

NPO-CL-1.1: Audit Engagement Letter^a

[CPA Firm's Letterhead]

[Date][Identify the body or individual(s) charged with governance.] and [Name of Management] ^b[Client's Name and Address]

We are pleased to confirm our understanding of the services we are to provide for [Name of Nonprofit Organization] for the [period, year, OR years] ended [Date(s)].

We will audit the financial statements of [Name of Nonprofit Organization], which comprise the statement(s) of financial position as of [Period or Year End(s)], the related statements of [activities, functional expenses, and cash flows OR activities and cash flows] ^c for the [period, year, OR years] then ended, and the related notes to the financial statements (the financial statements).^d Also, the following supplementary information accompanying the financial statements will be subjected to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, in accordance with auditing standards generally accepted in the United States of America, and we will provide an opinion on it in relation to the financial statements as a whole, [in a separate written report accompanying our auditor's report on the financial statements OR in a report combined with our auditor's report on the financial statements] ^{e, f}

1. _____
2. _____

Audit Objective

The objective of our audit is the expression of an opinion about whether your financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.^g Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America and will include tests of your accounting records and other procedures we consider necessary to enable us to express such an opinion.^h We will issue a written report upon completion of our audit of [Name of Nonprofit Organization]'s financial statements. Our report will be addressed to [Identify parties, such as "board of trustees."] of [Name of Nonprofit Organization]. We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion or add an emphasis-of-matter or other-matter paragraph. If our opinion is other than unmodified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or withdraw from this engagement.ⁱ

Audit Procedures

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions.^{j, k, l} We will also request written representations from the Organization's attorneys as part of the engagement, and they may bill you for responding to this inquiry.^m At the conclusion of our audit, we will require certain written representations from you about the financial statements and related matters.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable assurance about

whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the Organization or to acts by management or employees acting on behalf of the Organization.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements.ⁿ However, we will inform the appropriate level of management of any material errors, any fraudulent financial reporting, or misappropriation of assets that comes to our attention.^o We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential.^{p, q} Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.^r

Our audit will include obtaining an understanding of the Organization and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures.^s An audit is not designed to provide assurance on internal control or to identify deficiencies in internal control. However, during the audit, we will communicate to you and those charged with governance internal control related matters that are required to be communicated under professional standards.^{t, u}

We may from time to time, and depending on the circumstances, use third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.^v

Other Services^w

We will prepare the Organization's federal and state information returns for the [period OR year] ended [Date(s)] for the [Identify jurisdictions.] based on information provided by you. We will also [prepare OR assist in preparing] the financial statements of the Organization in conformity with U.S. generally accepted accounting principles based on information provided by you.

We will perform the services in accordance with applicable professional standards, including the Statements on Standards for Tax Services issued by the American Institute of Certified Public Accountants. The other services are limited to the financial statement and tax services previously defined. We, in our sole professional judgment, reserve the right to refuse to perform any procedure or take any action that could be construed as assuming management responsibilities. We will advise management with regard to tax positions taken in the preparation of the tax return, but management must make all decisions with regard to those matters.

Management Responsibilities

You are responsible for establishing and maintaining internal controls, including monitoring ongoing activities; for the selection and application of accounting principles; and for the preparation and fair presentation of the financial statements in conformity with U.S. generally accepted accounting principles.^x You are also responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the organization from whom we determine it necessary to obtain audit evidence.^y

Your responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the Organization involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud affecting the Organization received in communications from employees, former employees, grantors, regulators, or others. In addition, you are responsible for identifying and ensuring the Organization complies with applicable laws and regulations.^{z, aa, ab}

You are responsible for the preparation of the supplementary information in conformity with U.S. generally accepted accounting principles. You agree to include our report on the supplementary information in any document that contains, and indicates that we have reported on, the supplementary information. You also agree to include the audited financial statements with any presentation of the supplementary information that includes our report thereon.^{ac, ad}

You agree to assume all management responsibilities for the tax services, financial statement preparation services, and any other nonattest services we provide; oversee the services by designating an individual, preferably from senior management, with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.^{ae}

Engagement Administration, Fees, and Other

We understand that your employees will prepare all cash, accounts receivable, and other confirmations we request and will locate any documents selected by us for testing.^{af}

