

---

# DISCUSSION PAPER

---

## IMPROVING THE CLARITY OF ASB STANDARDS

**March 20, 2007**

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues

Comments should be received by June 15, 2007, and should be addressed to  
Sherry Hazel, Audit and Attest Standards,  
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775  
or via the Internet to [shazel@aicpa.org](mailto:shazel@aicpa.org).

*Copyright © 2007 by American Institute of Certified Public Accountants, Inc.*

*Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2007 by American Institute of Certified Public Accountants, Inc. Used with permission."*

March 20, 2007

Accompanying this letter is a discussion paper, approved by the Auditing Standards Board (ASB), entitled *Improving the Clarity of ASB Standards*. This discussion paper seeks feedback on the following issues being considered by the ASB:

- Establishing objectives for each of the standards that provide a conceptual framework for the application of professional judgment, and the obligation related to the objective.
- Making structural and drafting improvements to make the standards easier to read and understand.
- Including special considerations in the audits of public sector entities and small entities in the explanatory material of a Statement on Auditing Standard.
- Establishing a glossary of terms that would be presented in a separate section of the Codification of Statements on Auditing Standards.

Comments or suggestions on any aspect of this discussion paper will be appreciated. To facilitate the ASB's consideration of responses, comments should include supporting reasons for each suggestion or comment.

Written comments on the discussion paper will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after July 15, 2007, for one year. Responses should be sent to Sherry Hazel, Audit and Attest Standards, AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775 in time to be received by June 15, 2007. Responses may also be sent by electronic mail to [shazel@aicpa.org](mailto:shazel@aicpa.org).

Sincerely,

Harold L. Monk, Jr.  
*Chair*  
*Auditing Standards Board*

Charles E. Landes  
*Vice President*  
*Professional Standards and Services*

**Auditing Standards Board  
(2006-2007)**

Harold L. Monk, Jr. *Chair*  
Sheila M. Birch  
Gerald W. Burns  
Walton T. Conn, Jr.  
Anthony J. Costantini  
Robert D. Dohrer  
George P. Fritz  
Nicholas J. Mastracchio, Jr.  
Jorge Milo  
Keith O. Newton

Patricia P. Piteo  
Douglas F. Prawitt  
George A. Rippey  
Lisa A. Ritter  
Diane M. Rubin  
Darrel R. Schubert  
Stephanie A. Westington  
Art Winstead  
Megan Zietsman

**Clarity Task Force**

John A. Fogarty, *Chair*  
Gerald W. Burns  
Susan S. Jones

Keith O. Newton  
Patricia P. Piteo

**AICPA Staff**

Charles E. Landes  
*Vice President*  
*Professional Standards and Services*

Sharon Walker  
*Technical Manager*  
*Audit and Attest Standards*

## **DISCUSSION PAPER IMPROVING THE CLARITY OF ASB STANDARDS**

### **BACKGROUND**

The mission of the Auditing Standards Board (ASB) is to develop and communicate comprehensive performance, reporting, and quality control standards and practice guidance to enable auditors of nonissuers to provide high quality, objective audit and attestation services at a reasonable cost, with the ultimate purpose of serving the public interest by improving existing and enabling new audit and attestation services.

In 2004 the ASB considered how best to effectively meet its mission in light of the creation of the Public Company Accounting Oversight Board (PCAOB) and the increasingly widespread acceptance of the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB).

The first step the ASB took was to develop a plan to harmonize U.S. generally accepted auditing standards with the ISAs while also avoiding the creation of unnecessary differences with PCAOB standards. As part of the harmonization process, the ASB aligned its agenda with that of the IAASB. ASB standards will be developed concurrently with new ISAs. This allows the ASB to deliberate contemporaneously on the same projects as the IAASB and therefore to comment more effectively on the proposed ISAs. The approach taken by the ASB is to use the ISAs as a base in developing its auditing standards. The ISA base is modified only where modifications are deemed necessary to better serve the needs of the U.S. users of audited financial statements of nonissuers or where modifications are appropriate for U.S. legal and regulatory reasons. The intention of the ASB is that there will be very few or no differences between the requirements of the ISAs and the Statements on Auditing Standards (SASs). Differences in explanatory material would be expected to pertain to U.S. specific matters. The ASB's risk assessment suite of standards and SAS No. 114, *The Auditor's Communication With Those Charged With Governance*, are examples of SASs that use the ISAs as a base.

Consistent with its effort to avoid creating unnecessary differences with PCAOB standards and to react to situations where national standards for nonissuers are needed to be created or amended as a result of national circumstances, the ASB issued SAS No. 102, *Defining Professional Requirements in Statements on Auditing Standards*, which defines the use of terms in the same way as the PCAOB. The ASB also issued SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, to conform the definitions of material weakness and significant deficiency with the PCAOB definitions.

In addition, SAS No. 103, *Audit Documentation*, used the ISA as a base, modified as necessary for U.S. users so as not to create unnecessary differences with the PCAOB's audit documentation standard.

The IAASB has a significant project underway to clarify the ISAs. The purpose of this project is to address concerns over the clarity, use of terms, and the length and complexity of the ISAs. The ASB believes that simplifying the standards will be a benefit to all users. The ASB has been monitoring the progress of the IAASB and has concluded that by undertaking a similar clarity project, the ASB would more effectively meet its mission to issue standards that are understandable, clear, and capable of being consistently applied by those who perform engagements. This path includes establishing objectives for each SAS that are aligned with the overall objective of an audit of financial statements and the overall objective of the auditor in conducting the audit. These objectives are intended to better reflect a principles-based approach to standard setting.

The ASB will soon decide how best to meet its objective of harmonization with the ISAs in relation to its clarity project. In so doing, the ASB is seeking reaction to certain issues related to the structure, format, and style of the standards, including:

- Establishing objectives for each of the standards that provide a conceptual framework for the application of professional judgment, and the obligation related to the objective.
- Making structural and drafting improvements to make the standards easier to read and understand.
- Including special considerations in the audits of public sector entities and small entities in the explanatory material of a SAS.
- Establishing a glossary of terms that would be presented in a separate section of the Codification of Statements on Auditing Standards.

This discussion paper is drafted in terms of the Statements on Auditing Standards (SASs), but would apply equally to all standards issued under the authority of the ASB.

#### *Implementation of Proposals*

The public comment period on these proposals on how to clarify the SASs ends on June 15, 2007. The ASB plans to consider the comments received in response to this discussion paper and approve the approach to its clarity project at its August 2007 meeting. The new drafting conventions would be applied to all the ASB's standards, with the initial focus being on the SASs.

# IMPROVING THE CLARITY OF ASB STANDARDS

## Objectives of Standards

The aim of the ASB is to issue standards that allow the auditor to exercise professional judgment in conducting an audit of financial statements. Establishing objectives for each of the standards provides the auditor with a framework of sound principles and requirements within which to exercise professional judgment in achieving the overall objective of the audit.

### The Current Structure

The current structure of the auditing standards includes an overall objective of the audit; the general, fieldwork and reporting standards; the 10 standards (AICPA *Professional Standards*, vol. 1, AU sec. 150, “Generally Accepted Auditing Standards”); and the requirements of the individual SASs.

The overall objective of the audit is set out in SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 110, “Responsibilities and Functions of the Independent Auditor”).

*The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles.*

The 10 standards create a structure on which the requirements set out in the individual SASs are based.

### The Proposed Structure

The structure proposed by the ASB would retain the overall objective of the audit, the 10 standards, and the requirements of the individual SASs. It would add an overall objective of the auditor and establish objectives for each of the SASs. In addition, the relationships between each of these proposed elements of the structure, as described here, would be more clearly set out. The language used in this discussion paper to describe the overall objective of an audit, the overall objective of the auditor and the obligation attaching to the objectives of the SASs is based on the international standards and will be debated by the ASB and exposed for public comment in due course.

#### *Overall Objective of an Audit*

The overall objective of an audit of financial statements is the expression of an opinion whether the financial statements are fairly presented, in all material respects, in

accordance with an applicable financial reporting framework.<sup>1</sup> This is consistent with the overall objective of the audit, as currently set forth in SAS No. 1.

#### *Overall Objective of the Auditor*

In conducting the audit so as to achieve the overall objective of an audit, the overall objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report on the financial statements in accordance with the auditor's findings.

The overall objective of an audit (to express an opinion) cannot be achieved unless the auditor achieves the overall objective of the auditor (to obtain reasonable assurance to support the opinion). The SASs are designed to support the auditor in obtaining reasonable assurance. In all cases when the overall objective of the auditor has not been or cannot be achieved, the SASs require that the auditor modify the auditor's opinion accordingly or withdraw from the engagement.

