

For the attention of Jim Sylph
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY, 10017
USA

15 April 2008

Dear Sir

IAASB Exposure Draft – “Agreeing the Terms of Audit Engagements”

We appreciate the opportunity to comment on the IAASB’s Proposed Redrafted ISA 210, *Agreeing the Terms of Audit Engagements* (“proposed redrafted ISA”), and the related conforming amendments to other ISAs.

Following extensive consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this Exposure Draft. “PricewaterhouseCoopers” refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Overall comments

We are broadly satisfied that the Clarity drafting conventions have been appropriately applied in establishing the objective, requirements and application and other explanatory material in this ISA. However, as further explained in this response, we find some of the drafting awkward and believe that better linkages are needed both within the body of this ISA and in relation to other ISAs. In our view, further refinements are needed before finalising this ISA.

We support the proposed amendments on the preconditions for an audit. In particular, it is logical to define the premise relating to the responsibilities of management and, where appropriate, those charged with governance on which an audit is conducted in ISA 200, and require the auditor, in ISA 210, to obtain management’s (and, where appropriate, those charged with governance’s) agreement on these responsibilities as a precondition to accepting the audit engagement. We agree that obtaining management’s acknowledgement of its responsibilities is more appropriately dealt with in this ISA on engagement terms, than in the ISA 580 on written representations.

As explained more fully in our comments on specific paragraphs in the appendix, we have lingering concerns regarding the requirements and application material regarding engagement acceptance considerations of mandated wording of the auditor’s opinion and the acceptability of the financial reporting framework, which were transferred to ISA 210 as a result of the ISA 800 revision. Including these requirements and guidance in ISA 210 has resulted in the introduction of fairly specific and detailed requirements. Although it is not, in our view, a perfect fit, we accept that it is unavoidable as there is not another ISA that would be better placed to address these matters. However, the separation of these requirements from the related application material makes it difficult to understand how certain of the requirements interrelate and, as a result, we are concerned that the requirements lack clarity and appear to allow the underlying principles to be overridden. We offer suggestions that we believe will improve the logic of these requirements.

In addition to our comments on the questions posed in the Explanatory Memorandum, we offer, in the Appendix to this letter, a number of suggestions on specific paragraphs for the IAASB’s consideration in finalising the wording of this standard.

Responses to questions on the application of the Clarity drafting conventions

1. *Is the objective to be achieved by the auditor, stated in the proposed revised and redrafted ISA, appropriate?*

We believe that the objective in the proposed revised and redrafted ISA is broadly appropriate, but can be improved. In particular, the wording doesn't reflect responsibilities when there have been changes in engagement terms, and there is a degree of repetition between paragraphs 3(a) and 3(b).

The objective focuses on engagement acceptance. As noted in paragraph 1, the ISA also addresses the auditor's responsibilities when there is a proposed change in engagement terms, the requirements for which are set out in the requirements in paragraphs 13-16. As is illustrated below, we believe that the proposed wording of the objective can be modified without major restructuring so that it comprehensively covers this aspect of the requirements as well.

Paragraph 3(a) requires the auditor to establish whether necessary preconditions for an audit are present. The preconditions, as set out in paragraph 4(b), include "obtaining the agreement of management and, where appropriate, those charged with governance, that they understand and acknowledge their responsibilities". Paragraph 3(b) requires confirmation of a common understanding between the auditor and the entity of the terms of engagement as well as "of the respective responsibilities of the auditor, management and those charged with governance". Further, the terms of engagement that must be agreed include the respective responsibilities of the various parties (paragraph 8(b) and (c)). There is overlap amongst these various requirements. At a minimum, we believe that paragraph 3(b) should acknowledge that the respective responsibilities are part of the terms of the audit engagement by using "including" rather than "and". However, it is questionable whether it is necessary to repeat the reference to the respective responsibilities of the auditor, management and those charged with governance in paragraph 3(b).

