

Conforming Amendments to Other ISAs as a Result of the Auditor Reporting Proposals

A. The Relationship between Key Audit Matters (KAM) and Emphasis of Matter (EOM) and Other Matter (OM) Paragraphs in the Auditor's Report

DT-701 undertook a review of all requirements and guidance in the ISAs that refer to EOM and OM paragraphs and considered whether amendment would be needed to these references in light of the proposed definition of KAM in proposed ISA 701, *Communicating Key Audit Matters in the Auditor's Report*. Proposed changes to other ISAs are shown in marked text in this paper. The text relating to those ISAs for which no change has determined to be necessary will not be reproduced in the Exposure Draft (ED), provided the IAASB agrees with the DTs' recommendations.

Glossary

Emphasis of Matter paragraph—A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Other Matter paragraph—A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

DT-701 Recommendation: No change needed, as definitions in proposed ISA 706, *Emphasis of Matter and Other Matter Paragraphs in the Independent Auditor's Report*, have not changed. The definition of key audit matters will appear in the Glossary when finalized.

ISA 210, *Agreeing the Terms of Audit Engagements*

Additional Considerations in Engagement Acceptance

Financial Reporting Frameworks Prescribed by Law or Regulation—Other Matters Affecting Acceptance

19. If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present:
- (a) Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and
 - (b) It is recognized in the terms of the audit engagement that:
 - (i) The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with ISA 706; and
 - (ii) Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects," or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such

phrases.

DT-701 Recommendation: It would be beneficial to keep this as a separate EOM paragraph to give it the appropriate amount of attention, and in light of the fact that it would be relatively rare. No changes considered necessary to the requirement.

ISA 230, Audit Documentation

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content and Extent of Audit Documentation (Ref: Para. 8)

Documentation of Significant Matters and Related Significant Professional Judgments (Ref: Para. 8(c))

A8. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- Matters that give rise to significant risks (as defined in ISA 315).¹
- Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.

DT-701 Recommendation: Reference to EOM paragraph remains appropriate as a matter to be documented. Further changes to ISA 230 to require documentation of KAM are discussed in Section B of this paper.

ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements

Audit Procedures When Non-Compliance is Identified or Suspected

Evaluating the Implications of Non-Compliance (Ref: Para. 21)

A18. In exceptional cases, the auditor may consider whether withdrawal from the engagement, where withdrawal is possible under applicable law or regulation, is necessary when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances, even when the non-compliance is not material to the financial statements. When deciding whether withdrawal from the engagement is necessary, the auditor may consider seeking legal advice. If withdrawal from the engagement is not possible, the auditor may consider alternative actions, including describing the non-compliance in an Other Matter paragraph in the auditor's report.

¹ ISA 315, paragraph 4(e)

DT-701 Recommendation: As this would be a matter that would be relevant to users' understanding of the auditor's responsibilities or the auditor's report, it would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention to highlight the fact that the auditor could not withdraw from the engagement. No change considered necessary to the application material.

ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Further Substantive Procedures to Respond to Significant Risks (Ref: Para. 15)

Recognition and Measurement Criteria

Recognition of the Accounting Estimates in the Financial Statements (Ref: Para. 17(a))

A114. With respect to accounting estimates that have not been recognized, the focus of the auditor's evaluation is on whether the recognition criteria of the applicable financial reporting framework have in fact been met. Even where an accounting estimate has not been recognized, and the auditor concludes that this treatment is appropriate, there may be a need for disclosure of the circumstances in the notes to the financial statements. The auditor may also determine that there is a need to draw the reader's attention to a significant uncertainty by ~~adding~~ including an Emphasis of Matter paragraph (see proposed ISA 706 (Revised)) ~~to~~ or, where applicable, communicating this as a key audit matter in the auditor's report in accordance with proposed ISA 701.² If the matter is determined to be a key audit matter, proposed ISA 706 (Revised) prohibits the auditor from including an Emphasis of Matter paragraph in the auditor's report.³ ~~ISA 706 establishes requirements and provides guidance concerning such paragraphs.~~

DT-701 Recommendation: In addition to retaining the reference to EOM (in particular for auditors of financial statements of entities for which KAM is not required), it would also be helpful to indicate that this may represent a KAM.