[Name of Engagement Partner] is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign it.^{ag, ah} We expect to begin our audit on approximately [Date] and to complete your information returns and issue our report no later than [Date].^{ai}

We estimate that our fees for the audit and other services other than the preparation of the information returns will range from \$_____ to \$_____ and from \$_____ to \$_____ for the preparation of the information returns. You will also be billed for travel and other out-of-pocket costs such as report production, word processing, postage, etc. Additional expenses are estimated to be \$_____. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the engagement.^{aj} If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation.^{ak, al}

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.^{am}

Very truly yours,

[CPA Firm's Name]

RESPONSE:

This letter correctly sets forth the understanding of [Name of Nonprofit Organization].^{an}

Management signature: _____

Title: _____

Date: _____

Governance signature: _____

Title: _____

Date: _____

Practical Considerations:

- a** This letter should be used at the outset of each annual engagement to communicate and document the understanding with the client about the services to be performed. Auditors occasionally find that management of a small nonprofit organization does not understand some of the provisions of this agreement. As a result, small nonprofit organization clients may resist signing the letter. Section 203 discusses steps auditors can take in that situation. In addition, the authors believe that in most circumstances it is a best practice to obtain an engagement letter each year, rather than issuing a multi-year engagement letter. NPO-CL-1.5 presents a sample of a confirmation of terms of a multi-year engagement letter that may be used to remind management of the terms of the engagement.

A separate engagement letter for Single Audits of nonprofit organizations, in accordance with OMB Circular A-133, is provided at NPO-CL-1.2. A separate letter for audits subject to *Government Auditing Standards* is provided at NPO-CL-1.3.

- b** Depending on the structure of the organization, the engagement letter may be addressed to management, those charged with governance, or both. The auditor is required to obtain management's agreement that it acknowledges and understands its responsibilities and is also required to communicate with those charged with governance the auditor's responsibilities with regard to the audit and an overview of the planned scope and timing. To achieve those objectives, the authors recommend that the engagement letter be addressed to both management and those charged with governance. If the engagement letter is addressed only to those charged with governance or the audit committee, the references throughout the letter to "you" and "your" should be changed to "management" or "the organization," as appropriate. The letter at NPO-CL-5.1 can be used instead of the engagement letter to communicate with those charged with governance during planning. However, regardless of whether the engagement letter or NPO-CL-5.1 is used for that purpose, the authors recommend also having a face-to-face discussion with those charged with governance during planning to encourage appropriate two-way communication. If the auditor communicates with a subgroup of those charged with governance, such as an audit committee, the engagement letter may explicitly state that the auditor retains the right to communicate with the full governing body.
- c** For a voluntary health and welfare organization, use the wording "activities, functional expenses, and cash flows." For an organization other than a voluntary health and welfare organization, use the wording "activities and cash flows." In addition, any other financial statements that are to be audited should be identified (such as separate financial statements of a branch or a special purpose presentation).
- d** In a recurring audit engagement where comparative financial statements will be presented, the authors believe it is appropriate for the engagement letter to refer only to the period being audited (that is, the current period). Reference to prior periods may be necessary, however, when the auditor is engaged in the current period to audit both the current and one or more prior periods.
- e** List any supplementary information, on which you have been engaged to report, that will accompany the basic financial statements (for example, schedule of functional expenses presented as supplementary information by an organization not required to present one as a basic financial statement, or a special purpose presentation for a grant or program presented as supplementary information). The report under AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, which applies when the auditor is engaged to report on supplementary information, may be a separate report or included as an other-matter paragraph following the opinion paragraph of the report on the financial statements. If there is no supplementary information, delete this sentence and the following list. If the supplementary information will not accompany the basic financial statements, delete the phrase "accompanying the financial statements." If

you have not been engaged to report on all of the supplementary information that will accompany the audited financial statements, (1) replace this sentence with the following language or (2) add the following language with a listing of the applicable information, depending on the circumstances:

Also, the following information accompanying the financial statements will not be subjected to the auditing procedures applied in our audit of the financial statements, and our auditor's report will not provide an opinion or any assurance on that information.

