirements of section 307C of the *Corporations Act 2001.* [Ref: Para. Aus 17.1]

- 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 endeavour to ensure all members are appropriately informed of the contents of the report. [Ref: Para. Aus 19.1].

Compliance with this Auditing Standard enables compliance with ISA 260.

Appendix 1

(Ref: Para. 3)

Specific Requirements in ASQC 1 and Other Australian Auditing Standards that Refer to Communications with Those Charged With Governance

This Appendix identifies paragraphs in ASQC 1[11] and other Australian Auditing Standards, in effect for an audit of a financial report, or a complete set of financial statements, for periods commencing on or after 1 January 2010, that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in the Australian Auditing Standards.

- ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements* - paragraph 30(a)
- ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* - paragraphs 21, 38(c)(i) and 40-42
- ASA 250 *Consideration of Laws and Regulations in an Audit of a Financial Report* - paragraphs 14, 19 and 22-24
- ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* - paragraph 9
- ASA 450 *Evaluation of Misstatements Identified during the Audit* - paragraphs 12-13
- ASA 505 *External Confirmations* - paragraph 9
- ASA 510 *Initial Audit Engagements—Opening Balances* - paragraph 7
- ASA 550 *Related Parties* - paragraph 27
- ASA 560 *Subsequent Events* - paragraphs 7(b)-(c), 10(a), 13(b), 14(a) and 17

[11] See ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements*.

- ASA 570 *Going Concern* - paragraph 23
- ASA 600 *Special Considerations—Audits of a Group Financial Report (Including the Work of Component Auditors)* - paragraph 49
- ASA 705 *Modifications to the Opinion in the Independent Auditor's Report* - paragraphs 12, 14, 19(a) and 28
- ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* - paragraph 9
- ASA 710 *Comparative Information—Corresponding Figures and Comparative Financial Reports* - paragraph 18
- ASA 720 *The Auditor's Responsibilities Relating to Other Information in Documents Containing an Audited Financial Report* - paragraphs 10, 13 and 16
- ASRE 2410 *Review of a Financial Report by the Independent Auditor of the Entity* - paragraphs 27, 28, 30 and 31

Appendix 2

(Ref: Para. 16 (a) and A17)

Qualitative Aspects of Accounting Practices

The communication required by paragraph 16(a), and discussed in paragraph A17 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 report. Where acceptable alternative accounting policies exist, the communication may include identification of the financial report items that are affected by the choice of significant accounting 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 may 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 ASA 540,[12] including, for example:
  - ○ Management's identification of accounting estimates.
  - ○ Management's process for making accounting estimates.

[12] See ASA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures.*

- ○ Risks of material misstatement.
- ○ Indicators of possible management bias.
- ○ Disclosure of estimation uncertainty in the financial report.

Financial Report Disclosures

- The issues involved, and related judgements made, in formulating particularly sensitive financial report disclosures (for example, 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 report.

Related Matters

- The potential effect on the financial report of significant risks, exposures and uncertainties, such as pending litigation, that are disclosed in the financial report.
- The extent to which the financial report is affected by unusual transactions, including non-recurring amounts recognised during the period, and the extent to which such transactions are separately disclosed in the financial report.
- 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 may explain how factors affecting carrying values were selected and how alternative selections would have affected the financial report.
- The selective correction of misstatements, for example, correcting misstatements with the effect of increasing reported earnings, but not those that have the effect of decreasing reported earnings.