

**INTERNATIONAL STANDARD ON AUDITING
(UK AND IRELAND) 210
TERMS OF AUDIT ENGAGEMENTS
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International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) 210 “Terms of Audit Engagements” should be read in the context of the Auditing Practices Board’s Statement “The Auditing Practices Board - Scope and Authority of Pronouncements (Revised)” which sets out the application and authority of ISAs (UK and Ireland).

Introduction

1. The purpose of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance 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.

1-1. This ISA (UK and Ireland) uses the terms 'those charged with governance' and 'management'. The term 'governance' describes the role of persons entrusted with the supervision, control and direction of an entity. Ordinarily, those charged with governance are accountable for ensuring that the entity achieves its objectives, and for the quality of its financial reporting and reporting to interested parties. Those charged with governance include management only when they perform such functions.

1-2. In the UK and Ireland, those charged with governance include the directors (executive and non-executive) of a company or other body, the members of an audit committee where one exists, the partners, proprietors, committee of management or trustees of other forms of entity, or equivalent persons responsible for directing the entity's affairs and preparing its financial statements.

1-3. 'Management' comprises those persons who perform senior managerial functions.

1-4. In the UK and Ireland, depending on the nature and circumstances of the entity, management may include some or all of those charged with governance (e.g. executive directors). Management will not normally include non-executive directors.

1-5. For the purpose of this ISA (UK and Ireland) 'client' means the addressees of the auditor's report or, when as often will be the case it is not practical to agree such terms with the addressees, the entity itself through those charged with governance.

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.

2-1. **The terms of the engagement should be recorded in writing.**

3. This ISA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. The guidance is also applicable to related services. When other services such as tax, accounting, or management advisory services are to be provided, separate letters may be appropriate.
4. In some countries, the objective and scope of an audit and the auditor's obligations are established by law. Even in those situations the auditor may still find audit engagement letters informative for their clients.

Audit Engagement Letters

5. It is in the interest of both client and auditor that the auditor sends an engagement letter, preferably before the commencement of the engagement, to help in avoiding 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, the extent of the auditor's responsibilities to the client and the form of any reports.

5-1. **In the UK and Ireland, the auditor should ensure that the engagement letter documents and confirms the auditor's acceptance of the appointment, and includes a summary of the responsibilities of those charged with governance and of the auditor, the scope of the engagement and the form of any reports.**

5-2. Appendix 2 sets out illustrative wording to describe the responsibilities of the directors and the auditor and the scope of the audit, for a limited (non-listed) company client for an audit conducted in accordance with ISAs (UK and Ireland).

Principal Contents

6. The form and content of audit engagement letters may vary for each client, but they would generally include reference to:
 - The objective of the audit of financial statements.
 - Management's responsibility for the financial statements¹.
 - The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the

¹ In the UK and Ireland, those charged with governance are responsible for the preparation of the financial statements.

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.
- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.

7. The auditor may also wish to include in the 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 client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.²
- Description of any other letters or reports the auditor expects to issue to the client.
- Any confidentiality of other letters or reports to be issued and, where appropriate, the conditions, if any, on which permission might be given to those charged with governance to make those reports available to others.
- Basis on which fees are computed and any billing arrangements.

8. When relevant, the following points could also be made:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other client staff.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.

² Acceptance by the client of the terms of the engagement is normally evidenced by signature by a person at an appropriate level within the entity, for example the finance director or equivalent.

- 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 audit engagement letter is set out in the Appendix³.

Audits 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 the terms for each component are the same.
- Whether a separate audit report is to be issued on the component.
- Legal requirements.
- Regulatory requirements.
- The extent of any work performed by other auditors.
- Degree of ownership by parent.
- Degree of independence of the component’s management.

9-1. If the auditor sends one letter relating to the group as a whole, it identifies the components for which the auditor is appointed as auditor. Those charged with governance of the parent entity are requested to forward the letter to those charged with governance of the components concerned. Each board is requested to confirm that the terms of the engagement letter are accepted.

Recurring Audits

10. **On recurring audits, the auditor should consider whether 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.**

³ The example letter in the Appendix is not tailored for the United Kingdom and Ireland.

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 or those charged with governance.
 - A significant change in ownership.
 - A significant change in nature or size of the client's business.
 - Legal or regulatory requirements.

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 appeared 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 ISAs (UK and Ireland) 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 ISAs (UK and Ireland) applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusing the reader, 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 audit opinion 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 to other parties, such as those charged with governance or shareholders, the circumstances necessitating the withdrawal.**
- 19-1. The auditor of a limited company in Great Britain who ceases to hold office as auditor is required to comply with the requirements of section 394 of the Companies Act 1985 regarding the statement to be made by the auditor in relation to ceasing to hold office. Equivalent requirements for Northern Ireland are contained in Article 401A of the Companies (Northern Ireland) Order 1986 and, for the Republic of Ireland, are contained in section 185 of the Companies Act 1990.