^f AU-C 720, *Other Information in Documents Containing Audited Financial Statements*, requires you to communicate your responsibility with respect to such other information to those charged with governance during planning. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1) and you are aware that other information will be included in a document containing the audited financial statements and your report thereon, include the following:

- A statement that your responsibility for other information included in documents containing the Organization's audited financial statements and auditor's report does not extend beyond the financial information identified in the report.
- A statement that you have no responsibility for determining whether such other information contained in these documents is properly stated.

Additional information should be communicated at or near the conclusion of the audit, as illustrated at NPO-CL-5.2.

^g If the financial statements are prepared in conformity with a special purpose framework, modify this paragraph to refer to the special purpose framework used (for example, modified cash basis of accounting). Also, the titles of the financial statements should differ from those for financial statements prepared in accordance with GAAP so that there is no implication that the statements are presented in conformity with GAAP. If the financial statements are prepared in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board, modify this paragraph to refer to IFRS.

^h In an audit of group financial statements (group audit), the following sentences may be added as necessary, depending on the significance of the components and the relationship between the client and the components (AU-C 600.A28):

If making reference to a component auditor in the auditor's report:

We will make reference to [Name of Component Auditor] 's audit of [Name of Component] in our report on your financial statements.

If assuming responsibility for the work of component auditors:

Our audit will also include performing procedures on the financial information of [Name of Component(s)] (or requesting other auditors to perform procedures on the financial information of [Name of Component(s)]) to enable us to express such an opinion.

You may also consider changes in language throughout the letter to include the terms *group* and *component* as appropriate.

ⁱ This sentence is recommended by the authors to mitigate the firm's exposure to a breach of contract claim, should it withdraw from the engagement prior to completion, disclaim an opinion, or decline to issue a report. For example, if a significant risk of material misstatement due to fraud exists and the auditor is not satisfied with the integrity of management and the diligence and cooperation from management in investigating the circumstances and taking the appropriate action to mitigate or resolve such risks, the auditor may consider withdrawing from the engagement. Auditors may want to replace this sentence with the following language to further clarify the auditor's right to withdraw from the engagement:

If circumstances occur related to the condition of your records, the availability of sufficient, appropriate audit evidence, or the existence of a significant risk of material misstatement of the financial statements caused by error, fraudulent financial reporting, or misappropriation of assets, which in our professional judgment prevent us from completing the audit or forming an opinion on the financial statements, we retain the right to take any course of action permitted by professional standards, including declining to express an opinion or issue a report, or withdrawing from the engagement.

- j This sentence needs to be modified to exclude tests of the physical existence of inventories if no significant inventories exist due to the nature of the organization's activities.
- k In an audit of group financial statements (group audit), if the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), the following matters should be communicated to those charged with governance of the group (AU-C 600.49):
 1. An overview of the type of work to be performed on the financial information of components, including the basis for a decision to make reference to a component auditor in the auditor's report.
 2. An overview of the engagement team's planned involvement in the work of component auditors on the financial information of significant components.

The communication may be oral or written. If made orally, the communication should be documented.

- l AU-C 610.19 and AU-C 610.28 state that the auditor should communicate with those charged with governance the planned use of the work of the internal audit function and the nature and extent of any planned use of internal audit personnel to provide direct assistance on the audit. Prior to using the internal auditors to provide direct assistance, AU-C 610.30 requires the external auditor to obtain written acknowledgement from management or those charged with governance, as appropriate, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in their work. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), that communication and acknowledgment should be made in this letter. The following may be used to communicate the planned use of the work of internal audit:

We plan to use the work of [Describe the internal audit function.] of [Organization's Name] to assist us in obtaining audit evidence [Describe the planned use of internal audit's work.].

The following may be used to communicate the planned use of internal audit personnel to provide direct assistance and to obtain the required acknowledgment from management or those charged with governance:

We plan to use personnel from [Describe the internal audit function.] of [Name of Nonprofit Organization] to provide direct assistance to us during the audit in [Describe the planned use of internal audit personnel for direct assistance.]. You acknowledge that those personnel will be allowed to follow our instructions and you will not intervene in their work.

