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**Basis for Conclusions:
ISA 210 (Redrafted), Agreeing
the Terms of Audit Engagements**

*Prepared by the Staff of the International Auditing and
Assurance Standards Board*



**International Federation
of Accountants**

**BASIS FOR CONCLUSIONS:
ISA 210 (REDRAFTED), AGREEING THE TERMS OF AUDIT ENGAGEMENTS**

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements,” which was approved by the IAASB in December 2008.¹

Background

1. In September 2006, the IAASB agreed the conventions to be used in drafting future International Standards on Auditing (ISAs). These conventions are commonly referred to as the IAASB’s Clarity conventions.²
2. The IAASB has undertaken to redraft all of its ISAs in accordance with the Clarity conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. Extant ISA 210³ is in the latter category. However, because of the relationship between the agreement on the respective responsibilities of the auditor and management, and the representations sought by the auditor from management about the fulfillment of those responsibilities (see ISA 580 (Revised and Redrafted)⁴), ISA 210 (Redrafted) became the standard through which certain matters arising from the revision of extant ISA 580 were settled.
3. In January 2008, the IAASB issued an exposure draft of proposed ISA 210 (Redrafted)⁵ (ED-ISA 210). The comment period for ED-ISA 210 closed on April 15, 2008. The IAASB received forty-three comment letters from a variety of respondents, including regulators and oversight authorities, IFAC member bodies, national auditing standard setters, audit firms, preparers and users of financial statements, and professional and public sector organizations. Input was also received from IFAC’s Small and Medium Practices Committee. The IAASB revised the proposed ISA as a result of the comments received. In addition, the IAASB discussed significant issues in the development of ED-ISA 210, and the finalization of ISA 210 (Redrafted), with its Consultative Advisory Group (CAG).

¹ See minutes of the December 8-11, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0166>.

² The IAASB’s Clarity conventions, and the authority and obligation attaching to them, are established in ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,” which was issued in October 2008 after the Public Interest Oversight Board confirmed that due process was followed in developing the ISA.

³ ISA 210, “Terms of Audit Engagements.”

⁴ ISA 580 (Revised and Redrafted), “Written Representations.”

⁵ Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements.”

4. This Basis for Conclusions explains the more significant issues raised by respondents on ED-ISA 210, and how the IAASB addressed them. In general, ED-ISA 210 received strong support from respondents in terms of how the extant ISA had been redrafted in accordance with the IAASB's Clarity conventions.

Scope of the ISA

5. Several respondents raised the issue of giving greater prominence to client acceptance and continuance responsibilities in ISA 220 (Redrafted).⁶ The relationship between ED-ISA 210 and ISA 220 (Redrafted) was thought not to be clear. In particular, one 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.
6. The IAASB concluded that the proposed division between ED-ISA 210 and ISA 220 (Redrafted) was appropriate, but accepted that this could have been better explained. ED-ISA 210, paragraph A1, included a reference to ISA 220 (Redrafted). In the light of comments received, ISA 210 (Redrafted) now includes a further sentence in the Scope of this ISA section, noting that ISA 220 (Redrafted) deals with those aspects of engagement acceptance that are within the control of the auditor (see paragraph 1 of the ISA). In addition, paragraph A1 of ISA 210 (Redrafted) contains the following explanation:

Assurance engagements, which include audit 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.⁷ 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 ISA 220 (Redrafted).⁸ 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.

Objectives

7. 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.

8. The majority of respondents to ED-ISA 210 supported the objective. Most agreed with the two parts of the objective; that is, one that focuses on establishing whether the necessary preconditions for an audit are present, and another that focuses on confirming that there is a common understanding between the auditor and the entity in terms of the audit engagement and of the respective responsibilities of the auditor, management and those charged with

⁶ ISA 220 (Redrafted), "Quality Control for an Audit of Financial Statements."

⁷ "International Framework for Assurance Engagements," paragraph 17.

⁸ ISA 220 (Redrafted), paragraphs 9-11.

governance. There were, however, specific suggestions for refinement. For example, some respondents suggested that the objective of the auditor should refer not only to “acceptance” of the audit engagement but also to “continuance.” Several respondents suggested that it was superfluous to refer to preconditions as being “necessary” as preconditions are by definition necessary. Another respondent was concerned that it was inappropriate to refer to the “entity” when the auditor attempts to confirm the terms of the audit engagement. The auditor is not attempting to confirm such an understanding with the entity – rather the auditor is attempting to confirm an understanding with “management and, where appropriate, those charged with governance.”

