

INTOSAI



*Practice Note to ISA 210*

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## *Agreeing the Terms of Audit Engagements*

# INTOSAI



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*Practice Note to International Standard on Auditing (ISA) 210*

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# Agreeing the Terms of Audit Engagements

## Background

This Practice Note provides supplementary guidance on ISA 210 – Agreeing the Terms of Audit Engagements. It is read together with the ISA. ISA 210 is effective for audits of financial statements for periods ending on or after December 15, 2016. The Practice Note is effective the same date as the ISA.

## Introduction to the ISA

ISA 210 deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present. ISA 2202 deals with those aspects of engagement acceptance that are within the control of the auditor.

## Content of the Practice Note

- P1. The Practice Note provides additional guidance for public sector auditors related to:
- (a) Preconditions for an Audit.
  - (b) Agreement on Audit Engagement Terms.
  - (c) Acceptance of a Change in the Terms of the Audit Engagement.

## Applicability of the ISA in Public Sector Auditing

- P2. ISA 210 is applicable to auditors of public sector entities in their role as auditors of financial statements.
- P3. The terms of an audit engagement in the public sector are normally mandated and therefore not subject to requests from, and agreement with, management. Therefore the requirements in the ISA, when applied in the public sector context, are useful in establishing a common, formal understanding of the respective roles and responsibilities of management and the auditor. Since the public sector auditor is normally engaged by and reports to the legislature, agreements often need to be reached with both the legislature and management.

## Additional Guidance on Public Sector Issues

- P4. ISA 210 contains application and other explanatory material with considerations specific to public sector entities in paragraphs A27 and A37.

## Preconditions for an Audit

P5. When establishing whether necessary preconditions for an audit are present as required in paragraph 6(a) of the ISA, public sector auditors consider that in the public sector the financial reporting framework may often be prescribed by law and regulation. If public sector auditors determine that the framework prescribed by law and regulation is not acceptable they apply the requirements of paragraphs 8, 19 and 20 of the ISA, and also consider:

- Informing the legislature; and
- Influencing standard setting by professional or regulatory organizations

P6. When obtaining the agreement of management and, where appropriate, the legislature and those charged with governance that they acknowledge and understand their responsibility as stated in paragraph 6(b) of ISA 210, public sector auditors take into account the fact that the responsibilities of management and those charged with governance in the public sector may be broader than those responsibilities in the private sector. The form of legislation, as well as management and governance structures may vary widely within the public sector, thereby enhancing the need to formalize the acknowledgement and understanding of such responsibilities.

## Agreement on Audit Engagement Terms

P7. In the public sector there may be additional matters, besides the examples listed in paragraph A23 of the ISA, that public sector auditors have to report if they become aware of them during the course of the audit and that, therefore, may be relevant to the engagement letter, such as:

- Non-effective performance of operations – relates to management's responsibility to undertake activities in an effective and efficient manner;
- Instances of non-compliance with authorities – relates to management's responsibility to undertake activities, use resources, and fulfill accountability requirements, in accordance with authority granted by the legislature and all other relevant directions;
- Waste – relates to management's responsibility to obtain and apply resources in an economical manner, without any public money being wasted; and
- Instances of abuse – relates to management's responsibility to meet the expectations of the legislature and the public as they relate to appropriate standards of behavior. It may also be advisable to describe the arrangements to protect the public sector auditor's independence. When relevant, other audit objectives stipulated by the mandate may also be included in the engagement letter.

P8. In addition to the points listed in paragraph A24 of the ISA public sector auditors may also consider it relevant to include any arrangements whereby the audit is contracted out to another auditor.

- P9. In the public sector, the acceptance and continuance process referred to in paragraph 7 of the ISA is influenced by the fact that public sector auditors may not have the option to decline or withdraw from the audit. However, in cases where management or the legislature imposes a scope limitation prior to the start of the engagement, the effect of which may result in the auditor disclaiming the opinion on the financial statements, public sector auditors consider the situation and how it may impact the risk assessment, the audit approach and the auditor's report. In some cases it may also be appropriate to report separately to the legislature.
- P10. Paragraph 8 of the ISA discusses other factors affecting audit engagements acceptance. In a situation where the preconditions for an audit are not present and when public sector auditors do not have the option to decline an audit engagement, an appropriate response in addition to the requirements in paragraphs 19 and 20 of the ISA may include informing the legislature.
- P11. Paragraph A23a of the ISA recommends that it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating key audit matters in the auditor's report. Public sector auditors may be required to or decide to communicate to other parties, such as the legislature, in addition to management or those charged with governance.

