

**STATEMENT OF AUDITING STANDARDS**  
**610**  
**COMMUNICATIONS OF AUDIT MATTERS WITH**  
**THOSE CHARGED WITH GOVERNANCE**

*(Effective for audits of financial statements for periods beginning before 15 December 2004)\**

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\* HKSA 260 “Communication of Audit Matters with Those Charged with Governance” is effective for audits of financial statements for periods beginning on or after 15 December 2004.

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*Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

### **Introduction**

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance on communication of audit matters arising from the audit of financial statements between the auditors and those charged with governance of an entity. These communications relate to audit matters of governance interest as defined in this SAS. This SAS does not provide guidance on communications by the auditors to parties outside the entity, for example, external regulatory or supervisory agencies.
2. ***The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with governance of an entity. (SAS 610.1)***
3. For the purposes of this SAS, "governance" is the term used to describe the role of persons entrusted with the supervision, control and direction of an entity.<sup>1</sup> Those charged with governance ordinarily are 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 SAS, "audit matters of governance interest" are those that arise from the audit of financial statements and, in the opinion of the auditors, are 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 auditors as a result of the performance of the audit. The auditors are not required, in an audit in accordance with SASs, to design procedures for the specific purpose of identifying matters of governance interest.

### **Relevant persons**

5. ***The auditors should determine the relevant persons who are charged with governance and with whom audit matters of governance interest are communicated. (SAS 610.2)***
6. The structures of governance vary from country to country reflecting cultural and legal backgrounds. For example, in some countries, the supervision function, and the management function are legally separated into different bodies, such as a supervisory (wholly or mainly non-executive) board and a management (executive) board. In other countries, both functions are the legal responsibility of a single, unitary board, although there may be an audit committee that assists that board in its governance responsibilities with respect to financial reporting.

<sup>1</sup> Principles of corporate governance have been developed by many countries as a point of reference for the establishment of good corporate behavior. Such principles generally focus on publicly traded companies; however, they may also serve to improve governance in other forms of entities. There is no single model of good corporate governance. Board structures and practices vary from country to country. A common principle is that the entity should have in place a governance structure which enables the board to exercise objective judgment on corporate affairs, including financial reporting, independent in particular from management.

7. This diversity makes it difficult to establish a universal identification of the persons who are charged with governance and with whom the auditors communicate audit matters of governance interest. The auditors use judgment 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 any relevant legislation. The auditors also consider the legal responsibilities of those persons. For example, in entities with supervisory boards or with audit committees, the relevant persons may be those bodies. However, in entities where a unitary board has established an audit committee, the auditors 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 auditors come to an agreement with the entity about with whom audit matters of governance interest are to be communicated. Examples include some owner-managed entities, some not for profit organizations, and some government agencies.
9. To avoid misunderstandings, an audit engagement letter may explain that the auditors will communicate only those matters of governance interest that come to attention as a result of the performance of an audit and that the auditors are not required to design procedures for the specific purpose of identifying matters of governance interest. The engagement letter may also:
  - Describe the form in which any communications 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 auditors 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 auditors should consider audit matters of governance interest that arise from the audit of the financial statements and communicate them with those charged with governance. (SAS 610.3)*
12. Ordinarily such matters 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;
  - Audit adjustments, whether or not recorded by the entity 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 auditors' report. These communications include consideration of whether the matter has, or has not, been resolved and the significance of the matter;
  - Expected modifications to the auditors' 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.

13. As part of the auditors' communications, those charged with governance are informed that:
- the auditors' communications of matters include only those audit matters of governance interest that have come to the attention of the auditors 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.

### **Timing of communications**

14. *The auditors should communicate audit matters of governance interest on a timely basis. (SAS 610.4)*
15. Such timely communication enables those charged with governance to take appropriate action.
16. In order to achieve timely communications, the auditors discuss with those charged with governance the basis and timing of such communications. In certain cases, because of the nature of the matter, the auditors may communicate that matter sooner than previously agreed.

### **Forms of communications**

17. The auditors' communications with those charged with governance may be made orally or in writing. The auditors' 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 communicated;
  - 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 auditors have with those charged with governance.
18. When audit matters of governance interest are communicated orally, the auditors document in the working papers the matters communicated and any responses to those matters. This documentation may take the form of a copy of the minutes of the auditors' 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 auditors to confirm in writing with those charged with governance any oral communications on audit matters of governance interest.
19. Ordinarily, the auditors initially discuss audit matters of governance interest with management, except where those matters relate to questions of management competence or integrity. 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 auditors may not need to repeat the communications, provided that the auditors are satisfied that such communications have effectively and appropriately been made.

### **Other matters**

20. If the auditors consider that a modification of the auditors' report on the financial statements is required, as described in SAS 600 "Auditors' reports on financial statements", communications between the auditors and those charged with governance cannot be regarded as a substitute.
21. The auditors consider whether audit matters of governance interest previously communicated may have an effect on the current year's financial statements. The auditors consider whether the point continues to be a matter of governance interest and whether to communicate the matter again with those charged with governance.

### **Laws and regulations**

22. The requirements of legislation or regulation may impose obligations on the auditors to make communications on governance related matters. These additional communications requirements are not covered by this SAS; however, they may affect the content, form and timing of communications with those charged with governance.

### **Compliance with International Standards on Auditing**

23. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 260 "Communications of Audit Matters With Those Charged With Governance".

### **Effective date**

24. This SAS is effective for audits of financial statements for periods beginning before 15 December 2004.