In 2014, the AICPA issued SAS No. 128, *Using the Work of Internal Auditors*, which supersedes the existing guidance related to consideration of the internal audit function in an audit of financial statements in AU-C 610. The SAS is effective for audits of financial statements for periods ending on or after December 15, 2014. This *Guide* has been updated for SAS No. 128. Chapter 3 discusses consideration of the internal audit function in performing risk assessment procedures and planning, and section 904 of *PPC's Guide to Audits of Nonpublic Companies* provides additional discussion on the use of internal audit.

- m This sentence is optional. It is added to avoid negative reactions from clients if they are billed by an attorney for responding to a legal representation letter. Legal representation letters are discussed in section 1103.
- n Some CPA firms like to mention to their clients that extended procedures designed to detect fraud can be performed at the client's option, but would be beyond the scope of the audit. The following wording can be used in those situations:

We have advised you of the limitations of our audit regarding the detection of fraud and the possible effect on the financial statements (including misappropriation of cash or other assets). We have offered to perform, as a separate engagement, extended procedures specifically designed to detect fraud, and you have declined to engage us to do so at this time.

- If there is evidence that fraud may exist, the auditor is required to bring it to the attention of the appropriate levels of management, even if the matter is considered inconsequential. If the fraud involves management (regardless of materiality) or is material to the financial statements, the auditor is required to report it directly to the audit committee or others charged with governance (such as the governing board). AU-C 240.A69 indicates that auditors also may consider it appropriate to reach an understanding with those charged with governance about the nature and extent of communication about misappropriations committed by lower-level employees. Absent such an agreement, the authors recommend reporting all fraud matters both to the appropriate level of management and those charged with governance. Section 1116 provides a discussion regarding communicating evidence of fraud.
- P Professional standards do not require the auditor to address these communications in the engagement letter. Some firms omit these sentences because they believe they may increase a firm's liability. They believe the auditor may be left in a position of proving why a fraudulent act or a violation of law or regulation did not come to his or her attention. See the discussion in section 1116 concerning the communications about violations of laws and regulations.
- q In a group audit, this and the preceding sentence may be modified to refer to communications with group management and those charged with governance of the group, as appropriate, related to identified, reported, or suspected fraud involving group or component management, employees with significant roles in group-wide controls, or others if fraud has or may have resulted in a material misstatement of the group financial statements.
- r Chapter 2 of *PPC's Guide to Audits of Nonpublic Companies* and Chapter 10 of *PPC's Guide to Managing an Accounting Practice* discuss some other clauses auditors might use to limit their exposure to legal liability and other losses. The authors recommend that auditors consult their legal counsel and insurance carrier when assessing such language in an engagement letter. Examples of clauses relating to the following matters are included (see also practical consideration ai):
 - Loss limitation and indemnification.
 - Time limitations.
 - Undertaking to be truthful.
 - Statute of limitations.
 - Collection of fees relating to client litigation when the auditor is not a party.
 - Reliance on oral advice or the absence of advice.
 - Obtaining a retainer.
 - Compensation for employees hired by clients.
 - Notification of report reproduction.
 - Alternative dispute resolution.
- s In a group audit, this sentence may be modified to refer to the auditor's responsibilities related to group-wide controls.
- t AU-C 265, *Communicating Internal Control Related Matters Identified in an Audit*, is discussed in more detail in section 1114. Illustrative letters that comply with AU-C 265 are at NPO-CL-4.1, NPO-CL-4.2, and NPO-CL-4.3. If management is interested, the auditor might provide a sample of the letters before conducting the audit. In a group audit, this sentence may be modified, as appropriate, to refer to the auditor's communication with group management and those charged with governance of the group, related to material weaknesses or significant deficiencies in group-wide controls.
- u AU-C 9230.02, an auditing interpretation, states that the auditor may choose, and in some cases may be required by law, regulation, or audit contract, to confirm in writing with the client that the auditor may be required to provide access to and copies of audit documentation to a regulatory agency. The following language may be added in this situation:

The audit documentation for this engagement is the property of [CPA Firm's Name] and constitutes confidential information. However, we may be requested to make certain audit documentation available to [Name of a Regulator] pursuant to authority given to it by law or regulation. If requested, access to such audit documentation will be provided under the supervision of [CPA Firm's Name] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to [Name of Regulator]. The [Name of Regulator] may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

The discussion "Access by Regulators to Workpapers" at section 804 includes additional information on providing regulators access to workpapers.

