INTERNATIONAL STANDARD ON AUDITING 210

TERMS OF AUDIT ENGAGEMENTS

(Effective for audits of financial statements for periods beginning on or after December 15, 2006. Appendix 2 contains conforming amendments to the Standard that become effective at a future date.)*

CONTENTS

International Standard on Auditing (ISA) 210, "Terms of Audit Engagements" should be read in the context of the "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services," which sets out the application and authority of ISAs.

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* ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement," ISA 330, "The Auditor's Procedures in Response to Assessed Risks" and ISA 500, "Audit Evidence" gave rise to conforming amendments to ISA 210. These conforming amendments are effective for audits of financial statements for periods beginning on or after December 15, 2004 and have been incorporated in the text of ISA 210.

ISRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" gave rise to a conforming amendment to ISA 210. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2006 and has been incorporated in the text of ISA 210.

ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to ISA 210. Implementation of these amendments has been deferred until such time as proposed ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" becomes effective. The amended ISA 210 is set out in Appendix 2 to this ISA.

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on:

   (a) Agreeing the terms of the engagement with the client; and

   (b) The auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.

2. **The auditor and the client should agree on the terms of the engagement.** The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.

3. This ISA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. The guidance is also applicable to related services. When other services such as tax, accounting, or management advisory services are to be provided, separate letters may be appropriate.

4. In some countries, the objective and scope of an audit and the auditor's obligations are established by law. Even in those situations the auditor may still find audit engagement letters informative for their clients.

Audit Engagement Letters

5. It is in the interest of both client and auditor that the auditor sends an engagement letter, preferably before the commencement of the engagement, to help in avoiding misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.

Principal Contents

6. The form and content of audit engagement letters may vary for each client, but they would generally include reference to:

   - The objective of the audit of financial statements;

   - Management's responsibility for the financial statements;

   - The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres;

   - The form of any reports or other communication of results of the engagement;

   - The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered;

- Unrestricted access to whatever records, documentation and other information requested in connection with the audit; and
- Management's responsibility for establishing and maintaining effective internal control.

7. The auditor may also wish to include the following in the letter:

- Arrangements regarding the planning and performance of the audit.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
- Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- Description of any other letters or reports the auditor expects to issue to the client.
- Basis on which fees are computed and any billing arrangements.

8. When relevant, the following points could also be made:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other client staff.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the client.
- An example of an audit engagement letter is set out in the Appendix.

Audits of Components

9. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the decision whether to send a separate engagement letter to the component include the following:

- Who appoints the auditor of the component.
- Whether a separate auditor's report is to be issued on the component.
- Legal requirements.
- The extent of any work performed by other auditors.

- Degree of ownership by parent.
- Degree of independence of the component's management.

Recurring Audits

10. **On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.**

11. The auditor may decide not to send a new engagement letter each period. However, the following factors may make it appropriate to send a new letter:
    - Any indication that the client misunderstands the objective and scope of the audit.
    - Any revised or special terms of the engagement.
    - A recent change of senior management or those charged with governance.
    - A significant change in ownership.
    - A significant change in nature or size of the client's business.
    - Legal or regulatory requirements.

Acceptance of a Change in Engagement

12. **An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.**

13. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.

14. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of service originally requested would ordinarily be considered a reasonable basis for requesting a change in the engagement. In contrast a change would not be considered reasonable if it appeared that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

15. Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with ISAs would consider, in addition to the above matters, any legal or contractual implications of the change.

16. If the auditor concludes, that there is reasonable justification to change the engagement and if the audit work performed complies with the ISAs applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusing the reader, the report would not include reference to:

    (a) The original engagement; or

    (b) Any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

17. **Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.**

18. **The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.** An example might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.

19. **If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as those charged with governance or shareholders, the circumstances necessitating the withdrawal.**

Public Sector Perspective

1. The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement or recognizing an engagement not indicated in the legislative mandate may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagements letters when undertaking an audit.

2. Paragraphs 12-19 of this ISA deal with the action a private sector auditor may take when there are attempts to change an audit engagement to one which provides a lower level of assurance. In the public sector specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the

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public if management (including the department head) attempts to limit the scope of the audit.

Appendix 1

Example of an Audit Engagement Letter

The following letter is for use as a guide in conjunction with the considerations outlined in this ISA and will need to be varied according to individual requirements and circumstances.

