



## Agenda Item 5A

### Proposed Amendment to AU-C Section 210, *Terms of Engagement*

1. This amendment is effective to be determined by the Task Force.

*(Boldface italics* denotes new language. Deleted text is shown in ~~strikethrough~~.)

[No proposed amendment to paragraphs .01–.08. Paragraphs .09–.10 are included for contextual purposes]

#### **Agreement on Audit Engagement Terms**

- .09** The auditor should agree upon the terms of the audit engagement with management or those charged with governance, as appropriate. (Ref: par. A20 -.A21)
- .10** The agreed-upon terms of the audit engagement should be documented in an audit engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A22 -.A26)
  - a. The objective and scope of the audit of the financial statements
  - b. The responsibilities of the auditor
  - c. The responsibilities of management
  - d. A statement that because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS
  - e. Identification of the applicable financial reporting framework for the preparation of the financial statements
  - f. Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content

## **Initial Audits, Including Reaudit Engagements**

- .11** Before accepting an engagement for an initial audit, including a reaudit engagement, the auditor should, if applicable, request management to authorize the predecessor auditor to respond fully to the auditor’s inquiries regarding matters that will assist the auditor in determining whether to accept the engagement. If management refuses to authorize the predecessor auditor to respond, or limits the response, the auditor should inquire about the reasons and consider the implications of that refusal in deciding whether to accept the engagement. (*Ref: par. .A27 - .A28*)
- .12** *If applicable, the auditor should inquire of the predecessor auditor about matters that will assist the auditor in determining whether to accept the engagement including: (Ref: par. .A27 and A29 - .A30)*
- a. Identified or suspected fraud involving*
    - i. management,*
    - ii. employees who have significant roles in internal control, or*
    - iii. others, where the fraud results in a material misstatement in the financial statements*
  - b. Matters involving noncompliance or suspected noncompliance with laws and regulations that came to the predecessor auditor’s attention during the audit, other than when matters are clearly inconsequential.*
- .13** *In responding to the auditor’s inquiries the predecessor auditor should (Ref: par. A27)*
- a. determine whether applicable law would limit the predecessor auditor’s potential response to the auditor’s inquiries; and*
  - b. respond to the auditor’s inquiries promptly and to the extent permitted by applicable law, fully on the basis of known facts. (Ref: par. .A31 -.A33)*
- .14** *The auditor should document matters required to be communicated by paragraphs .12 - .13 when such matters have been communicated by the predecessor auditor orally. When matters have been communicated in writing, the auditor should retain a copy of the communication. (Ref; Par. A27)*
- .12.15** The auditor should evaluate the predecessor auditor’s response, or consider the implications if the predecessor auditor provides no response or a limited response, in determining whether to accept the engagement. (*Ref: par. ~~.A27~~-.A32A34*)

[Paragraphs .13–.18 are renumbered to paragraphs .16–.21. The content is unchanged.]

## **Application and Other Explanatory Material**

[No amendment to paragraphs .A1–.A21. Paragraph .A22 is included for contextual purposes.]

***Audit Engagement Letter or Other Form of Written Agreement<sup>fn 10</sup> (Ref: par. .10)***

**.A22** Both management and the auditor have an interest in documenting the agreed-upon terms of the audit engagement before the commencement of the audit to help avoid misunderstandings with respect to the audit. For example, it reduces the risk that management may inappropriately rely on the auditor to protect management against certain risks or to perform certain functions that are management’s responsibility.

*Form and Content of the Audit Engagement Letter*

**.A23** 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 section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.<sup>fn 11</sup> Paragraph .06b of this section addresses the description of the responsibilities of management. In addition to including the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres
- ***The auditor’s responsibility to communicate matters to a successor auditor or to those charged with governance including identified or suspected fraud and matters involving noncompliance with laws and regulations that come to the auditor’s attention during the audit.***
- ***The agreement of management to explicitly consent to the auditor’s communication of matters to a successor auditor including identified or suspected fraud and matters involving noncompliance with laws and regulations that come to the auditor’s attention during the audit.***
- The form of any other communication of results of the audit engagement

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<sup>fn 10</sup> In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

<sup>fn 11</sup> [Paragraphs .04–.10](#) of section 200.

