Explanatory Memorandum to the Exposure Draft

Revised Standard on Auditing (SA) 210
Agreeing the Terms of Audit Engagements

Background

The Institute of Chartered Accountants of India had in January, 2003 issued the Standard on Auditing (SA) 210[1], "Terms of Audit Engagements", effective for all audits relating to accounting periods beginning on or after April 1, 2003. The Institute is a member of the International Federation of Accountants (IFAC). Therefore, as a part of its membership obligations, while formulating any Standard on Auditing, it is required to harmonise with the corresponding International Standards on Auditing (ISAs), if any, issued by the International Auditing and Assurance Standards Board (IAASB) of the IFAC.

IAASB's Clarity Project

The IAASB had, in January 2008, issued the Exposure Draft of the Redrafted ISA 210 meaning thereby that the IAASB proposed a Redrafted version of ISA 210, written pursuant to the style adopted under the Clarity Project. As a part of its Clarity Project, an International Standard on Auditing is divided into two sections, one the Requirements part containing the fundamental principles of the Standard and second, the Application and Other Explanatory Materials section and Appendices, detailing the implementation aspects of the principles. Attention of the readers is also drawn to, "A Guide for National Standard Setters that Adopt IAASB's International Standards but Find it Necessary to Make Limited Modifications"[2], issued by the IAASB in July, 2006.

ICAI's Response

The Council of the Institute, at its 267th meeting held in April, 2007 has also decided to adopt this approach for writing Standards. The Council, at the said meeting, also decided to rename, re-categorise and re-number the existing Auditing and Assurance Standards on the lines followed by the IAASB. The readers are also requested to refer to the Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services[3], published in the July, 2007 issue of the Journal. This revised Preface is effective from April 1, 2008.

Highlights of the New Preface

I. Engagement Standards

The new Preface introduces the concept of Engagement Standards. The term "Engagement Standards" comprises the following Standards:

(a) Standards on Auditing (SAs), to be applied in the audit of historical financial information.

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[1] Hitherto known as Standard on Auditing (SA) 210 (AAS 26).

[2] The full text of the Policy Position can be downloaded free of charge at http://www.ifac.org/IAASB/downloads/Modification_Policy_Position.pdf.

[3] The full text of the Preface can be downloaded free of charge at http://www.icai.org/resource_file/7744announ1050.pdf.

(b) Standards on Review Engagements (SREs), to be applied in the review of historical financial information.

(c) Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, dealing with subject matters other than historical financial information.

(d) Standards on Related Services (SRSs), to be applied to engagements involving application of agreed upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI .

The new Preface therefore, does away with the terminology “Auditing and Assurance Standards” in use till date.

The Standards on Quality Control (SQCs) are to be applied to all services covered by the Engagement Standards.

II. Standards on Auditing

The Standards on Auditing (SAs) referred to in I. above are formulated in the context of an audit of financial statements by an independent auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

III. New Format of Presenting the Standards on Auditing

In line with the format adopted by the IAASB under its Clarity Project, the Standards on Auditing would now contain five distinct sections, namely, Introduction including scope and effective date, Objectives, Definitions, Requirements and Application and Explanatory Material. A brief description of each of these Sections is given below:

- Introduction: The ‘Introduction’ section deals the purpose and scope of the Standard, subject matter of the Standard and effective date of the Standard.
- Objectives: The ‘Objectives’ section provides the reference in which the Requirements are elaborated in the Standard. The aim of the auditor is to achieve the Objectives as specified in all Standards of Auditing (SAs).
- Definitions: The ‘Definitions’ section deals with the meaning attributed to certain expressions for the purpose of SAs. The aim is to assist the auditors to ensure consistent application of the Standards.
- Requirements: The fundamental principles of the Standard are contained in the Requirements section and presented by use of “shall”. Hitherto, the word, “should” was used in the Standards, for this purpose. Further, this format also does away with the need to present the principles laid down by the Standard in bold text. The ‘Requirements’ section also contains cross reference to the relevant Application and Other Explanatory Material.
- Application and Other Explanatory Material: The ‘Application and Other Explanatory Material’ contained in an SA is an integral part of the SA as it provides further explanation of, and guidance for carrying out, the requirements of an SA, along with the background information on the matters addressed in the SA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.

Appendices which form part of Application and Other Explanatory Material are an integral part of a Standard.

