

ASA 210
(April 2006)

Auditing Standard ASA 210 *Terms of Audit Engagements*

Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

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PREFACE

Reasons for Issuing Auditing Standard ASA 210 *Terms of Audit Engagements*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 210 *Terms of Audit Engagements* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Main Features

This Auditing Standard establishes mandatory requirements and provides explanatory guidance on:

- (a) agreeing and documenting the terms of the audit engagement with the entity; and
- (b) the auditor's response to a request by the entity to change the terms of the audit engagement to an engagement that provides a lower level of assurance.

Operative Date

This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from AUS 204 (June 2000) *Terms of Audit Engagements*

The main differences between this Auditing Standard and the Auditing Standard issued by the Auditing & Assurance Standards Board of the Australian Accounting Research Foundation, AUS 204 (June 2000) *Terms of Audit Engagements*, are that in this Auditing Standard:

1. The word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility is described in AUS 204 by the word 'should'.
2. The explanatory guidance paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 204 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.
3. The following additional mandatory requirement, not contained in AUS 204, is included:
 - (a) the terms of the engagement shall identify the applicable financial reporting framework (paragraph 17).
4. The following additional explanatory guidance, not contained in AUS 204, is included:
 - (a) the auditor independence requirements of the *Corporations Act 2001* (paragraphs 13 and 14).
5. The example engagement letter at Appendix 1 has been re-worded based on the example engagement letter in the equivalent ISA 210 *Terms of Audit Engagements*, and also includes matters relating to auditor independence and the entity's annual general meeting.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard ASA 210 *Terms of Audit Engagements* as set out in paragraphs 1 to 30 and Appendix 1, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

Dated 28 April 2006

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 210

Terms of Audit Engagements

Application

- 1 **This Auditing Standard applies to:**
 - (a) **an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and**
 - (b) **an audit of a financial report for any other purpose.**
- 2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

Operative Date

- 3 **This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.**

Introduction

- 4 The purpose of this Auditing Standard is to establish mandatory requirements and to provide explanatory guidance on:
 - (a) agreeing and documenting the terms of the audit engagement with the entity; and
 - (b) the auditor's response to a request by the entity to change the terms of the audit engagement to one that provides a lower level of assurance.
- 5 **The auditor shall agree on the terms of the audit engagement with the entity, which shall be recorded in writing by the auditor and forwarded to the entity. When the audit engagement is undertaken pursuant to legislation, the minimum applicable terms are those contained in the legislation.**
- 6 The agreed terms are ordinarily recorded in an audit engagement letter but may also be recorded in another suitable form of contract.

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- 7 This Auditing Standard is intended to assist the auditor in the preparation of an engagement letter relating to an audit of a financial report.
- 8 In some instances, the objective and scope of an audit and the auditor's obligations are established by law. For example, the objective of the audit of a financial report of certain entities is established by the *Corporations Act 2001*. Even in those situations, auditors may still find engagement letters informative for their clients.

Audit Engagement Letters

- 9 It is in the interests of both the entity and the auditor that the auditor sends an engagement letter, preferably before the commencement of the audit, to help avoid misunderstandings with respect to the engagement. Ordinarily, the engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the entity and the form of any reports.

Principal Contents

- 10 The form and content of audit engagement letters may vary for each entity, but they would generally include reference to:
- The objective of the audit of the financial report.
 - Management's responsibility, with oversight from those charged with governance, for the subject matter of the audit as described in ASA 200 *Objective and General Principles Governing an Audit of a Financial Report*.
 - The scope of the audit, including reference to applicable regulations and the relevant ethical requirements relating to audit engagements to which the auditor adheres.
 - The form of any reports or other communication of results of the engagement.
 - The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered.

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- Unrestricted access to whatever records, documentation and other information is requested in connection with the audit.
- 11 The auditor may also wish to include in the engagement letter:
- Arrangements regarding the planning and performance of the audit.
 - Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
 - Request for the entity to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
 - Description of any other letters or reports the auditor expects to issue to the entity.
 - Basis on which fees are computed and any billing arrangements.
- 12 When relevant, the following points could also be included:
- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
 - Arrangements concerning the involvement of internal auditors and other entity staff.
 - 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.
 - A reference to other applicable legislation such as the privacy legislation.
 - Clarification of the entity's responsibility for control issues relevant to the presentation of electronic information, where the entity's audited financial report (or other audited subject matter) is presented on an internet web site.

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- For special purpose audit engagements, a reference to the auditor not assuming any responsibility for reliance on the audited financial report (or other audited subject matter) if it is used or disseminated other than for the stated purpose for which it was intended (for example, when the audited financial report is released to third parties without the auditor's consent).

An example of an audit engagement letter is set out in Appendix 1.