#### *The 10 Standards*

The 10 standards have long been part of generally accepted auditing standards and provide a level of summarization into which the individual SASs fit. They set the foundation for the AICPA's Codification of Statements on Auditing Standards. The objectives stated in the individual SASs (as discussed in the following sections) link to the general, fieldwork, and reporting standards.

The 10 standards are stated as unconditional requirements and must be met by the auditor to achieve the overall objective of the auditor. The 10 standards support the overall objective of the auditor previously set out.

#### *Objectives Stated in Each SAS*

Each SAS would contain an objective or objectives that provide the context in which the requirements are set. These objectives support the 10 standards and therefore the overall objective of the auditor previously set out.

In conducting an audit in accordance with generally accepted auditing standards, the auditor must achieve the objectives stated in each SAS, considering the consequences for the completion of the audit and reporting result if the objectives are not achieved. Where the objective of a SAS has not been or cannot be achieved, the auditor must consider whether this prevents the auditor from achieving the overall objective of the auditor, thereby requiring the auditor to modify the auditor's opinion accordingly or withdraw from the engagement. In most cases, the failure to achieve the objective of a SAS will prevent the auditor from meeting the requirements of the 10 standards and achieving the overall objective of the auditor.

---

<sup>1</sup> The term *applicable financial reporting framework* includes generally accepted accounting principles and other comprehensive bases of accounting. It is also used to describe other frameworks that might be applicable, for example, International Financial Reporting Standards.

The objectives of the SASs are used to determine whether the overall objective of the auditor has been achieved. The requirements of the SAS, identified by use of the terms *must*, *is required*, and *should*, assist the auditor in meeting the objective specified in the SAS and thereby the overall objective of the auditor. The proper application of the requirements of the SASs will ordinarily provide a sufficient basis for the auditor's achievement of the objectives. However, the SASs cannot be expected to anticipate all circumstances that may arise, and consequently, the auditor may judge it necessary to perform further procedures to meet the objective of the SAS.

### *Questions for Respondents*

1. Do you agree that the use of objectives, as proposed, will enhance the clarity of standards and how professional judgment should be exercised in applying them? Please explain why or why not.

### **Improving Readability and Understandability**

In addition to establishing objectives for each of the SASs, the ASB is proposing to make drafting improvements to the SASs to make them easier to read and understand and to simplify the SASs by restructuring them.

#### *Drafting Improvements*

Drafting improvements would include:

- Reducing or eliminating duplication throughout the SASs, as appropriate, thereby improving their overall clarity through more effective presentation.
- Using shorter sentences and formatting techniques such as bullet points, headings, and sub-headings to improve the understandability and flow of the SASs.

Drafting improvements to existing SASs to reduce or eliminate duplication would be made only to the extent that there is no loss of understandability.

#### *Structural Changes*

The appendixes to this paper present the three structures that respondents are being asked to consider and comment on. In each appendix, SAS No. 114 has been used to show the style and format described in the following paragraphs.

Appendixes 1 and 2 present SAS No. 114 in a format in which:

- The introductory section describes the scope, sets out the effective date, and provides other essential material.
- The objective of the SAS provides the overall context for the requirements.

- Definitions are clearly set out in a separate section. The definitions section is only necessary when new terms or expressions are introduced in a standard for the first time.
- The requirements of the standard are easily identifiable.
- Consistent with the proposed drafting improvements, repetition has been eliminated where appropriate, and shorter sentences and other drafting techniques, such as using bullet lists, have been applied.

The difference between Appendix 1 and Appendix 2 is in the placement of the explanatory material. Appendix 1 retains the explanatory material with the requirements, but uses formatting, in addition to the use of terms, to clearly identify the requirements. The presentation in Appendix 2, where the requirements and explanatory material are separated, is the format chosen by the IAASB. Either of these approaches can work. The ASB is interested in hearing which presentation would work best, bearing in mind that regardless of the format of the standard, the auditor has a responsibility to consider the entire text of a SAS in carrying out his or her work on an engagement and in understanding and applying the professional requirements of the relevant SASs.

In Appendix 1, each requirement is followed immediately by the related explanatory material. There are various ways in which the requirements can be offset from the related explanatory material. Use of grey shaded boxes is one way and has been used in the appendix as an example. If respondents prefer the form of presentation in Appendix 1, the ASB will consider other ways in which the requirements can be offset from the explanatory material and will determine which it believes is appropriate.

In Appendix 2, the requirements and the explanatory material are in separate sections. All the requirements are presented together, followed by the explanatory material. Related material contained in the requirements and explanatory material sections is cross-referenced.

Appendix 3 presents SAS No. 114, as issued in December 2006, with requirements and explanatory material commingled within the text of a paragraph. Definitions are not separately identified and the drafting improvements previously discussed have not been applied.

#### *Questions for Respondents*

2. Which presentation do you believe will help you better understand and implement the standard? Please explain why.

#### **Special Considerations in the Audits of Public Sector Entities and Small Entities**

The ASB will also address, at appropriate points throughout each SAS, any special considerations that are specific to audits of public sector entities and to audits of small entities, and include such considerations in a paragraph with the heading *Considerations Specific to the Public Sector Entities* or *Considerations Specific to Smaller Entities*. These paragraphs would be contained within the explanatory material of a SAS and

would provide guidance on the application of the requirements specific to the audits of these entities.

*Questions for Respondents*

3. Will inclusion of these special considerations throughout the SASs be helpful? Please explain why or why not.

**Glossary of Terms**

The ASB will establish a glossary of terms that are defined throughout the SASs. Establishing a glossary of terms will allow the auditor to easily identify the definition of each term. It will also help ensure consistency of definitions within the SASs. The glossary of terms would be presented in a separate section of the Codification of Statements on Auditing Standards.

*Questions for Respondents*

4. Will inclusion of a glossary of terms in the Codification of the Statements on Auditing Standards be helpful? Please explain why or why not.

**Deadline for Comments**

The ASB is asking for comments to be received by June 15, 2007. Any delay in analyzing and considering the responses to this discussion paper will affect the ability of the ASB to consider the comments and approve the approach to its clarity project at its August 2007 meeting. Accordingly, the ASB will consider comments received on or before June 15, 2007. Comments received after that date will be considered at the discretion of the Clarity Task Force.

## Appendix 1

In this Appendix, SAS No. 114 is presented in a restructured format.

- The introductory section describes the scope, gives the effective date and provides other essential material;
- The objective of the SAS provides the overall context for the requirements;
- Definitions are clearly set out in a separate section;
- The requirements of the Standard are presented in shaded boxes with the related application material following directly after the requirement.
- The appendices referred to in the text of the reformatted SAS have not been included in the illustrative presentation.

### **Reformatted Statement on Auditing Standards No. 114, *The Auditor's Communication With Those Charged With Governance***

#### **Introduction**

##### **Scope**

1. This Statement on Auditing Standards (SAS) establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial statements.<sup>2</sup> Although this Statement applies regardless of an entity's governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity. This Statement 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 Statement has been drafted in terms of an audit of financial statements, but may also be applied, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation and presentation of the other historical financial information.
3. Recognizing the importance of effective two-way communication to the audit, this Statement provides a 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 are identified in other SASs (see Appendix A). Further matters may be communicated by agreement with those charged with governance or management, or in accordance with external requirements.
4. Nothing in this Statement precludes the auditor from communicating any other matters to those charged with governance.

---

<sup>2</sup> The provisions of this Statement apply to audits of financial statements prepared either in accordance with generally accepted accounting principles or in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. References in this Statement to generally accepted accounting principles are intended to also refer to other comprehensive bases of accounting when the reference is relevant to the basis of accounting used.

## Effective Date

5. This statement is effective for audits of financial statements for periods beginning on or after December 15, 2006.

## Objective

6 The auditor must:

- a. Communicate clearly with those charged with governance matters related to the financial statement audit that are, in the auditor's professional judgment, significant and relevant to the responsibilities of those charged with governance in overseeing the financial reporting process, including the responsibilities of the auditor in relation to the financial statement audit, and an overview of the scope and timing of the audit.
- b. Obtain from those charged with governance information relevant to the audit.
- c. Provide those charged with governance with timely observations arising from the audit that are relevant to their responsibilities in overseeing the financial reporting process.