In view of this format of writing, the standard portion or principles enunciated in a Standard are no longer given in bold face.

There is no change in the authority attached to the Standards, i.e., they are mandatory in nature, notwithstanding the new format of writing the Standards.

This Exposure Draft

This Exposure Draft of the Revised Standard on Auditing (SA) 210, "Agreeing the Terms of Audit Engagements", is based on the corresponding Exposure Draft of Redrafted ISA 210 issued by the IAASB in January, 2008 and follows the same writing style. In addition to the other things, the title of the then existing SA 210, "Terms of Audit Engagements" has been changed to "Agreeing the Terms of Audit Engagements" thereby imposed a condition on the auditor that until the auditor and the management agrees on the terms of the audit engagement, the auditor shall not start the audit of an entity. The first, i.e., the Introduction and Requirements section contains the principles. The second, i.e., the Application and Explanatory Material section contains implementation guidance on the topics discussed in the Requirements section. Cross reference to the relevant paragraphs of the Application Material is built within the Requirements section. The paragraphs in the Requirements section have been numbered as 1 to 20 and the paragraphs in the Application and Other Explanatory Material are numbered as A1 to A34.

Topics Covered by Revised SA 210

The Standard contains the following main aspects:

i) Scope

ii) Effective date

iii) Objectives

iv) Requirements

  (a) Preconditions for an Audit

  (b) Agreement on Audit Engagement Terms

  (c) Recurring Audits

  (d) Acceptance of a Change in the Terms of the Audit Engagement

  (e) Additional Considerations in Engagement Acceptance

v) Application guidance on the above aspects

Highlights of Revised SA 210

1. SA 210 (Revised) deals with the auditor's responsibilities in: agreeing the terms of audit engagement with the entity and also to respond to a request by an entity to change the terms of audit engagement.
2. The objective of auditor under SA 210 (Revised) is to accept audit engagement only when the preconditions for an audit and common understanding between him and the client exist and to perform necessary

procedures for the same. Further, it states that if the preconditions to the audit are not present, the auditor shall discuss the matter with management or those charged with governance or shall not accept the proposed audit engagement.

3. SA 210 (Revised) requires the auditor not to accept the engagements where the management or those charged with governance imposes such a limitations on the scope of the engagement that leads to the disclaimer of opinion by the auditor, unless required by law to do so.

4. SA 210 (Revised) requires the auditor to judge whether there is any conflict between the financial reporting standards and the additional requirements of the applicable laws and regulations and if yes, discuss the same with management and those charged with governance. Further, it also requires providing the effect of the same in the auditor's opinion.

5. As per SA 210 (Revised), agreement on audit engagement terms includes the objective and scope of the audit of the financial statements, responsibilities of the auditor, responsibilities of management and, where appropriate, those charged with governance, identification of the applicable financial reporting framework for the preparation and presentation of the financial statements, expected form of any reports to be issued by the auditor and peer review mechanism.

6. SA 210 (Revised) requires the auditor in case of recurring audits to consider whether circumstances requires that the terms of the audit engagement needs to be revised and whether there is a need to remind the entity about the existing terms of the audit engagement.

7. SA 210 (Revised) requires the auditor to obtain written representation as per SA 580 so as to support other audit evidence relevant to the financial statements.

8. SA 210 (Revised) contains the detailed guidelines on the Financial or General Reporting Framework and its acceptability that the auditor is required to consider while accepting the audit engagement. If auditor has determined that the financial reporting framework prescribed by law or regulation is unacceptable, the auditor may agree to accept the audit engagement only if the management agrees to provide additional disclosures in the financial statements.

9. SA 210 (Revised) also provides the appropriate wordings to be used by an auditor while expressing an opinion on the financial statements.

Your comments on the Exposure Draft should reach us by December 31, 2008. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board
The Institute of Chartered Accountants of India
ICAI Bhawan, C-1, Sector-1,
NOIDA,
Uttar Pradesh – 201 301.

Comments can also be emailed at: aasb@icai.in

Exposure Draft
Standard on Auditing 210 (Revised)*
Agreeing the Terms of Audit Engagements

Contents

Paragraphs

[Proposed] Standard on Auditing (SA) 210 (Revised), "Agreeing the Terms of Audit Engagements" should be read in conjunction with "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services[4]," which sets out the authority of SAs.