ISA 560, Subsequent Events

Facts Which Become Known to the Auditor after the Date of the Auditor's Report but before the Date the Financial Statements Are Issued

12. Where law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent event or events causing that amendment and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events required in paragraph 11(b)(i) to that amendment. In such cases, the auditor shall either:
- (a) Amend the auditor's report to include an additional date restricted to that amendment that thereby indicates that the auditor's procedures on subsequent events are restricted solely to

² Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

³ Proposed ISA 706 (Revised), paragraph 7(b)

- the amendment of the financial statements described in the relevant note to the financial statements; or
- (b) Provide a new or amended auditor’s report that includes a statement in an Emphasis of Matter paragraph or Other Matter paragraph that conveys that the auditor’s procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

16. The auditor shall include in the new or amended auditor’s report an Emphasis of Matter paragraph or Other Matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

DT-701 Recommendation: Because ISA 560 allows either an EOM or OM paragraph it would seem that flexibility continues to be necessary. The IAASB’s rationale for allowing for either an EOM or OM paragraph in the circumstances addressed by paragraph 12 of ISA 560 was because the requirement includes both a reference to the relevant note to the financial statements and context about the auditor’s procedures in relation to the subsequent events – so the auditor’s report was somewhat of a hybrid EOM/OM paragraph. DT-701 is generally of the view that such treatment would be sufficient for subsequent events, noting in particular that it may be confusing to introduce the concept of KAM in ISA 560 when such matters may be less likely to be KAM (i.e., because they may not be of most significance in the audit of the current period financial statements). However, nothing in proposed ISA 706 (Revised) or proposed ISA 701 would prohibit the auditor from including KAM for subsequent events in situations beyond those addressed by paragraphs 12 and 16 of ISA 560. No change is proposed to these requirements.

ISA 705, Modifications to the Opinion in the Independent Auditor’s Report

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement (Ref: Para. 13(b)–14)

- A14. In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor that is appointed to audit the financial statements of public sector entities. It may also be the case in jurisdictions where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor’s report.

DT-701 Recommendation: As this would be a matter that would be relevant to users’ understanding of the auditor’s responsibilities or the auditor’s report, it would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention to highlight the fact that the auditor could not withdraw from the engagement. No change considered necessary to the application material.

ISA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements

Auditor Reporting

Corresponding Figures

Prior Period Financial Statements Audited by a Predecessor Auditor

13. If the financial statements of the prior period were audited by a predecessor auditor and the auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:
- (a) That the financial statements of the prior period were audited by the predecessor auditor;
 - (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
 - (c) The date of that report.

DT-701 Recommendation: As this would be a matter that would be relevant to users' understanding of the auditor's responsibilities or the auditor's report, it would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention, and draw attention to the responsibilities of another auditor in the context of the financial statements. In addition, this would not be a KAM based on DT-701's recommendation that KAM be limited to matters relating to the current year audit / most recent financial period. No changes considered necessary to the requirement.

14. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

DT-701 Recommendation: As this would fall under the heading "Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report", it would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention, and draw attention to the responsibilities of another auditor in the context of the financial statements. However, the auditor may decide to provide additional context about the audit if obtaining sufficient appropriate evidence to support the opening balances was a significant issue. No changes considered necessary to the requirement. New application material could be included to support this requirement as follows:

A7a. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor is required by proposed ISA 705 (Revised)⁴ to express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with proposed ISA 705 (Revised). If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the

⁴ Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

current period's financial statements, the auditor may determine this to be a key audit matter in accordance with proposed ISA 701.⁵

Comparative Financial Statements

16. When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with proposed ISA 706 (Revised).

DT-701 Recommendation: As this would be a matter that would be relevant to users' understanding of the auditor's responsibilities or the auditor's report, it would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention. No changes considered necessary to the requirement.

Prior Period Financial Statements Audited by a Predecessor Auditor

17. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:
- (a) that the financial statements of the prior period were audited by a predecessor auditor;
 - (b) the type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
 - (c) the date of that report,
- unless the predecessor auditor's report on the prior period's financial statements is reissued with the financial statements.

DT-701 Recommendation: It would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention, and draw attention to the responsibilities of another auditor in the context of the financial statements. In addition, this would not be a KAM based on DT-701's recommendation that KAM be limited to matters relating to the current year audit / most recent financial period. No changes considered necessary to the requirement.

Prior Period Financial Statements Not Audited

19. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

DT-701 Recommendation: As this would fall under the heading "Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report", it would be beneficial to keep this as a separate OM paragraph to give it the appropriate amount of attention, and draw attention to the fact that the prior

⁵ Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

period financial statements are unaudited. However, the auditor may decide to provide additional context about the audit if obtaining sufficient appropriate evidence to support the opening balances was a significant issue. No changes considered necessary to the requirement. Additional application material to mirror new paragraph A7a proposed above may be useful as follows:

A12. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor is required by proposed ISA 705 (Revised)⁶ to express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with proposed ISA 705 (Revised). If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements, the auditor may determine this to be a key audit matter in accordance with proposed ISA 701.