## Definitions

7. For purposes of this Statement:

- a. *Those charged with governance* means the person(s) 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. In some cases, those charged with governance are responsible for approving the entity's financial statements (in other cases management has this responsibility). For entities with a board of directors, this term encompasses the term *board of directors* or *audit committee* used elsewhere in generally accepted auditing standards.
- b. *Management* means the person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting.

## Requirements and Application Guidance

### The Role of Communication

8. This Statement focuses primarily on communications from the auditor to those charged with governance. However, effective two-way communication is also very 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.
- c. Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

9. Although the auditor is responsible for communicating specific matters in accordance with this Statement, 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.

10. Clear communication of specific matters in accordance with this Statement is an integral part of every audit. However, the auditor is not required to perform procedures specifically to identify other significant matters to communicate with those charged with governance.

## Legal Considerations

11. In certain circumstances, the auditor may be required to report to a regulatory or enforcement body certain matters communicated with those charged with governance. For example, governmental auditing standards require auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties outside the audited entity in certain circumstances.

12. In rare circumstances, laws or regulations may prevent the auditor from communicating certain matters with those charged with governance, or others within the entity. For example, laws or regulations 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 such circumstances, it may be appropriate for the auditor to seek legal advice.

## Those Charged With Governance

13. The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. The appropriate person(s) may vary depending on the matter to be communicated.

14. Governance structures vary by entity, reflecting influences such as size and ownership characteristics. For example:

- In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. For other entities, a body that is not part of the entity may be charged with governance, as with some government agencies.
- In some cases, some or all of those charged with governance also have management responsibilities. In others, those charged with governance and management are different people.

15. 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, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, such as 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.

16. Such diversity means that it is not possible for this Statement 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 engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. The auditor's understanding of the entity's governance structure and processes obtained in accordance with SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, is relevant in deciding with whom to communicate matters.

17. When the appropriate person(s) with whom to communicate are not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate.

18. When the entity being audited is a component<sup>3</sup> of a group,<sup>4</sup> the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

### **Communication With the Audit Committee or Other Subgroup of Those Charged With Governance**

19. The auditor should evaluate whether communication with a subgroup of those charged with governance, such as the audit committee or an individual, adequately fulfills the auditor's responsibility to communicate with those charged with governance.

20. Audit committees (or similar subgroups with different names) exist in many entities. Although their specific authority and functions may differ, communication with the audit committee, where one exists, is a key element in the auditor's communication with those charged with governance. Good governance principles suggest that:

- The auditor has access to the audit committee as necessary.
- The chair of the audit committee and, when relevant, the other members of the audit committee, meet with the auditor periodically.
- The audit committee meets with the auditor without management present at least annually.

21. 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.
- Whether the subgroup (a) has the authority to take action in relation to the information communicated and (b) can provide further information and explanations the auditor may need.
- Whether the auditor is aware of potential conflicts of interest between the subgroup and other members of the governing body.
- Whether there is also a need to communicate the information, in full or in summary form, to the governing body. This decision may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor retains the right to communicate with the governing body, a fact the auditor may make explicit in the terms of the engagement.

### **Communication With Management**

22. Many matters may be discussed with management in the ordinary course of an audit, including matters to be communicated with those charged with governance in accordance with this Statement. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the financial statements.

<sup>3</sup> *Component* means a head office, parent, division, branch, subsidiary, joint venture, associated company, equity investee, or other entity whose financial information is or should be included in the consolidated financial statements of a group.

<sup>4</sup> *Group* means an entity whose consolidated financial statements include or should include financial information of more than one component.

23. 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 with management questions of management's competence or integrity. In addition to recognizing management's 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.

### ***When All of Those Charged With Governance Are Involved in Managing the Entity***

24. In some cases, all of those charged with governance are involved in managing the entity. In these cases, if matters required by this Statement 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. When all of those charged with governance are involved in managing the entity, the auditor should consider whether communication with person(s) with financial reporting responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity. (See paragraphs 13 and 19.)

### **Matters to Be Communicated**

25. The auditor should communicate with those charged with governance:

- a. The auditor's responsibilities under generally accepted auditing standards (see paragraphs 27 through 29);
- b. An overview of the planned scope and timing of the audit (see paragraphs 30 through 35); and
- c. Significant findings from the audit (see paragraphs 36 through 43).

26. Management's communication of these matters to those charged with governance does not relieve the auditor of the responsibility to also communicate them. However, communication of these matters by management may affect the form or timing of the auditor's communication.

### ***The Auditor's Responsibilities Under Generally Accepted Auditing Standards***

27. The auditor should communicate with those charged with governance the auditor's responsibilities under generally accepted auditing standards, including that:

- a. The auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of those charged with governance are presented fairly, in all material respects, in conformity with generally accepted accounting principles.
- b. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

These responsibilities may be communicated through the engagement letter or other form of contract that records the terms of the engagement, if that letter or contract is provided to those charged with governance.

28. The auditor may also communicate that:

- a. The auditor is responsible for performing the audit in accordance with generally accepted auditing standards and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement.

- b. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting.
- c. The auditor is responsible for communicating significant matters related to the financial statement audit that are, in the auditor's professional judgment, relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Generally accepted auditing standards do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.
- d. When applicable, the auditor is also responsible for communicating particular matters required by laws or regulations, by agreement with the entity or by additional requirements applicable to the engagement.

29. SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, establishes the auditor's responsibility for information prepared by management that accompanies the audited financial statements.<sup>5</sup> If the entity includes other information in documents containing audited financial statements, the auditor should communicate with those charged with governance the auditor's responsibility with respect to such other information, any procedures performed relating to the other information, and the results.

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

30. The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit.

31. It is important for the auditor 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. Certain factors described in paragraph 53 may be relevant in determining the nature and extent of this communication.

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

- a. Assist those charged with governance in understanding better the consequences of the auditor's work for their oversight activities, discussing with the auditor issues of risk and materiality, and identifying 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.

33. Matters communicated may include the following:

- 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, including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.
- The concept of materiality in planning and executing the audit, focusing on the factors considered rather than on specific thresholds or amounts.

---

<sup>5</sup> Guidance on the auditor's consideration of other information is also provided by "Required Supplementary Information," of Statement on Auditing Standards (SAS) No. 52, *Omnibus Statement on Auditing Standards—1987*, and SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*.

- 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.

34. Other planning matters that the auditor may consider discussing with those charged with governance include:

- The views of those charged with governance about:
  - 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 believe are relevant to the audit of the financial statements.
- 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 the possibility of fraud.
- The actions of those charged with governance in response to developments in financial reporting, laws, accounting standards, corporate governance practices, and other related matters.
- The actions of those charged with governance in response to previous communications with the auditor.

35. While communication with those charged with governance may assist the auditor in planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine 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**

36. The auditor should communicate with those charged with governance the following matters:
- a. The auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures. The auditor should explain to those charged with governance why the auditor considers a significant accounting practice not to be appropriate and, when considered necessary, request changes. If requested changes are not made, the auditor should inform those charged with governance that the auditor will consider the effect of this on the financial statements of the current and future years, and on the auditor's report. (see paragraph 39).
  - b. Significant difficulties, if any, encountered in dealing with management during the audit (see paragraph 40).
  - c. Uncorrected misstatements, other than those the auditor believes are trivial, if any. The auditor should communicate with those charged with governance uncorrected misstatements and the effect that they may have on the opinion in the auditor's report, and request their correction. In communicating the effect that material uncorrected

misstatements may have on the opinion in the auditor's report, the auditor should communicate them individually. The auditor should discuss with those charged with governance the implications of a failure to correct known and likely misstatements, if any, considering qualitative as well as quantitative considerations, including possible implications in relation to future financial statements. The auditor should also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (see paragraph 41).

- d. Disagreements with management, if any, whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the entity's financial statements or the auditor's report. (see paragraph 42).
- e. Other findings or issues, if any, arising from the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their oversight of the financial reporting process.

37. Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate:

- a. Material, corrected misstatements that were brought to the attention of management as a result of audit procedures. The auditor also may communicate other corrected immaterial misstatements, such as frequently recurring immaterial misstatements that may indicate a particular bias in the preparation of the financial statements.
- b. Representations the auditor is requesting from management. The auditor may provide those charged with governance with a copy of management's written representations.
- c. Management's consultations with other accountants about auditing and accounting matters. When the auditor is aware that such consultation has occurred, the auditor should discuss with those charged with governance his or her views about significant matters that were the subject of such consultation.<sup>6</sup>
- d. Significant issues, if any, arising from the audit that were discussed, or the subject of correspondence, with management. (see paragraph 43).

