

# Agreeing the terms of Audit Engagements - SA 210

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## Case study - Recent NFRA order

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NFRA found that none of the branch auditors for ABC Ltd were officially approved at the company's Annual General Meeting (AGM), as required by the CA, 2013. Despite this, the Partner of XYZ & Co, accepted the role of "Branch Statutory Auditor" for five branches of ABC Ltd. This action was in violation of the Chartered Accountants Act, 1949, which mandates that such appointments must be legally valid.

The CA was charged with **non-compliance with SA 210** and displaying an absence of professional skepticism. SA 210 stipulates that the auditor shall agree to the terms of the audit engagement with management or TCWG and that subject to exception (earlier slide), the agreed terms of the audit engagement shall be recorded in an audit engagement letter and shall include points (a) to (e) in the earlier slide.

The contention of the CA is not acceptable in the absence of a valid engagement letter in the Audit File. The CA was required to exercise due diligence and adhere to the requirements of SA 210. The CA's negligence of the provisions of SA 210 has resulted in accepting an invalid appointment and issuing report that is not legally valid. Apart from non-compliance with SA 210, this shows the absence of professional skepticism and professional judgment in understanding the objective and scope of the audit, thereby violating SA 200 also.

# Scope and Objective

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## Scope:

This SA deals with the auditor's responsibilities in agreeing the terms of the audit engagement with Mgmt / TCWG.

## Objective:

This SA deals with 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. 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:

Establishing whether the **preconditions for an audit** are present; and

Confirming that there is a **common understanding between the auditor and management** and, where appropriate, TCWG of the terms of the audit engagement

***Preconditions for an audit – The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, TCWG to the premise on which an audit is conducted.***

# Preconditions for an audit

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In order to establish whether the preconditions for an audit are present, the auditor shall:

- i. Determine whether the **financial reporting framework** to be applied **is acceptable**; and
- ii. Obtain the agreement of management that **it acknowledges and understands its responsibility**
  - i. For the **preparation of the financial statements** in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
  - ii. For such **internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
  - iii. To provide the auditor with:
    - i. **Access to all information** of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - ii. **Additional information** that the auditor may request from management for the purpose of the audit; and
    - iii. **Unrestricted access to persons** within the entity from whom the auditor determines it necessary to obtain audit evidence.

***Limitation on Scope Prior to Audit Engagement Acceptance – Shall not accept such a limited engagement as an audit engagement***

***Absence of preconditions for an audit – Discuss the matter with Mgmt. Auditor shall not accept such a limited engagement as an audit engagement***

# Agreement on audit engagement terms

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## Contents of engagement letter

The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- (a) Objective and scope
- (b) Responsibilities of the auditor
- (c) Responsibilities of management (@)
- (d) Identification of the applicable financial reporting framework
- (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

## Exception

If law or regulation prescribes in sufficient detail the terms of the audit engagement referred above, the Auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that Mgmt acknowledges and understands its responsibilities. The auditor may **nevertheless consider it appropriate to include the matters** described above in an engagement letter for the information of management.

*@ SA 580 requires the auditor to request Mgmt to provide written representations that it has fulfilled certain of its responsibilities. It may therefore be appropriate to make Mgmt. aware that receipt of such written representations will be expected, together with written representations required by other SAs and, where necessary, written representations to support other audit evidence relevant to the FS or one or more specific assertions in the FS.*

# Examples of form and content of audit engagement letter

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- Elaboration of the scope of the audit including reference to applicable legislation
- The form of any other communication of results of the audit engagement
- The requirement for the auditor to communicate KAMs
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs
- Arrangements regarding the planning and performance of the audit
- The expectation that management will provide written representations
- The agreement of management to make available the draft financial statements
- The agreement of management to inform the auditor of facts that may affect the FS, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued
- 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
- The fact that the audit process may be subjected to a peer review under the Chartered Accountants Act, 1949
- Any other legal requirements, for example – SEBI Circular CIR/CFD/CMD1/114/2019 dated 18<sup>th</sup> Oct 2019 with respect to resignation of statutory auditors from listed entities and their material subsidiaries