To the Board of Directors or the appropriate representative of senior management:

You have requested that we audit the balance sheet of .... as of ...., and the related statements of income and cash flows for the year then ending. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be made with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with International Standards on Auditing (or refer to relevant national standards or practices). Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In addition to our report on the financial statements, we expect to provide you with a separate letter concerning any material weaknesses in accounting and internal control systems which come to our notice.

We remind you that the responsibility for the preparation of financial statements including adequate disclosure is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the company. As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records, documentation and other information are requested in connection with our audit. Our fees, which will be billed as work progresses, are based on the time required by the individuals assigned to the engagement plus out-of-pocket expenses. Individual hourly rates vary according to the degree of responsibility involved and the experience and skill required.

This letter will be effective for future years unless it is terminated, amended or superseded.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our audit of the financial statements.

XYZ & Co.

Acknowledged on behalf of ABC Company by

(signed)
....
Name and Title
Date

Appendix 2

ISA 210 Amended as a Result of ISA 700—Effective Date to be Determined

ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" issued in December 2004 and effective for auditors' reports dated on or after December 31, 2006 gave rise to conforming amendments to ISA 210. Implementation of these amendments has been deferred until such time as ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" becomes effective.

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on:

   (a) Agreeing the terms of the engagement with the client; and

   (b) The auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.

2. **The auditor and the client should agree on the terms of the engagement.** The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.

3. This ISA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements.

4. In some countries, the objective and scope of an audit and the auditor's obligations are established by law. Even in those situations the auditor may still find audit engagement letters informative for their clients.

Audit Engagement Letters

5. It is in the interest of both client and auditor that the auditor sends an engagement letter, preferably before the commencement of the engagement, to help in avoiding misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.

Principal Contents

6. The form and content of audit engagement letters may vary for each client, but they would generally include reference to:

   - The objective of the audit of financial statements.

- Management's responsibility for the financial statements as described in ISA 200, "Objective and General Principles Governing an Audit of Financial Statements."
- The financial reporting framework adopted by management in preparing the financial statements, i.e., the applicable financial reporting framework.
- The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres.
- The form of any reports or other communication of results of the engagement.
- The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered.
- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.
- Management's responsibility for establishing and maintaining effective internal control.

7. The auditor may also wish to include in the letter:

- Arrangements regarding the planning and performance of the audit.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
- Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- Description of any other letters or reports the auditor expects to issue to the client.
- Basis on which fees are computed and any billing arrangements.

8. When relevant, the following points could also be made:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other client staff.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the client.

An example of an audit engagement letter is set out in the Appendix.

Audits of Components

9. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the decision whether to send a separate engagement letter to the component include the following:

- Who appoints the auditor of the component.
- Whether a separate auditor's report is to be issued on the component.
- Legal requirements.
- The extent of any work performed by other auditors.
- Degree of ownership by parent.
- Degree of independence of the component's management.

Agreement on the Applicable Financial Reporting Framework

10. **The terms of the engagement should identify the applicable financial reporting framework.**

11. As stated in ISA 200 the acceptability of the financial reporting framework adopted by management in preparing the financial statements will depend on the nature of the entity and on the objective of the financial statements. In some cases, the objective of the financial statements will be to meet the common information needs of a wide range of users; in others, to meet the needs of specific users.

12. ISA 200 describes the financial reporting frameworks that are presumed to be acceptable for general purpose financial statements. Legislative and regulatory requirements often identify the applicable financial reporting framework for general purpose financial statements. In most cases, the applicable financial reporting framework will be established by a standards setting organization that is authorized or recognized to promulgate standards in the jurisdiction in which the entity is registered or operates.

13. **The auditor should accept an engagement for an audit of financial statements only when the auditor concludes that the financial reporting framework adopted by management is acceptable or when it is required by law or regulation. When law or regulation requires use of a financial reporting framework for general purpose financial statements that the auditor considers to be unacceptable, the auditor should accept the engagement only if the deficiencies in the framework can be adequately explained to avoid misleading users.**

14. Without an acceptable financial reporting framework management does not have an appropriate basis for preparing the financial statements and the auditor does

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not have suitable criteria for evaluating the entity's financial statements. In these circumstances, unless use of the financial reporting framework is required by law or regulation, the auditor encourages management to address the deficiencies in the financial reporting framework or to adopt another financial reporting framework that is acceptable. When the financial reporting framework is required by law or regulation and management has no choice but to adopt this framework, the auditor accepts the engagement only if the deficiencies can be adequately explained to avoid misleading users, see ISA 701, "Modifications to the Independent Auditor's Report," paragraph 5 and, unless required by law or regulation to do so, does not express the opinion on the financial statements using the terms "give a true and fair view" or "are presented fairly, in all material respects," in accordance with the applicable financial reporting framework.

