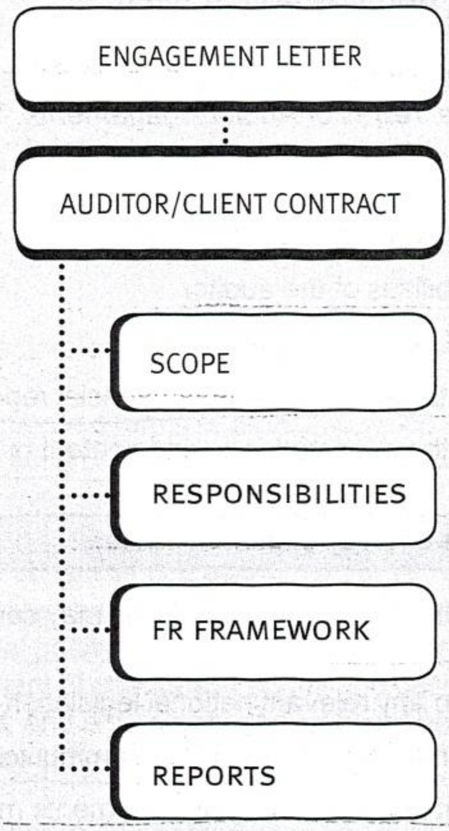
7 Engagement letters



Engagement letters – main considerations

The engagement letter will be **sent before the audit**. It specifies the nature of the **contract** between the audit firm and the client and minimises the risk of any misunderstanding of the auditor's role.

It should be **reviewed every year** to ensure that it is up to date but does not need to be reissued every year unless there are changes to the terms of the engagement. The auditor must issue a **new engagement letter if the scope or context** of the assignment **changes** after initial appointment.

ISA 210 requires the auditor to consider whether there is a need to remind the entity of the existing terms of the audit engagement for recurring audits and many firms choose to send a new letter every year, to emphasise its importance to clients.

Reasons for changes

Reasons for changes include:

- Changes to statutory duties due to new legislation.
- Changes to professional duties, perhaps due to new ISAs.
- Changes to 'other services' as requested by clients.

The contents of the engagement letter

The contents of a letter of engagement for audit services are listed in ISA 210 *Agreeing the Terms of Audit Engagements*. The contents should include:

- the objective and scope of the audit
- the responsibilities of the auditor
- the responsibilities of management
- the identification of an applicable financial reporting framework
- reference to the expected form and content of any reports to be issued.

Other contents of an engagement letter

Other matters that the engagement letter may cover include:

- reference to any relevant national legislation
- the form (and timing) of any other communication during the audit
- the fact that some material misstatements may not be detected
- key members of the audit team
- period of engagement
- the basis on which fees are calculated and any billing arrangements
- arrangements concerning the involvement of internal auditors and other staff of the entity
- limitations to the auditor's liability
- a request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement.

e.g

Illustration 3: Murray Co engagement letter

Wimble & Co
14 The Grove
Kingston
KI4 6AP

25 November 2011

To the Board of Directors of Murray Company.

This letter and the attached terms of business dated 25 November 2011 set out the basis on which we are to provide services as auditors and your and our respective responsibilities.

The objective and scope of the audit: You have requested that we audit the financial statements of Murray Company, which comprise the statement of financial position as at December 31, and the statement of profit or loss, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

The responsibilities of the auditor: We will conduct our audit in accordance with International Standards on Auditing (ISAs). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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 ISAs.

In making our risk assessments, we consider internal control relevant to Murray Company's preparation of the financial statements 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 Murray Company's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

The responsibilities of management: Our audit will be conducted on the basis that management acknowledge and understand that they have responsibility:

(a) For the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards.

(b) 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.

(c) To provide us 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 we may request from management for the purpose of the audit.

   (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

Report: We will report to the members of Murray Company as a body, whether in our opinion the financial statements present fairly in all material respects, the financial position of Murray Company as at December 31, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards. The form and content of our report may need to be amended in the light of our audit findings.

Fees: Our fees, which will be billed as work progresses, are based on the time required by the individuals assigned to the engagement plus out-of-pocket expenses. Individual hourly rates vary according to the degree of responsibility involved and the experience and skill required.

Period of engagement: This engagement will start on 01 January 2012 with the company's accounting period ending on 31 December. We will not be responsible for earlier years. The company's previous advisers, Roland, Garros & Co will deal with outstanding returns, assessments and other matters relating to earlier periods.

This letter supersedes any previous engagement letter for the period covered. Once agreed, this letter will remain effective for future years from the date of signature unless it is terminated, amended or superseded. You or we may agree to vary or terminate our authority to act on your behalf at any time without penalty. Notice of variation or termination must be given in writing.

Limitation of liability: To the fullest extent permitted by law, we will not be responsible for any losses, where you or others supply incorrect or incomplete information, or fail to supply any appropriate information or where you fail to act on our advice or respond promptly to communications from us.

Our work is not, unless there is a legal or regulatory requirement, to be made available to third parties without our written permission and we will accept no responsibility to third parties for any aspect of our professional services or work that is made available to them.

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

If this letter and the attached terms of business are not in accordance with your understanding of our terms of appointment, please let us know.

Wimble & Co

Wimble & Co

Acknowledged and agreed on behalf of Murray Company by
(signed)

....
Name and Title
Date

Murray Co engagement letter

To the Board of Directors of Murray Company...

- Although the audit report is issued to the shareholders, the engagement letter is addressed to and signed by the directors of a company.

The responsibilities of the auditor... The responsibilities of management...

- It is important to set out the directors and auditors responsibilities for clarity and to reduce any expectation gap.
- The responsibilities of the auditor include the scope of the audit, i.e. the process by which the auditor will form their opinion. The same description of the scope of an audit is included in the audit report.

We will report to the members of Murray Company as a body...

- It is important to define who the intended users of the report are, i.e. who can place reliance on it.

This engagement will start on 01 January 2012 with the company's accounting period ending on 31 December. We will not be responsible for earlier years...

- The auditor's responsibility starts at the beginning of the period for which they are providing the first audit report.

Confirmation of your agreement...

- Both the client and the auditor must sign and retain a copy of the engagement letter for reference and to support the contract agreed.