## Acceptance of a Change in the Terms of the Audit Engagement

- P12. When considering the requirements in paragraphs 14 and 15 of the ISA, public sector auditors may note that the terms of an audit engagement in the public sector are normally mandated and therefore not subject to requests from, and agreement with, management.

## Appendix 1:

### Example of an Audit Engagement Letter in the Public Sector

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with International Public Sector Accounting Standards. This letter is intended only to be a guide that may be used, but will need to be tailored according to individual requirements and circumstances. It may be appropriate to seek legal advice that any proposed engagement letter is suitable.

Addressee

[To the appropriate representative of management or those charged with governance of the entity]

Date

Dear Sir/Madam

Audit Engagement Letter

### Introduction

The [group] financial statements as of [date] and for the year then ended of the [name of the entity] and the [names of subsidiaries] are subject to auditing by the [Public Sector Audit Organization] in accordance with [relevant legislation]

The purpose of this letter is to outline:

- (a) The terms of the audit engagement and the nature, and limitations, of the annual audit; and
- (b) The respective responsibilities of the auditor and the [appropriate level of management] in the annual audit.

The terms of the audit engagement are set out below. This letter will remain effective until a new audit engagement letter is issued.

### Objective(s) of the Audit

The objective(s) of the annual audit are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion; and
- (b) [Additional objectives e.g., related to compliance with authorities or internal controls].

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with [relevant auditing standards] will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

## Responsibilities of the Auditors

### *The Auditing Standards Applied when Conducting the Audit*

We will conduct our audit in accordance with the [relevant auditing standards].

The auditing standards require that we comply with ethical requirements. As part of an audit in accordance with [relevant auditing standards], we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with [relevant auditing standards].

*[When relevant, public sector auditors consider including information on their responsibilities related to any additional audit objectives]*

While our audit is not directed to reporting the following, we will report these items if we become aware of them during the course of the audit:

- (a) Non-effective performance of operations – relates to management's responsibility to undertake activities in an effective and efficient manner;

- (b) Instances of non-compliance with authorities – relates to management’s responsibility to undertake activities, use resources, and fulfill accountability requirements, in accordance with authority granted by the legislature and all other relevant directions;
- (c) Waste – relates to management’s responsibility to obtain and apply resources in an economical manner, without any public money being wasted; and
- (d) Instances of abuse – relates to management’s responsibility to meet the expectations of the legislature and the public as they relate to appropriate standards of behavior.

## Reporting

The form and content of our report may need to be amended in the light of our audit findings.

*[Insert appropriate reference to the expected form and content of the auditor’s report including, if applicable, the reporting on other information in accordance with ISA 720 (Revised).]*

## Independence

Our ethical requirements require us to remain independent of the [entity type], and we hereby confirm our independence with respect to this audit. This means we are, in both fact and appearance, free of any interest that, whatever its actual effect, might be deemed incompatible with integrity, objectivity and independence.

*[Clarify any perceived limitations of independence by describing the threats and safeguards to independence.]*

### Responsibilities of management and those charged with governance

*[The responsibilities of management and, where appropriate, those charged with governance, and identification of the applicable financial reporting framework. For purposes of this example it is assumed that the auditor has determined that the law or regulation does not prescribe those responsibilities in appropriate terms. The description in paragraph 6(b) of ISA 210 is therefore used. When relevant, information on management’s responsibilities related to additional audit objectives needs to be included.]*

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

- (a) For the preparation and fair presentation of the financial statements (or for the preparation of financial statements that give a true and fair view) in accordance with (applicable financial reporting framework);
- (b) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement; whether due to fraud or error; and
- (c) To provide us with:
  - (i) Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - (ii) Additional information that we may request from management for the purpose of the audit; and
  - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.



## Representation letter

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

## Other relevant information

*[Under this heading it may be appropriate to include information regarding for example:*

- *Statutory reporting deadlines;*
- *Ownership of working papers;*
- *Contractual arrangements with auditors doing work on behalf of the public sector audit organization;*
- *Fees;*
- *Relevant contact information, staff accommodation and resources; and*
- *Any other matters to assist in clarifying the expectation gap and to enhance effective communication].*

## Acknowledgement of the terms of the engagement

Please acknowledge receipt of this letter and acceptance of the terms of the audit engagement by signing the enclosed copy of this letter in the space provided and returning it to [insert name].

If you require any further information, or wish to discuss the terms of the audit engagement further before replying, please do not hesitate to contact me.

Yours sincerely,

Signed

.....

Appointed public sector auditor

The terms of this audit engagement are agreed to and acknowledged by *[designation of person signing]* on behalf of the [name of entity].

.....

Signed

.....

Name and position Date

*[appropriate representative of management or those charged with governance]*