38. The communication of significant 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.

### *Qualitative Aspects of the Entity's Significant Accounting Practices*

39. Generally accepted accounting principles provide for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may include comment on the acceptability of significant accounting practices. Appendix B provides guidance on the matters that may be included in this communication.

### *Significant Difficulties Encountered During the Audit*

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

- Significant delays in management providing required information.
- An unnecessarily brief time within which to complete the audit.

<sup>6</sup> Circumstances in which the auditor should be informed of such consultations are described in paragraph 7 of SAS No. 50, *Reports on the Application of Accounting Principles*.

- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.
- Restrictions imposed on the auditors by management.
- Management's unwillingness to provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about the entity's ability to continue as a going concern.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

### *Uncorrected Misstatements*

41. SAS No. 107, *Audit Risk and Materiality in Conducting an Audit*, requires the auditor to accumulate all known and likely misstatements identified during the audit, other than those that the auditor believes are trivial, and communicate them to the appropriate level of management. Where there are a large number of small uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the misstatements, rather than the details of each individual misstatement.

### *Disagreements With Management*

42. Disagreements with management may occasionally arise over, among other things, the application of accounting principles to the entity's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements may also arise regarding the scope of the audit, disclosures to be included in the entity's financial statements, and the wording of the auditor's report. For purposes of this Statement, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved.

### *Significant Issues Discussed, or Subject to Correspondence With Management*

43. Significant issues may include such matters as:

- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- Discussions or correspondence in connection with the initial or recurring retention of the auditor including, among other matters, any discussions or correspondence regarding the application of accounting principles and auditing standards.

### ***Independence***

44. Generally accepted auditing standards require independence for all audits. Relevant matters to consider in reaching a conclusion about independence include circumstances or relationships that create threats to auditor independence and the related safeguards that have been applied to eliminate those threats or reduce them to an acceptable level.<sup>7</sup>

45. Although the auditor's report affirms the auditor's independence, in certain situations, particularly for public interest entities,<sup>8</sup> the auditor may determine that it is appropriate to

<sup>7</sup> Comprehensive guidance on threats to independence and safeguards, including application to specific situations, is set forth in the AICPA's Conceptual Framework for AICPA Independence Standards.

<sup>8</sup> In addition to entities subject to Securities and Exchange Commission reporting requirements, the Conceptual Framework for AICPA Independence Standards considers the following entities to be *public interest entities*: (1) employee benefit and health and welfare plans subject to Employee Retirement Income Security Act audit requirements; (2) governmental retirement plans; (3) entities or programs (including for-profit entities) subject to Single Audit Act OMB Circular A-133 audit requirements and entities or programs subject to similar program oversight; and (4)

communicate with those charged with governance circumstances or relationships (for example, financial interests, business or family relationships, or nonaudit services provided or expected to be provided) that in the auditor's professional judgment may reasonably be thought to bear on independence and that the auditor gave significant consideration to in reaching the conclusion that independence has not been impaired.

46. The form and timing of communications regarding independence may be affected by the entity's governance structure and whether a formal subgroup such as an audit committee exists. In situations where all of those charged with governance are involved in managing the entity, the auditor may determine that those charged with governance have been informed of relevant facts regarding the auditor's independence through their management activities or through other means, such as the engagement letter. This is particularly likely where the entity is owner-managed, and the auditor's firm has little involvement with the entity beyond a financial statement audit.

## **The Communication Process**

### ***Establishing a Mutual Understanding***

47. The auditor should communicate with those charged with governance the form, timing, and expected general content of communications.

48. Clear communication of the auditor's responsibilities (paragraphs 27 through 29), an overview of the planned scope and timing of the audit (paragraphs 30 through 35), and the expected general content of communications helps establish the basis for effective two-way communication.

49. 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 in a better position 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) on the audit team and among 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. Such matters might include strategic decisions that may significantly affect the nature, timing, and extent of audit procedures; the suspicion or the detection of fraud; or concerns about 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.

50. 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 60).

---

financial institutions, credit unions, and insurance companies. These entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decisions or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant.

## ***Forms of Communication***

51. The auditor should communicate in writing with those charged with governance significant findings from the audit (see paragraphs 36 and 37) when, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved. Other communications may be oral or in writing.

52. Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions. Written communications may include an engagement letter that is provided to those charged with governance.

53. 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 summarization in the communication, and whether to communicate in a formal or informal 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 being audited.
- Legal or regulatory requirements that may require a written communication with those charged with governance.
- 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.
- In the case of a special purpose financial statement audit, whether the auditor also audits the entity's general purpose financial statements.

54. 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 summarize the matter in later communications so that all of those charged with governance have full and balanced information.

55. When the auditor communicates matters in accordance with this Statement in writing, the auditor should indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management and is not intended to be and should not be used by anyone other than these specified parties.

## ***Timing of Communications***

56. The auditor should communicate with those charged with governance on a sufficiently timely basis to enable those charged with governance to take appropriate action.

57. The appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, and the action expected to be taken by those charged with governance. The auditor may consider communicating:

- Planning matters early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.

- Significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulties, or if the difficulties are likely to lead to a modified opinion.

58. 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, timely communication of a material weakness to enable appropriate remedial action to be taken.
- Whether the auditor is auditing both general purpose and special purpose financial statements.

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

59. 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. If it has not, the auditor should take appropriate action to address the effectiveness of the communication process. If, in the auditor's judgment, the two-way communication between the auditor and those charged with governance is not adequate, there is a risk the auditor may not have obtained all the audit evidence required to form an opinion on the financial statements. The auditor should consider the effect, if any, on the auditor's assessment of the risks of material misstatements.

60. As discussed in paragraph 8, effective two-way communication assists both the auditor and those charged with governance. Further, SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, 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. Inadequate two-way communication may indicate an unsatisfactory control environment, which will influence the auditor's assessment of the risks of material misstatements.

61. The auditor need not design specific procedures to support the evaluation required by paragraph 59. 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 communicated by the auditor.
- 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 communicated by the auditor, such as 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.

62. The auditor may discuss the situation with those charged with governance. If 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 agency for certain governmental entities.
- Withdrawing from the engagement.

## Documentation

63. When matters required to be communicated by this Statement have been communicated orally, the auditor should document them.<sup>9</sup> When matters have been communicated in writing, the auditor should retain a copy of the communication.

64. Documentation of oral communication may include a copy of minutes prepared by the entity if those minutes are an appropriate record of the communication.

---

<sup>9</sup> SAS 103, *Audit Documentation*, requires the auditor to document discussions of significant findings or issues with management and others (including those charged with governance) on a timely basis, including responses. That SAS also requires that the audit documentation include documentation of the significant findings or issues discussed, and when and with whom the discussions took place.

## Appendix 2

In this Appendix, SAS No. 114 is presented in a restructured format.

- The introductory section describes the scope, sets out the effective date and provides other essential material;
- The objective of the SAS provides the overall context for the requirements;
- Definitions are clearly set out in a separate section;
- The requirements of the Standard are presented separately from the application material. Cross references between requirements and application material are provided.
- The appendices referred to in the text of the reformatted SAS have not been included in the illustrative presentation.

### **Reformatted Statement on Auditing Standards No. 114, *The Auditor's Communication With Those Charged With Governance***

#### **Introduction**

##### **Scope**

1. This Statement on Auditing Standards (SAS) establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial statements.<sup>10</sup> Although this Statement applies regardless of an entity's governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity. This Statement 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 Statement has been drafted in terms of an audit of financial statements, but may also be applied, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation and presentation of the other historical financial information.
3. Recognizing the importance of effective two-way communication to the audit, this Statement provides a 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 are identified in other SASs (see Appendix A). Further matters may be communicated by agreement with those charged with governance or management, or in accordance with external requirements.
4. Nothing in this Statement precludes the auditor from communicating any other matters to those charged with governance.

---

<sup>10</sup> The provisions of this Statement apply to audits of financial statements prepared either in accordance with generally accepted accounting principles or in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. References in this Statement to generally accepted accounting principles are intended to also refer to other comprehensive bases of accounting when the reference is relevant to the basis of accounting used.

## Effective Date

5. This statement is effective for audits of financial statements for periods beginning on or after December 15, 2006.

## Objective

6. The auditor must:
- a. Communicate clearly with those charged with governance matters related to the financial statement audit that are, in the auditor's professional judgment, significant and relevant to the responsibilities of those charged with governance in overseeing the financial reporting process, including the responsibilities of the auditor in relation to the financial statement audit, and an overview of the scope and timing of the audit.
  - b. Obtain from those charged with governance information relevant to the audit.
  - c. Provide those charged with governance with timely observations arising from the audit that are relevant to their responsibilities in overseeing the financial reporting process. (Ref: Para A1-A5)

## Definitions

7. For purposes of this Statement:
- a. *Those charged with governance* means the person(s) 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. In some cases, those charged with governance are responsible for approving the entity's financial statements (in other cases management has this responsibility). For entities with a board of directors, this term encompasses the term *board of directors* or *audit committee* used elsewhere in generally accepted auditing standards.
  - b. *Management* means the person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting.