As the requirements cover considerations in continuing engagements as well as initial engagement acceptance, and other ISAs (such as ISA 220) discuss both engagement acceptance *and* continuance, we believe it would be relevant to refer to acceptance and continuance in the objective.

Finally, paragraph 3 (a) refers to *necessary* preconditions for an audit. By definition, preconditions are necessary. We therefore suggest deleting the word 'necessary' and simply referring, in paragraph 3 (a) of the objective, to 'the preconditions'.

The following proposed wording for the objective addresses these comments:

"3. *The objective of the auditor is to accept **or continue** an audit engagement only when the basis upon which it is to be performed has been agreed, through:*

(a) *Establishing whether ~~necessary~~ preconditions for an audit are present; and*

(b) *Confirming that there is a common understanding between the auditor and the entity of the terms of the audit engagement **or, when applicable, of a justifiable change in the terms of the audit engagement.** ~~and of the respective responsibilities of the auditor, management and those charged with governance.~~"*

2. *Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgement by auditors?*

Subject to the specific comments and suggestions set out below and in the Appendix to this letter, we believe that the criteria have been applied appropriately and consistently.

Responses to request for specific comments

1. *Do you agree with the proposed description of management's responsibilities in the ISAs?*

Yes, we agree with the proposed description of management's responsibilities in the ISAs. In many jurisdictions these responsibilities are reflected in law, and may be more onerous than the minimum requirements set out in ISA 200 and ISA 210. In jurisdictions where such responsibilities are not

prescribed by law, we fully support the inclusion, in the engagement letter, of the responsibilities as described in proposed ISA 210.

- 2. Do you agree that the description of management's responsibilities in the terms of the audit engagement, written representations and auditor's report may use the wording of the law or regulation if the auditor has determined that the law or regulation includes responsibilities that are equivalent in effect to those described in the ISAs?**

Yes.

- 3. Do you agree with the proposed conforming amendments to proposed ISA 700 (Redrafted)?**

Yes, it is a pragmatic proposal. The original revision to ISA 700, which mandated specific, consistent wording to describe managements' responsibilities in the auditor's report, proved to be one of the impediments to the adoption of ISA 700 (Revised) in some jurisdictions. We support the proposal that the wording relating to management's responsibilities be consistent in the engagement letter and the auditor's report, and that a degree of flexibility be permitted to enable the wording of the auditors' report to align with legal and regulatory requirements, provided such requirements are equivalent in effect with those set out in the ISAs.

However, as explained in our detailed comments on specific paragraphs in the appendix, we question the proposal to move former paragraph A23 (which explains that the use of the term "management" in ISA 700 can be modified if appropriate in the context of the engagement) to paragraph 3(a). With the introduction of a definition of management in ISA 200, including this paragraph in the introduction to ISA 700 is unnecessary.

- 4. Are there any residual concerns about the way in which management's responsibilities are dealt with that may cause difficulty in any particular jurisdiction?**

No.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Roger Marshall (+44 20 7804 4866).

