



International Federation of Accountants

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Agenda Item

9

Committee: IAASB

Meeting Location: Sydney

Meeting Date: April 16 - 20, 2007

Terms of Audit Engagements

Objective of Agenda Item

1. The objective of this Agenda Item is to discuss and approve for exposure a draft of an Exposure Draft of the proposed redrafted ISA 210, "Terms of Audit Engagements" ('redrafted ISA 210') based on the clarity conventions and format adopted by the IAASB.

Task Force Members

2. The Task Force members are:

John Kellas	Chairman, IAASB
Ian McPhee	IAASB Member /Task Force Chair
Richard Mifsud	(Technical Advisor)

The redrafting support was provided by the Australian Auditing and Assurance Standards Board (AUASB) Technical Group and in particular by Howard Pratt, Michael Sadhu and Chiara Carotenuto.

Introduction

3. The Task Force used the closed-off version of ISA 210 (attached) as provided by the IAASB as the Extant, rather than the existing ISA 210 contained in the IAASB Handbook. This is because the close-off document includes all the conforming and other amendments that have been incorporated in ISA 210. The Task Force was asked to redraft ISA 210 in accordance with the IAASB's Clarity conventions.

Matters for IAASB Consideration

Suggested basis for reviewing the accompanying material

4. The Task Force has highlighted in a single document (see Agenda Item 9-B) all proposed changes to be incorporated into the redrafted ISA 210. In Agenda Item 9-B, the proposed amendments include:
 - (a) The clarity changes (see explanation below) comprising those required to conform with the clarity drafting conventions, which are shown as marked-up text in Agenda Item 9-B;

- (b) Proposed elevations and deletions as between the extant ISA 210 and redrafted ISA 210 (see shaded text in Agenda Item 9-B).
5. Accordingly, the IAASB's review of the attached material may be assisted if it is read in the following sequence:
- (i) Commence with Agenda Item 9-B, as this document shows all proposed changes.
 - (ii) For the purposes of reviewing proposed elevations, refer to the text in the shaded rows in Agenda Item 9-B, along with the explanations contained in this Paper.
 - (iii) Agenda Item 9-C (Disposition of the Present Tense), Agenda Item 9-D (Mapping Document) provide additional explanation of changes to conform to the clarity drafting conventions.

Amendments to implement elementary clarity changes

6. The amendments to implement the elementary clarity changes or drafting conventions that have been adopted for redrafted ISA 210 are:
- a. Re-ordering the extant ISA 210 into the clarity format.
 - b. Setting the objective, derived from the form and wording discussed at the September 2006 IAASB meeting.
 - c. Changing "should" to "shall."
 - d. Redrafting text containing the present tense (see Agenda Item 9-C Disposition of the Present Tense). See below for further details regarding proposed elevations, deletions and other related matters.
 - e. Integrating public sector paragraphs into the body of the ISA.
 - f. Re-formatting lengthy paragraphs or sentences into bullet points etc. to improve readability.
 - g. Minor editorial changes to improve readability and expression.

The comments below provide additional explanations of the proposed elevations and deletion of requirements or application material, as between the extant ISA 210 and redrafted ISA 210.

A. PROPOSED ELEVATIONS

Audit Engagement Letter

[REDRAFTED ISA 210 PARAGRAPH 5—EXTANT ISA 210 PARAGRAPH 2]

7. The Task Force considered it was appropriate to elevate explanatory guidance in the extant ISA 210 concerning the need to record the agreed terms of the audit engagement in an audit engagement letter or other suitable form of contract. The suggested amendment recognizes that in some jurisdictions or countries, including for some audits in the public sector, the terms of the audit engagement may be specified in sufficient detail by law or regulation. In such circumstances, an audit engagement letter or separate contract may be unnecessary.

[REDRAFTED ISA 210 PARAGRAPH 6&7—EXTANT ISA 210 PARAGRAPH 9]

8. The Task Force considered that all audit engagement letters should include reference to the following:

- The objective and scope of the audit of the financial statements;
- The auditor's responsibilities;
- Management's responsibilities;
- Identification of the applicable financial reporting framework for the preparation and presentation of the entity's financial statements; and
- The form of any reports to be issued by the auditor.