## Requirements

### Those Charged With Governance

8. The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. The appropriate person(s) may vary depending on the matter to be communicated.
9. When the appropriate person(s) with whom to communicate are not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate. (Ref: Para A6 – A9)

### **Communication With the Audit Committee or Other Subgroup of Those Charged With Governance**

10. The auditor should evaluate whether communication with a subgroup of those charged with governance, such as the audit committee or an individual, adequately fulfills the auditor's responsibility to communicate with those charged with governance. (Ref: Para. A10 – A11)

### **When All of Those Charged With Governance Are Involved in Managing the Entity**

11. In some cases, all of those charged with governance are involved in managing the entity. In these cases, if matters required by this Statement 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. When all of those charged with governance are involved in managing the entity, the auditor should consider whether communication with person(s) with financial reporting responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.

## **Matters to Be Communicated**

12. Management's communication of these matters to those charged with governance does not relieve the auditor of the responsibility to also communicate them. However, communication of these matters by management may affect the form or timing of the auditor's communication.

### ***The Auditor's Responsibilities Under Generally Accepted Auditing Standards***

13. The auditor should communicate with those charged with governance the auditor's responsibilities under generally accepted auditing standards, including that:

- a. The auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of those charged with governance are presented fairly, in all material respects, in conformity with generally accepted accounting principles.
- b. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

These responsibilities may be communicated through the engagement letter or other form of contract that records the terms of the engagement, if that letter or contract is provided to those charged with governance. (Ref: Para. A12)

14. SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, establishes the auditor's responsibility for information prepared by management that accompanies the audited financial statements.<sup>11</sup> If the entity includes other information in documents containing audited financial statements, the auditor should communicate with those charged with governance the auditor's responsibility with respect to such other information, any procedures performed relating to the other information, and the results.

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

15. The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit. (Ref: Para. A13 – A17)

### ***Significant Findings From the Audit***

16. The auditor should communicate with those charged with governance the following matters (Ref: Para. A18):

- a. The auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures. The auditor should explain to those charged with governance why the auditor considers a significant accounting practice not to be appropriate and, when considered necessary, request changes. If requested changes are not made, the auditor should inform those charged with governance that the auditor will consider the effect of

---

<sup>11</sup> Guidance on the auditor's consideration of other information is also provided by "Required Supplementary Information," of Statement on Auditing Standards (SAS) No. 52, *Omnibus Statement on Auditing Standards—1987*, and SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*.

- this on the financial statements of the current and future years, and on the auditor's report. (Ref: Para. A19)
- b. Significant difficulties, if any, encountered in dealing with management during the audit (Ref: Para. A20)
  - c. Uncorrected misstatements, other than those the auditor believes are trivial, if any. The auditor should communicate with those charged with governance uncorrected misstatements and the effect that they may have on the opinion in the auditor's report, and request their correction. In communicating the effect that material uncorrected misstatements may have on the opinion in the auditor's report, the auditor should communicate them individually. The auditor should discuss with those charged with governance the implications of a failure to correct known and likely misstatements, if any, considering qualitative as well as quantitative considerations, including possible implications in relation to future financial statements. The auditor should also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (Ref: Para. 21)
  - d. Disagreements with management, if any, whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the entity's financial statements or the auditor's report. (Ref: Para. A22)
  - e. Other findings or issues, if any, arising from the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their oversight of the financial reporting process.
17. Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate:
- a. Material, corrected misstatements that were brought to the attention of management as a result of audit procedures. The auditor also may communicate other corrected immaterial misstatements, such as frequently recurring immaterial misstatements that may indicate a particular bias in the preparation of the financial statements.
  - b. Representations the auditor is requesting from management. The auditor may provide those charged with governance with a copy of management's written representations.
  - c. Management's consultations with other accountants about auditing and accounting matters. When the auditor is aware that such consultation has occurred, the auditor should discuss with those charged with governance his or her views about significant matters that were the subject of such consultation.<sup>12</sup>
  - d. Significant issues, if any, arising from the audit that were discussed, or the subject of correspondence, with management. (Ref: Para. A23)

## **The Communication Process**

### ***Establishing a Mutual Understanding***

18. The auditor should communicate with those charged with governance the form, timing, and expected general content of communications. (Ref: Para. A27-A31)

### ***Forms of Communication***

19. The auditor should communicate in writing with those charged with governance significant findings from the audit when, in the auditor's professional judgment, oral

---

<sup>12</sup> Circumstances in which the auditor should be informed of such consultations are described in paragraph 7 of SAS No. 50, *Reports on the Application of Accounting Principles*.

communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved. Other communications may be oral or in writing.

20. When the auditor communicates matters in accordance with this Statement in writing, the auditor should indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management and is not intended to be and should not be used by anyone other than these specified parties. (Ref: Para. A32-A34)

### ***Timing of Communications***

21. The auditor should communicate with those charged with governance on a sufficiently timely basis to enable those charged with governance to take appropriate action. (Ref: Para. A35-A36)

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

22. 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. If it has not, the auditor should take appropriate action to address the effectiveness of the communication process. If, in the auditor's judgment, the two-way communication between the auditor and those charged with governance is not adequate, there is a risk the auditor may not have obtained all the audit evidence required to form an opinion on the financial statements. The auditor should consider the effect, if any, on the auditor's assessment of the risks of material misstatements.

23. The auditor need not design specific procedures to support the evaluation required by paragraph 22. Rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. (Ref: Para. A37-A39)

### **Documentation**

24. When matters required to be communicated by this Statement have been communicated orally, the auditor should document them.<sup>13</sup> When matters have been communicated in writing, the auditor should retain a copy of the communication. (Ref: Para. A40)

## **Application and Other Explanatory Material**

### **The Role of Communication** (Ref: Para. 6)

- A1. This Statement focuses primarily on communications from the auditor to those charged with governance. However, effective two-way communication is also very 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.
  - c. Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

---

<sup>13</sup> SAS 103, *Audit Documentation*, requires the auditor to document discussions of significant findings or issues with management and others (including those charged with governance) on a timely basis, including responses. That SAS also requires that the audit documentation include documentation of the significant findings or issues discussed, and when and with whom the discussions took place.

A2. Although the auditor is responsible for communicating specific matters in accordance with this Statement, 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.

A3. Clear communication of specific matters in accordance with this Statement is an integral part of every audit. However, the auditor is not required to perform procedures specifically to identify other significant matters to communicate with those charged with governance.

### **Legal Considerations**

A4. In certain circumstances, the auditor may be required to report to a regulatory or enforcement body certain matters communicated with those charged with governance. For example, governmental auditing standards require auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties outside the audited entity in certain circumstances.

A5. In rare circumstances, laws or regulations may prevent the auditor from communicating certain matters with those charged with governance, or others within the entity. For example, laws or regulations 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 such circumstances, it may be appropriate for the auditor to seek legal advice.

### **Those Charged With Governance** (Ref: Para. 8 – 9)

A6. Governance structures vary by entity, reflecting influences such as size and ownership characteristics. For example:

- In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. For other entities, a body that is not part of the entity may be charged with governance, as with some government agencies.
- In some cases, some or all of those charged with governance also have management responsibilities. In others, those charged with governance and management are different people.

A7. 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, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, such as 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.

A8. Such diversity means that it is not possible for this Statement 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 engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. The auditor's understanding of the entity's governance structure and processes obtained in accordance with SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, is relevant in deciding with whom to communicate matters.

A9. When the entity being audited is a component<sup>14</sup> of a group,<sup>15</sup> the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

***Communication With the Audit Committee or Other Subgroup of Those Charged With Governance*** (Ref: Para. 10)

A10. Audit committees (or similar subgroups with different names) exist in many entities. Although their specific authority and functions may differ, communication with the audit committee, where one exists, is a key element in the auditor's communication with those charged with governance. Good governance principles suggest that:

- The auditor has access to the audit committee as necessary.
- The chair of the audit committee and, when relevant, the other members of the audit committee, meet with the auditor periodically.
- The audit committee meets with the auditor without management present at least annually.

