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United States Government Accountability Office
Washington, DC 20548

April 15, 2008

International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017

Subject: International Auditing and Assurance Standards Board (IAASB) January 2008 Exposure Draft: ISA 210 (Redrafted), *Agreeing the Terms of Audit Engagements and Related Conforming Amendments to Other ISAs*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the IAASB's proposed redrafts to ISA 210.

GAO is committed to transforming and modernizing the accountability profession; accordingly, we support the IAASB's efforts to enhance the consistency of auditor performance in an audit of financial statements by developing a set of international standards that are generally accepted worldwide. Overall, we support the proposed revisions to ISA 210. In particular, we believe that the proposed revisions to ISA 210 will help provide clarity and improve the consistency of practice related to agreeing the terms of an audit engagement.

The Board has asked respondents to comment on specific questions regarding the application of the clarity drafting conventions and the proposed conforming amendments. We have identified certain issues that, in our opinion, would benefit from additional clarification or better descriptive terminology. Our suggested revisions focus on the following:

- Clarifying and Reorganizing the Proposed Standard
- Agreeing the Terms of Engagements on Recurring Audits
- Considerations Specific to Public Sector Entities
- Additional Proposed Revisions

Clarifying and Reorganizing the Proposed Standard

To improve the clarity of the proposed standard and provide for a more logical flow of its provisions, which will encourage consistency of practice, we recommend revising and reorganizing the proposed standard as follows:

- The reasons discussed in the proposed ISA for not proceeding with or accepting an audit engagement could be more clearly stated by expanding paragraph 6 to refer to the reasons addressed in paragraphs 17 and 19. Paragraph 5 can be deleted since it is essentially the same as the proposed paragraph 6(b).

- Paragraphs that address the Agreement on Audit Engagement Terms should be organized together under the subheading on page 4. Paragraph 7 can be deleted since it is essentially the same as proposed paragraph 4(b).

- Paragraphs 10 and 11 provide additional guidance – rather than requirements – to an auditor in situations whereby the engagement framework is prescribed by law or regulation. We recommend moving this guidance to follow paragraph A18 in the Application and Other Explanatory Material section of the standard.

The attached reformatted draft of this proposed standard illustrates these recommended changes. While we have made changes to the cross-references in the attachment, we have not reformatted applicable paragraphs of the application and other explanatory material to align with grouping changes suggested in the requirements section of the standard.

<u>Agreeing to Terms of Engagements on Recurring Audits</u>

We recommend adding to paragraph 12 a requirement for auditors to assess the need to revise the terms of recurring engagements. This change will make clear that auditors should make this assessment for each engagement, even when no changes in circumstances have occurred. We also recommend providing principle-based guidance in paragraph A24 to assist auditors in determining when to revise the terms of recurring engagements. Such guidance would compliment the factors for making the determination discussed in paragraph A24.

The attached reformatted draft of this proposed standard illustrates these recommended changes to paragraphs 12 and A24.

<u>Considerations Specific to Public Sector Entities</u>

In addition to being required by law or regulation to accept certain engagements, some government audit offices are authorized to perform engagements under their own authority when there is a compelling public interest reason for doing so. We recommend adding a public sector consideration to address such situations. Specifically, the IAASB should add a new paragraph in the application material stating that in some situations, auditors in the public sector may perform audit engagements under their own legal authority and that in those situations, for purposes of applying ISA 210, those types of engagements would be considered equivalent to situations where the auditor is required by law or regulation to conduct the audit.

We have provided proposed wording for this revision in new paragraph A35 of the attachment to this letter.

Additional Proposed Revisions

In addition to the above comments, we have included the following proposed changes in the attachment to this letter:

- We recommend replacing the term “entity” with “management, and where appropriate, those charged with governance” in paragraph 1(a), to conform the wording in this paragraph with the wording used throughout the proposed ISA.
- The guidance in paragraph 16(b) could be improved by including regulators in the other parties for the auditor to inform of circumstances necessitating the auditor to withdraw from the engagement.
- Rewording paragraphs 17, 19, and A30 as indicated in the attachment will facilitate translation of the ISA into other languages.

We thank you for considering our comments on these important issues.

