

AU-C Section 210

Terms of Engagement

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 137; SAS No. 138.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities in agreeing upon the terms of the audit engagement with management and, when appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, for which management and, when appropriate, those charged with governance are responsible, are present. Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, addresses those aspects of engagement acceptance that are within the control of the auditor. (Ref: par. .A1)

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor is to accept an audit engagement for a new or existing audit client only when the basis upon which it is to be performed has been agreed upon through

- a. establishing whether the preconditions for an audit are present and
- b. confirming that a common understanding of the terms of the audit engagement exists between the auditor and management and, when appropriate, those charged with governance.

Definitions

.04 For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

Preconditions for an audit. The use by management of an acceptable financial reporting framework in the preparation and fair presentation of the financial statements and the agreement of management and, when appropriate, those charged with governance, to the premise¹ on which an audit is conducted.

¹ Paragraphs .05 and .A2 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Recurring audit. An audit engagement for an existing audit client for whom the auditor performed the preceding audit.

.05 For purposes of this section, references to *management* are to be read hereafter as "management and, when appropriate, those charged with governance" unless the context suggests otherwise.

Requirements

Preconditions for an Audit

.06 In order to establish whether the preconditions for an audit are present, the auditor should

- a. determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable and (Ref: par. .A2--.A8)
- b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A9--.A12 and .A18)
 - i. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; (Ref: par. .A13)
 - ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: par. .A14--.A16)
 - iii. to provide the auditor with
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - (2) additional information that the auditor may request from management for the purpose of the audit; and (Ref: par. .A17)
 - (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Management-Imposed Limitation on Scope Prior to Audit Engagement Acceptance That Would Result in a Disclaimer of Opinion

.07 If management or those charged with governance of an entity that is not required by law or regulation to have an audit 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 statements as a whole, the auditor should not accept such a limited engagement as an audit engagement. If management or those charged with governance of an entity that is required by law or regulation to have an audit imposes such a scope limitation and a disclaimer of opinion is acceptable under the applicable law or to the regulator, the auditor is permitted, but not required, to accept the engagement. (Ref: par. .A19--.A20)

Other Factors Affecting Audit Engagement Acceptance

.08 If the preconditions for an audit are not present, the auditor should discuss the matter with management. Unless the auditor is required by law or regulation to do so, the auditor should not accept the proposed audit engagement

- a. if the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- b. if the agreement referred to in paragraph .06*b* has not been obtained.

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. .A21–.A22)

.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. .A23–.A28)

- 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 (Ref: par. .A25)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Initial Audits, Including Reaudit Engagements

.11 Before accepting an engagement for an initial audit, including a reaudit engagement, the auditor should 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.

.12 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. .A29–.A34)

Recurring Audits

.13 On recurring audits, the auditor should assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of the engagement, and the reminder should be documented. (Ref: par. .A35–.A36)

Acceptance of a Change in the Terms of the Audit Engagement

.14 The auditor should not agree to a change in the terms of the audit engagement when no reasonable justification for doing so exists. (Ref: par. .A37–.A39)

.15 If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement for which the auditor obtains a lower level of assurance, the auditor should determine whether reasonable justification for doing so exists. (Ref: par. .A40–.A41)

.16 If the terms of the audit engagement are changed, the auditor and management should agree on and document the new terms of the engagement in an engagement letter or other suitable form of written agreement.

.17 If the auditor concludes that no reasonable justification for a change of the terms of the audit engagement exists and is not permitted by management to continue the original audit engagement, the auditor should

- a. withdraw from the audit engagement when possible under applicable law or regulation,
- b. communicate the circumstances to those charged with governance, and
- c. determine whether any obligation, either legal, contractual, or otherwise, exists to report the circumstances to other parties, such as owners, or regulators.