Yours faithfully,

PricewaterhouseCoopers

PROPOSED ISA 210

Paragraph	Comment on paragraph
	Requirements
Paragraph 1	<p>The ISA 200 Exposure Draft proposes to include as paragraph 2 in its introductory paragraphs:</p> <p><i>“ISAs are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.”</i></p> <p>Having established that principle in the overarching ISA, it is unnecessary to repeat this concept in each individual ISA. Therefore, we recommend that the second sentence of paragraph 1 be deleted.</p>
Paragraphs 4-6 and related application material	<p>These paragraphs deal with the <i>preconditions</i> for an audit. However, it is not clear whether the requirements set out in these paragraphs <u>are</u> the preconditions, or whether the requirements are intended to set out the procedures to be carried out to determine whether the preconditions are present. Paragraph 4 requires the auditor to carry out procedures to “establish whether necessary preconditions for an auditor are present” but does not clearly set out what such preconditions are.</p> <p>Further, the guidance in A11 refers to the audit being conducted on the <i>premise</i> that management, and where appropriate, those charged with governance, have the responsibilities set out in paragraph 4(b). It is not clear whether this ‘premise’ is intended to convey the same meaning as ‘precondition’.</p> <p>As the ‘premise’ is fundamental to the conduct of the audit, it is important that both this term and the term ‘precondition’ are clearly defined and their interrelationship is explained. We believe this should be relatively easy to fix in the application material by adding an introductory paragraph under the heading “Preconditions for an Audit” that sets out the preconditions, one of which would include that there is evidence that the premise exists:</p> <ul style="list-style-type: none"> ▪ An acceptable financial reporting framework ▪ Evidence that the premise regarding management’s and, where appropriate, those charged with governance is valid in the circumstances (through their acknowledgement of those responsibilities) ▪ No predetermined scope limitations that would result in a disclaimer of opinion.
Paragraph 4(b)	<p>We believe that the following editorial changes would improve the readability of this paragraph. The reasons for the proposed changes are described below.</p> <p>“4.....</p> <p>(b) <i>Obtain the agreement of management and, where appropriate, those charged with governance (as part of the terms of the audit engagement in paragraph 8) that they acknowledge and understand their responsibility: (Ref: Para. A11-A13, A17)</i></p> <p>(i) <i><u>In the case of a compliance framework, for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework or, and (Ref: Para. A14-A16) in the case of a fair presentation framework, for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework; or the preparation and presentation of financial statements that give a true and fair view in accordance with the financial reporting framework. This includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; (Ref: Para. A14-A16); and</u></i></p> <p>(ii) <i>To provide the auditor with:</i></p> <ol style="list-style-type: none"> a. <i><u>Access to a</u>All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;</i> b. <i>Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and</i> c. <i>Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.</i> <p><i>In the case of a fair presentation framework, management and, where appropriate, those charged with governance, are responsible for the preparation and fair presentation of the</i></p>

	<p>financial statements in accordance with the financial reporting framework; or the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework.”</p> <ul style="list-style-type: none"> ▪ Paragraph 4(b)(i) requires the auditor to “obtain the agreement of management and, where appropriate, those charged with governance that they acknowledge and understand their responsibility...”. Paragraph 8 requires the terms of the audit engagement to include the responsibilities of the auditor and the responsibilities of management and, where appropriate, those charged with governance. Paragraph A11 notes that the agreement required in paragraph 4 is obtained “as part of agreeing and recording the terms of the audit engagement” (i.e., though fulfilling the requirements in paragraph 8). Thus, there is a certain amount of circularity. <p>We believe it would be helpful to give greater visibility to the linkage between the requirements in paragraphs 4(b)(i) and 8 by noting in paragraph 4(b)(i) that the agreement is obtained as part of the agreed terms of the audit engagement.</p> <ul style="list-style-type: none"> ▪ Paragraph 4(b)(ii)(a) refers to the obligation to provide the auditor “with all information..... and other matters...”. Not only does this not read well (in particular, the sentence doesn’t work in relation to “other matters”), but it is the ability to access the information that is relevant to the auditor. It is unrealistic that the information be “provided”, which can mean to supply as well as to make available. ▪ The final section of the proposed paragraph explains that in the case of a fair presentation framework, the wording of the responsibility regarding the preparation and presentation of the financial statements would be appropriately amended to refer to “fair presentation”. As currently positioned at the end of a long requirement with subsections, it is not clear to which part of paragraph 4 it relates. We suggest that it be included as part of paragraph 4(b)(i) as illustrated above. ▪ In addition, the wording of the sentence refers to the “<i>preparation and fair presentation</i> of the financial statements.....; or the <i>preparation</i> of financial statements that give a true and fair view....” The second part of the sentence should refer to both <u>preparation and presentation</u> of such financial statements.
<p>Paragraph 6</p>	<p>The revision to this paragraph arising from the ISA 580 conforming amendments has reduced the clarity of the original wording. Indeed, the wording could now be misinterpreted as implying that compliance, by management, with paragraph 19 is sufficient to deal with a failure to obtain the agreement referred to in paragraph 4(b).</p> <p>This paragraph attempts to deal with two separate matters – the acceptability of the reporting framework and the agreement of management and those charged with governance. We suggest that the two concepts be addressed separately, as follows.</p> <p><i>“Where the preconditions for an audit are not present, the auditor shall discuss the matter(s) with management and, where appropriate, those charged with governance to determine whether the problems can be overcome. Unless the requirements of paragraph 19 are met, or the auditor is required by law or regulation to do so, the auditor shall not accept the proposed audit engagement if:</i></p> <p><i>(a) the auditor has determined that the applicable financial reporting framework is unacceptable, unless the requirements in paragraph 19 are met to ensure that readers are not misled, or</i></p> <p><i>(b) if the agreement referred to in paragraph 4(b) has not been obtained.”</i></p>
<p>Paragraphs 10-11</p>	<p>As currently worded, paragraph 10 and the first two sentences of paragraph 11 are not requirements. We suggest these paragraphs be reworded to clarify that the auditor shall use the words prescribed by the proposed ISA unless the auditor has determined that the law or regulation prescribes responsibilities that are equivalent. Alternatively, some of this language could be moved to the application material.</p>
<p>Paragraphs 17-20</p>	<p>The interrelationship of these paragraphs would be easier to understand if paragraph 17, on the wording used to express the opinion, followed the requirements regarding the financial reporting framework. This would be more closely aligned with the structure of the ISA, which deals with consideration of the acceptability of the financial reporting framework first. Thus, the requirements would be in the following order:</p> <ol style="list-style-type: none"> (i) conflicts resulting from financial reporting standards being supplemented by law or regulation; (ii) financial reporting frameworks which are determined to be unacceptable; and (iii) considerations dealing with the impact of these matters on the audit opinion.