Auditor Independence

- 13 When the audit is conducted in accordance with Part 2M.3 of the *Corporations Act 2001*, the auditor ordinarily includes in the written terms of the engagement:
- A statement confirming that, to the best of the auditor's knowledge and belief, the auditor currently meets the independence requirements of the *Corporations Act 2001* in relation to the audit of the financial report.
 - A statement confirming that, should the auditor become aware that the auditor has contravened the independence requirements of the *Corporations Act 2001*, the auditor will notify the entity on a timely basis.
- 14 The *Corporations Act 2001* contains general and specific provisions in relation to auditor independence, a range of specific restrictions on the employment relationships existing between the audited entity and its auditor and provisions relating to the auditor's attendance at an entity's annual general meeting, which the auditor may also include in the engagement letter.

Audits of Components

- 15 When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the auditor's decision whether to send a separate engagement letter to the component include:
- Who appoints the auditor of the component.
 - Whether a separate audit report is to be issued on the component.
 - Legal requirements.

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- The extent of any work performed by other auditors.
 - The degree of ownership by the parent entity.
 - The degree of independence of the component management.
 - Whether the terms of engagement for each component are the same.
 - Relevant regulatory requirements.
- 16 The auditor may send one engagement letter relating to the group as a whole. In such cases, the auditor ordinarily identifies each component of the entity whose financial report is to be audited, the date and period covered by the financial report and any other relevant reporting requirements.
- 17 **The terms of the engagement shall identify the applicable financial reporting framework.**

Recurring Audits

- 18 **On recurring audits, the auditor shall consider whether circumstances require the terms of the engagement to be revised, and whether there is a need to re-confirm in writing the existing terms of the engagement with the entity.**
- 19 The auditor may decide not to send a new engagement letter each period. However, the following factors may make it appropriate to send a new engagement letter:
- Any indication that the entity misunderstands the objective and scope of the audit.
 - Any revised or special terms of the engagement.
 - A recent change of senior management or those charged with governance.
 - A significant change in ownership.
 - A significant change in the nature or size of the entity's business.
 - Legal or regulatory requirements.

Acceptance of a Change in the Terms of the Engagement

- 20** The auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, shall consider the appropriateness of doing so.
- 21 A request from the entity for the auditor to change the terms of the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of the audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. Under paragraph 26 of this Auditing Standard, the auditor needs to carefully consider the reason given for the request, particularly the implications of a restriction on the scope of the engagement.
- 22 A change in circumstances that affects the entity's requirements, or a misunderstanding concerning the nature of the service originally requested, is ordinarily considered to be a reasonable basis for requesting a change in the engagement. In contrast, a change is not considered to be reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.
- 23 Before agreeing to change the audit engagement to a review¹ or related service engagement, an auditor who was engaged to perform the audit in accordance with Auditing Standards ordinarily considers, in addition to the above matters, any legal or contractual implications of the change.
- 24 If the auditor concludes that there is reasonable justification to change the terms of the engagement and if the audit work performed complies with the Auditing Standards relevant to the changed terms of the engagement, the report issued would be that appropriate for the revised terms of the engagement. In order to avoid confusing the user, the report would not ordinarily include reference to:
- (a) the original engagement; or
 - (b) any procedures that may have been performed in the original engagement, except where the 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.

¹ A review provides a lower level of assurance than an audit.

- 25 **Where the terms of the engagement are changed the auditor shall agree on the new terms with the entity and confirm them in writing.**
- 26 **The auditor shall not agree to a change in the terms of the engagement where there is no reasonable justification for doing so.**
- 27 An example of where there is no reasonable justification might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.
- 28 **If the auditor is unable to agree to a change in the terms of the engagement and is not permitted to continue the original engagement, unless prohibited by law or regulation, the auditor shall withdraw from the engagement and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as those charged with governance or shareholders, the circumstances necessitating the withdrawal.**
- 29 In some cases, law or regulation may limit the auditor's ability to withdraw from the engagement. In such cases, the auditor ordinarily considers the effect on the auditor's report.

Conformity with International Standards on Auditing

- 30 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 210 *Terms of Audit Engagements*, issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The main differences between this Auditing Standard and ISA 210 are:
- This Auditing Standard contains mandatory requirements for the auditor to record the agreed terms of the audit engagement in writing and forward them to the entity (paragraphs 5, 18 and 25). ISA 210 does not require the terms of the audit engagement to be recorded in writing.
 - This Auditing Standard contains a mandatory requirement that where the audit is undertaken pursuant to legislation, the minimum applicable terms in an engagement letter are those contained in the legislation whereas ISA 210 does not (paragraph 5).