9. While the IAASB concluded that the objective appropriately represented the requirements of the ISA, it agreed that the abovementioned refinements would improve the ISA and as a consequence they were included in the objective, which now reads:

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.

Definitions

10. ED-ISA 210 did not include a Definitions section. The introduction of a Definitions section in the final version of ISA 210 (Redrafted) focused on two issues which addressed a number of respondents’ concerns.
11. The first issue was concerned with the relationship between the preconditions for an audit and the premise on which an audit is conducted. While most respondents agreed with the approach for structuring the ISA around establishing whether the preconditions for an audit are present before dealing with the requirements for agreeing the terms of the audit engagement, some respondents considered that there was a need to clarify the relationship between the preconditions for an audit and the premise on which an audit is conducted (that management is responsible for the preparation of the financial statements.)
12. To address this issue, the IAASB included the following paragraph in the Definitions section, which explains the preconditions including its relationship with the premise. Paragraph 4 reads: “Preconditions for an audit – The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise⁹ on which an audit is conducted.”
13. The second issue was concerned with the relationship between the entity, management and, where appropriate, those charged with governance. More specifically, several respondents drew attention to the fact that the scope and objective paragraphs referred to “entity;” some paragraphs referred to “management and, where appropriate, those charged with

⁹ ISA 200 (Revised and Redrafted), paragraph 13.

governance;” and other paragraphs referred to “management or those charged with governance.” Further, some respondents thought that there was confusion between the responsibilities of management and those charged with governance, which were considered to be inconsistently used.

14. The IAASB confirmed that the focus of the ISA was on the respective responsibilities of management and, where appropriate, those charged with governance, and the auditor. However, given the differing responsibilities in different jurisdictions and with different governance structures, it is necessary that the auditor exercise judgment as to who appropriately assumes certain responsibilities.
15. The IAASB agreed to clarify the focus of, and to simplify, the ISA by adopting an approach similar to that in ISA 580 (Revised and Redrafted), That is:
 - To refer to “management and, where appropriate, those charged with governance” in the scope and objective paragraphs; and
 - To use the Definitions section to explain that, for purposes of ISA 210 (Redrafted), subsequent references to “management” should be read as “management and, where appropriate, those charged with governance.”

In addition, paragraph A12 of ISA 210 (Redrafted) now explains how responsibilities may be divided between management and those charged with governance.

16. The IAASB considered whether the abovementioned approach should be adopted generally throughout the ISAs, based on a single specification in ISA 210 (Redrafted) that this would be the case. This was not accepted by the IAASB. It was pointed out that, in the case of ISA 265,¹⁰ for example, there is a significant distinction between management and those charged with governance. Furthermore, some CAG Representatives were concerned that a reference to management only may have the effect of directing the auditor towards management rather than those charged with governance in cases where this would be inappropriate.

Requirements

17. The majority of respondents to ED-ISA 210 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. Although some respondents commented on the appropriateness of some of the requirements, or suggested refinement, few individual requirements received a significant number of comments.

Management’s Responsibility for Internal Control

18. The issue which received the strongest comment on exposure concerned the articulation of management’s responsibilities, particularly for “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” (ED-

¹⁰ ISA 265, “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management.”

ISA 210, paragraph 4(b)(i)). Several respondents who were concerned with this aspect of ED-ISA 210 expressed the view that it was not appropriate for an ISA to set any corporate responsibilities for internal control or to standardize the way in which companies should designate responsibilities for the design, implementation or maintenance of internal control. They were of the view that this should be left to parliaments and governments in jurisdictions where such responsibilities are specified externally, and to management and those charged with governance where this is not the case.

