

July 31, 2005

Mr. James Sylph  
Technical Director, IAASB  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, NY 10017

**Re: Exposure Draft: *Proposed (Revised) International Standard on Auditing (ISA) 260, “The Auditor’s Communication with Those Charged With Governance”***

Dear Mr. Sylph:

The American Institute of Certified Public Accountants (AICPA) is pleased to have the opportunity to comment on the above referenced exposure draft.

We would like to commend the International Auditing and Assurance Standards Board (IAASB) on the issuance of this exposure draft. We believe that the document provides much needed enhanced guidance on auditor’s communications and we support its issuance. However, we have concerns about the requirement for the auditor to communicate matters that are deemed to be “serious and relevant” to the responsibilities of those charged with governance. We also offer some recommendations we believe will improve the clarity of the document and provide additional guidance. Finally, we offer some additional editorial comments for your consideration.

Following are our comments on the exposure draft.

### **Communication of “Serious and Relevant” Matters**

Paragraphs 25 and 46-48 discuss the auditor’s responsibility to communicate matters that are “serious and relevant to the responsibilities of those charged with governance.” We are concerned that there are no boundaries on the types of issues the auditor would be required to communicate. We are particularly concerned that issues that are relevant to the responsibilities of those charged with governance may be interpreted to include issues that do not affect the

financial reporting and disclosure process. We believe it will be difficult for the auditor to determine what matters are relevant without a proper frame of reference, such as “matters that come to his or her attention as a result of the audit of the financial statements.” In our view, the primary focus of this requirement should be on those matters *related to the financial statement audit* that are serious and relevant to the responsibilities of those charged with governance *in overseeing the financial reporting and disclosure process*. We recommend that the language in paragraphs 22(e), 25 and 46 be revised accordingly to provide consistency throughout the ISA.

In addition, we do not believe that the examples in paragraph 47 provide sufficient guidance as to the nature of the matters to be communicated, as these examples appear to be matters that would have come to the auditor’s attention as a by-product of the audit. We recommend that the IAASB provide additional guidance as to what is considered “serious and relevant” and consider providing additional examples in paragraph 47.

We recommend the addition of a paragraph stating that nothing precludes the auditor from communicating other matters of which the auditor is aware, that in the auditor’s professional judgment, are serious and relevant to the responsibilities of those charged with governance other than those responsibilities related to overseeing the financial reporting and disclosure process.

We also observe that paragraph 47 states that such matters “may arise from the audit of the financial statements or otherwise come to the attention of the auditor.” This is inconsistent with paragraph 48(a), which states that these matters are “identified as a by-product of the audit.” Matters may come to the attention of the auditor outside the audit process, for example through social activities or possibly through the audit of another, unrelated, entity. We recommend eliminating “which may arise from the audit of the financial statements or otherwise come to the attention of the auditor” from paragraph 47 and moving paragraph 48 to precede paragraph 47.

We also believe that this requirement would be put in proper context by including the “*Other Matters*” section of the ISA (paragraphs 46-48) under the broader sub-heading of “*Conduct of and Findings from the Audit*” and placing it immediately following “Uncorrected Misstatements” in that section. We also recommend that “*Other Matters*” be re-titled “*Other Significant Matters*” and that this section incorporate existing paragraph 40, thereby removing the necessity for the heading “*Other Matters Relevant to the Financial Reporting and Disclosure Process*” in the proposed ISA.

### **Planned Scope and Timing of the Audit**

Paragraph 27 requires that the auditor communicate an outline of the planned scope and timing of the audit to those charged with governance. However, the bullets in paragraph 29 seem to suggest more detail than the word “outline” implies. As addressed in paragraph 28 of the

proposed standard, we are sensitive to the concern that a too-detailed discussion of materiality thresholds and specific accounts to be audited would compromise the effectiveness of the audit.

In particular, we suggest the following changes:

- Paragraph 27, delete “outline” and insert “overview”.
- Paragraph 27, delete “areas in which they may request the auditor to undertake additional procedures” and insert “particular matters that they believe the auditor should consider in planning and executing the audit of the financial statements.”
- Paragraph 28, delete “Care is required when communicating with those charged with governance about the scope and timing of the audit, not to compromise the effectiveness of the audit”; insert “However, the auditor should be careful not to compromise the effectiveness of the audit when communicating with those charged with governance about the scope and timing of the audit”; and combine paragraphs 27 and 28.
- Paragraph 29, third bullet: refer to the “concept of materiality in planning and executing the audit” rather than “the application of materiality in the audit.” and add “The communication should focus on the factors considered rather than on specific thresholds or amounts.”
- Paragraph 30, fourth sub-bullet of the second bullet: Reword as follows: “Particular matters those charged with governance ~~consider should influence the auditor’s materiality decisions, or may otherwise influence~~ believe that the auditor should consider in planning and executing the audit of the financial statements.” The word “influence” has connotations that might be inferred by a reader to have a negative impact on the auditor’s independence and objectivity.

### **Communicating a Summary of Representations Requested from Management**

Paragraph 33 (b) requires that the auditor communicate a summary of requested management representations. We believe that the emphasis of this communication should be on the significance of the representations related to non-standard issues. We suggest the following revision:

“A summary of representations the auditor is requesting from management, *with a specific focus on those relating to non-standard issues*. In some cases, the auditor may request both management and those charged with governance to sign a representation letter. ~~The auditor should explain the significance of representations that have been requested relating to non-standard issues”~~

We interpret "non-standard" issues to be accounting or financial reporting issues that are both more complex in nature and material to one or more financial statement accounts or assertions, as opposed to general representations relating to management's responsibility for the financial statements. We recommend that the IAASB provide additional guidance on the definition of non-standard issues for this purpose, including some examples.