The above matters reflect significant agreed terms for the proper conduct of the audit of the entity's financial statements.

Furthermore, the Task Force considered that the auditor should obtain written acknowledgement and agreement of the responsibilities of management, and where appropriate, those charged with governance, for preparing and presenting the financial statements, internal controls and providing information and access to records.

[REDRAFTED ISA 210 PARAGRAPH 6—EXTANT ISA 210 PARAGRAPH 13]

9. A consequence of elevating as a requirement, the reference to the applicable financial reporting framework for the preparation and presentation of the entity's financial statements in the audit engagement letter (redrafted ISA 210 paragraph 6), is that it is not necessary to require separately that the agreed terms refer to the applicable financial reporting framework (see extant ISA 210 paragraph 13). To do so would be repetitive and accordingly it is proposed to incorporate extant ISA 210 paragraph 13 into Redrafted paragraph 6.

Agreement on the Applicable Financial Reporting Framework

[REDRAFTED ISA 210 PARAGRAPH 11—EXTANT ISA 210 PARAGRAPH 23]

10. When a conflict exists between requirements in financial reporting standards, as issued by an authorized standard setting organization, and supplementary requirements contained in law or regulation, the Task Force was of the view that the auditor ought to be required to discuss the nature of the respective conflicting requirements with management and the action to be taken. This is currently guidance, but seems appropriate as a requirement.

Wording Used to Express the Audit Opinion

[REDRAFTED ISA 210 PARAGRAPH 12—EXTANT ISA 210 PARAGRAPH 28]

11. The explanatory guidance in extant ISA 210 paragraph 28 was inextricably linked to the requirement in that paragraph, and therefore elevation of the entire paragraph is unavoidable to ensure the requirement is understood within its proper context. In the extant ISA, the explanatory guidance dealt with the situation where law or regulation prescribed the wording for the audit opinion in terms that were significantly different from the wording described in the ISAs. It was noted that in such circumstances users might misunderstand the assurance to

be obtained from the audited financial statements. Accordingly, the auditor considers whether the risk of misunderstanding can be mitigated through appropriate explanation in the auditor's report. If not, the auditor is required to decline the engagement unless prohibited by law or regulation. It seems appropriate to make the consideration a requirement as well as the possible consequences of that consideration.

B. DISPOSITION OF SPECIAL CONSIDERATIONS IN THE AUDIT OF SMALL ENTITIES

12. The Task Force did not see a strong case for the content of IAPS 1005 "The Special Considerations in the Audit of Small Entities" (paragraphs 20 to 23) to be included in the redrafted ISA 210. Among other matters, the above paragraphs note the importance of identifying in the audit engagement letter the auditor's expectations about receiving written representations regarding, for example, management's responsibility for the financial statements. This matter is addressed in redrafted ISA 210 (paragraph 7).

The matters contained in IAPS 1005 (paragraphs 20 to 23) are copied below for the information of Board members:

- 20 *In many cases, owner-managers of small entities are not fully aware of their own responsibilities or those of their auditors. In particular, owner-managers may not appreciate that the financial statements are their responsibility, particularly where the owner-manager has outsourced the preparation of the financial statements.*
- 21 *One of the purposes of an engagement letter is to communicate clearly the respective responsibilities of the owner-manager and the auditor. The Appendix to ISA 210 provides an example of an audit engagement letter.*
- 22 *Paragraph 7 of ISA 210 states that the auditor may wish to include in the engagement letter the auditor's expectation of receiving written confirmation concerning representations made in connection with the audit. ISA 580, "Management Representations" requires the auditor to obtain evidence that management acknowledges its responsibility for the fair presentation of the financial statements in accordance with the relevant financial reporting framework, and has approved the financial statements. Other ISAs require certain specific representations. The auditor may consider including in the engagement letter an indication of the anticipated matters on which management representations will be obtained. This provides an opportunity for the auditor to discuss with the owner-manager at the outset of the engagement the reasons for obtaining such representations and the potential impact on the auditor's report should such representations not be obtained, which may help to avoid a problem arising as the audit is nearing completion. It will also help the auditor consider audit and reporting implications if the owner-manager cannot make or refuse to make the necessary representations.*
- 23 *In some cases the auditor may determine that it will not be possible to obtain sufficient evidence to form an opinion on the financial statements because of weaknesses that may arise from the characteristics of the small entity. In these circumstances, and where permitted by the relevant jurisdiction, the auditor may decide not to accept the engagement, or to withdraw from the engagement after acceptance. Alternatively, the auditor may decide to continue with the engagement but qualify or disclaim the audit opinion. The auditor has regard to paragraph 41 of ISA 700 "The*

Auditor's Report on Financial Statements”¹ which states that the auditor would not ordinarily accept an audit engagement in which the terms of the engagement are such that the auditor believes that the need to express a disclaimer of opinion exists.

Other Matters for IAASB Consideration

13. The Task force has deleted the words “lower level of assurance” in paragraph 14 (Acceptance of a Change in Engagement) because:

- the task force considers that the auditor should be required to determine the appropriateness of any requested change to the agreed terms of the audit engagement, not just a request to provide a lower level of assurance; and
- the remaining paragraphs in this section (continue) to refer to an “audit” and not a “review”. Removing the words therefore better complements the requirements in these subsequent paragraphs.

As a consequence, paragraphs 14 to 17 of the draft are more coherent than previously. However, it is clear that any suggestion of a change to an engagement with a lower level of assurance requires particular consideration – see paragraphs 15, and A23 to A25. The words “lower level of assurance” have been removed also from paragraph 1(b), Scope of this ISA.

14. The Task force has revised Appendix 1: Example of an Engagement Letter only for changes proposed to the body of the standard. The Task Force is aware that in practice, engagement letters are often more expansive, and therefore seeks the Board’s view on whether an example engagement letter should be retained in the ISA and if so, its content.
15. The IFAC SMP Committee expressed the view that certain paragraphs appear too detailed and prescriptive. Accordingly, the Task Force seeks the Board’s view on whether:
- paragraph 9(b)(i) should be made into application material; and
 - paragraph 9(b)(ii) should be turned into a reporting requirement.
16. Following on with the SMP Committee’s comment, paragraph 11 of the ISA, dealing with financial reporting standards supplemented by law or regulation, is based on paragraph 23 of the extant ISA, as amended by recent changes agreed at the October 2006 IAASB meeting. It is a suggested requirement as a result of elevating the relevant present tenses in the extant ISA, though this is subject to the IAASB’s consideration. The paragraph does not, however, deal with the acceptability of the framework or the terms of engagement, and it seems to the task force that it is misplaced in this ISA. The task force therefore proposes that it be removed from this ISA, and dealt with elsewhere (possibly with the application material to ISA 700, which already contains a cross reference to ISA 210 in respect of this issue).

¹ ISA 700, “The Auditor’s Report on Financial Statements” was withdrawn in December 2006 when ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” became effective.

Material Presented (Note: Agenda Item 9-A will be used for purposes of the discussion at the meeting.)

Agenda Item 9-A (Pages 1301-1318)	Proposed ISA 210 (Redrafted) (Clean)
Agenda Item 9-B (Pages 1319-1332)	Proposed ISA 210 (Redrafted) Marked up to reflect clarity redrafting changes
Agenda Item 9-C (Pages 1333-1344)	Disposition of the Present Tense in Extant ISA 210
Agenda Item 9-D (Pages 1345-1364)	ISA 210 Mapping Document
Agenda Item 9-E (Pages 1365-1378)	ISA 210 Close Off Document

Action Requested

17. The IAASB is asked to consider the accompanying material and consider whether the draft of the redrafted ISA 210 may be approved for exposure.