<p>Paragraph 17</p>	<p>This paragraph relies on the fact that, where law or regulation prescribes the wording of the audit opinion in terms that are significantly different from the requirements of ISAs, and the auditor is prohibited by law from declining the engagement, the auditor’s report will not refer to the audit having been conducted in accordance with ISAs. However, it seems odd for an ISA dealing with terms of engagement to include a requirement regarding wording to be used in the auditor’s report. There is considerable risk that auditors will not look to this ISA for direction in these circumstances.</p> <p>ISA 200 already includes the requirement that an auditor shall not represent compliance with ISAs unless the auditor has complied with the requirements of ISA 200 and all other ISAs relevant to the auditor. Therefore, for the purposes of this ISA, we believe that an appropriate cross reference to that requirement in ISA 200 could be made in the application material as the basis for explaining the implications for the auditor’s report when the risk that prescribed wording for the opinion will be misleading cannot be otherwise mitigated. Thus, the requirement in this ISA could appropriately focus on the implications for engagement acceptance alone.</p> <p>In addition, we recommend that the application material in ISAs 700 and 800 related to the requirements on the opinion wording should include appropriate cross references to this ISA to ensure the matter receives appropriate visibility in those ISAs as well.</p> <p>Finally, we question whether, under the circumstances described, it is sufficient, or in the public interest, simply to omit reference to the ISAs in an opinion on financial statements. It is far too subtle for a reader to comprehend the possible implications of a lack of reference, particularly as the report would still assert that an audit had been conducted. An explicit statement, in the auditor’s report, that the audit was not conducted in accordance with the ISAs would be a more direct caution to the reader.</p>
<p>Paragraph 18</p>	<p>We question whether there is sufficient guidance in this ISA, and in the ISAs collectively, for readers to understand how to apply this requirement.</p> <p>Need for guidance on amending the framework reference</p> <p>Paragraph 18(b) suggests that one option to address the problem of a conflict between financial reporting standards and law or regulation that supplements them is to amend the description of the applicable financial reporting framework. However, the application material in A31 simply provides an illustration of how law or regulation may supplement financial reporting standards—it does not provide an example of what would be considered a conflict, nor provide guidance on the type of amendment to the framework reference would be appropriate in the circumstances.</p> <p>The Clarity Exposure Draft of ISA 700 includes both a requirement regarding the need to evaluate whether the financial statements adequately refer to or describe the application financial reporting framework (paragraph 12) and application material to provide guidance on considerations in determining whether references or descriptions are adequate (paragraphs A3-A11). At a minimum, a cross reference to those paragraphs in paragraph A31 of this ISA would be useful to readers.</p> <p>Need for amendment to ISA 705 to recognise all circumstances requiring modification</p> <p>Perhaps even more importantly, the last sentence of this paragraph, which directs the auditor to proposed ISA 705 regarding the modifications to the auditor’s opinion that might be necessary, could be misleading without amendment to ISA 705.</p> <p>ISA 705 deals with misstatements resulting from the financial statements failing to comply with the applicable financial reporting framework. It does not discuss modifications required when the financial reporting framework is not acceptable, nor when the description of the framework is not adequate – neither of which are issues that arise from complying with the framework itself.</p> <p>In the ISAs, ISA 700 (Revised and Redrafted) proposes to establish the principle that an inadequate description of the framework can be <i>misleading</i>. Paragraphs 15 and 16 of ISA 700 indicate that it may be necessary to modify the auditor’s opinion if the financial statements do not give a fair presentation (for fair presentation frameworks) or modify the auditor’s report if they are misleading (for compliance frameworks). ISA 450 provides a link between ISAs 700 and 705 in establishing that misstatements include adjustments to amounts, classifications, presentation, or disclosures that are necessary for the financial statements to give a true and fair view or present fairly, in all material respects. However, a similar principle is not established in ISA 450 or any other ISA for matters that cause the financial statements to be <i>misleading</i>. Thus, ISA 705 doesn’t appear to provide direction on the modifications to the audit opinion or report that would be appropriate in these circumstances, even though ISA 210 directs the auditor to ISA 705 for direction.</p> <p>In order for the ISAs to align logically together, we believe that it would be useful for ISA 705 to explicitly include an inadequate description of the financial reporting framework in its discussions of</p>

