

The Auditor's Report on Financial Statements Proposed Revisions to ISA 210

***Note to IAASB:** The following is a mark-up of the proposed wording presented on the Friday morning of the Tokyo meeting.*

ISA 210, TERMS OF AUDIT ENGAGEMENTS

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on:
 - (a) agreeing the terms of the engagement with the client; and
 - (b) the auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.
2. **The auditor and the client should agree on the terms of the engagement.** The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.
3. This ISA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. ~~The guidance is also applicable to related services.~~
4. In some jurisdictions, the objective and scope of an audit and the auditor's obligations are established by law. Even in those situations the auditor may still find audit engagement letters informative for their clients.

Audit Engagement Letters

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

PRINCIPAL CONTENTS

6. The form and content of audit engagement letters may vary for each client, but they would generally include reference to:
 - The objective of the audit of financial statements.
 - Management's responsibility for the financial statements as described in ISA 200, "Objective and General Principles Governing an Audit of Financial Statements", paragraphs ~~33~~ 32 to 34.
 - The applicable financial reporting framework.
 - The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres.

- The form of any reports or other communication of results of the engagement.
- The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatement may remain undiscovered.
- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.

[Paragraphs 7-19 unchanged]

Agreement on the Applicable Financial Reporting Framework

- 20. The terms of the engagement should identify the applicable financial reporting framework.**
21. As stated in ISA 200, “Objective and General Principles Governing an Audit of Financial Statements”, the financial reporting framework identified by management to prepare the financial statements will depend on the users-nature of the entity and on the objective of the financial statements. In some cases, the objective of the financial statements will be intended to meet the common information needs of a wide range of users; in others, they will be intended to meet the needs of specifically identified users.
- 22. The auditor should not accept an engagement for an audit of financial statements when the auditor concludes that the financial reporting framework identified by management is not acceptable.**
23. ~~The auditor does not accept an engagement to audit of financial statements when the financial reporting framework identified by management is not acceptable.~~ Without an acceptable financial reporting framework the auditor does not have suitable criteria for evaluating the entity’s financial statements. In these circumstances, the auditor encourages management to address the deficiencies in the financial reporting framework or to identify another financial reporting framework that is acceptable.
24. ISA 200 describes the financial reporting frameworks that are presumed to be acceptable for general purpose financial statements ~~of profit-oriented entities~~. Legislative and regulatory requirements often determine the applicable financial reporting framework for general purpose financial statements. In most cases, the applicable financial reporting framework will be that of the jurisdiction in which the entity is registered or operates and the auditor is based. The legislative and regulatory obligations of the entity often determine the applicable financial reporting framework. In such cases, the auditor and the entity will have a common understanding of the applicable financial reporting framework.
25. When the reporting entity is registered or operating in a jurisdiction where there are no legislative and regulatory obligations-requirements with respect to the applicable financial reporting framework, the entity identifies an applicable financial reporting framework. The entity’s choice will be governed by local practice, industry practice, user needs, or other factors. For example, the entity’s competitors may apply International Financial Reporting Standards and the entity may determine that International Financial Reporting Standards are also appropriate for its financial reporting requirements. In these cases, the auditor obtains an understanding of the matters considered by the entity in identifying an applicable financial reporting framework.

26. When the applicable financial reporting framework identified by the entity is not established by an authorized international or national standards setting organization, ~~International Financial Reporting Standards or an established financial reporting framework in a particular jurisdiction~~, the auditor considers whether the financial reporting framework is suitable and is clearly described in the financial statements. The auditor uses the criteria provided in ISA 200, “Objective and General Principles Governing an Audit of Financial Statements”, paragraphs ~~41~~42-44 in making this judgment.
27. The auditor may also decide to compare the framework to the requirements of recognized frameworks established by authorized international or national standards setting organizations such as, for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board ~~or another established financial reporting framework in a particular jurisdiction~~. When the auditor makes such a comparison and significant differences are identified, the decision as to whether the financial reporting framework is suitable includes consideration of the reasons for the differences and whether application of the framework will likely result in financial statements that are misleading.
28. When the auditor accepts an engagement involving an applicable financial reporting framework that is not established by an authorized international or national standards setting organization, the auditor may encounter deficiencies in that framework that were not anticipated when the engagement was initially accepted and that indicate that the framework is not acceptable for general purpose financial statements. In these circumstances, the auditor discusses the deficiencies with management and the need for management to adopt another financial reporting framework that is suitable.

Example of an Audit Engagement Letter

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

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

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

We will conduct our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable, but not absolute, assurance whether the financial statements are free from material misstatements whether caused by fraud or error. An audit includes involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The audit procedures selected depend on the auditor's assessment of the risks of misstatement in the financial statements. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall financial statement presentation and disclosures.

- Obtaining an understanding of the company, including its internal control over financial reporting, sufficient to assess the risks of material misstatement of the financial statements, and to design and perform audit procedures that in the our judgment address those risks;
- Evaluating the evidence obtained through tests and other procedures;
- Evaluating the appropriateness of the accounting policies selected and applied;
- Evaluating the reasonableness of significant estimates; and
- Evaluating the overall financial statement presentation and disclosures.

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.

An audit includes considering internal control relevant to the entity's preparation of the financial statements as a basis for designing procedures that are appropriate in the circumstances. Our understanding of internal control over financial reporting will not, however, be a sufficient basis for expressing an opinion on the design or effective operation of some or all of the company's internal controls. However, we expect to provide you with a separate letter concerning any material weaknesses in the design or

implementation of internal control over financial reporting that come to our attention during the audit of the financial statements.¹

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

- ~~Designing and implementing~~Maintaining internal control ~~over financial reporting to prevent or detect and correct~~relevant to the preparation of financial statements that are free of misstatements, whether due to fraud and error;
- Selecting and applying appropriate accounting policies that are consistent with International Financial Reporting Standards ~~and appropriate in the circumstances~~; and
- Making ~~necessary~~ accounting estimates that are appropriate in the circumstances, including the significant assumptions on which those estimates are based.

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

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

~~Our fees, which will be billed as work progresses, are based on the time required by the individuals assigned to the engagement plus out of pocket expenses. Individual hourly rates vary according to the degree of responsibility involved and the experience and skill required.~~

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

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

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

XYZ & Co.

Acknowledged on behalf of
ABC Company by

(signed)

.....
Name and Title
Date

¹ In some jurisdictions, the auditor may have responsibilities to report separately on the entity's internal control. In such circumstances, the auditor reports on that responsibility as required in that jurisdiction. This paragraph may not be appropriate in such circumstances.

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