Agenda Item 4-A

PROPOSED INTERNATIONAL STANDARD ON AUDITING 210 (REDRAFTED) AGREEING THE TERMS OF AUDIT ENGAGEMENTS

(Revised Draft post April 2007 IAASB meeting)

(Effective for audits of financial statements for periods beginning on or after [date])*

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Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) 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 an audit engagement.

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

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:
   (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. (Ref: Para. A1)

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 to be used in the preparation and presentation of the financial statements is acceptable; and (Ref: Para. A2-A9)
   (b) Obtain the acknowledgement and agreement of management, and where appropriate, those charged with governance, that they understand their responsibilities for:
      (i) Preparing and presenting the financial statements in accordance with the applicable financial reporting framework;
      (ii) Designing, implementing and maintaining internal control relevant to preparing and presenting financial statements that are free from material misstatement, whether due to fraud or error; and
      (iii) Providing complete information to the auditor in connection with the audit of the entity. (Ref: Para. A10-A13)

[1] This date will not be earlier than December 15, 2008.

Law and Regulation

5. When law or regulation prescribes the use of a financial reporting framework that the auditor concludes is unacceptable, or when there are supplementary legal or regulatory requirements that conflict with the financial reporting framework, the requirements in paragraphs 16, 17 and 18 apply respectively.

6. When law or regulation prescribes the words of the auditor's opinion in terms that are significantly different from the requirements of the ISAs, the requirements of paragraph 19 apply.

Limitation on Scope Prior to Audit Engagement Acceptance

7. If management imposes 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 entity's financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so. (Ref: Para. A14)

Reasons for not Proceeding with the Audit Engagement

8. 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 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 acknowledgement and agreement referred to in paragraph 4(b) has not been obtained.

Agreement on Audit Engagement Terms

9. The auditor shall agree with management, or where appropriate those charged with governance, on the terms of the audit engagement. Unless sufficiently specified by law or regulation, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. (Ref: Para. A15-A17)

10. The audit engagement letter or other agreement shall include:

    (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 (see paragraph 4(b));

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

    (e) The form of any reports to be issued by the auditor. (Ref: Para. A18-A19)

Recurring Audits

11. 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. A20)

Acceptance of a Change in Engagement

12. 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. A21-A23)

13. 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. A24-A25)

14. Where the terms of the audit engagement are changed, the auditor and management, or where appropriate 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.

15. 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.

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

16. 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:

    (a) Management agrees to provide additional disclosures in the entity's financial statements, to avoid the financial statements being misleading; and

    (b) It is recognized in the terms of the audit engagement that:

        (i) The auditor's report on the entity's financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with [proposed] ISA 706 (Revised and Redrafted), "Emphasis of Matter Paragraphs or Other Matter(s) Paragraphs in the Independent Auditor's Report,"[2]; and

[2] The IAASB has a project in progress to revise extant ISA 701, "Modifications to the Independent Auditor's Report." Where this Exposure Draft refers to proposed draft wording under consideration at present, the IAASB will consider the need for modification of the wording of this ISA as part of the deliberations relating to the future exposure and finalization of proposed revised and redrafted ISA 706.

(ii) Unless the auditor is required by law or regulation to express the auditor's opinion on the entity's 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 entity's financial statements will not include such phrases.

17. If management refuses to provide additional disclosures, and the auditor is prohibited by law and 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.

Financial Reporting Standards Supplemented by Law or Regulation—Conflicts

18. If financial reporting standards established by an authorized or recognized standards setting organization 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 the nature of the additional requirements and shall agree whether:

(a) The additional requirements can be met through additional disclosures in the entity's 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 is necessary to modify the audit opinion in the auditor's report in accordance with [proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report."[3] (Ref: Para. A26)

Wording Used to Express the Opinion

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

(a) Whether users might misunderstand the assurance obtained from the audit of the entity's financial statements; and if so

(b) Whether additional explanation in the auditor's report (see [proposed] ISA 706 (Revised and Redrafted) can mitigate possible misunderstanding.

[3] The IAASB has a project in progress to revise extant ISA 701, "Modifications to the Independent Auditor's Report." Where this Exposure Draft refers to proposed draft wording under consideration at present, the IAASB will consider the need for modification of the wording of this ISA as part of the deliberations relating to the future exposure and finalization of proposed revised and redrafted ISA 705.

