

IAASB CAG PAPER



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Agenda Item

Committee: IAASB Consultative Advisory Group

Meeting Location: Paris

Meeting Date: May 11-12, 2006

Report Back—Communication with Those Charged with Governance

Objectives of Agenda Item

1. To provide a brief report back on the November 30-December 1, 2005 proposals of Representatives on the first read of a revised “old” format ISA 260 “Communication with Those Charged with Governance”.

November 30-December 1, 2005 CAG Proposals

Below is an extract from the minutes of the November 30-December 1, 2005 CAG meeting minutes¹ and an indication of how the IAASB Task Force or the IAASB responded to the Representatives’ comments.

Representatives’ comments	IAASB Task Force/IAASB response
<p>USE OF THE TERM “SIGNIFICANT”:</p> <ul style="list-style-type: none">• Ms. Koski-Grafer supported the suggested initiative to promote common terminology and, if possible, to find one word to replace the many synonyms that are presently used, noting that this could help to simplify the ISAs and increase understanding.• Mr. Lamoureux was unclear as to how the term “significant” relates to “material.” Mr. Roussey shared the concern, noting that he would interpret a matter that is “significant” to be of lower importance than a matter that is “material.” Mr. Rabine suggested that the term “significant,” if used in the ISA, be defined in the Glossary of Terms	<p>“Significant” is now used throughout the draft.</p> <p>The Task Force drafted a definition of “significant” for consideration by the IAASB. The IAASB agreed not to include the definition as it was repetitive of the definition of “<u>significance</u>” already included in the Glossary. The definition of significance provides a context for distinguishing “material” from “significant.”</p>

¹ The minutes will be approved at the May 11-12, 2006 IAASB CAG meeting.

IAASB CAG PAPER

IAASB CAG Agenda (May 2006)

Agenda Item I

Report Back—Proposed ISA 260 (Revised and Redrafted), Communication with Those Charged with Governance

Representatives' comments	IAASB Task Force/IAASB response
<p>GUIDANCE PERTAINING TO SMES:</p> <ul style="list-style-type: none"> • Mr. Popham was of the view that several of the requirements are important in the context of SMEs, but that their importance is lost when they are presented with the other requirements. He suggested that the Task Force consider further those requirements that are essential to be communicated even when those charged with governance are also involved in managing the entity. • He also noted that the paragraph pertaining to the audit of group financial statements omits the fact that the parent is often charged with governance responsibilities for wholly-owned subsidiaries. He was of the view that reference to such circumstances was necessary to avoid unnecessary boilerplate reporting to the boards of wholly owned subsidiaries. 	<p>These matters were reconsidered by the Task Force. While no significant changes were made as a direct result, the requirements relating to the findings from the audit as they relate to SMEs have been reformatted (now included in paragraph 36 of the “old” format), which is thought to be clearer.</p> <p>The IAASB reconsidered the guidance regarding group audits in its entirety, and agreed it should be simplified to a reference to ISA 600 plus the general guidance that “the appropriate person(s) with whom the component auditor communicates depends on the engagement circumstances and the matter to be communicated (<i>see paragraph 17.2 of “old” format – Agenda Item I.2</i>).</p>
<p>APPENDIX OF OTHER ISAS:</p> <ul style="list-style-type: none"> • Mr. Roussey was of the view that a list of the requirements in other ISAs to communicate to those charged with governance is helpful from an SMP perspective. He did not, however, see it as essential that the list be included as an appendix to the ISA. He suggested that the IAASB provide the list on the IAASB website or in the proposed ISA Guide under consideration by the IFAC SMP Committee. 	<p>The IAASB agreed to include such a list as an appendix – it was noted that updating the appendix by way of “conforming amendments” should not prove too unmanageable.</p>
<p>Mr. Pickeur noted that the comment letter submitted by the Basel Committee on Banking Supervision expressed concern over the proposal that the auditor’s written communications to those charged with governance should not be disclosed to others, or quoted or referred to, without the auditor’s prior written consent. He noted that the need to seek consent may possibly delay timely communication of relevant issues to appropriate authorities. He</p>	<p>This matter was raised and discussed at the December 2005 IAASB meeting, and as a result <i>paragraph 61 (“old” format – Agenda Item I.2)</i> is now expressed in neutral terms, i.e., it no longer implies that communications should not be disclosed, but rather notes that where there are any restrictions on disclosure, they should be stated in written communications.</p>