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation

.18 If law or regulation prescribes a specific layout, form, or wording of the auditor's report that significantly differs from the requirements of GAAS, the auditor should evaluate

- a. whether users might misunderstand the auditor's report and, if so,
- b. whether the auditor would be permitted to reword the prescribed form to be in accordance with the requirements of GAAS or attach a separate report.²

If the auditor determines that rewording the prescribed form or attaching a separate report would not be permitted or would not mitigate the risk of users misunderstanding the auditor's report, the auditor should not accept the audit engagement unless the auditor is required by law or regulation to do so. An audit performed in accordance with such law or regulation does not comply with GAAS. Accordingly, for such an audit, the auditor should not include any

² Paragraphs .22–.23 of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*.

reference to the audit having been performed in accordance with GAAS within the auditor's report.³ (Ref: par. .A42–.A43)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibilities regarding relevant ethical requirements in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are addressed in section 220. This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

Preconditions for an Audit

The Financial Reporting Framework (Ref: par. .06a)

.A2 An applicable financial reporting framework provides the criteria for management to present the financial statements of an entity, including the fair presentation of those financial statements. The criteria used by the auditor to evaluate or measure the subject matter, including, when relevant, a basis for presentation and disclosure, are also provided by the financial reporting framework. These criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

.A3 Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements, and the auditor does not have suitable criteria for auditing the financial statements. In many cases, the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs .A6–.A8.

Determining the Acceptability of the Financial Reporting Framework

.A4 Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)
- Whether law or regulation prescribes the applicable financial reporting framework

.A5 Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. Although all the information needs of specific users cannot be met, financial information needs that are common to a wide range of users exist. Financial statements prepared in accordance with a financial reporting framework designed to meet

³ Paragraph .22 of section 800.

the common financial information needs of a wide range of users are referred to as *general purpose financial statements*.

.A6 *General purpose frameworks.* The sources of established accounting principles that are generally accepted are accounting principles promulgated by a body designated by the Council of the AICPA to establish such principles, pursuant to the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. Such financial reporting standards often are identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A7 *Special purpose frameworks.* In some cases, the financial statements will be prepared in accordance with a special purpose framework. For example, law or regulation may prescribe the financial reporting framework to be used in the preparation of financial statements for certain types of entities. Such financial statements are referred to as *special purpose financial statements*. Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses the acceptability of special purpose frameworks.⁴

.A8 After the audit engagement has been accepted, the auditor may encounter deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the previously agreed-upon terms will have changed, and the auditor is required by paragraph .16 to agree upon new terms of the audit engagement that reflect the change in the framework.

Agreement of the Responsibilities of Management (Ref: par. .06b)

.A9 An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph .06b.⁵ The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit.^{*} However, the concept of an independent audit requires that the auditor's role does not involve assuming management's responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity's related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (including information obtained from outside of the general and subsidiary ledgers) insofar as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of

⁴ Paragraph .10 of section 800.

⁵ Paragraphs .05 and .A2 of section 200.

^{*} In January 2013, the Professional Ethics Executive Committee adopted a provision in the "Scope and Applicability of Nonattest Services" interpretation (ET sec. 1.295.010) under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. This provision provides, among other things, that financial statement preparation is considered outside the scope of the attest engagement and, therefore, constitutes a nonattest service subject to the requirements of the "Nonattest Services" subtopic (ET sec. 1.295). The provision is effective for engagements covering periods beginning on or after December 15, 2014. [Footnote added, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the audit engagement as required by paragraphs .09–.10. [Revised, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A10 The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution and those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

.A11 Section 580, *Written Representations*, requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities.⁶ It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other AU-C sections and, when necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

.A12 If management will not acknowledge its responsibilities or indicates that it will not provide written representations as requested, the auditor will be unable to obtain sufficient appropriate audit evidence.⁷ In such circumstances, it would not be appropriate for the auditor to accept the audit engagement unless law or regulation requires the auditor to do so. In cases when the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters and the implications for the auditor's report.

Preparation and Fair Presentation of the Financial Statements (Ref: par. .06b(i))

.A13 In an audit of special purpose financial statements, the auditor is required by section 800 to obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements.⁸ This agreement is a precondition of the audit included in the terms of the engagement.

Internal Control (Ref: par. .06b(ii))

.A14 Management maintains such internal control as it determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives, due to the inherent limitations of internal control.

⁶ Paragraphs .10–.11 of section 580, *Written Representations*.

⁷ Paragraph .A34 of section 580.

⁸ Paragraph .11 of section 800.