McCoy Williams

McCoy Williams
Managing Director
Financial Management and Assurance

Attachment

cc: Mr. James M. Sylph, Technical Director
International Auditing and Assurance Standards Board

The Honorable Christopher Cox, Chairman
Securities and Exchange Commission

Mr. Kjell Larsson, Public Member
International Auditing and Assurance Standards Board

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board

Mr. Harold Monk, Chair
Auditing Standards Board

ATTACHMENT TO GAO's COMMENT LETTER
GAO's proposed changes to proposed ISA 210

Exposure Draft
January 2008
Comments are requested by April 15, 2008

Proposed Redrafted International Standard on Auditing

ISA 210, Agreeing the Terms of Audit Engagements and Related Conforming Amendments to Other ISAs

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~~ management, and where appropriate, those charged with governance; 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 ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2009].

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[1]

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 applied in the preparation and presentation of the financial statements is acceptable; (Ref: Para. A3-A10)

   (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.~~ [delete this paragraph]~~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. Unless required by law or regulation to do so, the auditor shall not accept a proposed engagement if the any of following conditions exist:

(a) The agreement referred to in paragraph 4(b) has not been obtained.

(b) Limitations are imposed by management or those charged with governance that the auditor believes will result in the auditor disclaiming an opinion on the financial statements.

(c) Laws or regulations prescribe the wording of the audit opinion in terms that are significantly different from the requirements of the ISAs and the requirements of paragraph 17 are not met.

(d) The financial reporting framework is unacceptable and the requirements of paragraph 19 are not met.

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.~~

Agreement on Audit Engagement Terms

~~7.~~ [delete this paragraph]~~The auditor shall agree the terms of the audit engagement with management or those charged with governance.~~

8. The agreed-upon 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, t~~The agreed-upon terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. (Ref: Para. A21)

~~10.~~ [moved to paragraph A18A] ~~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.~~ [moved to paragraph A18B] ~~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 determine~~consider~~ each year whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind ~~the entity~~ management, and where appropriate, those charged with governance 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 or regulators.

Additional Consideration 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 ISAs. In these circumstances, the auditor shall evaluate:

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

(b) Whether additional explanation in the auditor's report is likely to~~can~~ mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor's report is unlikely to~~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 ISAs. Accordingly, the auditor shall include no reference within the auditor's report to the audit having been conducted in accordance with ISAs. (Ref: Para. A30 and A33)

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 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] ISA 705 (Revised and Redrafted). (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 recognized in t~~The terms of the audit engagement indicate 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] ISA 706 (Revised and Redrafted); 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.

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.

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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] ISA 220 (Redrafted).

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 ISAs, 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:

- 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.

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] ISA 800 (Revised and Redrafted) 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 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.

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 jurisdictions, 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 authorized or recognized standards setting organizations 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 authorized or recognized standards setting organization, 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 ISAs is conducted on the premise only if management and, where appropriate, those charged with governance have the responsibilities set out in paragraph 4(b). 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.

A12. ISA 580 (Revised and Redrafted) requires the auditor to request management and, where appropriate, those charged with governance to provide written representations that they have fulfilled these responsibilities.[7] 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 ISAs 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.[8] 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."[9] 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 jurisdictions, 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 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[10] (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 countries, 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.~~

A18A. [*Moved from Paragraph 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)

A18B. [*Moved from Paragraph 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 may ~~shall~~ reflect the description in paragraph 4 (b). (Ref: Para. A20)

Considerations Specific to Public Sector Entities

A19. Law or 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 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 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 or national standard setter in a jurisdiction may provide guidance as to whether the description in law or regulation is equivalent.

Audits of Components (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] ISA 200 (Revised and Redrafted). Paragraphs 4(b) and 11 of this ISA 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, 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 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.

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, it may be appropriate to ~~the following factors may make it appropriate to it to~~ revise the terms of the audit engagement or to remind the entity of existing terms if any changes in circumstances have occurred that could increase the risk that the auditor, management, or those charged with governance may misunderstand the needs or expectations of the other parties. Examples of such changes may include:~~:~~

- 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 ISAs 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. ISAs require that the auditor shall not represent compliance with ISAs unless the auditor has complied with all of the ISAs 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 ISAs and the auditor concludes that additional explanation in the auditor's report cannot mitigate likely~~possible~~ misunderstanding, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with ISAs. The auditor is, however, encouraged to apply ISAs, including the ISAs 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 ISAs.

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

A31. 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 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 ISAs (see paragraph 17).

Considerations Specific to Public Sector Entities

A34. 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 the entity attempts to limit the scope of the audit.

A35. In some cases, auditors in the public sector may choose to perform a particular audit engagement under the legal authority of the public sector audit office. The provisions of paragraphs 6, 16, 17, 20, and A13 relating to situations where the auditor is required by law or regulation to conduct the audit would also apply in situations where the public sector auditor chooses to perform the engagement under its legal authority.