SA 210 (AAS 26)

TERMS OF AUDIT ENGAGEMENT

(Effective for all audits relating to accounting periods beginning on or after April 1, 2003)

Contents

Paragraph(s)

Standard on Auditing (SA) 210*, "Terms of Audit Engagement" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"[1], which sets out the authority of SAs. From the date this Standard on Auditing becomes effective, the Guidance Note on Audit Engagement Letters issued by the Institute shall stand withdrawn.

* Issued in January, 2003.

[1] Published in the July 2007 issue of the Journal.

Introduction

1. The purpose of this Standard on Auditing (SA) is to establish standards on:

   (a) agreeing the terms of the engagement with the client; and

   (b) the auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance[2].

2. The auditor and the client should agree on the terms of the engagement. The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.

3. This SA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. The Standard is also applicable to related services. When other services such as tax, accounting, or management consultancy and other services[3] are to be provided, separate letters may be appropriate.

4. Though the objective and scope of an audit and the auditor's obligations are, normally, laid down in the applicable statute or regulations and the pronouncements of the Institute of Chartered Accountants of India, the audit engagement letters would be informative for the clients.

Audit Engagement Letters

5. In the interest of both client and auditor, the auditor should send an engagement letter, preferably before the commencement of the engagement, to help avoid any misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit and the extent of the auditor's responsibilities to the client.

Principal Contents

6. The form and content of audit engagement letter may vary for each

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[2] Refer to Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services issued in July, 2001 for the meaning of the term "assurance" and the type of engagements that provide a lower level of assurance than an audit.

(The readers may note that the Framework issued in 2001 has been withdrawn pursuant to the issuance of the "Framework for Assurance Engagements", by the Institute of Chartered Accountants of India, in July, 2007. The Revised Framework is applicable from April 1, 2008. The text of the Revised Framework is reproduced elsewhere in this Handbook.)

[3] Code of Ethics issued by the Institute of Chartered Accountants of India defines the term "management consultancy and other services".

client, but it would generally include reference to:

- The objective of the audit of financial statements.
- Management's responsibility for the financial statements.
- Management's responsibility for selection and consistent application of appropriate accounting policies, including implementation of the applicable accounting standards alongwith proper explanation relating to material departures from those accounting standards.
- Management's responsibility for preparation of the financial statements on a going concern basis.
- Management's responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.
- Management's responsibility for the maintenance of adequate accounting records and internal controls for safeguarding the assets of the company and for preventing and detecting fraud or other irregularities.
- The scope of the audit, including reference to the applicable legislation, regulations, and the pronouncements of the Institute of Chartered Accountants of India.
- The fact that having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.
- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.
- The fact that the audit process may be subjected to a peer review under the Chartered Accountants Act, 1949.

7. The auditor may also include the following matters in the engagement letter:

- Arrangements regarding the planning of the audit.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
- Request for the client 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 client.
- Basis on which fees are computed and any billing arrangements.

8. When relevant, the following points could also be included in the 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 client.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit, i.e., when the financial statements for the preceding period were audited by another auditor.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the client.

An example of an engagement letter for audit under a statute is set out in the Appendix [4].

Audit of Components

9. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the 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.
- The extent of any work performed by other auditors.
- Degree of ownership by parent.
- Degree of independence of the management of the component.

Recurring Audits

10. On recurring audits, the auditor should consider whether

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[4] The formats of the engagement letters to be issued in case of compilation, agreed upon procedures or review are given in the Standard on Related Services (SRS) 4410, "Engagements to Compile Financial Information"; SRS 4400, "Engagements to Perform Agreed Upon Procedures Regarding Financial Information", and Standard on Review Engagements (SRE) 2400, "Engagements to Review Financial Statements", respectively.

circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.

11. 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 letter:

- Any indication that the client misunderstands the objective and scope of the audit.
- Any revised or special terms of the engagement.
- A recent change of senior management, board of directors or ownership.
- A significant change in nature or size of the client's business.
- Legal requirements or pronouncements of the Institute of Chartered Accountants of India, or changes in the existing ones.

Acceptance of a Change in Engagement

12. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

13. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.

14. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of service originally requested would ordinarily be considered a reasonable basis for requesting a change in the engagement. In contrast, a change would not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

15. Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with SAs would consider, in addition to the above matters, any legal or contractual implications of the change.

16. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complies with the SAs applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusion, the report would not 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.

17. Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.

18. The auditor should not agree to a change of engagement where there is no reasonable justification for doing so. An example 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, adverse or a disclaimer of opinion.

19. If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report the circumstances necessitating the withdrawal to other parties, such as the board of directors or shareholders.

Effective Date

20. This Standard on Auditing becomes operative for all audits relating to accounting periods beginning on or after 1st April, 2003.

Compatibility with International Standard on Auditing (ISA) 210

The auditing standards established in this SA are generally consistent in all material respects with those set out in ISA 210 “Terms of Audit Engagements".

