ISA-210
TERMS OF AUDIT ENGAGEMENT

1-Objective of the standard: Under this ISA, objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed through:

I) Establishing whether the preconditions for an audit are present
II) Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

2-Preconditions for an Audit: In order to establish whether the preconditions for an audit are present, the auditor shall:

a. Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
b. Obtain the agreement of management that it acknowledges and understands its responsibility to the premise.

3-Limitations on Scope prior to Audit Engagement Acceptance: 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.

4-Contents of Audit Engagement Letter:

a. The objective and scope of the audit of the financial statements;
b. The responsibilities of the auditor;
c. The responsibilities of management;
d. Identification of the applicable financial reporting framework for the preparation of the financial statements; and
e. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

(Note) If law or regulation prescribes in sufficient details the terms of audit engagement referred to in above paragraph the auditor need not to record them in a written agreement except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities as set out in premise.

5-Recurring Audits: On recurring audits, the auditor shall assess 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.

6-Circumstances which require change in terms of audit engagement in case of recurring audit:

- 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.
- 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 of the financial statements.
- A change in other reporting requirements.

7-Acceptance of a Change in the Terms of the Audit Engagement:

✓ If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

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- ✓ The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.
- ✓ If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.
- ✓ If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

  (a) Withdraw from the audit engagement where possible under applicable law or regulation; and

  (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

8- Financial Reporting Standards Supplemented by Law or Regulation: 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:

- The additional requirements can be met through additional disclosures in the financial statements; or
- 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 auditor's opinion in accordance with ISA 705.

9- Financial Reporting Framework Prescribed by Law or Regulation—Other Matters Affecting Acceptance: If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present:

- Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and
- It is recognized in the terms of the audit engagement that:

  ✓ The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph;

  ✓ Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects," or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.
- If the conditions outlined above are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor shall:

  ✓ Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and

  ✓ Include appropriate reference to this matter in the terms of the audit engagement.

10- Auditor's Report Prescribed by Law or Regulation: If any law or regulation prescribes the layout or wording of the auditor's report the auditor shall evaluate:

- Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,
- Whether additional explanation in the auditor's report can mitigate possible misunderstanding.
- 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 required by law or regulation to do so. An audit conducted in accordance with such law or regulation does not comply with ISAs. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with ISAs

11-Factors that is relevant to auditor's determination of acceptability of financial reporting framework to be applied in preparation of financial statements:

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- The nature of the entity;
- The purpose of the financial statements;
- The nature of the financial statements;
- Whether law or regulation prescribes the applicable financial reporting framework.

12-Audit of Component: When the auditor of a parent entity is also the auditor of a 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 component auditor;
- Whether a separate auditor's report is to be issued on the component;
- Legal requirements in relation to audit appointments;
- Degree of ownership by parent; and
- Degree of independence of the component management from the parent entity.

13-Contents of Engagement Letter:

Principle Contents:

- Objective of financial Statements
- Scope of audit
- Management's responsibility of financial statements
- The form of any reports or other communication
- The fact that due to inherent limitation of audit there is an unavoidable risk that some material misstatement may not be detected even though audit is properly conducted.
- Requirement of unrestricted access to record etc.

Optional Contents:

- Arrangements regarding planning of audit
- Expectation of receiving written representation
- Description of any other letters or reports the auditor expects to issue to the client.
- Basis for computation of fee.
- Arrangements concerning the involvement of other auditors, experts, internal auditors, and other client staff.
- Arrangement s to be made with predecessor auditor in case of initial arrangements.
- Restrictions on auditor's liability
- Reference to any further agreement between the auditor and the client.

14-Factors to be considered before accepting a new audit engagement:

1. Ascertain if there are any professional reasons why the appointment should not be accepted by communicating with the existing auditor.
2. Ascertain whether a proper legally valid appointment is made.
3. Other Considerations may include:
    - **Management's History:** Is there been any involvement of client in illegal acts or unethical practices.
    - **Motivational factors:** Auditor should assess about the presence of factors that can motivate the client towards misrepresentations and frauds.
    - **Assess internal environmental factors whether those are:**
        - ✓ Poor accounting system
        - ✓ Non-presence of policies
        - ✓ Lack of internal control procedures
        - ✓ Under staffing
    - In addition auditor should consider fee arrangements, audibility.

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