

SLAuS 210 : Agreeing with the Terms of Audit Engagement

AAT Level III
Financial Control & Audit
(FCA)

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TERMS OF AUDIT ENGAGEMENTS (SLAuS 210)

4.1 Audit Engagement Letters

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
- the form of any reports.

4.2 Principal Contents

The form and content of audit engagement letters may vary for each client. Generally, they would refer to:

- The objective of the audit
- Management's responsibility for the financial statements
- The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of the Institute of Chartered Accountants
- 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
- 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
- Description of any other letters or reports the auditor expects to issue to the client
- Basis on which fees are computed
- Arrangements concerning the involvement of other auditors and experts in some audit aspects
- 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
- Any restriction of the auditor's liability when such possibility exists
- A reference to any further agreements between the auditor and the client



Example of an Audit Engagement Letter

The following letter 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 Sri Lanka Auditing Standards (or refer to relevant other 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

4.3 Audits of Components

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 the following:

- Who appoints the auditor of the component
- Whether a separate auditor's 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 component's management

4.4 Recurring Audits

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.

The auditor may decide not to send a new engagement letter each period. However, certain factors may make it appropriate to send a new letter.

What are the 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

4.5 Acceptance of a Change in Engagement

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

- The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.
- 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.



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