

## NSA 02

### NEPAL STANDARDS ON AUDITING TERMS OF AUDIT ENGAGEMENT

<b>Contents</b>	<b>Paragraphs</b>
Introduction	1-4
Audit Engagement Letter	5
Principal Contents	6-8
Audits of Components	9
Recurring Audits	10-11
Acceptance of a Change in Engagement	12-15
Public Sector Perspective	16
Compliance with International Standards on Auditing	17
Effective Date	18

#### **Introduction**

01. The purpose of this Nepal Standards on Auditing (NSA) is to establish standards and provide guidance on the terms of audit engagement. This NSA is to be read in conjunction with the Preface to Nepal Standards on Auditing.
02. This NSA contains the basic principles and essential procedures (Identified in bold type black lettering) together with related guidance in the form of explanatory and other material.
03. This NSA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements.
04. This NSA needs only to be applied to material matters.

#### **Audit Engagement Letters**

05. **The auditor and the client should agree on the terms of the engagement.** The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract. It is in the interest of both client and auditor that the auditor sends an engagement letter, preferably before the commencement of the engagement, to help in avoiding misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.

#### **Principal Contents**

06. The form and content of audit engagement letters may vary for each client , but they would generally include reference to :

- The objective of the audit of financial statements.
- Management's responsibility for the financial statements.
- The scope of the audit, including reference to applicable legislation, regulations or pronouncements of the Institute of Chartered Accountants of Nepal (ICAN).
- The form of any reports or other communication of results of the engagement
- The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatement may remain undiscovered.
- Unrestricted access to whatever records, documentation and other information requested in connection with the audit.

07. The auditor may also wish to include in the letter:

- Arrangements regarding the planning of audit.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
- Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- Description of any other letters or reports the auditor expects to issue to the client.
- Basis on which fees are computed and any billing arrangement.

08. When relevant, the following points could also be made:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other client staff.
- 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 client.
- An example of an audit engagement letter is set out in the Appendix of this NSA.

### **Audits of Components**

09. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the decision whether to send a separate engagement letter to the component include:

- Who appoints the auditor of the components.
- Whether a separate audit report is to be issued on the component.
- Legal requirements.
- The extent of any work performed by other auditors.
- Degree of ownership of parent.

- Degree of independence of the component's management.

### **Recurring Audits**

10. **On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.**
11. The Auditor may decide not to send a new engagement letter each period. However, the following factors may make it appropriate to send a new letter:
  - Any indication that the client misunderstands the objective and scope of the audit.
  - Any revised or special terms of the engagement.
  - A recent change of senior management, board of directors or ownership.
  - A significant change in nature or size of the client's business.
  - Legal requirements.

### **Acceptance of a Change in Engagement**

12. **An auditor who, before the completion of the engagement, is requested to change, the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.**
13. **Where the terms of the engagement are changed the auditor and the client should agree on the new terms.**
14. **The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.** An example might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.
15. **If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as the board of directors or shareholders, the circumstances necessitating the withdrawal.**

### **Compliance with International Standards on Auditing**

16. Compliance with this NSA ensures compliance in all material respects with ISA 210 (Terms of Audit Engagement).

## **Effective Date**

17. This Nepal Standards on Auditing becomes operative for Financial Statements covering periods beginning on or after 01 Shrawan, 2060 corresponding to 17 July, 2003.

## **Public Sector Perspective**

The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement or recognising an engagement not indicated in the legislative mandate may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagement letters when undertaking an audit.

Paragraph 12 to 15 of this NSA deal with the action a private sector auditor may take when there are attempts to change an audit engagement to one which provides a lower level of assurance. In the public sector specific requirements may exist within the legislation governing the audit mandate.

## APPENDIX

### Example of an Audit Engagement Letter

The following letter is for use as a guide in conjunction with the considerations outlined in this NSA and will need to be varied according to individual requirements and circumstances.

To,  
The Board of Directors, (or the appropriate representative of senior management)

You have requested that we audit the balance sheet of .....as of ..... and the related statements of income and cash flows for the year ending..... We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be made with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with Nepal Standards on Auditing (NSA). Those NSAs require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitation of any accounting and internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In addition to our report on the financial statements, we expect to provide you with a separate letter concerning any material weaknesses in accounting and internal control systems which come to our notice.

We remind you that the responsibility for the preparation of financial statements including adequate disclosure is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the company. 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 with your staff and we trust that they will make available to us whatever records, documentation and other information that are requested in connection with our audit. 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.

This letter will be effective for future years unless it is terminated, amended or superseded.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our audit of the financial statements.

(For Auditee)

Acknowledged on behalf of  
ABC Company (client) by

Signature .....

Name .....

Title .....

Date .....

(For Auditors)

XYZ & Co.

Signature .....

Name .....

Chartered Accountants/ Registered  
Auditors

Partner .....

Date .....

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To,  
The Board of Directors, (or the appropriate representative of senior management)

You have requested that we audit the balance sheet of .....as of ..... and the related statements of income and cash flows for the year then ending. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be made with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with Nepal Standards on Auditing (NSA). Those NSAs require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

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(For Auditee)

Acknowledged on behalf of  
ABC Company (client) by

Signature .....

Name .....

Title .....

Date .....

(For Auditors)

XYZ & Co.

Signature .....

Name .....

Chartered Accountants/ Registered  
Auditors

Partner .....

Date .....