



GAO

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Comptroller General  
of the United States

United States Government Accountability Office  
Washington, DC 20548

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Mr. James M. Sylph  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

*Subject: Proposed International Standard on Auditing (ISA) 260 (Revised) – The Auditor’s Communication with Those Charged with Governance*

This letter provides the U.S. Government Accountability Office’s (GAO) comments on the International Auditing and Assurance Standards Board’s (IAASB) proposed ISA 260 issued in March 2005. Overall, we support the IAASB’s proposed revisions to ISA 260. A strong communication process between auditors and those charged with governance can help to improve accountability and increase understanding of the audit and the role of the auditor. We believe that the proposed standard could be enhanced in several areas that would strengthen audits in both the public and private sectors.

## **General**

To help auditors effectively implement this standard, we recommend creating an appendix that contains a comprehensive listing of the specific items that the auditor is required by ISA 260 and other ISAs to communicate to those charged with governance. While paragraph 44 contains certain examples of items required to be communicated by other ISAs, the wording of the introductory sentence in paragraph 44 seems to indicate that the list is not complete. Auditors could misinterpret the examples shown as being a comprehensive list. A comprehensive list in an appendix would be useful as a tool for auditors and could be easily updated as ISA 260 or other ISA communication requirements are revised.

## **Introduction**

Paragraphs 7a and 7b – Overall, we agree with the definitions in the proposed ISA for defining those charged with governance and management. We believe that responsibility with respect to internal control is of critical importance and should be

included in the definition similar to the discussion in ISA 700 regarding management's responsibility. Specifically, we suggest adding the following revisions:

7. In this ISA:

(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 and disclosure process, including related internal control over financial reporting. In some cases, those charged with governance are responsible for approving the financial statements (in other cases management has this responsibility).

(b) "Management" means the person(s) who have executive responsibility for the conduct of the entity's operations. In some entities, management includes some or all of those charged with governance, e.g., executive directors, or owner-managers. Management is responsible for preparing the financial statements, including designing, implementing, and maintaining internal control over financial reporting overseen by those charged with governance, and in some cases management is also responsible for approving the financial statements (in other cases those charged with governance have this responsibility).

### **Those Charged with Governance**

Paragraphs 9 through 13 -- We fully support the requirement for the auditor to determine the relevant persons in the entity's governance structure with whom to communicate particular matters. For government entities in particular, there is generally not a board of directors or audit committee; thus the auditor needs a process such as that discussed in the proposed standard for evaluating the governance structure to identify such persons. We support the idea in paragraph 13 of reaching agreement with the engaging party as to whom particular communications will be made if the governance structure is not formally defined and the relevant persons for communication are not clearly identifiable. Due to the importance of the evaluation discussed in paragraphs 9 through 13, we suggest adding the following: "In complex situations, the auditor should document the process followed and conclusions reached for identifying relevant persons with whom to communicate these matters."

### **Other Matters to be Communicated**

Paragraphs 22 (e), 25, and 46 -- The requirement to communicate "other matters of which the auditor is aware that the auditor judges to be serious and relevant to the responsibilities of those charged with governance" is very broad. While paragraph 47 provides some examples of these matters, more guidance should be provided to assist auditors in making judgments to apply the criteria of "serious and relevant" when considering other matters to be communicated.

Additionally, defining the scope of the required communication of other matters more specifically can assist both auditors and those charged with governance in avoiding misunderstandings. We suggest adding the following underlined text to add specificity to paragraphs 22 (e), 25, and 46: “Other matters related to the financial statement audit that are serious and relevant to the responsibilities of those charged with governance in overseeing the financial reporting and disclosure process.” This change would help to reinforce the communications regarding the scope of the auditor’s work discussed in paragraph 48.

We also suggest adding a paragraph that states the following: “The auditor is not precluded from communicating other matters of which the auditor is aware, that in the auditor’s professional judgment, are serious and relevant to the responsibilities of those charged with governance other than those responsibilities related to overseeing the financial reporting and disclosure process.”

Paragraphs 47 and 48 -- With respect to the auditor’s responsibility for identifying other matters, further clarification of paragraphs 47 and 48(a) is needed. We agree with the wording in paragraph 48(a) that limits the auditor’s responsibility for identifying other matters by stating that these matters are “identified as a by-product of the audit.” We suggest moving paragraph 47, which provides examples, to follow paragraph 48 which contains the requirement and making the following revisions:

478. Unless the auditor is required by additional external requirements or by an agreement with the entity to undertake procedures to determine whether matters such as those noted in the preceding paragraph have occurred, in reporting such matters, the auditor makes those charged with governance aware that:

- (a) The matters were identified as a by-product of the audit, and therefore no procedures were carried out in addition to those necessary to form an opinion on the financial statements;
- (b) No procedures have been undertaken to determine whether other matters of the nature of the items reported have occurred; and
- (c) When appropriate, these matters have been discussed with management.

48.7. Such matters, ~~which may arise from the audit of the financial statements or otherwise come to the attention of the auditor,~~ include significant decisions or actions by senior management that lack appropriate authorization, and seriously deficient governance structures or processes.

If the above changes are incorporated, we suggest moving the section on “Other Matters,” (paragraphs 46 through 48) to follow “Uncorrected Misstatements” as a new subheading entitled “Other Significant Matters.”

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

Paragraph 29, second bullet – The auditor’s approach to internal control relevant to the audit should be expanded to include a discussion of whether the auditor plans to express an opinion on internal control as well as the internal control objectives addressed as part of the financial statement audit. In certain jurisdictions, particularly for certain governmental entities, it is required or is customary for the auditor to provide an opinion on internal control effectiveness in conjunction with an audit of the financial statements.

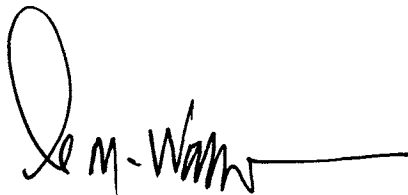
Paragraph 29, third bullet – Using the term “application” of materiality could be misinterpreted, thus resulting in discussions that focus around threshold amounts used for materiality that could compromise the effectiveness of the audit. Although paragraph 28 warns against compromising the effectiveness of the audit through communicating the nature and timing of detailed procedures, changing the phrase “application of materiality” to “concept of materiality” in the third bullet of paragraph 29 would be beneficial. We also recommend that the following sentence be added to the third bullet: “The communication should focus on the factors considered rather than on specific thresholds or amounts.”

### Group Audits

Paragraph 16 – We agree that there may be circumstances when the auditor of a component of a group should communicate with those charged with governance of the group in addition to those charged with governance of the component. We suggest that in those situations, the auditor should first communicate with the group auditor. The group auditor might have information that would influence the communication. The protocols for such communication are typically addressed in the arrangements between auditors on an engagement.

We thank you for considering our comments on this very important issue. We look forward to working with the IAASB and the U.S. auditing standards setting organizations on future issues of mutual interest to strengthen auditing standards globally, both in the public and private sectors.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D M Walker", with a long horizontal line extending to the right.

David M. Walker  
Comptroller General  
of the United States

cc:

Mr. Kjell Larsson  
Auditor General of Sweden and  
Chair of the INTOSAI Financial Audit Working Group

The Honorable Cynthia A. Glassman, Acting Chairman  
U.S. Securities and Exchange Commission

The Honorable William J. McDonough, Chairman  
U.S. Public Company Accounting Oversight Board

Mr. John Fogarty, Chair  
Auditing Standards Board, AICPA