ISA 800, Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

Forming an Opinion and Reporting Considerations

Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework

14. The auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading.

DT-701 Recommendation: It would be beneficial to keep this as a separate EOM paragraph to give it the appropriate amount of attention, and in light of the fact that it is merely intended to provide context to the fact that the auditor is reporting in accordance with a special purpose framework. In addition, KAM will not be required for special purpose frameworks. No changes proposed at this time, but the IAASB may further consider the matter as the broader implications of the changes to the ISA 700 series of standards are considered on the 800 series.

ISA 805, Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statements

Forming an Opinion and Reporting Considerations

Reporting on the Entity's Complete Set of Financial Statements and on a Single Financial Statement or on a Specific Element of Those Financial Statements

Modified Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Entity's Complete Set of Financial Statements

14. If the opinion in the auditor's report on an entity's complete set of financial statements is modified, or that report includes an Emphasis of Matter paragraph or an Other Matter paragraph, the auditor shall determine the effect that this may have on the auditor's report on a single financial statement

⁶ Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

or on a specific element of those financial statements. When deemed appropriate, the auditor shall modify the opinion on the single financial statement or on the specific element of a financial statement, or include an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report, accordingly. (Ref: Para. A17)

- A17. Even when the modified opinion on the entity's complete set of financial statements, Emphasis of Matter paragraph or Other Matter paragraph does not relate to the audited financial statement or the audited element, the auditor may still deem it appropriate to refer to the modification in an Other Matter paragraph in an auditor's report on the financial statement or on the element because the auditor judges it to be relevant to the users' understanding of the audited financial statement or the audited element or the related auditor's report (see proposed ISA 706 (Revised)).

DT-701 Recommendation: Reference to EOM and OM paragraphs continues to be appropriate, as KAM will not be required for special purpose frameworks. No changes proposed at this time, but the IAASB may further consider the matter as the broader implications of the changes to the ISA 700 series of standards are considered on the 800 series.

ISA 810, Engagements to Report on Summary Financial Statements

Auditor's Report on Summary Financial Statements

Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Audited Financial Statements (Ref: Para. A15)

17. When the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph, but the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:
- (a) State that the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph; and
 - (b) Describe:
 - (i) The basis for the qualified opinion on the audited financial statements, and that qualified opinion; or the Emphasis of Matter or the Other Matter paragraph in the auditor's report on the audited financial statements; and
 - (ii) The effect thereof on the summary financial statements, if any.

DT-701 Recommendation: Reference to EOM and OM paragraphs continues to be appropriate, as KAM will not be required for special purpose frameworks. No changes proposed at this time, but the IAASB may further consider the matter as the broader implications of the changes to the ISA 700 series of standards are considered on the 800 series.

B. Changes to Other ISAs Primarily as a Result of Proposed ISA 701

ISA 210, *Agreeing the Terms of Audit Engagements*

As a result of discussions about the possibility of auditors of other than listed entities deciding to communicate KAM in the auditor's report, or being requested by management or those charged with governance (TCWG) to do so, DT-701 is of the view that amendments to ISA 210 would be appropriate. DT-701 previously considered whether to require the auditor of an entity other than a listed entity to agree with management or TCWG that the auditor would include KAM in the auditor's report. However, some concern was expressed that TCWG may not agree and this would restrict the auditor from having the ability to communicate in the auditor's report about the audit. It was also noted that if the auditor of an other than listed entity did not anticipate including KAM at the time the terms of agreement were agreed, but later decided to do so, this could be seen as a change in the terms of agreement and may cause difficulties in practice. The following are the relevant requirements addressing the form and content of the auditor's report (for which no changes are proposed), and the application material that supports these requirements, for which limited amendments are being proposed.

In addition, DT-700 is of the view that conforming changes to the illustrative engagement letter in ISA 210 are necessary to align with the revised description of the auditor's responsibilities required by proposed ISA 700 (Revised), the additional reporting responsibilities in relation to going concern, other information and key audit matters.

Agreement on Audit Engagement Terms

9. The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. (Ref: Para. A21)
10. Subject to paragraph 11, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include: (Ref: Para. A22–A25)
 - (a) The objective and scope of the audit of the financial statements;
 - (b) The responsibilities of the auditor;
 - (c) The responsibilities of management;
 - (d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
 - (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Agreement on Audit Engagement Terms

Agreeing the Terms of the Audit Engagement (Ref: Para. 9)

- A21. The roles of management and those charged with governance in agreeing the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or

regulation.

*Audit Engagement Letter or Other Form of Written Agreement*⁷ (Ref: Para. 10–11)

A22. It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. In some countries, however, the objective and scope of an audit and the responsibilities of management and of the auditor may be sufficiently established by law, that is, they prescribe the matters described in paragraph 10. Although in these circumstances paragraph 11 permits the auditor to include in the engagement letter only reference to the fact that relevant law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 6(b), the auditor may nevertheless consider it appropriate to include the matters described in paragraph 10 in an engagement letter for the information of management.

