

Auditing and Assurance Standard (AAS) 27*

Communications of Audit Matters with Those Charged with Governance

The following is the text of the Auditing and Assurance Standard (AAS) 27, "Communications of Audit Matters with Those Charged with Governance" issued by the Council of the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the "Preface to the Statements on Standard Auditing Practices" issued by the Institute¹.

INTRODUCTION

1. The purpose of this Auditing and Assurance Standard (AAS) is to establish standards on communications of audit matters arising from the audit of financial statements between the auditor and those charged with governance of an entity. These communications relate to audit matters of governance interest as defined in this AAS. This AAS does not provide guidance on communications by the auditor to parties outside the entity, for example, external regulatory or supervisory agencies.
2. **The auditor should communicate audit matters of governance interest arising from the audit of financial statement with those charged with governance of an entity.**
3. For the purpose of this AAS, the term "governance" is used to describe the role of persons entrusted with

the supervision, control and direction of an entity. Those charged with governance are, ordinarily, accountable for ensuring that the entity achieves its objectives, financial reporting, and reporting to interested parties. Those charged with governance include management only when it performs such functions.

4. For the purpose of this AAS, "audit matters of governance interest" are those matters that arise from the audit of financial statements and are, in the opinion of the auditor, both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Audit matters of governance interest include only those matters that have come to the attention of the auditor as a result of the performance of the audit. The auditor is not required, in an audit in accordance with auditing standards generally accepted in India², to

*Issued in January 2003.

¹With the formation of the Auditing Practices Committee {now known as the Auditing and Assurance Standards Board} in 1982, the Council of the Institute has been issuing a series of Statements on Standard Auditing Practices (SAPs). SAPs have recently been renamed as Auditing and Assurance Standards (AASs). Auditing and Assurance Standards (hitherto known as SAPs) lay down the principles governing an audit. These principles apply whenever an independent audit is carried out. Auditing and Assurance Standards become mandatory on the dates specified in the respective AAS. Their mandatory status implies that, while discharging their attest function, it will be the duty of the members of the Institute to ensure that the AASs are followed in the audit of financial information covered by their audit reports. If, for any reason, a member has not been able to perform an audit in accordance with the AASs, his report should draw attention to the material departures therefrom. The Auditing and Assurance Standards have the same authority as that is attached to the Statements on Standard Auditing Practices.

²Paragraph 15 of AAS 28, "The Auditor's Report on Financial Statements" describes auditing standards generally accepted in India.

design procedures for the specific purpose of identifying matters of governance interest.

RELEVANT PERSONS

5. **The auditor should determine the relevant persons who are charged with governance and with whom audit matters of governance interest are to be communicated.**
6. The structure of governance may vary from entity to entity, depending upon size and legal constitution. For example, in case of companies, the Board of Directors and the committees constituted under the Board like the audit committee, ethics committee; in case of trusts, societies etc., the board of trustees or the management committee; etc.
7. The auditor uses judgement to determine those persons with whom audit matters of governance interest are communicated, taking into account, the governance structure of the entity, the circumstances of the engagement and relevant legislation, if any. The auditor also considers the legal responsibilities of those persons. The auditor also considers the importance and sensitivity of the audit matters of governance interest to be communicated. For example, in case of a company where the board of directors has established an audit committee under it, the auditor may decide to communicate with the audit committee, or with the whole board, depending on the importance of the audit matters of governance interest.
8. When the entity's governance structure is not well defined, or those charged with governance are not clearly identified by the circumstances of the engagement, or by legislation, the auditor comes to an agreement with the entity about with whom the audit matters of governance interest are to be communicated. Examples include some owner-managed entities, not for profit organisations, government agencies, etc.
9. To avoid misunderstandings, an audit engagement letter³ may explain that the auditor will communicate only those matters of governance interest that come to attention as a result of the performance of an audit and that the auditor is not required to design procedures for the specific purpose of identifying matters of governance interest. The engagement let-

ter may also:

- Describe the form in which any communication on audit matters of governance interest will be made;
- Identify the relevant persons with whom such communications will be made;
- Identify any specific audit matters of governance interest which it has been agreed are to be communicated.
- 10. The effectiveness of communications is enhanced by developing a constructive working relationship between the auditor and those charged with governance. This relationship is developed while maintaining an attitude of professional independence and objectivity.

AUDIT MATTERS OF GOVERNANCE INTEREST TO BE COMMUNICATED

11. **The auditor should consider audit matters of governance interest that arise from the audit of financial statements and communicate them with those charged with governance.** Such matters may include:
 - The general approach and overall scope of the audit, including any expected limitations thereon, or any additional requirements;
 - The selection of or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements;
 - The potential effect on the financial statements of any significant risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements;
 - Adjustments to financial statements arising out of audit that have, or could have, a significant effect on the entity's financial statements;
 - Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern;
 - Disagreements with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report. These communications include

³Refer Auditing and Assurance Standard (AAS) 26, "Terms of Audit Engagement" issued by the Council of the Institute of Chartered Accountants of India.