- Arrangements regarding the planning and performance of the audit, including the composition of the audit team
- The expectation that management will provide written representations (see also paragraph .A11)
- The agreement of management 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 agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- The basis on which fees are computed and any billing arrangements
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by their signature on the engagement letter

[Paragraph .A24-.A26 are included for contextual purposes.]

**.A24** When relevant, the following points also could be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and specialists 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 not prohibited
- Any obligations of the auditor to provide audit documentation to other parties
- Additional services to be provided, such as those relating to regulatory requirements
- A reference to any further agreements between the auditor and the entity

**.A25** Reference to the expected form and content of any reports to be issued by the auditor may include a description of the types of reports to be issued. The auditor need not describe the type of opinion expected to be expressed. An example of an audit engagement letter is set out in the exhibit “Example of an Audit Engagement Letter.”

**.A26** *Audits of components.* When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to obtain a separate audit engagement letter from the component include the following:

- Who engages the component auditor
- Whether a separate auditor’s report is to be issued on the component
- Legal requirements regarding the appointment of the auditor
- Degree of ownership by parent
- Degree of independence of the component management from the parent entity

**Initial Audits, Including Reaudit Engagements (Ref: par. .11--~~.12.15~~)**

**.A27** *References to auditor in paragraphs .11-15 and .A28 - .A34 refer to successor auditor.*

~~.A27~~**.A28** An auditor may make a proposal for an audit engagement before being granted permission to make inquiries of a predecessor auditor. The auditor may advise management in the proposal or otherwise that the auditor’s acceptance of the engagement cannot be final until the inquiries have been made and the responses of the predecessor auditor have been evaluated.

**.A29** Relevant ethical and professional requirements guide the auditor’s communications with the predecessor auditor and management, as well as the predecessor auditor’s response. Such requirements provide that, except as permitted by the rules of the AICPA Code of Professional Conduct an auditor is precluded from disclosing confidential information obtained in the course of an engagement unless management specifically consents. ~~Such~~ **Relevant ethical and professional** requirements also provide that both the auditor and the predecessor auditor hold in confidence information obtained from each other. This obligation applies regardless of whether the auditor accepts the engagement.

~~.A31~~**.A30** The communication with the predecessor auditor may be either written or oral. **In addition to the inquiries specified in paragraph .12a-b,** ~~A~~ matters subject to the auditor’s inquiry of the predecessor auditor may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters

- ~~Communications to those charged with governance regarding fraud and noncompliance with laws or regulations by the entity~~
- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
- The predecessor auditor's understanding about the reasons for the change of auditors

~~.A30~~**A31** In accordance with the AICPA Code of Professional Conduct, which states that members have a responsibility to cooperate with each other, the predecessor auditor is expected to respond to the auditor's inquiries promptly and, in the absence of unusual circumstances, fully, on the basis of known facts. If, due to unusual circumstances, such as pending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, the predecessor auditor decides not to respond fully to the inquiries, the predecessor auditor is expected to clearly state that the response is limited.

**.A32** *Prior to responding to the auditor's inquiries made pursuant to paragraph .12, the predecessor auditor may consult legal counsel to determine whether any professional or legal or requirements exist in the circumstances.*

~~.A28~~**A33** When more than one auditor is considering accepting an engagement, the predecessor auditor is not expected to be available to respond to inquiries until an auditor has been selected by the entity and has accepted the engagement, subject to the evaluation of the communications with the predecessor auditor as provided in paragraph ~~.12~~**13**.

#### ***Considerations Specific to Governmental Entities***

~~.A32~~**A34** When the auditor is required by law or regulation to audit a governmental entity, inquiries of the predecessor auditor for the purpose of obtaining information about whether to accept the engagement may not be relevant. However, inquiries of the predecessor auditor may still be relevant for the purpose of obtaining information that is used by the auditor in planning and performing the audit.

[Paragraphs .A33–.A42 are renumbered to paragraphs .A35–.A44. The content is unchanged.]