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* Earlier known as the Standard on Auditing (SA) 210 (AAS 26), "Terms of Audit Engagements".

[4] Published in the July, 2007 issue of the Journal.

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities in:

(a) agreeing the terms of the audit engagement with the entity; and

(b) responding to a request by an entity to change the terms of an audit engagement for an audit of financial statements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

Effective Date

2. This SA is effective for audits of financial statements for periods beginning on or after-------------.

Objective

3. 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: (Ref: Para. A1-A2)

(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.

Requirements

Preconditions for an Audit

4. In order to establish whether necessary preconditions for an audit are present, the auditor shall:

(a) Determine whether the financial reporting framework[5] to be applied in the preparation and presentation of the financial statements is acceptable; and (Ref: Para. A3-A10)

[5] Proposed SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing", Paragraph 13 (a) defines the applicable financial reporting framework as "The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:
(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(b) Obtain the agreement of management and, where appropriate, those charged with governance that they acknowledge and understand their responsibility: (Ref: Para. A11-A13, A17)

(i) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes 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; and (Ref: Para. A14-A16)

(ii) To provide the auditor with:

a. All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;

b. Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and

c. Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, management and, where appropriate, those charged with governance, are responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework.

Limitation on Scope Prior to Audit Engagement Acceptance

5. If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

Reasons for not Proceeding with the Audit Engagement

6. Where the preconditions for an audit are not present, the auditor shall discuss the matter(s) with management and, where appropriate, those charged with governance. Unless the requirements of paragraph 19 are met, or the auditor is required by law or regulation to do so, the auditor shall not accept the proposed audit engagement if the auditor has determined that the applicable financial reporting framework is unacceptable or if the agreement referred to in paragraph 4(b) has not been obtained.

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above".

Agreement on Audit Engagement Terms

7. The auditor shall agree the terms of the audit engagement with management or those charged with governance.

8. The agreed terms of the audit engagement shall include: (Ref: Para. A22-A23)

(a) The objective and scope of the audit of the financial statements;

(b) The responsibilities of the auditor;

(c) The responsibilities of management and, where appropriate, those charged with governance (including those in paragraph 4(b));

(d) Identification of the applicable financial reporting framework for the preparation and presentation of the financial statements; and

(e) The expected form of any reports to be issued by the auditor.

9. Subject to paragraph 10, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. (Ref: Para. A21)

10. If law or regulation prescribes in sufficient detail the terms of the engagement, it may not be necessary to record them in an audit engagement letter or other suitable form of written agreement, except for the agreement of management and, where appropriate, those charged with governance that they acknowledge and understand the responsibilities set out in paragraph 4(b). (Ref: Para. A18-A20)

11. If law or regulation prescribes the responsibilities of management and, where appropriate, those charged with governance in relation to financial reporting, the auditor may determine that the law or regulation includes responsibilities that are equivalent in effect to those set out in paragraph 4(b). For such responsibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the engagement letter or other suitable form of written agreement. For those that are not prescribed by law or regulation such that their effect is equivalent, the engagement letter or other suitable form of written agreement shall reflect the description in paragraph 4(b). (Ref: Para. A20)

Recurring Audits

12. On recurring audits, the auditor shall consider whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. (Ref: Para. A24)

Acceptance of a Change in the Terms of the Audit Engagement

13. The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so. (Ref: Para. A25-A27)

14. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that provides a lower level of assurance, the auditor shall determine whether it is appropriate to do so. (Ref: Para. A28-A29)

15. Where the terms of the audit engagement are changed, the auditor and management or those charged with governance shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

16. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted to continue the original audit engagement, the auditor shall, unless prohibited by law or regulation:

(a) Withdraw from the audit engagement; and

(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances necessitating the auditor's withdrawal from the audit engagement to other parties, such as those charged with governance or shareholders.