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- consideration of whether the matter has, or has not, been resolved and the significance of the matter;
- Expected modifications to the auditor's report;
 - Other matters warranting attention by those charged with governance, such as material weaknesses in internal control, questions regarding management integrity, and fraud involving management;
 - Any other matters agreed upon in the terms of the audit engagement.
12. As part of the auditor's communications, those charged with governance are informed that:
- The auditor's communications of matters include only those audit matters of governance interest that have come to the attention of the auditor as a result of the performance of the audit;
 - An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.
13. **The auditor should communicate audit matters of governance interest on a timely basis.** This enables those charged with governance to take appropriate action.
14. In order to achieve timely communications, the auditor discusses with those charged with governance the basis and timing of such communications. In certain cases, because of the nature of the matter, the auditor may communicate that matter sooner than previously agreed.
- The arrangements made with respect to periodic meetings or reporting of audit matters of governance interest;
- The amount of on-going contact and dialogue the auditor has with those charged with governance.
16. **When audit matters of governance interest are communicated orally, the auditor should document in the working papers the matters communicated and any responses to those matters.** This document may take the form of minutes of the auditor's discussion with those charged with governance. In certain circumstances, depending on the nature, sensitivity, and significance of the matter, it may be advisable for the auditor to confirm in writing with those charged with governance any oral communication on audit matters of governance interest.
17. Ordinarily, the auditor initially discusses audit matters of governance interest with management, except those matters relating to questions related to management's competence or integrity. In case of matters relating to questions related to management's competence or integrity, the auditor discusses the audit matters with those charged with governance. These initial discussions with management are important in order to clarify facts and issues, and to give management an opportunity to provide further information. If management agrees to communicate a matter of governance interest with those charged with governance, the auditor may not need to repeat the communications, provided that the auditor is satisfied that such communications have effectively and appropriately been made.

FORMS OF COMMUNICATION

15. **The auditor's communication with those charged with governance may be made orally or in writing.** The auditor's decision whether to communicate orally or in writing is affected by factors such as:
- The size, operating structure, legal structure, and communications processes of the entity being audited;
 - The nature, sensitivity and significance of the audit matters of governance interest to be com-

OTHER MATTERS

18. **If the auditor considers that having regard to the facts and circumstances of the case a modification⁴ of the auditor's report on financial statements is required, as described in AAS 28, "The Auditor's Report in Financial Statements communications between the auditor and those charged with governance cannot be regarded as a substitute.**
19. The auditor considers whether audit matters of governance interest previously communicated may have an

⁴ Paragraph 31 of AAS 28, "The Auditor's Report on Financial Statements" deals with the concept of "modified audit report".

effect on the current year's financial statements. The auditor considers whether the point continues to be a matter of governance interest and whether to communicate the matter again with those charged with governance.

CONFIDENTIALITY

20. The requirements of professional pronouncements, legislation or regulation may impose obligations of confidentiality that restrict the auditor's communications of audit matters of governance interest. The auditor refers to such requirements before communicating with those charged with governance. In some circumstances, the potential conflicts with the auditor's ethical and legal obligations of confidentiality and reporting may be complex. In these cases, the auditor may wish to consult a legal counsel.

LAWS AND REGULATIONS

21. The requirements of professional pronouncements, legislation or regulation may impose obligation on the auditor to make communications on governance related matters. These additional communication requirements are not covered by this AAS; however, they may affect the content, form and timing of com-

Limited Revision to Accounting Standard (AS) 13, Accounting for Investments

The Council of the Institute of Chartered Accountants of India has decided to make the following limited revision to Accounting Standard (AS) 13, Accounting for Investments:

Paragraph 2 of AS 13 is decided to be revised as under. The limited revision is shown as underlined.
"2.This Statement does not deal with:

- (a) the bases for recognition of interest, dividends and rentals earned on investments which are covered by Accounting Standard 9 on Revenue Recognition;
- (b) operating or finance leases;
- (c) investments of retirement benefit plans and life insurance enterprises; and
- (d) mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 1956."

The above revision comes into effect in respect of accounting periods commencing on or after 1-4-2002.

munications with those charged with governance.

22. The requirements of regulators, such as report under Section 619 (3) of the Companies Act, 1956, in case of Public Sector Undertakings and Long Form Audit Report in the case of Public Sector Banks, may impose obligation on the auditor to make communications on governance related matters. These additional communications requirements are not covered by this Standard; however they may affect the content, form and timing of communications with those charged with governance.

EFFECTIVE DATE

23. This Auditing and Assurance Standard is effective for all audits relating to accounting periods beginning on or after 1st April, 2003.

COMPATIBILITY WITH INTERNATIONAL STANDARD ON AUDITING (ISA) 260

The auditing standards established in this AAS are generally consistent in all material respects with those set out in ISA 260 "Communications of Audit Matters with Those Charged with Governance".

IMPORTANT ANNOUNCEMENT

Members are informed that the Notification inviting applications from Chartered Accountant firms for Empanelment/updating the particulars for allotment of audit of **Public Sector Undertakings** for the year 2003-2004 along with the application form and annexures will be published in the March 2003 issue of the Journal 'The Chartered Accountant'. However, the same is right now available on the website of the Institute www.icai.org and also on the website of the C&AG www.cag.nic.in