.A15 An independent audit conducted in accordance with GAAS does not act as a substitute for the maintenance of internal control necessary for the preparation and fair presentation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands that it has responsibility for the design, implementation, and maintenance of internal control necessary for this purpose. However, the agreement required by paragraph .06b(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free from deficiencies.

.A16 Management has the responsibility to determine what internal control is necessary to enable the preparation and fair presentation of the financial statements. The term *internal control* encompasses a wide range of activities within components that may be described as the control environment; the entity's risk assessment process; the information system, including the related business processes relevant to financial reporting, and communication; control activities; and monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement, and maintain its internal control or how it may classify any particular component.⁹ An entity's internal control will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulations.

Additional Information (Ref: par. .06biii(2))

.A17 Additional information that the auditor may request from management for the purpose of the audit may include, when applicable, matters related to other information in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. When the auditor expects to obtain other information after the date of the auditor's report, the terms of the audit engagement may also acknowledge the auditor's responsibilities relating to such other information including, if applicable, the actions that may be appropriate or necessary if the auditor concludes that an uncorrected material misstatement of the other information exists in such other information. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Considerations Relevant to Smaller Entities (Ref: par. .06b)

.A18 One of the purposes of agreeing upon the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when the auditor or a third party has assisted with drafting the financial statements, it may be useful to remind management that the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Management-Imposed Limitation on Scope Prior to Audit Engagement Acceptance That Would Result in a Disclaimer of Opinion (Ref: par. .07)

.A19 Scope limitations may be imposed by management or by circumstances. Examples of scope limitations that would not preclude the auditor from accepting the engagement include the following:

- A restriction imposed by management that the auditor believes will result in a qualified opinion

⁹ Paragraph .A51 and appendix B, "Internal Control Components," of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

- A restriction imposed by circumstances beyond the control of management

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A20 Employee benefit plans are an example of entities that are required to have an audit by law or regulation and a disclaimer of opinion is acceptable under the applicable law or to the regulator. For such entities, the auditor is neither precluded from accepting, nor required to accept, the engagement, regardless of whether management imposes a scope limitation that is expected to result in the auditor disclaiming an opinion on the financial statements as a whole. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Agreement on Audit Engagement Terms

Agreeing Upon the Terms of the Audit Engagement (Ref: par. .09)

.A21 The roles of management and those charged with governance in agreeing upon the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless in accordance with paragraph .06, the auditor is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A22 When a third party has contracted for the audit of the entity's financial statements, agreeing the terms of the audit with management of the entity is necessary in order to establish that the preconditions for an audit are present. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Audit Engagement Letter or Other Form of Written Agreement¹⁰ ***(Ref: par. .10)***

.A23 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. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Form and Content of the Audit Engagement Letter

.A24 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*.¹¹ Paragraph .06b of this section addresses the description of the responsibilities of management. In addition to including

¹⁰ 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.

¹¹ Paragraphs .04–.10 of section 200.

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
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team
- The communication of key audit matters
- The form of any other communication about the results of the audit engagement
- The expectation that management will provide written representations (see also paragraph .A11)
- The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, including an expectation that management will provide access to information relevant to disclosures
- The agreement of management to make available to the auditor draft financial statements, including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures), and any accompanying other information¹² 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 management signing the engagement letter

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A25 Although there is no requirement in GAAS to communicate key audit matters, the engagement letter may acknowledge that management has requested that the auditor communicate key audit matters in the auditor's report. If the terms of the audit engagement initially acknowledge that key audit matters will be communicated, but it is later decided that this will not be done, the engagement letter may need to be modified accordingly. If, after the engagement letter is signed, management requests that the auditor communicate key audit matters, the auditor may acknowledge this agreement in a new engagement letter or as an addendum to the originally signed letter. [Paragraph added,

¹² As defined in section 720, *Other Information in Documents Containing Audited Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A26 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

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A27 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." [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A28 *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

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Initial Audits, Including Reaudit Engagements (Ref: par. .11–.12)

.A29 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. [Paragraph

renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A30 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. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A31 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 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. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A32 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. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A33 The communication with the predecessor auditor may be either written or oral. 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
- The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Considerations Specific to Governmental Entities

.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.¹³ [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Recurring Audits (Ref: par. .13)