Additional Considerations in Engagement Acceptance

Wording Used to Express the Opinion

17. In some cases, law or regulation prescribes the wording of the audit opinion in terms that are significantly different from the requirements of SAs. In these circumstances, the auditor shall evaluate:

(a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,

(b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.[6]

If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless prohibited by law or regulation from doing so. An audit conducted in accordance with such law or regulation does not comply with SAs. Accordingly, the auditor shall

[6] At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 706, "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report". However, the concept of 'emphasis of matter paragraph' has been discussed in SA 700, "The Auditor's Report on Financial Statements". The Auditing and Assurance Standards Board will issue an Exposure Draft of the Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 706, "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report" in the near future.

include no reference within the auditor's report to the audit having been conducted in accordance with SAs. (Ref: Para. A30 and A33)

Financial Reporting Standards Supplemented by Law or Regulation—Conflicts

18. If financial reporting standards established by an authorised or recognised standards setting organisation are supplemented by law or regulation, the auditor shall determine whether there are any conflicts between the financial reporting standards and the additional requirements. If such conflicts exist, the auditor shall discuss with management and, where appropriate, those charged with governance the nature of the additional requirements and shall agree whether:

(a) The additional requirements can be met through additional disclosures in the financial statements; or

(b) The description of the applicable financial reporting framework in the financial statements can be amended accordingly.

If neither of the above actions is possible, the auditor shall determine whether it will be necessary to modify the audit opinion in the auditor's report in accordance with [proposed] SA 705.[7](Ref: Para. A31)

Financial Reporting Framework Prescribed by Law or Regulation—Determined as Unacceptable

19. If the auditor has determined that the financial reporting framework prescribed by law or regulation is unacceptable, the auditor may nevertheless agree to accept the audit engagement but shall do so only if: (Ref: Para. A32-A33)

(a) Management or those charged with governance agree to provide additional disclosures in the financial statements, to avoid the financial statements being misleading; and

(b) It is recognised 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 [proposed] SA 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 "give a true and fair view" or "present fairly, in all material respects" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.

[7] At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report". However, the concept of modified audit report has been discussed in SA 700, "The Auditor's Report on Financial Statements". The Standard is being revised in the light of the corresponding International Standards. The Auditing and Assurance Standards Board will issue an Exposure Draft of the Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report" in the near future.

20. If management or those charged with governance refuse to provide additional disclosures and the auditor is prohibited by law or regulation from refusing to undertake the audit engagement, the auditor shall:

(a) Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and

(b) Include appropriate reference to this matter in the terms of the audit engagement.

Application and Other Explanatory Material

Objective (Ref: Para. 3)

A1. Establishing whether the necessary preconditions for an audit are present and agreeing on the terms of the audit engagement are complemented by acceptance and continuance requirements in [proposed] SA 220 (Revised)[8].

A2. The responsibilities of management and those charged with governance for agreeing the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant legislation.

Preconditions for an Audit

The Financial Reporting Framework (Ref: Para. 4(a))

A3. A condition for acceptance of an assurance engagement is that the criteria referred to in the definition of an assurance engagement are suitable and available to intended users. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. For purposes of the SAs, the applicable financial reporting framework provides the criteria the auditor uses to evaluate or measure the preparation and presentation of the financial statements.

A4. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation and presentation of the financial statements and the auditor does not have suitable criteria for evaluating the financial statements. In many cases the auditor may presume that the financial reporting framework is acceptable, as described in paragraphs A8-A9.

Determining the Acceptability of the Financial Reporting Framework

A5. Factors that may affect the auditor's determination of the acceptability of the applicable financial reporting framework include:

[8] Currently, SA 220 (AAS 17), "Quality Control for Audit Work" is in force. The standard is being revised in the light of the corresponding International Standard.

- The nature of the entity (for example, whether it is a business enterprise or a not-for-profit organisation);
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users);
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
- Whether applicable legislative and regulatory requirements prescribe the applicable financial reporting framework.

A6. Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. While all the information needs of specific users cannot be met, there are financial information needs that are common to a wide range of users. Financial statements prepared and presented in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as general purpose financial statements.

A7. In some cases, the financial statements will be prepared and presented in accordance with a financial reporting framework designed to meet the financial information needs of specific users. Such financial statements are referred to as special purpose financial statements. The financial information needs of the intended users will determine the applicable financial reporting framework in these circumstances. [Proposed] SA 800[9] discusses the acceptability of financial reporting frameworks designed to meet the financial information needs of specific users.