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- This Auditing Standard contains explanatory guidance on documenting certain matters in the engagement letter relating to auditor independence where the engagement is conducted pursuant to Part 2M.3 of the *Corporations Act 2001* (paragraphs 13 and 14). ISA 210 does not require the auditor to document certain matters in the engagement letter relating to auditor independence.
- This Auditing Standard provides explanatory guidance relating to circumstances where the auditor of a parent entity is also the auditor of its component and elects to send one engagement letter relating to a group as a whole (the audit of components), whereas ISA 210 does not (paragraphs 15 and 16).
- The example engagement letter in Appendix 1 of this Auditing Standard includes matters relating to auditor independence and the presentation of the financial report on the internet, whereas ISA 210 does not.
- This Auditing Standard does not include a separate section on the public sector as it is sector neutral. ISA 210 includes a Public Sector Perspective section.

Compliance with this Auditing Standard enables compliance with ISA 210.

APPENDIX 1

EXAMPLE OF AN ENGAGEMENT LETTER FOR A FINANCIAL REPORT AUDIT ENGAGEMENT

The following example audit engagement letter is for use as a guide only, in conjunction with the mandatory requirements and explanatory guidance in this Auditing Standard, and will need to be varied according to individual needs and circumstances. The engagement letter is written in the context of an engagement to audit a general purpose financial report under the *Corporations Act 2001*.

To [the board of directors, those charged with governance or the appropriate representative of senior management]:

Scope

You have requested that we audit the financial report of [name of entity], which comprises the balance sheet as at 30 June 20XX, and the income statement, statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies, other explanatory notes and the directors' declaration. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial report.

We will conduct our audit in accordance with Australian Auditing Standards. Those Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement. An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. An audit also includes evaluating the appropriateness of the financial reporting framework, accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial report.

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 report in order to design audit procedures

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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 report.²

We take this opportunity to remind you that the responsibility for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards³ (including the Australian Accounting Interpretations) and the *Corporations Act 2001* is that of [the directors, those charged with governance or insert title]. Our auditor's report will explain that [the directors, those charged with governance or insert title] are responsible for the preparation and the fair presentation of the financial report in accordance with the applicable financial reporting framework and this responsibility includes:

- designing, implementing and maintaining internal control relevant to the preparation of a financial report that is free from misstatement, whether due to fraud or error;
- selecting and applying appropriate accounting policies; and
- making accounting estimates that are reasonable in the circumstances.

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

Other Matters under the *Corporations Act 2001*

Independence

We confirm that, to the best of our knowledge and belief, we currently meet the independence requirements of the *Corporations Act 2001* in relation to the audit of the financial report. In conducting our audit of the financial report, should we become aware that we have contravened the independence

² In some jurisdictions, the auditor may have responsibilities to report separately on the entity's internal control. In such circumstances, the auditor reports on that responsibility as required in that jurisdiction. The reference in the auditor's report on the financial report to the fact that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control may not be appropriate in such circumstances.

³ Under paragraph 17 of this Auditing Standard, the auditor needs to identify the applicable financial reporting framework. In the case of the audit of a special purpose financial report conducted under the *Corporations Act 2001*, the auditor may, for example, list the Australian Accounting Standards deemed to be relevant by those charged with governance in the preparation and presentation of the financial report.

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requirements of the *Corporations Act 2001*, we shall notify you on a timely basis. As part of our audit process, we shall also provide you with a written independence declaration as required by the *Corporations Act 2001*.

The *Corporations Act 2001* includes specific restrictions on the employment relationships that can exist between the audited entity and its auditors. To assist us in meeting the independence requirements of the *Corporations Act 2001*, and to the extent permitted by law and regulation, we request you discuss with us:

- the provision of services offered to you by [insert firm name] prior to engaging or accepting the service; and
- the prospective employment opportunities of any current or former partner or professional employee of [insert firm name] prior to the commencement of formal employment discussions with the current or former partner or professional employee.

Annual General Meetings

The *Corporations Act 2001* provides that shareholders can submit written questions to the auditor before an Annual General Meeting provided that they relate to the auditor's report or the conduct of the audit. To assist us in meeting this requirement in the *Corporations Act 2001* relating to Annual General Meetings, we request you provide to us written questions submitted to you by shareholders as soon as practicable after the question(s) is received and no later than five business days before the Annual General Meeting, regardless of whether you believe them to be irrelevant.

Presentation of Audited Financial Report on the Internet

It is our understanding that the entity intends to publish a hard copy of the audited financial report and auditor's report for members, and to electronically present the audited financial report and auditor's report on its internet web site. When information is presented electronically on a web site, the security and controls over information on the web site should be addressed by the entity to maintain the integrity of the data presented. The examination of the controls over the electronic presentation of audited financial information on the entity's web site is beyond the scope of the audit of the financial report. Responsibility for the electronic presentation of the financial report on the entity's web site is that of the governing body of the entity.

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Fees

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

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

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

Yours faithfully,

(signed)

.....

Name and Title

Date

Acknowledged on behalf of [entity] by (signed)

.....

Name and Title

Date