A11. 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.
- Whether the subgroup (a) has the authority to take action in relation to the information communicated and (b) can provide further information and explanations the auditor may need.
- Whether the auditor is aware of potential conflicts of interest between the subgroup and other members of the governing body.
- Whether there is also a need to communicate the information, in full or in summary form, to the governing body. This decision may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor retains the right to communicate with the governing body, a fact the auditor may make explicit in the terms of the engagement.

## **Matters to Be Communicated**

***The Auditor's Responsibilities Under Generally Accepted Auditing Standards*** (Ref: Para. 13)

A12. The auditor may also communicate that:

- a. The auditor is responsible for performing the audit in accordance with generally accepted auditing standards and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement.

---

<sup>14</sup> *Component* means a head office, parent, division, branch, subsidiary, joint venture, associated company, equity investee, or other entity whose financial information is or should be included in the consolidated financial statements of a group.

<sup>15</sup> *Group* means an entity whose consolidated financial statements include or should include financial information of more than one component.

- b. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting.
- c. The auditor is responsible for communicating significant matters related to the financial statement audit that are, in the auditor's professional judgment, relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Generally accepted auditing standards do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.
- d. When applicable, the auditor is also responsible for communicating particular matters required by laws or regulations, by agreement with the entity or by additional requirements applicable to the engagement.

***Planned Scope and Timing of the Audit*** (Ref: Para. 15)

A13. It is important for the auditor 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. Certain factors described in paragraph A33 may be relevant in determining the nature and extent of this communication.

A14. Communication regarding the planned scope and timing of the audit may:

- a. Assist those charged with governance in understanding better the consequences of the auditor's work for their oversight activities, discussing with the auditor issues of risk and materiality, and identifying 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.

A15. Matters communicated may include the following:

- 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, including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.
- The concept of materiality in planning and executing the audit, focusing on the factors considered rather than on specific thresholds or amounts.
- 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.

A16. Other planning matters that the auditor may consider discussing with those charged with governance include:

- The views of those charged with governance about:
  - 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 believe are relevant to the audit of the financial statements.
- 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 the possibility of fraud.
  - The actions of those charged with governance in response to developments in financial reporting, laws, accounting standards, corporate governance practices, and other related matters.
  - The actions of those charged with governance in response to previous communications with the auditor.

A17. While communication with those charged with governance may assist the auditor in planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine 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)

A18. The communication of significant 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.

***Qualitative Aspects of the Entity's Significant Accounting Practices*** (Ref: Para. 16(a))

A19. Generally accepted accounting principles provide for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may include comment on the acceptability of significant accounting practices. Appendix B provides guidance on the matters that may be included in this communication.

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

A20. Significant difficulties encountered during the audit may include such matters as:

- Significant delays in management providing required information.
- An unnecessarily brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.
- Restrictions imposed on the auditors by management.
- Management's unwillingness to provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about the entity's ability to continue as a going concern.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

***Uncorrected Misstatements*** (Ref: Para. 16(c))

A21. SAS No. 107, *Audit Risk and Materiality in Conducting an Audit*, requires the auditor to accumulate all known and likely misstatements identified during the audit, other than those that the auditor believes are trivial, and communicate them to the appropriate level of management. Where there are a large number of small uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the misstatements, rather than the details of each individual misstatement.

#### *Disagreements With Management* (Ref: Para. 16(d))

A22. Disagreements with management may occasionally arise over, among other things, the application of accounting principles to the entity's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements may also arise regarding the scope of the audit, disclosures to be included in the entity's financial statements, and the wording of the auditor's report. For purposes of this Statement, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved.

#### *Significant Issues Discussed, or Subject to Correspondence With Management* (Ref: Para. 17(d))

A23. Significant issues may include such matters as:

- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- Discussions or correspondence in connection with the initial or recurring retention of the auditor including, among other matters, any discussions or correspondence regarding the application of accounting principles and auditing standards.

### ***Independence***

A24. Generally accepted auditing standards require independence for all audits. Relevant matters to consider in reaching a conclusion about independence include circumstances or relationships that create threats to auditor independence and the related safeguards that have been applied to eliminate those threats or reduce them to an acceptable level.<sup>16</sup>

A25. Although the auditor's report affirms the auditor's independence, in certain situations, particularly for public interest entities,<sup>17</sup> the auditor may determine that it is appropriate to communicate with those charged with governance circumstances or relationships (for example, financial interests, business or family relationships, or nonaudit services provided or expected to be provided) that in the auditor's professional judgment may reasonably be thought to bear on independence and that the auditor gave significant consideration to in reaching the conclusion that independence has not been impaired.

A26. The form and timing of communications regarding independence may be affected by the entity's governance structure and whether a formal subgroup such as an audit committee exists.

---

<sup>16</sup> Comprehensive guidance on threats to independence and safeguards, including application to specific situations, is set forth in the AICPA's Conceptual Framework for AICPA Independence Standards.

<sup>17</sup> In addition to entities subject to Securities and Exchange Commission reporting requirements, the Conceptual Framework for AICPA Independence Standards considers the following entities to be *public interest entities*: (1) employee benefit and health and welfare plans subject to Employee Retirement Income Security Act audit requirements; (2) governmental retirement plans; (3) entities or programs (including for-profit entities) subject to Single Audit Act OMB Circular A-133 audit requirements and entities or programs subject to similar program oversight; and (4) financial institutions, credit unions, and insurance companies. These entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decisions or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant.

In situations where all of those charged with governance are involved in managing the entity, the auditor may determine that those charged with governance have been informed of relevant facts regarding the auditor's independence through their management activities or through other means, such as the engagement letter. This is particularly likely where the entity is owner-managed, and the auditor's firm has little involvement with the entity beyond a financial statement audit.

## **The Communication Process**

### ***Establishing a Mutual Understanding*** (Ref: Para. 18)

A27. Clear communication of the auditor's responsibilities, an overview of the planned scope and timing of the audit, and the expected general content of communications helps establish the basis for effective two-way communication.

A28. 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 in a better position 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) on the audit team and among 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. Such matters might include strategic decisions that may significantly affect the nature, timing, and extent of audit procedures; the suspicion or the detection of fraud; or concerns about 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.

A29. 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 A37).

### ***Communication With Management***

A30. Many matters may be discussed with management in the ordinary course of an audit, including matters to be communicated with those charged with governance in accordance with this Statement. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the financial statements.

A31. 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 with management questions of management's competence or integrity. In addition to recognizing management's 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.

**Forms of Communication** (Ref: Para. 19)

A32. Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions. Written communications may include an engagement letter that is provided to those charged with governance.

A33. 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 summarization in the communication, and whether to communicate in a formal or informal 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 being audited.
- Legal or regulatory requirements that may require a written communication with those charged with governance.
- 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.
- In the case of a special purpose financial statement audit, whether the auditor also audits the entity's general purpose financial statements.

A34. 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 summarize the matter in later communications so that all of those charged with governance have full and balanced information.

**Timing of Communications** (Ref: Para. 21)

A35. The appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, and the action expected to be taken by those charged with governance. The auditor may consider communicating:

- Planning matters early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- Significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulties, or if the difficulties are likely to lead to a modified opinion.

A36. 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, timely communication of a material weakness to enable appropriate remedial action to be taken.

- Whether the auditor is auditing both general purpose and special purpose financial statements.

**Adequacy of the Communication Process** (Ref: Para. 22-23)

A37. As discussed in paragraph A1, effective two-way communication assists both the auditor and those charged with governance. Further, SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, 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. Inadequate two-way communication may indicate an unsatisfactory control environment, which will influence the auditor's assessment of the risks of material misstatements.

A38. Observations resulting from audit procedures performed for other purposes to support the evaluation required by paragraph 22 may include:

- The appropriateness and timeliness of actions taken by those charged with governance in response to matters communicated by the auditor.
- 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 communicated by the auditor, such as 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.

A39. The auditor may discuss the situation with those charged with governance. If 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 agency for certain governmental entities.
- Withdrawing from the engagement.

**Documentation** (Ref: Para. 24)

A40. Documentation of oral communication may include a copy of minutes prepared by the entity if those minutes are an appropriate record of the communication.

## Appendix C

In this Appendix, SAS No. 114 is presented in its current format. The reformatting and drafting improvements discussed in this paper have not been applied.