# Examples of form and content of audit engagement letter

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## If relevant, the following could be added :

- Arrangements concerning the involvement of other auditors and experts 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 such possibility exists
- A reference to any further agreements between the auditor and the entity
- **Any obligations to provide audit working papers to other parties #**

**# Recent NFRA circular:** *Whilst SA 600 does not mention specifically a review of audit work papers of the Component Auditor or Other Auditor by the Principal Auditor, such a review may need to be applied by an auditor in appropriate cases, in exercise of his professional duties, professional skepticism and professional judgement, for evaluating whether the work of the Component Auditor is adequate for his purposes (the purpose being evaluating the work done by the Component Auditor towards gathering sufficient and appropriate evidence that his overall opinion on the group financial statements is appropriate in the circumstances as per his obligations in CA 2013 and the SAs).*

*Such a review of audit work papers of the Component Auditor or Other Auditor by the Principal Auditor would also be consistent with the obligations of the Principal Auditor in SEBI's LODR. Sharing of work papers by the Component Auditors with the Principal Auditor will be permissible in such cases and the above provision of the Chartered Accountants Act, 1949 will not come in the way because such sharing is required for the lawful discharge of duties of the Principal Auditor.*

# Audit of Components

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When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to send a separate audit engagement letter to the component include the following:

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Who appoints the component auditor

Whether a separate auditor's report is to be issued on the component

Legal requirements in relation to audit appointments

Degree of ownership by parent

Degree of independence of the component management from the parent entity

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*The component teams that perform local procedures are not parties to the Primary Team's engagement agreement. A component team is not generally required to obtain a separate engagement agreement with the local entity to perform procedures for the purpose of the group audit unless there is a requirement of local laws and regulations.*

*The purpose of the Group engagement agreement is to establish that the component team will perform the work necessary to support the group audit and that component management will provide a representation letter.*



# Recurring Audits

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On recurring audits, the auditor shall **assess whether circumstances require** the terms of the audit engagement to be revised and whether there is a **need to remind the entity** of the existing terms of the audit engagement.

## Factors to be considered for revision of terms of audit engagement

- Any indication that the entity misunderstands the objective and scope of the audit
- Any revised or special terms of the audit engagement
- A recent change of senior management
- A significant change in ownership
- A significant change in 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

# Acceptance of change in terms of the Audit Engagement

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Change in the terms of the audit engagement only when there is a **reasonable justification for doing so**. This includes situations where a request for change to an engagement which conveys a lower level of assurance.

If the terms are changed, the auditor and Mgmt. **shall agree on and record the new terms of the engagement**

If **unable to change the terms** of the audit engagement & **not permitted to continue** the original audit engagement, the auditor shall :

- **Withdraw from the engagement** and
- **Report the circumstances** to Mgmt / TCWG / other relevant parties

(Example : The auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion. This is a case where change is considered reasonable as the change is unsatisfactory).

## QRB findings

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Non-compliance of SA 210 towards **issuance of EL prior to commencement** of audit

Did not clearly **specify the management's responsibility** as to the completeness and accuracy of accounts and other reports

EL issued by the firm was **not signed by TCWG** or as authorized by the BoD

EL issued was not covering all the aspects as mentioned in SA210. Further the **engagement letter was addressed to Senior General Manager**- F & A Department instead of BoD and was also not acknowledged by the client

Not including, in the EL, reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may be differ from its expected form and context

EL mentioned the assignment as review of interim financial information rather than the statutory audit. The firm was appointed as statutory auditors apart from the limited review and certification under corporate governance as well

No **separate engagement letter** for e-filing of Tax Audits was held on record

Audit engagement letter did not contain terms of assignment and fee

# **Resignation / Withdrawal from an Engagement to perform Audit of Financial statements**

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Evolution of Implementation guide on resignation / withdrawal from an Engagement to perform Audit of Financial statements