General purpose frameworks

A8. At present, there is no objective and authoritative basis that has been generally recognised globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organisations that are authorised or recognised to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared and presented by such entities, provided the organisations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Examples of such financial reporting standards include:

- International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board;
- International Public Sector Accounting Standards (IPSASs) promulgated by the International Public Sector Accounting Standards Board; and

[9] At present, there is no corresponding SA issued by AASB on the subject. The Auditing and Assurance Standards Board will issue an Exposure Draft of the Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 800, "Special Considerations Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement," in the near future. Attention of the reader is also drawn to the Guidance Note on Audit Reports and Certificates for Special Purposes issued by the Institute of Chartered Accountants of India (ICAI).

- Accounting Standards promulgated by Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006.
- Accounting Standards for Local Bodies promulgated by Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI).

These financial reporting standards are often identified as the applicable financial reporting framework in legislative and regulatory requirements governing the preparation and presentation of general purpose financial statements.

Financial reporting frameworks prescribed by law or regulation

A9. In accordance with paragraph 4(a), the auditor is required to determine whether the financial reporting framework, adopted in the preparation and presentation of the financial statements, is acceptable. In some cases, law or regulation may prescribe the financial reporting framework to be used in the preparation and presentation of general purpose financial statements for certain types of entities. In the absence of indications to the contrary, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared and presented by such entities. (In the event that the framework is not considered to be acceptable, paragraphs 19 and 20 apply.)

Jurisdictions that do not have authorised or recognised standards setting organisations or financial reporting frameworks prescribed by law or regulation

A10. When an entity is registered or operating in a jurisdiction that does not have an authorised or recognised standards setting organisation, or where use of the financial reporting framework is not prescribed by law or regulation, management or those charged with governance identify an applicable financial reporting framework. Appendix 2 contains guidance on determining the acceptability of financial reporting frameworks in such circumstances.

Agreement of the Responsibilities of Management and, where appropriate, Those Charged with Governance (Ref: Para. 4(b))

A11. An audit in accordance with SAs is conducted on the premise that management and, where appropriate, those charged with governance have the responsibilities set out in paragraph 4(b)[10].This premise is fundamental to the conduct of an effective independent audit. To avoid misunderstanding, agreement is reached with management and, where appropriate, those charged with governance that they acknowledge and understand their responsibilities, as part of agreeing and recording the terms of the audit engagement in paragraphs 7-11.

[10] Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the AASs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200.

A12. SA 580 (Revised) requires the auditor to request management and, where appropriate, those charged with governance to provide written representations that they have fulfilled these responsibilities.[11] It may therefore be appropriate to make them aware that receipt of such written representations will be expected, together with written representations required by other SAs and, where necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

A13. Where management and, where appropriate, those charged with governance will not agree to their responsibilities, or to provide the written representations, the auditor will be unable to obtain sufficient appropriate audit evidence.[12] In such circumstances, it may not be appropriate for the auditor to accept the audit engagement. In some cases, however, law or regulation may prohibit the auditor from declining an audit engagement. In these cases, the auditor may need to explain to management and, where appropriate, those charged with governance the importance of these matters, and the implications for the auditor's report.

Internal Control (Ref: Para. 4(b)(i))

A14. "Internal control" is defined as: "The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control assists management in fulfilling its responsibility for the preparation and presentation of the financial statements."[13] The entity's objective with regard to the reliability of financial reporting includes the preparation and presentation of financial statements that are in accordance with the applicable financial reporting framework and free from material misstatement, whether due to fraud or error.

A15. Internal control is an important aspect of the responsibility of management and, where appropriate, those charged with governance for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework. Accordingly, the auditor obtains their written agreement that they acknowledge and understand that this responsibility includes 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.

A16. In some cases, law or regulation may refer to the responsibility of management and, where appropriate, those charged with governance for the adequacy of accounting books and records, or accounting systems. As books, records and systems are an integral part of internal control as defined in paragraph A14, no specific reference is made to them in paragraph 4(b) for the description of the responsibility of management and, where appropriate, those charged with governance. However, if this responsibility of management and, where appropriate, those charged with governance is described using the wording of the law or regulation, as provided for in paragraph 11, it may include a reference to books, records and systems in addition to a reference to internal control. To avoid

[11] Published in October, 2008 issue of the Journal.
[12] SA 580 (Revised), paragraph A28.
[13] SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," paragraph 4(c).

misunderstanding, it may be appropriate for the auditor to explain to management and those charged with governance the scope of this responsibility.

