Importance of communication with management during audit of financial statement

Introduction

Communication is a tool to share various ideas and opinion between two person and group of person. For an organization effective communication is an essential tool in achieving productivity and maintaining strong working relationships across the organization. During the audit, for proper coordination of work between the management and the auditors it is important that both auditor and management communicates with each other at various stages of audit. Effective communication helps the audit process go smoothly.

Recognizing the importance of effective two-way communication in an audit of financial statements, ICAI has prescribed SA 260 – Communication with Those Charged with Governance & SA 701 – Communicating Key Audit Matters in Independent Auditor’s Report. The standard provides an overarching framework for the auditor’s communication with those charges with governance, and identifies some specific matters to be communicated with them.

Importance of communication between auditor and management

a. Developing relationship with management: Communication helps in understanding the matters relating to audit. It helps in developing a constructive working relationship. This relationship should be developed while maintaining the auditor’s independence and objectivity.
b. **Obtaining relevant information:** The management may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing specific transactions or events.

c. **Fulfilling the responsibility:** Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

Certain laws and regulations may restrict the auditor's communication of certain matters that might prejudice an investigation by authority into an actual, or suspected, illegal act. In some specific cases potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such circumstances, the auditor should take legal advice before communication.

**What matters are required to be communicated?**

1. Auditor's responsibility in Audit of Financial Statement
2. Planning of scope and timing of the Audit
3. Key audit matters
4. View about significant qualitative aspects
5. Significant difficulties (if any) encountered during the audit
6. Circumstances that affect the form and content of the auditor's report (if any).

While communicating with management, the auditor is required to communicate significant risks of the entity and why they require special audit consideration. The significant risks may assist those charged with governance/management in fulfilling their responsibility to oversee the financial reporting process. While communicating the significant risk, the auditor is also required to specify how he plans to address the areas of higher assessed risks of material misstatement. Further, if during the audit, the auditor needs any specialize skill or knowledge which is needed to perform the planned audit procedures or evaluate the audit results through an expert, the same is needed to be communicated.

**Determining and communicating key audit matters**
Key audit matters are those matters, which in the auditor’s professional judgement were most significant in the audit of financial statements of current period. The key audit matters are to be determined by the risk assessment procedure which helps in identification of significant risk, or significant events or transactions or high estimation of uncertainty in management’s judgement. The pre requisite of significant audit attention is that an audit is risk based and focuses on identifying and assessing the risks of material misstatement of financial statements, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is required to form audit opinion.

The key audit matters are required to be communicated using an appropriate sub heading in a separate section of the auditor’s report under the heading “Key audit matters”.

The key audit matters are required to be communicated unless and until laws and regulations precludes public disclosure about the matters or if the auditor determines that the matter should not be communicated in the auditor’s report because of adverse consequences of doing so would reasonably be expected to outweigh the public interest benefit of such communication. However, this shall not be applicable if the company has itself decided to publicly disclose the information about the matter.

Documentation

Generally communication with management is done orally during the course of audit. Since the auditor is required to maintain the audit evidences, the oral communication is needed to be documented. The documentation may include copy of minutes prepared or formal letter issued to the management during planning, execution or conclusion of audit.

References:

- SA 260 – (Revised) Communication with Those Charged with Governance
- SA 701 – Communicating key audit matters in the Independent Auditor’s report

Recommended Read

- Credit Note accounted in the Audited annual financial statement but not in GST
- Analysis & suggested answers of May 19 CA Final Audit (New Syllabus)