19. Several respondents were also concerned about whether it is appropriate to view the responsibilities of those charged with governance (where appropriate) as being “for the design, implementation and maintenance of internal control.”
20. The IAASB, in line with previous decisions, was of the view that it is essential to maintain the premise that it is management (and not the auditor) that is responsible for the preparation of the financial statements in accordance with the applicable financial reporting framework. However, based on the comments, the IAASB agreed that the description of management’s responsibility for internal control should be amended to clarify that it is “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.” Further, the IAASB agreed that it should be made clear that the responsibility for internal control is to be understood in the context of the inherent limitations of internal control.
21. Some IAASB members, however, were concerned that the words “as management determines is necessary,” may enable management to say that it does not consider internal control to be necessary; while some CAG Representatives were concerned that the application material may be read as implying that whatever management determines is necessary will be acceptable to the auditor. Some IAASB members suggested that ISA 210 (Redrafted) clarify that, irrespective of whether an audit is performed, management has to maintain internal control to enable it to prepare the financial statements. In addition, some IAASB members were concerned about the interaction between the requirement for the auditor to agree with management its responsibility for internal control and the requirement for the auditor to communicate deficiencies in internal control in accordance with ISA 265. Having discussed these possible reservations, the IAASB nevertheless considered that the proposal in the abovementioned paragraph was appropriate.
22. Some respondents were concerned that it was still not clear that ISA 580 (Revised and Redrafted) did not require the auditor to obtain a representation from management about the fulfillment of the responsibility for internal control. This concern arose from the fact that management’s responsibility for the preparation of the financial statements was expressed as including responsibility for related internal control in the premise on which an audit is conducted.¹¹ The IAASB considered whether – in order to put the matter beyond doubt – the reference to internal control should be removed from the premise and inserted as a separate matter to be included in the terms of the audit engagement. After extensive deliberation, the IAASB concluded that it is undesirable to split the responsibility for the preparation of the financial statements from the responsibility for internal control in this

¹¹ See paragraph 13(j)(i) of ISA 200 (Revised and Redrafted).

way, as the first cannot be fulfilled without fulfilling the second. As a result, the IAASB agreed that the reference to management's responsibility for internal control should remain in the premise, but as a separate term.

23. Consequential on this change, one IAASB member observed that the objectives of ISA 580 (Revised and Redrafted) include obtaining written representations from management that it believes that it has fulfilled the fundamental responsibilities that constitute the premise on which an audit is conducted, while the related required written representations are limited to fulfillment of its responsibility for the preparation of the financial statements and the responsibility for providing the auditor with all relevant information. If the reference to management's responsibility for internal control was to form part of the premise, the objectives of ISA 580 (Revised and Redrafted) would need to be amended to refer to the relevant responsibilities rather than the premise. The IAASB agreed that this consequential amendment is logical and appropriate.
24. As a final point, in response to continuing concern that the ISAs could be read as creating some legal or regulatory responsibility that did not otherwise exist (in the event that the ISAs were to be incorporated into law or regulation), the IAASB agreed that the premise be amended to read not that management and those charged with governance "have" such responsibilities, but that they have "acknowledged and understand" that they have them.
25. In summary, in response to the above issues the IAASB agreed that:
 - The premise on which an audit is conducted should include the fact that management and, where appropriate, those charged with governance have acknowledged and understand that they have responsibility for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
 - The objectives of ISA 580 (Revised and Redrafted) should be amended to refer to the specific relevant responsibilities as opposed to the premise on which an audit is conducted;
 - The application material should indicate that internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives due to the inherent limitations of internal control (see paragraph A16 of ISA 210 (Redrafted), and that an audit conducted in accordance with the ISAs does not act as a substitute for the maintenance of internal control necessary for the preparation of financial statements by management (see paragraph A17 of ISA 210 (Redrafted)); and
 - The definition of and related guidance on internal control in paragraph A14 of ED-ISA 210 should be deleted. It duplicates material in ISA 315 (Redrafted)¹² and is therefore unnecessary.

¹² ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

The above gave rise to conforming amendments to ISA 200 (Revised and Redrafted) and ISA 580 (Revised and Redrafted).

Agreement on Audit Engagement Terms

26. Paragraph 9 of ED-ISA 210 required that the agreed terms of the engagement be recorded in an audit engagement letter or other suitable form of written agreement. That requirement was subject to paragraph 10 which permitted the auditor not to record certain of the terms of the audit engagement in a written agreement where law or regulation prescribes them in sufficient detail. The IAASB reconsidered whether the provision in paragraph 10 would, as proposed, assist in achieving the objective stated in the ISA to confirm 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. It concluded that, to minimizing the potential for any inadvertent misunderstanding when agreeing the terms of the engagement, paragraph 10 should be amended to require that reference be made in the written agreement to the fact that such law or regulation applies. See paragraph 11 of ISA 210 (Redrafted).

Additional Considerations in Engagement Acceptance

27. Several respondents were of the view that the interrelationship of the requirements in the ISA would be easier to follow if the requirements in the section on Additional Considerations in Engagement Acceptance (paragraphs 17-20 of ED-ISA 210) were reordered so that the requirements relating to auditors' reports prescribed by law or regulation followed, rather than preceded, the requirements relating to financial reporting standards supplemented by law or regulation and financial reporting frameworks prescribed by law or regulation.
28. The IAASB agreed that, by presenting the section in this manner, the reordered requirements are more closely aligned with the earlier structure of the document.