Considerations Specific to Smaller Entities (Ref: Para. 4(b))

A17. One of the purposes of agreeing the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and, where appropriate, those charged with governance and the auditors. For example, when a third party has assisted with the preparation and presentation of the financial statements, it may be useful to remind management and, where appropriate, those charged with governance that the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility. This may be particularly relevant in the case of smaller entities.

Agreement on Audit Engagement Terms

Audit Engagement Letter or Other Form of Written Agreement[14] (Ref: Para. 10-11)

A18. It is in the interest of both entity and auditor that the auditor sends an audit engagement letter before the commencement of the audit, to help avoiding misunderstandings with respect to the audit. In some cases, however, the objective and scope of an audit and the responsibilities of management and, where appropriate, those charged with governance, and of the auditor may be sufficiently established by law, that is, they prescribe the matters described in paragraph 8. Even in those situations, the auditor may still find an audit engagement letter informative for these entities.

A19. In case of certain entities, law or regulation governing the operations of that entities may mandate the appointment of the auditor and also commonly set out the auditor's responsibilities and powers, including the power to access an entity's records and other information. When law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor may nonetheless consider that there are benefits in issuing audit engagement letters. When law or regulation does not prescribe in sufficient detail the terms of the audit engagement, a letter setting out those elements of paragraph 8 not sufficiently covered by law or regulation would satisfy this requirement.

Responsibilities of Management and, where appropriate, Those Charged with Governance Prescribed by Law or Regulation

A20. If, in the circumstances described in paragraphs A18-A19, the auditor concludes that it is not necessary to record the terms of the engagement in an engagement letter, the auditor is still required by paragraph 10 to obtain the written agreement from management and, where appropriate, those charged with governance that they acknowledge and understand the responsibilities set out in paragraph 4(b). However, in accordance with paragraph

[14] 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.

11, such written agreement may reflect the wording of the law or regulation if such law or regulation establishes responsibilities for management that are equivalent in effect to those described in paragraph 4(b). The accounting profession may provide guidance as to whether the description in law or regulation is equivalent.

Audits of Components[15] (Ref: Para. 9)

A21. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that may influence the decision whether to send a separate audit 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 in relation to audit appointments;
- The extent of any work performed by other auditors;
- Degree of ownership by parent; and
- Degree of independence of the component's management.

Form and Content of the Audit Engagement Letter (Ref: Para. 8)

A22. 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 [proposed] SA 200 (Revised). Paragraphs 4(b) and 11 of this SA deal with the description of the responsibilities of management and, where appropriate, those charged with governance. In addition to including the matters required by paragraphs 4(b) and 8, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, SAs 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 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.
- Arrangements regarding the planning and performance of the audit.

[15] Proposed SA 600 (Revised), "Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)", paragraph 9(a) defines component as "An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements".

- The expectation that management and, where appropriate, those charged with governance will provide written representations (see also paragraph A12).
- The agreement of management or those charged with governance 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.
- The basis on which fees are computed and any billing arrangements.
- A request for management or those charged with governance to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.
- Peer review mechanism under the Chartered Accountants Act, 1949.

A23. 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.
- The agreement of management or those charged with governance to inform the auditor of facts, that may affect the financial statements, of which management or those charged with governance may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- Any obligations to provide audit working papers to other parties.

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

Recurring Audits (Ref: Para. 12)

A24. The auditor may decide not to send a new engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit 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 entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation and presentation of the financial statements.
- A change in other reporting requirements.

Acceptance of a Change in the Terms of the Audit Engagement

Request to Change the Terms of the Audit Engagement (Ref: Para. 13)

A25. A request from the entity for the auditor to change the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or those charged with governance or caused by circumstances. The auditor, as required by paragraph 13, considers the reason given for the request, particularly the implications of a restriction on the scope of the audit engagement.

A26. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.

A27. In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.

Request to Change to a Review or a Related Service (Ref: Para. 14)

A28. Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may need to assess, in addition to the above matters, any legal or contractual implications of the change.

A29. If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

(a) The original audit engagement; or

(b) Any procedures that may have been performed in the original audit engagement, except where the audit 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.