Recent NFRA circular / Supreme Court ruling

Implementation guide on resignation / withdrawal from an Engagement to perform Audit of Financial statements

Circular from SEBI

# Evolution of Implementation guide on resignation / withdrawal from an Engagement to perform Audit of Financial statements

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## Evolution of the implementation guide – A case study

ICAI came out with an Implementation Guide “Implementation Guide on Resignation/ Withdrawal from an Engagement to Perform Audit of Financial Statements” on 30th November 2018 and SEBI issued a Circular dated 18th October 2019 regarding “Resignation of statutory auditors from listed entities and their material subsidiaries”

### Rationale:

- **Frequent Abrupt Resignations:** Statutory auditors of listed companies have been resigning suddenly, often citing vague reasons like "pre-occupation" or lack of information.
- **Investor Confidence at Risk:** These resignations, especially mid-term, undermine investor trust and leave stakeholders without reliable financial data.
- **Incomplete Audit Periods:** Resignations before completing audits create gaps in financial reporting, potentially hiding irregularities.

# Recent Supreme Court ruling / NFRA circular

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## Recent NFRA circular

Statutory Auditors are under a mandatory obligation to report fraud or suspected fraud if they observe suspicious activities, transactions or operating circumstances in a company that indicate reasons to believe that an offence of fraud is being or has been committed against the company by its officers or employees.

The auditor to initiate the steps prescribed under Rule 13 of Companies (Audit and Auditors) Rules 2014 which begins with reporting the matter to the Board/Audit Committee within TWO days of his/her knowledge of the fraud.

The Statutory Auditor is duty bound to submit Form ADT-4 to the CG even in cases where the Statutory Auditor **is not the first person** to identify the fraud/suspected fraud. Resignation does not absolve the Auditor of his responsibility to report suspected fraud or fraud as mandated by the law.

## Recent Supreme Court ruling

The Hon'ble Supreme Court of India in a recent judgment, has held that the consequences of section 140 (5) of CA 2013 will be applicable also on those auditors who resign from their audit engagements without reporting fraud/suspected fraud.

There shall not be any termination of the proceedings under section 140(5), even on resignation by an auditor of a company before / during the proceedings under section 140(5)

# Implementation guide on resignation / withdrawal from an Engagement to perform Audit of Financial statements

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## Background

An audit of financial statements is intended to provide **credibility to the financial statements** through the report issued by an auditor.

The auditor needs to comply with

- a. **SQC 1**
- b. **Standards on Auditing (SAs),**
- c. **Code of Ethics and**
- d. **Other relevant ICAI pronouncements**

**Premise** – The Management / TCWG have certain responsibilities that are fundamental to the conduct of an audit in accordance with SAs.

## Responsibilities of Management / TCWG

To provide the auditor with

- (a) **All information**, such as records and documentation,
- (b) **Any additional information** requested by the auditor; and
- (c) **Unrestricted access** to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

## Powers u/s 143

Wide range of powers to discharge the duties, including

- Right of access at all times to the books of accounts
- Entitlement to require from the officers of the Company information and explanation

# Implementation guide on resignation / withdrawal from an Engagement to perform Audit of Financial statements

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## Circumstances leading to resignation / withdrawal

Withdrawal may be appropriate for variety of circumstances.

- ▶ SAs envisage certain situations
- ▶ Resignation / withdrawal while evaluating the engagement and / or client acceptance – SQC 1
- ▶ The Code of Ethics also requires to consider resigning when it is concluded that a requirement established by the Code cannot be met and the resignation is the only available alternative.