	<p>misstatements in paragraphs A1-A5. This seems an appropriate place to do so because this guidance provides illustrative examples of sources of misstatements, rather than the generic description of how misstatements occur in the definition in ISA 450. It would also help to include appropriate cross references in ISA 705 to both this requirement in ISA 210, and to ISA 700.</p> <p>Similar changes are also needed to ensure that there is sufficient direction on the reporting implications of a matter the auditor has determined is misleading.</p>
Paragraph 20	<p>We are of the view that this paragraph would be strengthened by including a statement to the effect that the overriding principle is that the auditor's report should not be associated with misleading information.</p>
	<p>Application and other explanatory material</p>
A2	<p>To avoid confusion with the discussion of responsibilities of management and those charged with governance elsewhere in the ISA, we suggest referring to the "roles" of management and those charged with governance "in" agreeing the terms of the audit engagement in this sentence.</p>
A3- A4	<p>Paragraph A3 introduces the concept of the "suitability" of criteria. The ISA, however, focuses on the "acceptability" of the financial reporting framework. The linkage between these two concepts is made, albeit rather indirectly, in paragraph A4.</p> <p>We believe that the understandability of these concepts and their relationships could be improved if the third sentence of paragraph A3 was moved to A4 (as it seems superfluous in A3) and modified slightly, as follows:</p> <p><u>"Suitable criteria are required for enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation and presentation of the financial statements and the auditor does not have suitable criteria for evaluating the financial statements..."</u></p>
A5	<p>We suggest that this sentence be amended as follows:</p> <p><u>"Factors that may affect are relevant to the auditor's determination of the acceptability of the applicable financial reporting framework include: "</u></p>
A6	<p>For reasons that we have articulated in previous responses on other ISAs (e.g., ISA 700 and 800), we do not support the assertion in paragraph A6 that financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide ranged of users are always intended to be general purpose financial statements. Whilst financial statements prepared in accordance with a special purpose framework will always be intended for a special purpose (as the information is not, by definition, designed to meet the common information of users), specific users requesting a special purpose audit engagement may determine that a financial reporting framework that would otherwise be used for general purposes meets their special purpose needs. The fact that such a framework is used does not, in our view, negate that the engagement is designed to fulfil the needs of a special purpose engagement, nor that the auditor's report ought to be appropriately amended (for example, to include a restriction on use).</p> <p>This misapplication of the concept is at the heart of the problems we are already beginning to experience in applying ISA 700 and 800 in practice and we are concerned that there will be widespread misunderstanding and misapplication of the ISA reporting standards whilst this principle remains in the ISAs.</p>
A9	<p>We do not believe that the first sentence is necessary in this paragraph. However, a cross reference to the requirement in paragraph 18 and the related application material in paragraph A31 would be useful as they address circumstances when there are indications to the contrary.</p>
A18-A19	<p>Paragraph A18 seems to suggest that an audit engagement letter is not necessary if law or regulation sufficiently establishes the objective and scope of the audit, and the responsibilities of the auditor and of management and, where appropriate, those charged with governance. A similar point is made in A19 in the context of public sector law or regulation.</p> <p>Although paragraph A20 explains that written acknowledgement by management and, where those charged with governance, of their responsibilities must still be obtained by other means, reading these two paragraphs alone seems to contradict the requirement in paragraph 10. The use of subheadings in the application guidance exacerbates the problem as it implies the paragraphs can be read alone. If the</p>

