

ASA 210
(October 2009)

Explanatory Statement

ASA 210 Agreeing the Terms of Audit Engagements

Issued by the **Auditing and Assurance Standards Board**

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Australian Government

Auditing and Assurance Standards Board

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Draft

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Reasons for Issuing Auditing Standard ASA 210 *Agreeing the Terms of Audit Engagements*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 210 *Agreeing the Terms of Audit Engagements* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is as an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001* (the Act), the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the International Auditing and Assurance Standards Board (IAASB) for the revision and enhancement of the International Standards on Auditing (ISAs) and to make appropriate consequential amendments to the Australian Auditing Standards. The IAASB has undertaken a programme to redraft, and in some cases, revise, in “clarity” format, the entire suite of ISAs. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

Operative Date

ASA 210 *Agreeing the Terms of Audit Engagements* is operative for financial reporting periods commencing on or after 1 January 2010.

Purpose of Auditing Standard ASA 210 *Agreeing the Terms of Audit Engagements*

The purpose of the Auditing Standard is to establish Requirements and to provide Application and Other Explanatory Material to auditors regarding their responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance.

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Main Features

The Auditing Standard:

- (a) requires the auditor to establish that the preconditions for an audit are present, including management's use of an acceptable financial reporting framework, and agreement and acknowledgement of its responsibilities in the preparation of the financial report;
- (b) prohibits an auditor from accepting, unless required to by law or regulation, an audit engagement where management has imposed a limitation in scope that the auditor believes will result in a disclaimer of opinion on the financial report;
- (c) requires the auditor to agree the terms of the audit engagement with management or those charged with governance;
- (d) requires the auditor to record the terms of engagement in an audit engagement letter or other suitable form of written agreement;
- (e) describes the requirements when the auditor has to address a change in the terms of an audit engagement; and
- (f) provides direction when:
 - the financial reporting standards are supplemented by law or regulation;
 - the financial reporting framework is prescribed by law or regulation; and
 - the auditor's report is prescribed by law or regulation.

Preamble and Overall Objectives

ASA 210 is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. ASA 210 is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

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Process of making Australian Auditing Standards

The AUASB's Strategic Direction, *inter alia*, provides that the AUASB develop Australian Auditing Standards that:

- have a clear public interest focus and are of the highest quality;
- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as the underlying standards;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

In implementing the FRC's Strategic Direction, the AUASB has undertaken a process of revision and redrafting of the Australian Auditing Standards that has:

- updated the form, layout and content of the Australian Auditing Standards;
- addressed the legal enforceability of mandatory obligations;
- maintained clarity of the auditor's obligations;
- incorporated appropriate references to Australian laws and regulations;
- clearly identified, by use of the prefix "Aus", AUASB additions to paragraphs in the Requirements or the Application and Other Explanatory Material; and
- included other amendments as necessary.

Consultation Process prior to issuing the Auditing Standard

The AUASB has consulted publicly as part of its due process in developing the Auditing Standard. Exposure Draft ED 11/09, *Proposed Auditing Standard: Agreeing the Terms of Audit Engagements* (Re-issuance of ASA 210), was issued on 17 April 2009 with a 30 day comment period.

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As an integral part of its consultation with the public, the AUASB sought comments on specific questions including:

- the completeness and accuracy of references in the Auditing Standard to relevant laws and regulations;
- the significant costs, if any, and benefits, of compliance with any additional Requirements under the Auditing Standard; and
- whether or not there exist any matters of public interest affecting the issuance of the Auditing Standard.

Submissions were received by the AUASB and these were considered as part of the development and finalisation of the Auditing Standard.

Regulation Impact Statement

A *Regulation Impact Statement* (RIS) has been prepared in connection with the redrafting of Australian Auditing Standards in Clarity format, including ASA 210 *Agreeing the Terms of Audit Engagements*.

The RIS has considered both the expected benefits and expected costs of the introduction of clarified auditing standards, including comments provided by stakeholders during the redrafting process. It concluded that expected benefits to users of audit services, users of audit reports, auditors and the Australian economy in general are, on balance, likely to outweigh expected costs.

Main Differences from ASA 210 *Terms of Audit Engagements* (June 2007)

The main differences between the Auditing Standard and the Auditing Standard that it supersedes, ASA 210 *Terms of Audit Engagements* (June 2007), are:

1. Auditing Standard ASA 210 is written in the 'clarity' format using the equivalent International Standard on Auditing (ISA 210 *Agreeing the Terms of Audit Engagements*) as the underlying Auditing Standard. Consequently, the format, layout, and paragraph numbering styles are different from the extant Auditing Standard.
2. To improve clarity, certain requirements and guidance in the extant Auditing Standard have been re-written, however, the equivalent meanings have been retained.

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3. Certain guidance material in the extant Auditing Standard has been elevated to Requirements.
4. The following Requirements included in the Auditing Standard are in part, or full, additional compared to the extant Auditing Standard:
 - (a) 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 report, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so. (Ref: Para 7)
 - (b) If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:
 - If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial report is unacceptable, except as provided in paragraph 19; or
 - If the agreement referred to in paragraph 6(b) has not been obtained. (Ref: Para 8)
 - (c) If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in paragraph 10, the auditor need not 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 paragraph 6(b). (Ref: Para 11)
 - (d) If law or regulation prescribes responsibilities of management similar to those described in paragraph 6(b), the auditor may determine that the law or regulation includes responsibilities that, in the auditor's judgement, are equivalent in effect to those set out in that paragraph. For such responsibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the written agreement. For those responsibilities that are not prescribed by law or regulation such that their effect is equivalent, the written agreement shall use the description in paragraph 6(b). (Ref: Para 12)

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(e) If financial reporting standards established by an authorised or recognised standards setting organisation 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 report; or
- The description of the applicable financial reporting framework in the financial report 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 ASA 705.
(Ref: Para 18)

(f) 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 report required to avoid the financial report being misleading; and
- It is recognised in the terms of the audit engagement that:
 - ◆ The auditor's report on the financial report will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with ASA 706; and
 - ◆ Unless the auditor is required by law or regulation to express the auditor's opinion on the financial report by using the phrases "present fairly, in all material respects," or "give a true and fair view"

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in accordance with the applicable financial reporting framework, the auditor's opinion on the financial report will not include such phrases. (Ref: Para 19)

(g) If the conditions outlined in paragraph 19 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 report on the auditor's report; and
- Include appropriate reference to this matter in the terms of the audit engagement. (Ref: Para 20)

(h) In some cases, law or regulation of the relevant jurisdiction prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of the Australian Auditing Standards. In these circumstances, the auditor shall evaluate:

- Whether users might misunderstand the assurance obtained from the audit of the financial report 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 Australian Auditing Standards. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with Australian Auditing Standards. (Ref: Para 21)

5. Significant Application and Other Explanatory Material, linked to the additional Requirements listed at 4. above, is also included in the Auditing Standard.