Additional Considerations in Engagement Acceptance

Wording Used to Express the Opinion (Ref: Para. 17)

A30. SAs require that the auditor shall not represent compliance with SAs unless the auditor has complied with all of the SAs relevant to the audit. When law or regulation prescribes the wording of the auditor's report in terms that are significantly different from the requirements of SAs and the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with SAs. The auditor is, however, encouraged to apply SAs, including the SAs that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with SAs.

Financial Reporting Standards Supplemented by Law or Regulation—Conflicts (Ref: Para. 18)

A31. In some cases, legislative or regulatory requirements may supplement the financial reporting standards established by an authorised or recognised standards setting organisation with additional requirements relating to the preparation and presentation of financial statements. This may, for example, be the case when legislative or regulatory requirements prescribe disclosures in addition to those required by the financial reporting standards or when they narrow the range of acceptable choices that can be made within the financial reporting standards.

Financial Reporting Framework Prescribed by Law or Regulation—Determined as Unacceptable (Ref: Para. 17, 19-20)

A32. Deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable may be encountered after the audit engagement has been accepted. When use of that framework is prescribed by law or regulation, the requirements of paragraphs 19 and 20 apply. When use of that framework is not prescribed by law or regulation, management or those charged with governance may decide to adopt another framework that is acceptable. When management or those charged with governance do so, new terms of the audit engagement may need to be agreed to reflect the change in the framework as the previously agreed terms may no longer be accurate.

A33. Law or regulation may prescribe that the wording of the auditor's opinion use the phrases "give a true and fair view" or "present fairly, in all material respects," although the auditor concludes that the applicable financial reporting framework prescribed by law or regulation is unacceptable. In this case, the terms of the prescribed wording of the audit opinion are significantly different from the requirements of SAs (see paragraph 17).

A34. In case of certain entities, specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to the regulator or the legislative body or the stakeholders if the entity attempts to limit the scope of the audit.

Material Modifications to ISA 210, "Agreeing the Terms of Audit Engagements"

Additions

1. Paragraph A8 of ISA 210 provides the examples of the financial reporting standards, which can be used for the preparation and presentation of general purpose financial statements. Since in India, financial reporting standards, used for the preparation and presentation of financial statements, can be 'Accounting Standards promulgated by the Accounting Standards Board of the Institute of Chartered Accountants of India or Accounting Standards, notified under Companies (Accounting Standards) Rules, 2006' or 'Accounting Standards for Local Bodies promulgated by Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI)', these have been added in the list of examples of financial reporting standards. References have accordingly been changed.

2. Paragraph A22 of ISA 210 provides the forms and contents of the engagement letter, reference of which the auditor may provide in the engagement letter. Since in India, audit process performed by an auditor may be subjected to 'peer review' under the Chartered Accountants Act, 1949, an example, "peer review mechanism under the Chartered Accountants Act, 1949" has been added in the list of the matters that can be provided in the engagement letter.

Deletions

1. Paragraph A19 of ISA 210 deals with the condition where the law or regulation governs the operations of public sector audits, and mandate the appointment of an public sector auditor and also prescribes the public sector auditor's responsibilities and powers. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

   Further, it is also possible that such a condition of governing the entity by law or regulation, and mandating the appointment of an auditor and also prescribing the auditor's responsibilities and powers may also exist in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Accordingly, the spirit of erstwhile A19, highlighting the fact that in some cases, there may be a condition of governing the entity by law or regulation, and mandating the appointment of an auditor and also prescribing the auditor's responsibilities and powers.

2. Paragraph A34 of ISA 210 deals with the specific reporting requirements within the legislation governing the audit that may mandate; for example, the auditor may be required to report directly to a minister or the legislature or to public if the entity attempts to limit the scope of the audit in case of public sector entities. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

   Further, it is also possible that such a specific reporting requirement to the legislature may also exist in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Accordingly, the spirit of erstwhile A34, highlighting the fact that in some cases, there may be a specific reporting requirement within the legislation governing the audit.

Appendix 1

(Ref: Para. A23)

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 and presented in accordance with Financial Reporting Standards[16]. 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 SA. 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 12 of this SA). It may be appropriate to seek legal advice that any proposed letter is suitable.

To the appropriate representative of senior management:[17]

[The objective and scope of the audit]

.............., and the statement of profit & loss, 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 audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with Standards on Auditing (SAs). 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.

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[16] In India, financial reporting standards can be accounting standards promulgated by Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006.

[17] The addresses and references in the letter to management or those charged with governance would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction.