Effective Date

- 19-2. This ISA (UK and Ireland) is effective for audits of financial statements for periods commencing on or after 15 December 2004.

Public Sector Perspective

Additional guidance for auditors of public sector bodies in the UK and Ireland is given in:

- Practice Note 10 “Audit of Financial Statements of Public Sector Entities in the United Kingdom (Revised)”
- Practice Note 10(I) “The Audit of Central Government Financial Statements in Ireland”

1. *The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement or recognizing an engagement not indicated in the legislative mandate may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagements letters when undertaking an audit.*
2. *Paragraphs 12-19 of this ISA (UK and Ireland) deal with the action a private sector auditor may take when there are attempts to change an audit engagement to one which provides a lower level of assurance. In the public sector specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if management (including the department head) attempts to limit the scope of the audit.*

Appendix

The example letter in this Appendix is not tailored for the UK and Ireland. Appendix 2 sets out illustrative wording to describe the responsibilities of the directors and the auditor and the scope of the audit, for a limited (non-listed) company client for an audit conducted in accordance with ISAs (UK and Ireland).

Example of an Audit Engagement Letter

The following letter is for use as a guide in conjunction with the considerations outlined in this ISA and will need to be varied according to individual requirements and circumstances.

To the Board of Directors or the appropriate representative of senior management:

You have requested that we audit the balance sheet of as of, and the related statements of income and cash flows for the year then ending. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be made with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with International Standards on Auditing (or refer to relevant national standards or practices). 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.

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 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 come to our notice.

We remind you that the responsibility for the preparation of financial statements including adequate disclosure is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the company. As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

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, which will be billed as work progresses, are based on the time required by the individuals assigned to the engagement plus out-of-pocket expenses. Individual hourly rates vary according to the degree of responsibility involved and the experience and skill required.

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.

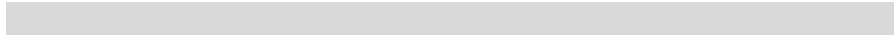
XYZ & Co.
Acknowledged on behalf of
ABC Company by

(signed)

.....

Name and Title

Date



Appendix 2**Illustrative wording to describe the responsibilities of the directors and the auditor and the scope of the audit, for a limited (non-listed) company client for an audit conducted in accordance with ISAs (UK and Ireland)**

The illustrative wording set out below is not necessarily comprehensive or appropriate to be used in relation to every non-listed company, and it must be tailored to specific circumstances - for example, to the special reporting requirements of regulated entities (*note 1*), or of small companies to which certain exemptions are given.

The wording reflects legal and professional responsibilities as at 15 December 2004. The wording should be amended as necessary to take account of changes in the responsibilities of the directors and the auditor after that date, for example as a result of changes in company legislation.

The auditor includes other wording as appropriate to address the matters set out in paragraphs 6 to 9-1 of this ISA (UK and Ireland).

Responsibilities of directors and auditors

As directors of xxxxxx, you are responsible for ensuring that the company maintains proper accounting records and for preparing financial statements which give a true and fair view and have been prepared in accordance with the Companies Act 1985 (*or other relevant legislation - note 2*). You are also responsible for making available to us, as and when required, all the company's accounting records and all other relevant records and related information, including minutes of all management and shareholders' meetings. We are entitled to require from the company's officers such other information and explanations as we think necessary for the performance of our duties as auditors.

We have a statutory responsibility to report to the members whether in our opinion the financial statements give a true and fair view and whether they have been properly prepared in accordance with the Companies Act 1985 (*or other relevant legislation*). In arriving at our opinion, we are required to consider the following matters, and to report on any in respect of which we are not satisfied (*note 3*):

- (a) Whether proper accounting records have been kept by the company (*note 4*) and proper returns adequate for our audit have been received from branches not visited by us;

- (b) Whether the company's (*note 4*) balance sheet and profit and loss account are in agreement with the accounting records and returns;
- (c) Whether we have obtained all the information and explanations which we consider necessary for the purposes of our audit; and
- (d) Whether the information given in the directors' report is consistent with the financial statements.

In addition, there are certain other matters which, according to the circumstances, may need to be dealt with in our report. For example, where the financial statements do not give details of directors' remuneration or of their transactions with the company, the Companies Act 1985 requires us to disclose such matters in our report.

We have a professional responsibility to report if the financial statements do not comply in any material respect with applicable accounting standards, unless in our opinion the non-compliance is justified in the circumstances. In determining whether or not the departure is justified we consider:

- (a) Whether the departure is required in order for the financial statements to give a true and fair view; and
- (b) Whether adequate disclosure has been made concerning the departure.

Our professional responsibilities also include:

- Including in our report a description of the directors' responsibilities for the financial statements where the financial statements or accompanying information do not include such a description; and
- Considering whether other information in documents containing audited financial statements is consistent with those financial statements.

(*note 5*)

Scope of audit

Our audit will be conducted in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, and will include such tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting and internal control systems in order to assess their adequacy as a basis for the preparation of the financial statements and to establish whether proper accounting records have been maintained by the company. We shall expect to obtain such appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom.