Appendix

Example of an Engagement Letter for an Audit under a Statute[5]

{The following letter is for use as a guide in conjunction with the considerations outlined in this SA and will need to be varied according to individual requirements and circumstances relevant to the engagement. This Appendix does not form part of the Standard.}

To the Board of Directors (or the appropriate representative of senior management).

You have requested that we audit the balance sheet of (Name of the Company) as at 31st March, 2XXX and the related profit and loss account and the (cash flow statement)[6] for the year ended on that date. 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 statements.

We will conduct our audit in accordance with the auditing standards generally accepted in India and with the requirements of the Companies Act, 1956. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

However, having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements of financial statements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.

In addition to our report on the financial statements, we expect to provide you with a separate letter concerning any material weaknesses in accounting and internal control systems which might come to our notice.

The responsibility for the preparation of financial statements on a going concern basis is that of the management. The management is also responsible for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along

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[5] In this illustration, the Companies Act, 1956.

[6] Only in cases where relevant.

with proper explanation relating to any material departures from those accounting standards. The management is also responsible for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

The responsibility of the management also includes the maintenance of adequate accounting records and internal controls for safeguarding of the assets of the company and for the preventing and detecting fraud or other irregularities. As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention to the fact that our audit process is subject to 'peer review' under the Chartered Accountants Act, 1949. The reviewer may examine our working papers during the course of the peer review.

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

Our fees will be billed as the work progresses.

This letter will be effective for future years unless it is terminated, amended or superseded.

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 statements.

XYZ & Co.
Chartered Accountants
…………………………
(Signature)

Date : (Name of the Member)

Place : (Designation[7])

Acknowledged on behalf of
ABC Company by
……………………..

(Signature)
Name and Designation
Date

[7] Partner or proprietor, as the case may be.

GENERAL CLARIFICATION (GC)–AASB/2/2004 ON SA 210

Standard on Auditing (SA) 210, "Terms of Audit Engagement"

{The following is the General Clarification (GC)–AASB/2/2004 issued by the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India on Standard on Auditing (SA) 210, "Terms of Audit Engagement."}

1. The Standard on Auditing (SA) 210, "Terms of Audit Engagement" was issued with a view to establish standards on:

(a) agreeing the terms of the engagement with the client; and

(b) the auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.

2. A question that arises is whether it is necessary that the engagement letter issued by the auditor should be acknowledged by addressee and returned to the auditor to indicate that the client's understanding of the terms of the engagement is in accordance with the engagement letter issued by the auditor and to establish that the auditor has complied with the requirements of the Standard in so far as they are related to sending the audit engagement letter.

3. Paragraphs 2 through 4 of SA 210 provide as follows:

> "2. The auditor and the client should agree on the terms of the engagement. The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.
>
> 3. This SA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. The Standard is also applicable to related services. When other services such as tax, accounting, or management consultancy and other services are to be provided, separate letters may be appropriate.
>
> 4. Though the objective and scope of an audit and the auditor's obligations are, normally, laid down in the applicable statute or regulations and the pronouncements of the Institute of Chartered Accountants of India, the audit engagement letters would be informative for the clients."

4. From the above it is clear that the basic purpose of issuing an engagement letter is that the auditor and the client should agree on the terms of the engagement. The auditor and the client are normally considered to be agreeing on the terms of the engagement if the objective and scope of an audit and the auditor's obligations are laid down in the statute or regulations governing the engagement. Examples of such engagements include audit under section 227 of the Companies Act, 1956, audit of public sector banks, etc. In such cases, it is not necessary that the engagement letter sent by the auditor in accordance with paragraph 5 of SA 210 is acknowledged by the addressee and returned to the auditor to establish that the client's understanding of the terms of the engagement is in accordance with the engagement letter issued by the auditor. It shall be sufficient compliance with the requirements related to sending the audit engagement letter, if an engagement letter is appropriately delivered to the client and the auditor retains the evidence for such delivery. In such cases, the audit engagement letters would be informative for the clients.

5. If, however, the client seeks any further explanations or clarification in regard to any terms, conditions or other contents of the engagement letter issued, it might indicate that there exists a difference in understanding of the terms of audit engagement either on the part of the client or on the part of the auditor. The auditor, in such cases, should take necessary steps to resolve the issues, for example by appropriately replying to the issues raised by the client. It is also desirable that the auditor documents the evidence indicating that the issues are settled and the client and auditor agree on the terms of the engagement.

6. There may be certain engagements where the objective and scope of the engagement and the auditor's obligations are not laid down in the applicable statute or regulations. In such situations, the auditor should request the client that a copy of the engagement letter be acknowledged by the addressee and returned to the auditor to establish:

(a) that the client's understanding of the arrangements for the engagement is in accordance with the engagement letter issued by the auditor; and

(b) that the auditor has complied with the requirements of the standard in so far as they are related to sending the audit engagement letter.