.A35 The following factors may make it appropriate to revise the terms of the audit engagement:

- Any indication that management misunderstands the objective and scope of the audit
- Any revised or special terms of the audit engagement
- A change of senior management
- A significant change in ownership
- A significant change in the nature or size of the entity's business
- A change in legal or regulatory requirements
- A change in the financial reporting framework adopted in the preparation of the financial statements
- A change in other reporting requirements

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A36 The auditor may remind management of the terms of the engagement in writing or orally. A written reminder might be a letter confirming that the terms of the preceding engagement will govern the current engagement. If the reminder is oral, audit documentation may include with whom the discussion took place, when, and the significant points discussed. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Acceptance of a Change in the Terms of the Audit Engagement**Request to Change the Terms of the Audit Engagement (Ref: par. .14)**

.A37 A request from management for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding about the nature of an audit as originally requested, or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor, as required by paragraph .14, considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

¹³ Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

.A38 A change in circumstances that affects management's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A39 In contrast, a change may not be considered reasonable if the change appears to relate to information that is incorrect, incomplete, or otherwise unsatisfactory. An example might be when the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and management asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Request to Change to a Review or Other Service (Ref: par. .15)

.A40 Before agreeing to change an audit engagement to a review or other service, an auditor who was engaged to perform an audit in accordance with GAAS may need to assess, in addition to the matters referred to in paragraphs .A37–.A39, any legal or contractual implications of the change. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A41 If the auditor concludes that reasonable justification to change the audit engagement to a review or other service exists, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the other service would not include reference to the following:

- a. The original audit engagement
- b. Any procedures that may have been performed in the original audit engagement, except when the audit 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

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation (Ref: par. .18)

.A42 GAAS require that the auditor not represent compliance with GAAS unless the auditor has complied with all of the AU-C sections relevant to the audit.¹⁴ If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, section 800 requires that the auditor's report refer to GAAS only if the auditor's report includes the minimum reporting elements.¹⁵ In accordance with section 800, if the specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor is required

¹⁴ Paragraph .22 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

¹⁵ Paragraph .22 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

to reword the prescribed form of report or attach an appropriately worded separate report.¹⁶ When the auditor concludes that rewording the prescribed form to be in accordance with the requirements of GAAS or attaching a separate report would not be permitted, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with GAAS. The auditor is, however, encouraged to apply GAAS, including the AU-C sections that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with GAAS. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Considerations Specific to Governmental Entities

.A43 For governmental entities, specific legal or regulatory requirements may exist; for example, the auditor may be required to report directly to the legislature or the public if management attempts to limit the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

¹⁶ Paragraph .23 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

.A44

Exhibit — Example of an Audit Engagement Letter (Ref: par. .A27)

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this section. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of those charged with governance of ABC Company:¹

[The objective and scope of the audit]

You² have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with GAAS. As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

¹ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A21.

² Throughout this letter, references to *you, we, us, management, those charged with governance, and auditor* would be used or amended as appropriate in the circumstances.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.³ However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Conclude, based on the audit evidence obtained, whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.

[The responsibilities of management and identification of the applicable financial reporting framework]

Our audit will be conducted on the basis that *[management and, when appropriate, those charged with governance]*⁴ acknowledge and understand that they have responsibility

- a. for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide us with
 - i. access to all information of which *[management]* is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
 - ii. additional information that we may request from *[management]* for the purpose of the audit; and
 - iii. unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

³ This sentence would be modified, as appropriate, in circumstances in which the auditor also has a responsibility to issue an opinion on the effectiveness of internal control over financial reporting in conjunction with the audit of the financial statements. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁴ Use terminology as appropriate in the circumstances. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

As part of our audit process, we will request from [*management and, when appropriate, those charged with governance*], written confirmation concerning representations made to us in connection with the audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.*]

[Reporting]

[*Insert appropriate reference to the expected form and content of the auditor's report, including, when applicable, the reporting on other information in accordance with section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports. Example follows:*]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. Circumstances may arise in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances, it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or if necessary, withdraw from the engagement.

We also will issue a written report on [*insert appropriate reference to other auditor's reports expected to be issued*] upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

[*Signed*]

[*Name and Title*]

[*Date*]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]