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 which the auditor is thereby required to accept is not an audit conducted in accordance with the ISAs.

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Application and Other Explanatory Material

Objective (Ref: Para. 3)

Audit Engagement Acceptance

A1. Establishing whether the necessary preconditions for an audit are present and agreeing on the audit engagement terms are complemented by acceptance and continuance requirements in [proposed] ISA 220 (Redrafted), "Quality Control for Audit Engagements."

Preconditions for an Audit (Ref: Para. 4-8)

The Financial Reporting Framework

A2. 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 ISAs, the applicable financial reporting framework provides the criteria the auditor uses to evaluate or measure the preparation and presentation of the financial statements.

A3. Without an acceptable financial reporting framework management does not have an appropriate basis for preparing and presenting the financial statements and the auditor does not have suitable criteria for evaluating the entity's financial statements. In many cases the auditor may presume that the financial reporting framework is acceptable, as described in paragraphs A7 and A8.

Determining the Acceptability of the Financial Reporting Framework

A4. Factors that may affect the auditor's determination of the acceptability of the applicable financial reporting framework include:

- The nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not for profit organization);
- 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.

A5. 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 in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users, are referred to as general purpose financial statements.

A6. 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] ISA 800 (Revised and Redrafted), "Special Considerations—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement"[4] discusses the acceptability of financial reporting frameworks designed to meet the financial information needs of specific users.

General Purpose Frameworks

A7. At present, there is no objective and authoritative basis that has been generally recognized globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organizations that are authorized or recognized 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 organizations 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
- Accounting principles promulgated by an authorized or recognized standards setting organization in a particular jurisdiction.

[4] The IAASB has a project in progress to revise extant ISA 800, "The Independent Auditor's Report on Special Purpose Audit Engagements." Where this Exposure Draft refers to proposed draft wording under consideration at present, the IAASB will consider the need for modification of the wording of this ISA as part of the deliberations relating to the future exposure and finalization of proposed revised and redrafted ISA 800.

1. 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

A8. In accordance with paragraph 4, the auditor is required to determine whether the financial reporting framework, adopted by management in preparing the financial statements, is acceptable. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used by management in preparing and presenting 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 16 and 17 apply.)

Jurisdictions that Do Not Have Authorized or Recognized Standards Setting Organizations or Financial Reporting Frameworks Prescribed by Law or Regulation

A9. When an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, or where use of the financial reporting framework is not prescribed by law or regulation, management identifies an applicable financial reporting framework. Appendix 2 contains guidance on determining the acceptability of financial reporting frameworks in such circumstances.

Acknowledgement and Agreement of Management, and where appropriate, Those Charged with Governance

A10. [Proposed] ISA 200 (Revised and Redrafted) "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing" states that audits are conducted on the premises that management and, where appropriate, those charged with governance, acknowledge and understand the responsibilities set out in paragraph 4 of this ISA. These premises are fundamental to the ability to conduct an effective independent audit, but there may be a risk that these premises may not be understood by management or those charged with governance. To avoid misunderstanding, agreement is reached with management and, where appropriate, those charged with governance about their responsibilities, as part of agreeing and recording the terms of audit engagement. The acknowledgement and agreement referred to above may be included in the written terms of the audit engagement required by paragraph 9.

A11. Since [proposed] ISA 580 (Revised and Redrafted), "Written Representations" requires the auditor to obtain written representations about the validity of these premises, it may also be appropriate to make management aware that receipt of such representations from relevant persons will be expected together with, where appropriate, specific written representations. It also may be useful to agree with management or those charged with governance who the relevant persons are expected to be.

A12. Management is also responsible for providing complete information to the auditor (see paragraph 4(b)(iii)). Providing complete information includes granting unrestricted access to records, documentation and other information that is requested by the auditor in connection with the audit of the entity.

A13. Where management or those charged with governance will not make the necessary acknowledgements and agreements, or will not agree to provide the necessary written representations, the auditor will be unable to obtain sufficient appropriate audit evidence. In such circumstances, it may not be appropriate for the auditor to accept the audit engagement. In some cases, however, law or regulation prevents the auditor from refusing an audit engagement. In these cases, the auditor may need to explain to management and those charged with governance the importance of these matters, and the implications for the auditor's report.