IAASB CAG PAPER

IAASB CAG Agenda (December 2005)

Agenda Item I

Report Back—Proposed ISA 260 (Revised and Redrafted), Communication with Those Charged with Governance

Representatives' comments	IAASB Task Force/IAASB response
observed that this was not addressed in the Issues Paper to be discussed with the IAASB. Messrs. Edwards and Gielen shared this concern.	
Mr. Popham expressed concern over the guidance that local laws preventing the auditor from communicating certain matters with those charged with governance, or others, within the entity may constitute a scope limitation that results in a modification of the auditor's opinion. He suggested that the guidance be amended to explain that the auditor reports illegal activities, for example, unless prohibited by national laws or regulations.	The paragraph containing this guidance (paragraph 12 of "old" format – Agenda Item I.2) has now been amended to be consistent with the same paragraph as it appears elsewhere in the ISAs. The reference to scope limitation has been deleted.
Mr. Gielen noted that Mr. Hegarty expressed concern at the last CAG meeting that the proposed revised ISA may not be governance-framework neutral. He was of the view that the proposed revised ISA does not adequately address the differences that exist amongst jurisdictions. He noted that an assumption underlying the ISAs generally has been the separation of "management" and "those charged with governance," a hallmark of U.S. publicly traded corporations in particular. There are, however, developing economies and non-U.S. systems where this assumption does not hold. Mr. Gielen referred to the role of shareholders as those charged with governance, the presence of controlling shareholders, and the definition of "listed entity." He agreed to submit the specifics of his concerns to IAASB Staff in writing.	This matter was noted at both the Task Force and the IAASB, and the subsequent written submission from the World Bank is referred to in the (draft) minutes of the March 2006 IAASB meeting. IAASB members, including Asian and European members, were of the view that the draft ISA is sufficiently governance-framework neutral. For example, the guidance refers to both two tier and one tier board structures (see para 14 of "old" format – Agenda Item I.2) and the definitions recognize that either those charged with governance or management may be responsible for approving the financial statements (paragraph 5 of "old" format – Agenda Item I.2).

Proposed Clarity Drafting Conventions

With regard to the application of the proposed clarity drafting conventions, Representatives are asked to consider the following:

- (a) Is the objective to be achieved by the auditor, stated in paragraph 5 of the proposed ISA, appropriate (**see Agenda Item I.3**)?
- (b) Have the guidelines identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements are

IAASB CAG PAPER

IAASB CAG Agenda (May 2006)

Agenda Item I

Report Back—Proposed ISA 260 (Revised and Redrafted), Communication with Those Charged with Governance

at a level that promotes consistency in performance and the use of professional judgment by auditors?²

Agenda Item I.4 “maps” the “should” requirements and present tense sentences in the revised “old” format draft (**Agenda Item I.2**) to the related “shall” requirements and application material in the “clarified” format draft (**Agenda Item I.3**).

Material Presented – FOR REFERENCE PURPOSES ONLY

Agenda Item I.1	Communication with Those Charged with Governance—Issues (May 2006 IAASB Agenda Item 8-A)
Agenda Item I.2	Clean copy of “old” format draft to be presented for “sign-off” at May 2006 IAASB meeting (May 2006 IAASB Agenda Item 8-B)
Agenda Item I.3	Clean copy of “clarified” format draft to be presented for exposure at May 2006 IAASB meeting (May 2006 IAASB Agenda Item 8-D)
Agenda Item I.4	ISA 260: Mapping document (May 2006 IAASB Agenda Item 8-F)

The remainder of the May 2006 IAASB meeting material is available from <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0065>.

² In accordance with the Exposure Draft on “Improving the Clarity of IAASB Standards,” the IAASB will determine the requirements of a Standard as follows:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.
- In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

These guidelines, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.