Form and Content of the Audit Engagement Letter

A23. The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on ISA 200.⁸ Paragraphs 6(b) and 12 of this ISA deal with the description of the responsibilities of management. In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, ISAs, and ethical and other pronouncements of professional bodies to which the auditor adheres.
- _____ The form of any other communication of results of the audit engagement.
- The requirement for, or ability of, the auditor to communicate key audit matters in the auditor's report in accordance with proposed ISA 701.⁹
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team.
- The expectation that management will provide written representations (see also paragraph A13).
- The agreement of management to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.

⁷ In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

⁸ ISA 200, paragraphs 3–9

⁹ Proposed ISA 701, *Communicating Key Audit Matters in the Auditor's Report*

- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.

A23a. The form and content of the auditor's report, including the description of key audit matters, is the sole responsibility of the auditor. Referring to the expected form and content of the auditor's report in agreeing the terms of the audit engagement enables management and, where appropriate, those charged with governance to understand how the auditor may communicate about the audit, in particular in relation to key audit matters. Explaining that the auditor of financial statements of an entity other than a listed entity that is not otherwise required by law or regulation to communicate key audit matters has the ability to communicate key audit matters in the auditor's report may result in management or those charged with governance requesting the auditor to do so. It also allows for flexibility in circumstances when, in light of the auditor's findings, the auditor of financial statements of an entity other than a listed entity decides to communicate key audit matters after the terms of the engagement have been agreed.

A24. When relevant, the following points could also be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other staff of the entity.
- 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 entity.
- Any obligations to provide audit working papers to other parties.

An example of an audit engagement letter is set out in Appendix 1.

Appendix 1

Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with International Financial Reporting Standards. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this ISA. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 13 of this ISA). It may be appropriate to seek legal advice that any proposed letter is suitable.

To the appropriate representative of management or those charged with governance of ABC Company:¹⁰

[The objective and scope of the audit]

You¹¹ have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

~~Our audit will be conducted with~~ The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our expressing an opinion on the financial statements. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with ~~International Standards on Auditing (ISAs).~~ Those standards require that we comply with ethical requirements. As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism through the planning and performing of the audit, to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit also involves ~~We also:~~

- ~~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~~ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error—, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- ~~In making our risk assessments, we~~ Obtain an understanding of ~~consider~~ internal control relevant to the ~~entity's preparation of the financial statements~~ audit 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.¹² However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

¹⁰ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons – see paragraph A21.

¹¹ Throughout this letter, references to “you,” “we,” “us,” “management,” “those charged with governance” and “auditor” would be used or amended as appropriate in the circumstances.

¹² This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

- ~~An audit also includes evaluating~~ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management, ~~as well as~~
- ~~evaluating~~ Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.

[The responsibilities of management and identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 6(b) of this ISA are therefore used).]

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance]¹³ acknowledge and understand that they have responsibility:

- (a) For the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards;¹⁴
- (b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- (c) To provide us with:
 - (i) Access to all information of which [management] is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - (ii) Additional information that we may request from [management] for the purpose of the audit; and
 - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[Other relevant information]

[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]

¹³ Use terminology as appropriate in the circumstances.

¹⁴ Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards"

[Reporting]

[Insert appropriate reference to the expected form and content of the auditor’s report, including the auditor’s required reporting responsibilities in relation to going concern, other information and, if applicable, key audit matters.]

The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

.....

Name and Title

Date

ISA 230, Audit Documentation

DT-701 is of the view that enhancements to the application material in ISA 230 would be useful to support the documentation requirement in proposed ISA 701 to explain that the determination of key audit matters is a significant professional judgment required to be documents. The following is the relevant requirement addressing documentation (for which no changes are proposed), and the application material that supports this requirement, for which limited amendments are being proposed. In addition, a bullet will be added to the Appendix in ISA 230 to refer to the specific documentation requirement in paragraph 18 of proposed ISA 701.

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content and Extent of Audit Documentation

8. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2–A5, A16–A17)
 - (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements; (Ref: Para. A6–A7)
 - (b) The results of the audit procedures performed, and the audit evidence obtained; and
 - (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8–A11)

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content and Extent of Audit Documentation

Documentation of Significant Matters and Related Significant Professional Judgments (Ref: Para. 8(c))

A10. Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

- The rationale for the auditor's conclusion when a requirement provides that the auditor "shall consider" certain information or factors, and that consideration is significant in the context of the particular engagement.
- The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- _____ The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
- The basis for the auditor's determination of key audit matters, including, where applicable, the rationale for the auditor's conclusion that there are no key audit matters to communicate in the auditor's report.¹⁵

A11. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant matters identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant ISA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

¹⁵ Proposed ISA 701, paragraph 18