

(April 2006)

Explanatory Statement

ASA 260 Communication of Audit Matters with Those Charged with Governance

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



Australian Government

Auditing and Assurance Standards Board

Explanatory Statement

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

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

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

Process of making Auditing Standards

Section 1455 of the *Corporations Act 2001* and *Corporations Regulation 10.5.01* gave interim legal endorsement from 1 July 2004 to the majority of Auditing Standards made by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation. The AUASB has reviewed the Auditing Standards and has proceeded to make them as legally enforceable Auditing Standards under the *Corporations Act 2001*.

The Auditing Standards have been made also in accordance with the Financial Reporting Council's Strategic Direction to the AUASB dated 6 April 2005, pursuant to section 225 of the *ASIC Act*.

The Strategic Direction, *inter alia*, provides that the AUASB develops Auditing Standards that:

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- have a clear public interest focus and are of the highest quality;
- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as a base;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

In implementing the Strategic Direction, the AUASB has undertaken a process of thorough review and revision that has:

- addressed the enforceability of mandatory requirements;
- clarified auditors' obligations under the Auditing Standards;
- provided for sector neutrality in the Auditing Standards; and
- included other amendments as necessary.

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

The purpose of Auditing Standard ASA 260 is to establish mandatory requirements and to provide explanatory guidance on communication of audit matters arising from the audit of the financial report between the auditor and those charged with governance of an entity.

Auditing Standard ASA 260 is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

Operative Date

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

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

The main differences between ASA 260 and AUS 710 are that in ASA 260:

1. The word ‘shall’, in the **bold-type** paragraphs, is the terminology used to describe an auditor’s mandatory requirements, whereas an auditor’s degree of responsibility is described in AUS 710 by the word ‘should’.
2. The explanatory paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 710 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.
3. The definition of “governance”, “audit matters of governance interest” and “those charged with governance” and the explanatory guidance on “relevant persons” replace the explanatory guidance on the different levels of management and the definitions of “report to management” and “operational management” in AUS 710.
4. The mandatory requirement and explanatory guidance paragraphs on “Audit Matters of Governance Interest to be Communicated” replace “Identification of Significant Matters” and “Reporting Significant Matters” in the existing AUS 710 with the following revised and/or additional requirements:

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- (a) The auditor shall consider audit matters of governance interest that arise from the audit of the financial report and communicate them with those charged with governance (paragraph 15).
 - (b) The auditor shall inform those charged with governance of those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial report taken as a whole (paragraph 17).
- 5. The following additional specific mandatory requirements are included:
 - (a) The auditor shall determine the relevant persons who are charged with governance and with whom audit matters of governance interest are communicated (paragraph 9).
 - (b) When the audit is conducted under Part 2M.3 of the *Corporations Act 2001*, the auditor shall communicate directly with those charged with governance:
 - (i) a statement as to whether the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms are independent in accordance with relevant ethical requirements and any regulatory requirements that apply to the audit engagement; and
 - (ii)
 - details of relationships that may reasonably have a bearing on auditor independence, as outlined in relevant ethical requirements relating to audit engagements; and
 - the related safeguards that have been applied to eliminate threats to

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independence or reduce them to an acceptable level (paragraph 20).

6. The following mandatory requirement and related explanatory guidance paragraphs on “Format and Presentation” in AUS 710 has been removed as it is included in ASA 230 *Audit Documentation*:
 - the auditor should document the subject matter of oral reports to management regarding significant matters (paragraph .31).
7. The mandatory requirement and related explanatory guidance paragraphs on “Management Response” in AUS 710 has been included as explanatory guidance (paragraph 32).
8. Appendices 1 to 3 in AUS 710 are not included.

Consultation prior to issuing this Auditing Standard

The AUASB has consulted publicly as part of its due process in developing this Auditing Standard. Exposure Draft ED 34/05 *Proposed Auditing Standard: Communication of Audit Matters With Those Charged With Governance (Re-issuance of AUS 710)* was issued on 16 December 2005 with a 45 day comment period. Submissions were received by the AUASB and it has considered these submissions as part of the development and finalisation of this Auditing Standard.