



International Federation of Accountants

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Agenda Item

D.5

Committee: IAASB Consultative Advisory Group

Meeting Location: Toronto

Meeting Date: September 4-5, 2008

IAASB Clarity Project— Issues on Exposure of Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements”

Objective of Agenda Item

1. The objective of this Agenda Item is to obtain the views of Representatives on the proposed resolution of key issues arising from respondents’ comments on the exposure draft of proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements” (ED-ISA 210) to be considered by the IAASB for approval at its September 2008 meeting.
2. Forty-three comment letters were received. On balance, respondents were in agreement with the application of the clarity conventions with many expressing the view that it was an improvement over extant ISA 210.

Matters for CAG Consideration

OBJECTIVE

3. ED-ISA 210 contained the following Objective:

The objective of the auditor is to accept an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- (a) Establishing whether necessary preconditions for an audit are present; and
 - (b) Confirming that there is a common understanding between the auditor and the entity of the terms of the audit engagement and of the respective responsibilities of the auditor, management and those charged with governance.
4. While there was general acceptance of the Objective, a number of respondents noted their concern regarding the following matters.
 5. Several respondents drew attention to the fact that the Scope of this ISA and Objective paragraphs referred to “entity;” some paragraphs referred to “management and, where appropriate, those charged with governance;” and other paragraphs referred to “management or those charged with governance.” Further, some thought that there was confusion between the responsibilities of management and those charged with governance, which were considered to be inconsistently used.

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6. There were some specific suggestions to improve the Objective. For example, a few respondents noted that the word “necessary” in the phrase “necessary preconditions” was superfluous and should be removed. On another matter, two respondents suggested that the terms of the audit engagement should not only refer to “acceptance;” it should also refer to “continuance.”
7. In response to these concerns, the Task Force redrafted the Objective as follows:

The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

 - (a) Establishing whether the preconditions for an audit are present; and
 - (b) Confirming that there is a common understanding between the auditor and management, and where appropriate, those charged with governance of the terms of the audit engagement.
8. In addition, the Task Force has amended proposed ISA 210 (Redrafted) to clarify and simplify the focus on the respective responsibilities of management and, where appropriate those charged with governance, and the auditor. Given the differing responsibilities in different jurisdictions with different governance structures, it provides for the auditor to exercise some judgment as to who appropriately takes certain responsibilities. *(See paragraph 6 of Agenda Item 8-A of the September 15-19, 2008 IAASB meeting.)*

REQUIREMENTS

9. The majority of respondents were of the view that the criteria identified by the IAASB for determining whether a requirement should be specified have been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and reporting, and the use of professional judgment by auditors. Most of the significant comments focused on specific proposals in the Requirements section of the proposed ISA. There were relatively fewer significant comments on the proposed guidance in the Application and Other Explanatory Material.

SIGNIFICANT COMMENTS THAT DO NOT RELATE TO THE APPLICATION OF THE CLARITY CONVENTIONS

Linkage with Proposed ISA 220 (Redrafted)

10. Some respondents raised the issue of giving greater prominence to client acceptance and continuance responsibilities in proposed ISA 220 (Redrafted).¹ The relationship between ED-ISA 210 and proposed ISA 220 (Redrafted) was thought not to be clear, and in particular a respondent questioned why all acceptance matters were not dealt with in ISA 220 (Redrafted), leaving ISA 210 (Redrafted) to deal with the engagement letter only.

¹ Proposed ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements.”

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11. The Task Force considers that the proposed division between proposed ISA 210 (Redrafted) and proposed ISA 220 (Redrafted) is appropriate, but accepts that ED-ISA 210 could have explained it better. In the light of the comments received, proposed ISA 210 (Redrafted) now includes a sentence in paragraph 1 that notes “ISA 220 (Redrafted) deals with those aspects of engagement acceptance that are within the control of the auditor.” In addition, paragraph A1 of proposed ISA 210 (Redrafted) has been expanded to make reference to the fact that:

Assurance engagements may only be accepted when the practitioner considers that relevant ethical requirements such as independence and professional competence will be satisfied, and when the engagement exhibits certain characteristics.² The auditor’s responsibilities in respect of ethical requirements in the context of the acceptance of an audit engagement and in so far as they are within the control of the auditor are dealt with in [proposed] ISA 220 (Redrafted). This ISA deals with those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity’s management to agree.