- v ET 1.150.040 requires that clients be informed, preferably in writing, if the audit firm will outsource professional services to third-party service providers (see section 202). If a third-party service provider is not used to perform professional services, this paragraph can be omitted.
- w The auditor should identify the return or returns that will be prepared (e.g., IRS Form 990, 990-PF, or 990-T) and list other services, including nonattest services, to be provided, such as preparation of a registration report for filing with a state charities regulatory agency. Before performing nonattest services, ET 1.295 requires the auditor to establish and document in writing the understanding with the client regarding the objective of the nonattest engagement, the service to be performed, the practitioner's responsibility, the client's acceptance of its responsibilities, and any limitations of the nonattest engagement. Those items can be documented in the engagement letter or in NPO-CX-1.2. (If the engagement letter incorporates the understanding requirements of ET 1.295, make reference to the letter at the applicable steps in NPO-CX-1.2.) As previously stated, the auditor is required to document both the service to be performed and the objective of the engagement. However, in some cases, the authors believe that, depending upon the nature of the nonattest services, listing the service to be performed will also be stating the objectives. For example, in this letter, stating that the auditor will prepare (or assist in preparing) the financial statements in accordance with GAAP helps satisfy the requirement to document the objective of the engagement and the service to be performed. NPO-CX-1.2 provides additional space to document the understanding with the entity about the objectives of each nonattest service to be provided, the auditor's responsibilities, and any limitations of the engagement. The client's acceptance of its responsibility is included in the last paragraph of the "Management Responsibilities" section of this engagement letter (see practical consideration ae). It is recommended that separate fee estimates be stated for each additional service to be rendered. Alternatively, a separate detailed engagement letter may be used for the other services. A separate engagement letter for tax services is illustrated in *PPC's 990 Deskbook*. See also practical consideration aa. (Revise the language in this section, as appropriate, for the specific services being provided. Omit this section if the auditor is not providing any other services.)
- x If the financial statements are prepared in conformity with a special purpose framework or IFRS, modify this paragraph to refer to the special purpose framework used or to IFRS. AU-C 800.11 states that the auditor should obtain management's agreement that it acknowledges and understands its responsibility to include all appropriate informative disclosures in special purpose financial statements. The following additional paragraph can be used in those situations:

You are responsible for including all informative disclosures that are appropriate for the [Name of Special Purpose Framework]. Those disclosures will include (1) a description of the [Name of Special Purpose Framework], including a summary of significant accounting policies, and how the [Name of Special Purpose Framework] differs from GAAP, (2) informative disclosures similar to those required by GAAP, and (3) additional disclosures beyond those specifically required that may be necessary for the financial statements to achieve fair presentation.

In a group audit, this sentence may be modified as necessary to also address responsibility for the selection and application of accounting principles for the group.

- y In a group audit, this sentence may be modified as necessary to also address access (or arrangements to facilitate access) to component information, instructions issued by group management to components related

to the consolidation process, persons at components (including management and those charged with governance), or component auditors.

- z Some nonprofit organizations may publish their financial statements and the related auditor's report in an electronic site, such as the organization's website. AU-C 720.A4 clarifies that, for GAAS purposes, information contained on an entity's website is not considered to be "other information" and, accordingly, is not subject to the requirements of AU-C 720. Thus, auditors are not responsible for reading information in electronic sites containing audited financial statements or for considering the consistency of other information in those sites with the original document. Because of the potential security issues surrounding audited financial statements published electronically, and to avoid any misconceptions clients may have about the auditor's responsibility for those statements, auditors may want to consider adding a clause such as the following to their engagement letter when a client publishes financial statements electronically:

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on your website, you understand that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document.

- aa Auditors may want to add an additional paragraph such as the following to address the confidentiality privilege related to certain written or oral tax advice. See also practical consideration w.

Certain communications involving tax advice are privileged and not subject to disclosure to the IRS. By disclosing the contents of those communications to anyone, or by turning over information about those communications to the government, you, your employees, or agents may be waiving this privilege. To protect this right to privileged communication, please consult with us or your attorney prior to disclosing any information about our tax advice. Should you decide that it is appropriate for us to disclose any potentially privileged communication, you agree to provide us with written, advance authority to make that disclosure.

