Establishing an understanding with the client; Statement on auditing standards, 083

American Institute of Certified Public Accountants. Auditing Standards Executive Committee

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Establishing an Understanding With the Client

(Amends Statement on Auditing Standards No. 1, AICPA, Professional Standards, vol. 1, AU sec. 310.)
Establishing an Understanding With the Client

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1. This Statement amends Statement on Auditing Standards (SAS) No. 1, Codification of Auditing Standards and Procedures (AICPA, Professional Standards, vol. 1, AU sec. 310, “Relationship Between the Auditor’s Appointment and Planning”), to incorporate guidance about auditors establishing an understanding with the client regarding the services to be performed. This Statement also renames the title of AU sec. 310 to Appointment of the Independent Auditor. This Statement is effective for engagements for periods ending on or after June 15, 1998. Earlier application is permitted.

Establishing an Understanding With the Client

5. The auditor should establish an understanding with the client regarding the services to be performed for each engagement.¹ Such an understanding reduces the risk that either the auditor or the client may misinterpret the needs or expectations of the other party. For example, it reduces the risk that the client may inappropriately rely on the auditor to protect the entity against certain risks or to perform certain functions that are the client’s responsibility. The understanding should include the objectives of the engagement, management’s responsibilities, the auditor’s responsibilities, and limitations of the engagement.² The auditor should document the understanding in the working papers, preferably


²The objectives of certain engagements may differ. The understanding should reflect the effects of those objectives on the responsibilities of management and the auditor, and on the limitations of the engagement. The following are examples:

- Reviews of interim financial information (see SAS No. 71, Interim Financial Information [AICPA, Professional Standards, vol. 1, AU sec. 722.09])
- Audits of recipients of governmental financial assistance (see SAS No. 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance [AICPA, Professional Standards, vol. 1, AU sec. 801.10])
- Application of agreed-upon procedures to specified elements, accounts or items of a financial statement (see SAS No. 75, Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement [AICPA, Professional Standards, vol. 1, AU sec. 622.03])
through a written communication with the client. If the auditor believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

6. An understanding with the client regarding an audit of the financial statements generally includes the following matters.

- The objective of the audit is the expression of an opinion on the financial statements.
- Management is responsible for the entity's financial statements.
- Management is responsible for establishing and maintaining effective internal control over financial reporting.
- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- Management is responsible for making all financial records and related information available to the auditor.
- At the conclusion of the engagement, management will provide the auditor with a letter that confirms certain representations made during the audit.
- The auditor is responsible for conducting the audit in accordance with generally accepted auditing standards. Those standards require that the auditor obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, a material misstatement may remain undetected. Also, an audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.
- An audit includes obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify reportable conditions. However, the auditor is responsible for ensuring that the audit committee or others with equivalent authority or responsibility are aware of any reportable conditions which come to his or her attention.

These matters may be communicated in the form of an engagement letter.

7. An understanding with the client also may include other matters, such as the following:

- Arrangements regarding the conduct of the engagement (for example, timing, client assistance regarding the preparation of schedules, and the availability of documents)
- Arrangements concerning involvement of specialists or internal auditors, if applicable
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- Arrangements involving a predecessor auditor
- Arrangements regarding fees and billing
- Any limitation of or other arrangements regarding the liability of the auditor or the client, such as indemnification to the auditor for liability arising from knowing misrepresentations to the auditor by management (Regulators, including the Securities and Exchange Commission, may restrict or prohibit such liability limitation arrangements.)
- Conditions under which access to the auditor’s working papers may be granted to others
- Additional services to be provided relating to regulatory requirements
- Arrangements regarding other services to be provided in connection with the engagement
This Statement entitled Establishing an Understanding With the Client was adopted unanimously by the fifteen members of the board.

Auditing Standards Board (1997)

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