The appendices referred to in the text of this SAS have not been included in the illustrative presentation

### **SAS No. 114, *The Auditor's Communication With Those Charged With Governance***

1. This Statement on Auditing Standards (SAS) establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial statements.<sup>18</sup> Although this Statement applies regardless of an entity's governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity. This Statement 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 Statement has been drafted in terms of an audit of financial statements, but may also be applied, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation and presentation of the other historical financial information.
3. For purposes of this Statement:
  - a. *Those charged with governance* means the person(s) 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. In some cases, those charged with governance are responsible for approving the entity's financial statements (in other cases management has this responsibility). For entities with a board of directors, this term encompasses the term *board of directors* or *audit committee* used elsewhere in generally accepted auditing standards.
  - b. *Management* means the person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting.
4. Recognizing the importance of effective two-way communication to the audit, this Statement provides a 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 are identified in other SASs (see Appendix A). Further matters may be communicated by agreement with those charged with governance or management, or in accordance with external requirements.
5. The auditor must communicate with those charged with governance matters related to the financial statement audit that are, in the auditor's professional judgment, significant and relevant to the responsibilities of those charged with governance in overseeing the financial reporting process.

---

<sup>18</sup> The provisions of this Statement apply to audits of financial statements prepared either in accordance with generally accepted accounting principles or in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. References in this Statement to generally accepted accounting principles are intended to also refer to other comprehensive bases of accounting when the reference is relevant to the basis of accounting used.

6. Clear communication of specific matters in accordance with this Statement is an integral part of every audit. However, the auditor is not required to perform procedures specifically to identify other significant matters to communicate with those charged with governance.

## **The Role of Communication**

7. The principal purposes of communication with those charged with governance are to:
- a. Communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the scope and timing of the audit.
  - b. Obtain from those charged with governance information relevant to the audit.
  - c. Provide those charged with governance with timely observations arising from the audit that are relevant to their responsibilities in overseeing the financial reporting process.
8. This Statement focuses primarily on communications from the auditor to those charged with governance. However, effective two-way communication is also very 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.
  - c. Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.
9. Although the auditor is responsible for communicating specific matters in accordance with this Statement, 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.

## **Legal Considerations**

10. In certain circumstances, the auditor may be required to report to a regulatory or enforcement body certain matters communicated with those charged with governance. For example, governmental auditing standards require auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties outside the audited entity in certain circumstances.

11. In rare circumstances, laws or regulations may prevent the auditor from communicating certain matters with those charged with governance, or others within the entity. For example, laws or regulations 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 such circumstances, it may be appropriate for the auditor to seek legal advice.

## **Those Charged With Governance**

12. The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. The appropriate person(s) may vary depending on the matter to be communicated.

13. Governance structures vary by entity, reflecting influences such as size and ownership characteristics. For example:

- In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. For other entities, a body that is not part of the entity may be charged with governance, as with some government agencies.
- In some cases, some or all of those charged with governance also have management responsibilities. In others, those charged with governance and management are different people.

14. 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, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, such as 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.

15. Such diversity means that it is not possible for this Statement 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 engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. The auditor's understanding of the entity's governance structure and processes obtained in accordance with SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, is relevant in deciding with whom to communicate matters.

16. When the appropriate person(s) with whom to communicate are not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate. When the entity being audited is a component<sup>19</sup> of a group,<sup>20</sup> the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

### ***Communication With the Audit Committee or Other Subgroup of Those Charged With Governance***

17. Audit committees (or similar subgroups with different names) exist in many entities. Although their specific authority and functions may differ, communication with the audit committee, where one exists, is a key element in the auditor's communication with those charged with governance. Good governance principles suggest that:

- The auditor has access to the audit committee as necessary.
- The chair of the audit committee and, when relevant, the other members of the audit committee, meet with the auditor periodically.
- The audit committee meets with the auditor without management present at least annually.

---

<sup>19</sup> *Component* means a head office, parent, division, branch, subsidiary, joint venture, associated company, equity investee, or other entity whose financial information is or should be included in the consolidated financial statements of a group.

<sup>20</sup> *Group* means an entity whose consolidated financial statements include or should include financial information of more than one component.

18. The auditor should evaluate whether communication with a subgroup of those charged with governance, such as the audit committee or an individual, adequately fulfills the auditor's responsibility to communicate with those charged with governance. 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.
- Whether the subgroup (a) has the authority to take action in relation to the information communicated and (b) can provide further information and explanations the auditor may need.
- Whether the auditor is aware of potential conflicts of interest between the subgroup and other members of the governing body.
- Whether there is also a need to communicate the information, in full or in summary form, to the governing body. This decision may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor retains the right to communicate with the governing body, a fact the auditor may make explicit in the terms of the engagement.

## **Communication With Management**

19. Many matters may be discussed with management in the ordinary course of an audit, including matters to be communicated with those charged with governance in accordance with this Statement. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the financial statements.

20. 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 with management questions of management's competence or integrity. In addition to recognizing management's 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.

### ***When All of Those Charged With Governance Are Involved in Managing the Entity***

21. In some cases, all of those charged with governance are involved in managing the entity. In these cases, if matters required by this Statement 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.

22. When all of those charged with governance are involved in managing the entity, the auditor should consider whether communication with person(s) with financial reporting responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity. (See paragraphs 12 and 18.)

## **Matters to Be Communicated**

23. The auditor should communicate with those charged with governance:

- a. The auditor's responsibilities under generally accepted auditing standards (see paragraphs 26 through 28);

- b. An overview of the planned scope and timing of the audit (see paragraphs 29 through 33); and
- c. Significant findings from the audit (see paragraphs 34 through 44).

24. Management's communication of these matters to those charged with governance does not relieve the auditor of the responsibility to also communicate them. However, communication of these matters by management may affect the form or timing of the auditor's communication.

25. Nothing in this Statement precludes the auditor from communicating any other matters to those charged with governance.

### ***The Auditor's Responsibilities Under Generally Accepted Auditing Standards***

26. The auditor should communicate with those charged with governance the auditor's responsibilities under generally accepted auditing standards, including that:

- a. The auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of those charged with governance are presented fairly, in all material respects, in conformity with generally accepted accounting principles.
- b. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

These responsibilities may be communicated through the engagement letter, or other form of contract that records the terms of the engagement, if that letter or contract is provided to those charged with governance.

27. The auditor may also communicate that:

- a. The auditor is responsible for performing the audit in accordance with generally accepted auditing standards and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement.
- b. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting.
- c. The auditor is responsible for communicating significant matters related to the financial statement audit that are, in the auditor's professional judgment, relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Generally accepted auditing standards do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.
- d. When applicable, the auditor is also responsible for communicating particular matters required by laws or regulations, by agreement with the entity or by additional requirements applicable to the engagement.

28. SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, establishes the auditor's responsibility for information prepared by management that accompanies the audited financial statements.<sup>21</sup> If the entity includes other information in documents containing audited financial statements, the auditor should communicate with those charged with governance the auditor's responsibility with respect to such other information, any procedures performed relating to the other information, and the results.

---

<sup>21</sup> Guidance on the auditor's consideration of other information is also provided by "Required Supplementary Information," of Statement on Auditing Standards (SAS) No. 52, *Omnibus Statement on Auditing Standards—1987*, and SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*.

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

29. The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit. However, it is important for the auditor 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. Certain factors described in paragraph 53 may be relevant in determining the nature and extent of this communication.

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

- a. Assist those charged with governance in understanding better the consequences of the auditor's work for their oversight activities, discussing with the auditor issues of risk and materiality, and identifying 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.

31. Matters communicated may include the following:

- 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, including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.
- The concept of materiality in planning and executing the audit, focusing on the factors considered rather than on specific thresholds or amounts.
- 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.

32. Other planning matters that the auditor may consider discussing with those charged with governance include:

- The views of those charged with governance about:
  - 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 believe are relevant to the audit of the financial statements.
- 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 the possibility of fraud.

- The actions of those charged with governance in response to developments in financial reporting, laws, accounting standards, corporate governance practices, and other related matters.
- The actions of those charged with governance in response to previous communications with the auditor.

33. While communication with those charged with governance may assist the auditor in planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine 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***

34. The auditor should communicate with those charged with governance the following matters:

- a. The auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures (see paragraphs 37 and 38).
- b. Significant difficulties, if any, encountered during the audit (see paragraph 39).
- c. Uncorrected misstatements, other than those the auditor believes are trivial, if any (see paragraphs 40 and 41).
- d. Disagreements with management, if any, (see paragraph 42).
- e. Other findings or issues, if any, arising from the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their oversight of the financial reporting process.

35. Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate:

- a. Material, corrected misstatements that were brought to the attention of management as a result of audit procedures. The auditor also may communicate other corrected immaterial misstatements, such as frequently recurring immaterial misstatements that may indicate a particular bias in the preparation of the financial statements.
- b. Representations the auditor is requesting from management. The auditor may provide those charged with governance with a copy of management's written representations.
- c. Management's consultations with other accountants (see paragraph 43).
- d. Significant issues, if any, arising from the audit that were discussed, or the subject of correspondence, with management (see paragraph 44).

36. The communication of significant 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.

### ***Qualitative Aspects of the Entity's Significant Accounting Practices***

37. Generally accepted accounting principles provide for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may include comment on the acceptability of significant accounting practices. Appendix B provides guidance on the matters that may be included in this communication.

38. The auditor should explain to those charged with governance why the auditor considers a significant accounting practice not to be appropriate and, when considered necessary, request changes. If requested changes are not made, the auditor should inform those charged with

governance that the auditor will consider the effect of this on the financial statements of the current and future years, and on the auditor's report.

### *Significant Difficulties Encountered During the Audit*

39. The auditor should inform those charged with governance of any significant difficulties encountered in dealing with management related to the performance of the audit. Significant difficulties encountered during the audit may include such matters as:

- Significant delays in management providing required information.
- An unnecessarily brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.
- Restrictions imposed on the auditors by management.
- Management's unwillingness to provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about the entity's ability to continue as a going concern.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

### *Uncorrected Misstatements*

40. SAS No. 107, *Audit Risk and Materiality in Conducting an Audit*, requires the auditor to accumulate all known and likely misstatements identified during the audit, other than those that the auditor believes are trivial, and communicate them to the appropriate level of management. The auditor should communicate with those charged with governance uncorrected misstatements and the effect that they may have on the opinion in the auditor's report, and request their correction. In communicating the effect that material uncorrected misstatements may have on the opinion in the auditor's report, the auditor should communicate them individually. Where there are a large number of small uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the misstatements, rather than the details of each individual misstatement.

41. The auditor should discuss with those charged with governance the implications of a failure to correct known and likely misstatements, if any, considering qualitative as well as quantitative considerations, including possible implications in relation to future financial statements. The auditor should also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

### *Disagreements With Management*

42. The auditor should discuss with those charged with governance any disagreements with management, whether or not satisfactorily resolved, about matters that individually or in the aggregate could be significant to the entity's financial statements or the auditor's report. Disagreements with management may occasionally arise over, among other things, the application of accounting principles to the entity's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements may also arise regarding the scope of the audit, disclosures to be included in the entity's financial statements, and the wording of the auditor's report. For purposes of this Statement, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved.

### *Management's Consultations With Other Accountants*

43. In some cases, management may decide to consult with other accountants about auditing and accounting matters. When the auditor is aware that such consultation has occurred, the auditor should discuss with those charged with governance his or her views about significant matters that were the subject of such consultation.<sup>22</sup>

### *Significant Issues Discussed, or Subject to Correspondence With Management*

44. The auditor should communicate with those charged with governance any significant issues that were discussed or were the subject of correspondence with management. Significant issues may include such matters as:

- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- Discussions or correspondence in connection with the initial or recurring retention of the auditor including, among other matters, any discussions or correspondence regarding the application of accounting principles and auditing standards.

### **Independence**

45. Generally accepted auditing standards require independence for all audits. Relevant matters to consider in reaching a conclusion about independence include circumstances or relationships that create threats to auditor independence and the related safeguards that have been applied to eliminate those threats or reduce them to an acceptable level.<sup>23</sup>

46. Although the auditor's report affirms the auditor's independence, in certain situations, particularly for public interest entities,<sup>24</sup> the auditor may determine that it is appropriate to communicate with those charged with governance circumstances or relationships (for example, financial interests, business or family relationships, or nonaudit services provided or expected to be provided) that in the auditor's professional judgment may reasonably be thought to bear on independence and that the auditor gave significant consideration to in reaching the conclusion that independence has not been impaired.

47. The form and timing of communications regarding independence may be affected by the entity's governance structure and whether a formal subgroup such as an audit committee exists. In situations where all of those charged with governance are involved in managing the entity, the auditor may determine that those charged with governance have been informed of relevant facts regarding the auditor's independence through their management activities or through other means, such as the engagement letter. This is particularly likely where the entity is owner-managed, and the auditor's firm has little involvement with the entity beyond a financial statement audit.

## **The Communication Process**

---

<sup>22</sup> Circumstances in which the auditor should be informed of such consultations are described in paragraph 7 of SAS No. 50, *Reports on the Application of Accounting Principles*.

<sup>23</sup> Comprehensive guidance on threats to independence and safeguards, including application to specific situations, is set forth in the AICPA's Conceptual Framework for AICPA Independence Standards.

<sup>24</sup> In addition to entities subject to Securities and Exchange Commission reporting requirements, the Conceptual Framework for AICPA Independence Standards considers the following entities to be *public interest entities*: (1) employee benefit and health and welfare plans subject to Employee Retirement Income Security Act audit requirements; (2) governmental retirement plans; (3) entities or programs (including for-profit entities) subject to Single Audit Act OMB Circular A-133 audit requirements and entities or programs subject to similar program oversight; and (4) financial institutions, credit unions, and insurance companies. These entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decisions or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant.

### ***Establishing a Mutual Understanding***

48. The auditor should communicate with those charged with governance the form, timing, and expected general content of communications. Clear communication of the auditor's responsibilities (paragraphs 26 through 28), an overview of the planned scope and timing of the audit (paragraphs 29 through 33), and the expected general content of communications helps establish the basis for effective two-way communication.

49. 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 in a better position 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) on the audit team and among 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. Such matters might include strategic decisions that may significantly affect the nature, timing, and extent of audit procedures; the suspicion or the detection of fraud; or concerns about 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.

50. 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 60).

### ***Forms of Communication***

51. The auditor should communicate in writing with those charged with governance significant findings from the audit (see paragraphs 34 and 35) when, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved. Other communications may be oral or in writing.

52. Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions. Written communications may include an engagement letter that is provided to those charged with governance.

53. 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 summarization in the communication, and whether to communicate in a formal or informal 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 being audited.
- Legal or regulatory requirements that may require a written communication with those charged with governance.

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

54. 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 summarize the matter in later communications so that all of those charged with governance have full and balanced information.

55. When the auditor communicates matters in accordance with this Statement in writing, the auditor should indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management and is not intended to be and should not be used by anyone other than these specified parties.

### ***Timing of Communications***

56. The auditor should communicate with those charged with governance on a sufficiently timely basis to enable those charged with governance to take appropriate action.

57. The appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, and the action expected to be taken by those charged with governance. The auditor may consider communicating:

- Planning matters early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- Significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulties, or if the difficulties are likely to lead to a modified opinion.

58. 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, timely communication of a material weakness to enable appropriate remedial action to be taken.
- Whether the auditor is auditing both general purpose and special purpose financial statements.

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

59. 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. If it has not, the auditor should take appropriate action to address the effectiveness of the communication process. (See paragraph 62.)

60. As discussed in paragraph 8, effective two-way communication assists both the auditor and those charged with governance. Further, SAS No. 109, *Understanding the Entity and Its*

*Environment and Assessing the Risks of Material Misstatement*, 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. Inadequate two-way communication may indicate an unsatisfactory control environment, which will influence the auditor's assessment of the risks of material misstatements.

61. The auditor need not design specific procedures to support the evaluation required by paragraph 59. 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 communicated by the auditor.
- 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 communicated by the auditor, such as 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.

62. If, in the auditor's judgment, the two-way communication between the auditor and those charged with governance is not adequate, there is a risk the auditor may not have obtained all the audit evidence required to form an opinion on the financial statements. The auditor should consider the effect, if any, on the auditor's assessment of the risks of material misstatements.

63. The auditor may discuss the situation with those charged with governance. If 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 agency for certain governmental entities.
- Withdrawing from the engagement.

## **Documentation**

64. When matters required to be communicated by this Statement have been communicated orally, the auditor should document them.<sup>25</sup> When matters have been communicated in writing, the auditor should retain a copy of the communication. Documentation of oral communication may include a copy of minutes prepared by the entity if those minutes are an appropriate record of the communication.

### **Effective Date**

65. This statement is effective for audits of financial statements for periods beginning on or after December 15, 2006.

---

<sup>25</sup> SAS 103, *Audit Documentation*, requires the auditor to document discussions of significant findings or issues with management and others (including those charged with governance) on a timely basis, including responses. That SAS also requires that the audit documentation include documentation of the significant findings or issues discussed, and when and with whom the discussions took place.