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 and fair presentation 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 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.

[The responsibilities of management and, where appropriate, those charged with governance, and identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has not determined whether the law or regulation prescribes those responsibilities in appropriate terms; the description in paragraph 4(b) of this SA is therefore used).]

Our audit will be conducted on the basis that management and, where appropriate, those charged with governance acknowledge and understand their responsibility:

(a) For the preparation and fair presentation of the financial statements (or preparation and presentation of financial statements that give a true and fair view) in accordance with Financial Reporting Standards; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

(b) To provide us with:

   (i) All information, such as records and documentation, and other matters that are relevant to the preparation and fair presentation of the financial statements;

   (ii) Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and

   (iii) Unrestricted access to those 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 also wish to invite your attention to the fact that our audit process is subject to 'peer review' under the Chartered Accountants Act, 1949. The reviewer may examine our working papers during the course of the peer review.

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.]

[Reporting]

We expect to report as follows:

[Insert text of sample report or include as an attachment.]

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.
Chartered Accountants

(Signature)

Date : (Name of the Member)

Place : (Designation[18])

Acknowledged on behalf of
ABC Company by

(Signature)
Name and Designation
Date

[18] Partner or proprietor, as the case may be.

Appendix 2

(Ref: Para. A10)

Determining the Acceptability of General Purpose Frameworks

Jurisdictions that Do Not Have Authorised or Recognised Standards Setting Organisations or Financial Reporting Frameworks Prescribed by Law or Regulation

1. As explained in paragraph A10 of this SA, when an entity is registered or operating in a jurisdiction that does not have an authorised or recognised standards setting organisation, or where use of the financial reporting framework is not prescribed by law or regulation, management or those charged with governance identify an applicable financial reporting framework. Practice in such jurisdictions is often to use the financial reporting standards established by one of the organisations described in paragraph A8 of this SA.

2. Alternatively, there may be established accounting conventions in a particular jurisdiction that are generally recognised as the financial reporting framework for general purpose financial statements prepared by certain specified entities operating in that jurisdiction. When such a financial reporting framework is adopted, the auditor is required by paragraph 4(a) of this SA to determine whether the accounting conventions collectively can be considered to constitute an acceptable financial reporting framework for general purpose financial statements. When the accounting conventions are widely used in a particular jurisdiction, the accounting profession in that jurisdiction may have considered the acceptability of the financial reporting framework on behalf of the auditors. Alternatively, the auditor may make this determination by considering whether the accounting conventions exhibit attributes normally exhibited by acceptable financial reporting frameworks (see paragraph 3 below), or by comparing the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable (see paragraph 4 below).

3. Acceptable financial reporting frameworks normally exhibit the following attributes that result in information provided in financial statements that is useful to the intended users:

(a) Relevance, in that the information provided in the financial statements is relevant to the nature of the entity and the objective of the financial statements. For example, in the case of a business enterprise that prepares general purpose financial statements, relevance is assessed in terms of the information necessary to meet the common financial information needs of a wide range of users in making economic decisions. These needs are ordinarily met by presenting the financial position, financial performance and cash flows of the business enterprise.

(b) Completeness, in that transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are not omitted.

(c) Reliability, in that the information provided in the financial statements:

   (i) Where applicable, reflects the economic substance of events and transactions and not merely their legal form; and

   (ii) Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances.

(d) Neutrality, in that it contributes to information in the financial statements that is free from bias.

(e) Understandability, in that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretation.

4. The auditor may decide to compare the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable. For example, the auditor may compare the accounting conventions to financial reporting standards. For an audit of a small entity, the auditor may decide to compare the accounting conventions to a financial reporting framework specifically developed for such entities by an authorised or recognised standards setting organisation. When the auditor makes such a comparison and differences are identified, the decision as to whether the accounting conventions adopted in the preparation and presentation of the financial statements constitute an acceptable financial reporting framework includes considering the reasons for the differences and whether application of the accounting conventions, or the description of the financial reporting framework in the financial statements, could result in financial statements that are misleading.

5. A conglomeration of accounting conventions devised to suit individual preferences is not an acceptable financial reporting framework for general purpose financial statements. Similarly, a compliance framework will not be an acceptable financial reporting framework, unless it is generally accepted in the particular jurisdictions by preparers and users.