The nature and extent of our procedures will vary according to our assessment of the company's accounting system and, where we wish to place reliance on it, the internal control system, and may cover any aspect of the business's operations that we consider appropriate. Our audit is not designed to identify all significant weaknesses in the company's systems but, if such weaknesses come to our notice during the course of our audit which we think should be brought to your attention, we shall report them to you. Any such report may not be provided to third parties without our prior written consent. Such consent will be granted only on the basis that such reports are not prepared with the interests of anyone other than the company in mind and that we accept no duty or responsibility to any other party as concerns the reports.

As part of our normal audit procedures, we may request you to provide written confirmation of certain oral representations which we have received from you during the course of the audit on matters having a material effect on the financial statements. In connection with representations and the supply of information to us generally, we draw your attention to section 389A of the Companies Act 1985 (*note 6*) under which it is an offence for an officer of the company to mislead the auditors.

In order to assist us with the examination of your financial statements, we shall request sight of all documents or statements, including the chairman's statement, operating and financial review and the directors' report, which are due to be issued with the financial statements. We are also entitled to attend all general meetings of the company and to receive notice of all such meetings.

The responsibility for safeguarding the assets of the company and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with yourselves. However, we shall endeavour to plan our audit so that we have a reasonable expectation of detecting material misstatements in the financial statements or accounting records (including those resulting from fraud, error or non-compliance with law or regulations), but our examination should not be relied upon to disclose all such material misstatements or frauds, errors or instances of non-compliance as may exist.

(Where appropriate - note 7) We shall not be treated as having notice, for the purposes of our audit responsibilities, of information provided to members of our firm other than those engaged on the audit (for example information provided in connection with accounting, taxation and other services).

Once we have issued our report we have no further direct responsibility in relation to the financial statements for that financial year. However, we expect that you will inform us of any material event occurring between the date of our report and that of the Annual General Meeting which may affect the financial statements.

Notes

- 1 *Additional guidance is provided in APB Practice Notes.*
- 2 *Relevant legislation for the Republic of Ireland is the Companies Acts 1963 to 2003 and for Northern Ireland is the Companies (Northern Ireland) Order 1986.*
- 3 *In the Republic of Ireland, auditors are required to report additionally on matters (a) to (d) as identified in the section 'Responsibilities of directors and auditors' of the example engagement letter, and on whether there existed at the balance sheet date a financial situation which, under section 40(1) of the Companies (Amendment) Act 1983, would require the convening of an extraordinary general meeting of the company. Hence this sentence would read:*

'... we are required to consider the following matters and to report on:'
- 4 *The reference to 'company' does not need to be altered in the case of groups as section 237 of the Companies Act 1985 refers only to the company being audited and not to any parent company or subsidiary or associated undertaking.*
- 5 *In the Republic of Ireland, auditors have the following additional legal responsibilities which are set out in the engagement letter:*

Company law

To report whether, in their opinion, proper books of account have been kept by the entity.

Where suspected indictable offences under the Companies Acts come to the attention of auditors, while carrying out their audit examination, they are obliged to report these to the Director of Corporate Enforcement. This reporting obligation imposed by Section 194, Companies Act, 1990, as amended by Section 74, Company Law Enforcement Act, 2001, applies regardless of the apparent materiality of the suspected offence, or whether the suspected offence has already been reported to the relevant authorities.

Criminal law

Where, in the course of conducting professional work, it comes to the attention of certain "relevant persons" (as defined), that information or documents indicate that an offence may have been committed under Section 59 Criminal

Justice (Theft and Fraud Offences) Act 2001, auditors have a reporting obligation to the Garda Siochana. This applies regardless of the apparent materiality of the suspected offence, or whether the suspected offence has already been reported to the relevant authorities.

Taxation

Auditors must report material relevant offences, as defined in Section 1079 of the Taxes Consolidation Act 1997, to the directors of the company in writing, requesting them to rectify the matter or notify an appropriate officer of the Revenue Commissioners of the offence within 6 months. In the event that the auditors request is not complied with, the auditor must cease to act as auditor to the company or to assist the company in any taxation matter. The auditor must also send a copy of the auditor's notice of resignation to an appropriate officer of the Revenue Commissioners within 14 days

- 6** *Relevant references for the Republic of Ireland are sections 193(3), 196 and 197 of the Companies Act 1990. The relevant reference for Northern Ireland is Article 397A of the Companies (Northern Ireland) Order 1986.*
- 7** *When accounting, taxation or other services are undertaken on behalf of an audit client, information may be provided to members of the audit firm other than those engaged on the audit. In such cases, it may be appropriate for the audit engagement letter to include this or a similar paragraph to indicate that the auditors are not to be treated as having notice, for the purposes of their audit responsibilities, of such information, to make it clear that a company would not be absolved from informing the auditors directly of a material matter.*

NOTICE TO READERS

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