Relationship between the Preconditions for an Audit and the Premise

12. Most respondents agreed with the approach for structuring proposed ISA 210 (Redrafted) around establishing whether the preconditions for the audit are present before dealing with the requirements for agreeing the audit engagement terms.
13. However, some respondents considered there was a need to clarify the relationship between the preconditions and the premise that management is responsible for the preparation of the financial statements.
14. To address this issue, the Task Force has included a paragraph in the Definitions section that explains the preconditions and their relationship with the premise on which an audit is conducted. Paragraph 4(b) of proposed ISA 210 (Redrafted) reads: “The ‘preconditions for an audit’ are the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management to the premise³ on which an audit is conducted.”

Reference to the Applicable Financial Reporting Framework

15. Some respondents raised the need to better integrate the references to compliance and fair presentation frameworks.
16. In the light of the comments, and the IAASB’s discussion of the issue at the June 16-20, 2008 IAASB meeting, the reference to “applicable financial reporting framework” has been extended to clarify that the applicable financial reporting framework also includes, where relevant, fair

² International Framework for Assurance Engagements, paragraph 17.

³ ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,” paragraph 13.

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presentation frameworks. Paragraph 5(b)(i) of proposed ISA 210 (Redrafted) reads: “Obtain the agreement of management that it acknowledges and understands its responsibility for the preparation of financial statements in accordance with the applicable financial reporting framework, *including where relevant their fair presentation ...*”

Management’s Responsibility for Internal Control

17. The matter that received the strongest comment on exposure concerned the articulation of management’s responsibilities, particularly for the “the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.” Several respondents concerned with this aspect of the ISA expressed the view that it is not appropriate in an ISA to set any corporate responsibilities on internal control, nor to standardize the way companies should designate responsibilities for the design, implementation or maintenance of their internal control – this should be left to parliaments and governments in the relevant jurisdictions, where specified externally, and to management and those charged with governance.
18. A related issued concerned whether it was appropriate to view the responsibilities of those charged with governance (where appropriate) as being “for the design, implementation and maintenance of internal control.”
19. The Task Force considers that it is essential to maintain the premise that it is management that is responsible for the preparation of the financial statements in accordance with the financial reporting framework (and that it acknowledges and understands this responsibility). The Task Force addressed the respondents’ concern by:
 - (a) Deleting the reference to internal control in the requirement to obtain the agreement of management that it acknowledges and understands its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework (paragraph 5(b)(i) of proposed ISA 210 (Redrafted));
 - (b) Inserting a new requirement to obtain agreement from management that it acknowledges and understands its responsibility for such internal control as it determines is necessary to enable its preparation of financial statements that are free from material misstatement, whether due to fraud or error, in support of its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework (paragraph 5(c) of proposed ISA 210 (Redrafted); and
 - (c) Supplementing the requirement referred to in (b) with guidance that explains the reason for the fundamental requirement for separation of responsibilities, acknowledges that exactly how management (or those charged with governance) share their responsibilities may differ, and indicates that management will be unable to prepare financial statements that are in accordance with the applicable financial reporting framework unless appropriate internal relevant to the preparation of the financial statements is in place (Paragraphs A11-A20 of proposed ISA 210 (Redrafted)).

(See paragraphs 14-22 of Agenda Item 8-A of the September 15-19, 2008 IAASB meeting.)

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Matters for Consideration by the IAASB CAG:

- Q1. Do Representatives have any views with regard to the comments relating to the proposed Objective?
- Q2. Do Representatives have any comments related to the description of management's responsibility for internal control?
- Q3. While the above are the issues that the Task Force believes may most usefully be discussed at the CAG meeting, the Representatives are welcome to express their views on any matter discussed in the IAASB Issue Paper for which consideration may be needed by the IAASB. **(Refer Agenda Item 8-A of the September 15-19, 2008 IAASB meeting.)** In this regard, are there any other comments that Representatives may wish to raise?

ISA 210 (Redrafted) Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item 8-A of the September 2008 IAASB Meeting – Summary of Significant Comments and Task Force's Recommendations on ED-ISA 210 <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4132>

Agenda Item 8-B of the September 2008 IAASB Meeting – Proposed ISA 210 (Redrafted) (Marked from Exposure Draft) <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4133>