When considering resigning, the auditor should :

- Consider the circumstances as above
- Comply with the requirements of the applicable SA's
- Communicate with TCWG – considerations thereof and the conclusions reached – Seek a written response to the communication – evaluate the responses received, if any of the responses have an effect on the conclusions reached

*The practicality of withdrawing may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation prior to withdrawing.*



# Implementation guide on resignation / withdrawal from an Engagement to perform Audit of Financial statements

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## Auditor's responsibilities

- a. File form ADT-3 & Notice of resignation by the Auditor with the RoC
- b. Reasons to be specified in ADT-3 – avoid ambiguous reasons such as preoccupation, personal reasons, administrative reasons, health reasons, mutual consent, unavoidable reasons etc. Valid reason to be specified.
- c. To additionally include,
  - a. Reasons for inability to obtain sufficient appropriate audit evidence, if the same is reason for resignation
  - b. Possible effects of undetected misstatements could be both material and pervasive
  - c. If the matter is related to a specific amounts in the FS – to include a description and quantification of the financial effects
  - d. If the withdrawal is due to bonafide reasons
  - e. Facts and circumstances leading to withdrawal – to be communicated to Mgmt / TCWG as applicable
  - f. Response from the Mgmt / TCWG – State the fact, if no response is received
  - g. Prior to resignation, the last audit / review report issued
- d. Seek legal advice if need be

*Professional obligation of the outgoing auditor to respond to any request from the incoming auditor, to set out in detail the reasons, which according to him had given rise to the change and other circumstances but without disclosing any information of the client affairs which he is not competent to do.*

*In view of the above, the outgoing auditor should share with the incoming auditor, a copy of letter of resignation stating the reasons as submitted with the ROC*

## Circular from SEBI

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SEBI has issued a circular clarifying mandatory conditions to be complied with when the statutory auditor of a listed entity or its material subsidiary resigns, in relation to a limited review / audit report.

Particulars	Remarks
If all the quarters are signed (either LR or audit) of a FY, except the last quarter	Finalize the audit report for the said FY before resignation
Resign within 45 days from end of the preceding qtr	Issue LR/ audit report of such preceding qtr
Resign after 45 days from end of the preceding qtr	Issue LR/ audit report of such preceding qtr + next qtr

*To the extent information is not provided to the auditor or the management imposes a scope limitation, the audit or should provide an appropriate disclaimer in the audit report.*

# Circular from SEBI

## Procedure to be followed in relation to resignation of auditors

Reporting of concerns to AC	Disclaimer of opinion	Others
Concerns to the AC without waiting for the qtrly AC meetings	In case of non-receipt of information, auditor to give an appropriate disclaimer of opinion	Terms of the appointment / reappointment of the auditor to include all the above conditions
If proposing to resign, all concerns along with relevant documents should be brought to the notice of AC including details of information / explanation not provided by the mgmt		Certificate of compliance from a practicing CS to certify the compliances in their annual secretarial report
Deliberation of AC and communicate their views to Mgmt. and Auditor		

# Circular from SEBI

## Obligations of the listed entity

### 1. To obtain from the outgoing auditor

Detailed reasons for resignation
Details of association with the listed entity / its material subsidiary
Details of efforts made by the auditor prior to resignation (viz., approaching AC etc)
Whether the inability to obtain audit evidence was due to a mgmt-imposed scope limitation or circumstances beyond the control of mgmt
Whether the lack of information would have a significant impact on the financial statements / results
Whether the auditor has performed alternative procedures to obtain appropriate evidence as laid down in SA 705
Whether the lack of information was prevalent in the prev. reported financial statements / results. If Yes, on what basis the previous audit / limited review reports were issued
Any other facts relevant to the resignation

*2. The listed entity and its material subsidiaries are required to provide all such documents / information for the audit / limited review till the reports of quarter are submitted by the auditor.*

*3. AC to deliberate on all concerns raised before the date of the next AC. AC to communicate their views to the Mgmt. Such views of the AC to be communicated by the listed entity to the stock exchange in 24 hours after the date of the AC meeting.*

*A declaration on the above needs to be given by the statutory auditor that the above is correct and complete*

Thank you