### **Uncorrected Misstatements**

Paragraph 39 states that the auditor may request a written representation from those charged with governance that explains why misstatements brought to their attention remain uncorrected. We suggest deleting this from paragraph 39. We question the benefit of obtaining a separate representation on uncorrected misstatements from those charged with governance, as the auditor is already required to obtain a representation from management that the effects of any uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. In addition, paragraph 38 requires the auditor to discuss with those charged with governance management's reasons for not correcting the misstatements and the possible implications in relation to future financial statements.

### **Adequacy of the Communication Process**

Paragraph 65 states that "The auditor should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit and, if it has not, should take appropriate action as required." Some of the criteria in paragraph 66 for making this evaluation are very subjective, e.g., "apparent openness", "apparent ability...to fully comprehend." We suggest that the subjectivity of the process and the need for the auditor to use professional judgment in this evaluation be recognized in the standard.

Furthermore, "adequate for the purpose of the audit" is also subjective. We note that there is no requirement in the proposed ISA to report or even to document the auditor's evaluation of the adequacy of communication, although documentation may be required as a result of the proposed documentation standard. We believe that this requirement is analogous to the requirement in the Public Company Accounting Oversight Board's (PCAOB) Auditing Standard No. 2 for the auditor to evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting process and internal control over financial reporting.<sup>1</sup> We suggest that similar language be provided in the standard that makes it clear that the auditor need not design specific procedures to perform a separate and distinct evaluation of the adequacy of the communication,

---

<sup>1</sup> PCAOB, Auditing Standard No. 2 – *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*, paragraph 57.

but may base the evaluation on his or her observations during the audit, as the examples indicate. The auditor should assess the adequacy of the two-way communication as part of understanding and evaluating the control environment and monitoring components of internal control and in assessing the risks of material misstatement.

### **Timing of Communications**

The examples provided in paragraph 63 suggest that timely communication throughout the audit is of benefit to the audit process. However, it may be difficult to implement in the audit of small entities, e.g. small non-profit organizations with boards that meet infrequently. We suggest that additional guidance for timely communication be provided for those small entities where those charged with governance meet infrequently. For example, alternatives to face-to-face meetings with the entire board, such as phone calls with a sub-group of those charged with governance or an individual, may be viable. Nonetheless, if those charged with governance are unable or unwilling to meet with the auditor on a timely basis, the auditor should consider the adequacy of the communication process and the implications for the auditor's assessment of the control environment.

### **Group Audits**

We believe that paragraph 16 should be clarified to better describe the communication protocols for the auditor of a component of a group. In our view, the appropriate person(s) with whom the component auditor should communicate generally is dependent on the nature of the matter to be communicated and the terms of the engagement. In most instances, the communication of matters related to the financial statement audit should be to those charged with governance of the component and to the group auditor. However, nothing should preclude the auditor of the component from communicating significant audit-related matters directly with those charged with governance of the group when he or she believes it is prudent to do so.

### **Communication with Management**

Paragraph 19 states that the auditor must communicate certain matters with those charged with governance, unless management communicates them and the auditor is satisfied that such matters have been effectively and appropriately communicated by management. "Effectively" is very subjective. We question how the auditor is to determine the effectiveness of management's communication to those charged with governance, and therefore recommend that "effectively" be deleted.

## **Editorial Comments**

- We suggest that consideration be given to incorporating the guidance provided in paragraphs 41 and 42 into paragraph 33, and eliminating paragraphs 41 and 42 as separate paragraphs. Similarly, if additional guidance is provided for paragraph 33(b), we recommend that it be included in paragraph 33 and not in a separate paragraph.
- Paragraph 37 – We suggest that it be clear from this paragraph which of the requirements are from [proposed revised] ISA 320 “Materiality in the Identification and Evaluation of Misstatements.” As currently written, the paragraph gives the impression that the requirements in the entire paragraph are in the [proposed revised] ISA 320, when only the requirements in the first sentence are from ISA 320.
- Paragraph 38 – “the reasons” should be “management’s reasons.” Since the failure to correct misstatements is management’s, the reasons for the failure to do so also belong to management.
- We believe that the reference to paragraph 43 in paragraph 32 is unnecessary. Paragraph 43 contains a bold text requirement that will not be overlooked, and it is apparent that many, if not most, of the items that other ISAs require to be communicated relate to the conduct of and findings from the audit.
- Paragraph 9 – We suggest changing “to whom” to “with whom” in keeping with the concept of two-way communication. While the requirement to communicate cannot be imposed on those charged with governance, it is incumbent upon the auditor to try to establish two-way communication.
- We suggest eliminating paragraphs 17, 26, 45 and 53. We believe that these paragraphs do not provide guidance but are explanatory in nature and should be eliminated for the sake of a more concise document.

\*\*\*\*\*

July 31, 2005  
Mr. James Sylph  
Page 7

Thank you for the opportunity to comment on this Exposure Draft. If you have any questions regarding the comments in this letter, please contact Sharon Walker at +1-212-596-6026, [swalker@aicpa.org](mailto:swalker@aicpa.org) or Ahava Goldman at +1-212-596-6056, [agoldman@aicpa.org](mailto:agoldman@aicpa.org).

Respectfully submitted,

/s/ William F. Messier, Jr.  
Chair, International Auditing Standards Subcommittee

/s/ Daniel D. Montgomery  
Chair, Auditing Standards Board Communications Task Force