15. When the auditor accepts an engagement involving an applicable financial reporting framework that is not established by an organization that is authorized or recognized to promulgate standards for general purpose financial statements of certain types of entities, the auditor may encounter deficiencies in that framework that were not anticipated when the engagement was initially accepted and that indicate that the framework is not acceptable for general purpose financial statements. In these circumstances, the auditor discusses the deficiencies with management and the ways in which such deficiencies may be addressed. If the deficiencies result in financial statements that are misleading and there is agreement that management will adopt another financial reporting framework that is acceptable, the auditor refers to the change in the financial reporting framework in a new engagement letter. If management refuses to adopt another financial reporting framework, the auditor considers the impact of the deficiencies on the auditor's report, see ISA 701.

Recurring Audits

16. **On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.**

17. The auditor may decide not to send a new engagement letter each period. However, the following factors may make it appropriate to send a new letter:

- Any indication that the client misunderstands the objective and scope of the audit.
- Any revised or special terms of the engagement.
- A recent change of senior management or those charged with governance.
- A significant change in ownership.
- A significant change in nature or size of the client's business.

- Legal or regulatory requirements.
- A change in the financial reporting framework adopted by management in preparing the financial statements (as discussed in paragraph 15).

Acceptance of a Change in Engagement

18. **An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.**

19. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.

20. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of service originally requested would ordinarily be considered a reasonable basis for requesting a change in the engagement. In contrast a change would not be considered reasonable if it appeared that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

21. Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with the ISAs would consider, in addition to the above matters, any legal or contractual implications of the change.

22. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complies with the ISAs applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusing the reader, the report would not include reference to:

    (a) The original engagement; or

    (b) Any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

23. **Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.**

24. **The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.** An example might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit

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evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.

25. **If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as those charged with governance or shareholders, the circumstances necessitating the withdrawal.**

Effective Date

26. This ISA is effective for audits of financial statements for periods beginning on or after [date].

Public Sector Perspective

1. *The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement or recognizing an engagement not indicated in the legislative mandate may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagement letters when undertaking an audit.*

2. *Paragraphs 18-25 of this ISA deal with the action a private sector auditor may take when there are attempts to change an audit engagement to one which provides a lower level of assurance. In the public sector specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if management (including the department head) attempts to limit the scope of the audit.*

Appendix: Example of an Engagement Letter

The following is an example of an engagement letter for an audit of general purpose financial statements prepared in accordance with International Financial Reporting Standards. This letter is to be used as a guide in conjunction with the considerations outlined in this ISA and will need to be varied according to individual requirements and circumstances.

To the Board of Directors or the appropriate representative of senior management:

You have requested that we audit the financial statements of …………, which comprise the balance sheet as at ...., and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In making our risk assessments, we consider internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we expect to provide you with a separate letter concerning any material weaknesses in the design or implementation of internal control over financial reporting that come to our attention during the audit of the financial statements.[1]

We remind you that the responsibility for the preparation of financial statements that present fairly the financial position, financial performance and cash flows of the company in accordance with International Financial Reporting Standards is that of the management of the company. Our auditors' report will explain that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable financial reporting framework and this responsibility includes:

- Designing, implementing and maintaining internal control relevant to the preparation of financial statements that are free from misstatement, whether due to fraud or error;
- Selecting and applying appropriate accounting policies; and
- Making accounting estimates that are appropriate in the circumstances.

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1 In some jurisdictions, the auditor may have responsibilities to report separately on the entity's internal control. In such circumstances, the auditor reports on that responsibility as required in that jurisdiction. The reference in the auditor's report on the financial statements to the fact that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control may not be appropriate in such circumstances.

As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff and we trust that they will make available to us whatever records, documentation and other information are requested in connection with our audit.

[*Insert additional information here regarding fee arrangements and billings, as appropriate.]*

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our audit of the financial statements.

XYZ & Co.

Acknowledged on behalf of ABC Company by

(signed)
....
Name and Title
Date