	point being made is that the written acknowledgement need not be obtained via an audit engagement letter, we suggest emphasising that point specifically in each of A18 and A19 to avoid misinterpretation.
A20	This paragraph addresses two points: (i) clarification that even if law or regulation defines the respective responsibilities, written acknowledgement must be obtained, and (ii) that the wording of the agreement can use the language in law or regulation. We suggest splitting this paragraph to deal with each separately. For the reasons discussed above for paragraphs A18-A19, it is important to complete the message regarding the need for written agreement even if an engagement letter is not obtained in those paragraphs to avoid misunderstanding. If this suggestion was adopted, paragraph A20 could then focus solely on the matter of the wording of the descriptions.
Appendix 1	Some of the wording of this illustrative engagement letter may need to be amended in light of the final agreed wording to other ISAs. For example, the discussion of the inherent limitations may need alignment with the final wording of ISA 200.

PROPOSED ISA 700 CONFORMING AMENDMENT

Paragraph	Comment on paragraph
	Requirements
3(a)	<p>Proposed paragraph 3 (a) moves the guidance that was in paragraph A23, explaining how the term “management” is used in that particular ISA, to the introductory paragraphs. We find this both an odd placement and uneasy construct.</p> <p>In other ISAs, terms that are used in a particular way in that ISA are described in a Definitions section rather than in the Introductory paragraphs. Therefore, at a minimum, we believe this sentence should be moved to the Definitions section rather than the Introduction.</p> <p>However, we are not convinced that would be the best solution. The proposed ISA 200 now includes a more ‘objective’ definition of management as it is to be applied in the ISAs. That definition should suffice for the purposes of interpreting the requirements and application material in ISA 700 as intended, with the possible exception of the requirements in paragraph 21 – 23a because they may be interpreted as mandating specific wording to be used in the auditor’s report. We suggest that this can be addressed by reinstating application guidance in paragraph A23, but to refocus it on the term to be used in the auditor’s report rather than a broader explanation of how the term is used in the ISA. For example, the guidance could read:</p> <p><i>“This section of the auditor’s report describes the responsibilities of those in the organisation that have responsibility for the preparation and presentation of the financial statements. The auditor’s report need not refer specifically to “management” in this context, but rather may use the term that is appropriate in the context of the legal framework in the particular jurisdiction. For example, in some jurisdictions, the appropriate reference may be to those charged with governance (for example, the directors).”</i></p> <p>If considered to be essential application guidance, which some might argue it is, it could also be placed in the requirements section after the subheading but before paragraph 21.</p>