Limitation on Scope Prior to Audit Engagement Acceptance

A14. A limitation on the scope of the auditor's work may sometimes be imposed by management prior to audit engagement acceptance (for example, when the proposed terms of the audit engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary).

Agreement on Audit Engagement Terms (Ref: Para. 9-10)

Audit Engagement Letter or Other Form of Written Agreement[5]

A15. It is in the interest of both entity and auditor that the auditor sends an audit engagement letter, preferably before the commencement of the audit engagement, to help in avoiding misunderstandings with respect to the audit engagement. In some countries, however, the objective and scope of an audit and the auditor's obligations are sufficiently established by law, that is, they prescribe the matters described in paragraphs 4 and 10. Even in those situations the auditor may still find an audit engagement letter informative for these entities.

Public Sector Entities—Terms of Audit Engagements

A16. Law and regulation governing the operations of public sector audits generally mandate the appointment of a public sector auditor and commonly set out the public sector 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 public sector 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 10 of this ISA not sufficiently covered by law or regulation, would satisfy this requirement.

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[5] 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.

Audits of Components

A17. 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

A18. 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 and management's responsibilities may be based on [proposed] ISA 200 (Revised and Redrafted). In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, ISAs and ethical and other pronouncements of professional bodies to which the auditor adheres.
- The form of any other communication of results of the audit engagement.
- The 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.
- The expectation of receiving from management written confirmation concerning representations made in connection with the audit (see also A11).
- The basis on which fees are computed and any billing arrangements.
- A request for management, and where appropriate, those charged with governance, to acknowledge receipt of the audit engagement letter.

A19. 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 to inform the auditor of facts, that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- 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. 11)

A20. 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 by management in preparing the entity's financial statements.
- A change in other reporting requirements.

Acceptance of a Change in Engagement (Ref: Para. 12-13)

A21. 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 caused by circumstances. The auditor, as required by paragraph 12, considers the reason given for the request, particularly the implications of a restriction on the scope of the audit engagement.

A22. 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.

A23. 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.

A24. Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with the ISAs may need to assess, in addition to the above matters, any legal or contractual implications of the change.

A25. If the auditor concludes that there is reasonable justification to change the audit engagement to 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.

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

A26. In some jurisdictions, legislative or regulatory requirements may supplement the financial reporting standards established by an authorized or recognized standards setting organization with additional requirements relating to preparing and presenting 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.

Deficiencies in the Applicable Financial Reporting Framework

A27. 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 16 and 17 apply. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does 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.

Considerations Specific to Audits of Public Sector Entities

A28. In the public sector specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if management attempts to limit the scope of the audit.

Appendix 1

(Ref: Para. A19)

Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with International Financial Reporting Standards. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this ISA. It will need to be varied according to individual requirements and circumstances. It may be appropriate to seek legal advice to ensure that any proposed letter is suitable.

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

[*The objective and scope of the audit*]

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 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 International Standards on Auditing. 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.

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 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 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.

[*The responsibilities of management, and where appropriate, those charged with governance and identification of the applicable financial reporting framework*]

Our audit will be conducted on the basis that management accepts the following responsibilities:

(a) The responsibility for the preparation of financial statements that present fairly the financial position, financial performance and cash flows of the entity in accordance with International Financial Reporting Standards. This includes selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

(b) The responsibility for designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

(c) The responsibility to provide us with complete information including unrestricted access to records, documentation and other information requested in connection with our audit.

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 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.

Acknowledged and agreed on behalf of ABC Company by

(signed)
.....
Name and Title
Date

Appendix 2

(Ref: Para. A9)

Determining the Acceptability of General Purpose Frameworks

Jurisdictions that Do Not Have Authorized or Recognized Standards Setting Organizations or Financial Reporting Frameworks Prescribed by Law or Regulation

1. As explained in paragraph A9 of this ISA, when an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, or where use of the financial reporting framework is not prescribed by law or regulation, management identifies an applicable financial reporting framework. Practice in such jurisdictions is often to use the financial reporting standards established by one of the organizations described in paragraph A7 of this ISA.

2. Alternatively, there may be established accounting conventions in a particular jurisdiction that are generally recognized 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 by management, the auditor is required by paragraph 4 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 IFRSs. 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 authorized or recognized standards setting organization. When the auditor makes such a comparison and differences are identified, the decision as to whether the accounting conventions adopted by management in preparing and presenting 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.

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