- ab In order to coordinate the auditor's report date, management representation letter date, and the subsequent events evaluation note disclosure date, the auditor may want to discuss the dating requirements with management before starting the audit. Additionally, the auditor may include in the engagement letter a provision that management will not date the subsequent event note earlier than the date of their management representation letter (also the date of the auditor's report). (See sections 1104, 1105, and 1113.) The following type of clause might be included in the letter:

You are required to disclose in the financial statements the date through which subsequent events have been evaluated and whether that date is the date the financial statements were issued or were available to be issued. You agree that you will not date the subsequent event note earlier than the date of the management representation letter.

- ac This letter assumes supplementary information will accompany the basic financial statements and the auditor has been engaged to report on that information in relation to the financial statements as a whole. If you have been engaged to report on supplementary information, AU-C 725.06 requires you to obtain management's agreement that it acknowledges and understands its responsibility for the supplementary information. If the supplementary information is prepared in conformity with criteria other than U.S. GAAP, replace the reference to U.S. GAAP with the criteria used for the preparation of the supplementary information. If there is no supplementary information, or you have not been engaged to report on the information, delete the preceding three sentences. If you have been engaged to report on supplementary information but it will not accompany the audited financial statements, replace the last sentence with the following:

You also agree to make the audited financial statements readily available to users of the supplementary information no later than the date the supplementary information is issued with our report thereon.

- ad Some auditors like to include a paragraph, such as the following, committing the client to notify the auditor if the client intends to reproduce the auditor's report in a document containing other information (such as an

annual report) and to provide the document in advance for the auditor to read. In that case a paragraph such as the following may be added:

If you intend to reproduce and publish the financial statements and our report thereon, they must be reproduced in their entirety. Inclusion of the audited financial statements in any document should be done only with our prior approval of the document. You are responsible for providing us the opportunity to review such document before issuance.

- ae** If the auditor provides nonattest services, such as consulting services, information return preparation, financial statement preparation, or other bookkeeping services, to an attest client, the auditor should comply with ET 1.295. That guidance requires practitioners providing nonattest services to their attest clients to establish and document in writing an understanding with the client about the nonattest services. See practical consideration w. Part of that understanding is the client's acceptance of its responsibilities for the nonattest services.

This paragraph should be modified to refer to all nonattest services provided. ET 1.295 is discussed in section 202. If the auditor is not providing nonattest services, the guidance does not apply and this paragraph should be omitted.

Some auditors may prefer to have the client specifically designate in the engagement letter the individual(s) responsible for overseeing the nonattest services. In that case, the paragraph can be replaced by the following:

You agree to assume all management responsibilities for the tax services, financial statement preparation services, and any other nonattest services we provide; oversee the services by designating an individual, [Name of Designated Individual, Preferably from Senior Management], with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.

Activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered nonattest services effective for engagements covering periods beginning on or after December 15, 2014. This letter has been revised for those changes to ET 1.295.

- af** The auditor may wish to add the words "and schedules" after "confirmations" and attach to the engagement letter a list of such schedules to be prepared by the client, for example, a copy of NPO-CL-12.10, "Client Assistance Request Letter." Some firms expand the paragraph about client assistance by including the following:

We will schedule the engagement based in part on deadlines, working conditions, and the availability of your key personnel. We will plan the engagement based on the assumption that your personnel will cooperate and provide assistance by performing tasks such as preparing requested schedules, retrieving supporting documents, and preparing confirmations. If, for whatever reason, your personnel are unavailable to provide the necessary assistance in a timely manner, it may substantially increase the work we have to do to complete the engagement within the established deadlines, resulting in an increase in fees over our original fee estimate.

If the client has insufficient personnel to assist with these items, it is advisable to include a fee provision for preparation of these items by the audit staff. Some firms add the following language noting that the firm will request written permission from the client before performing additional procedures necessitated by the client's failure to provide the agreed-upon level of assistance:

We will not undertake any accounting services (including but not limited to reconciliation of accounts and preparation of requested schedules) without obtaining approval through a written change order for such additional work.

If the services added are nonattest services, the auditor should follow the requirements of ET 1.295. See practical considerations w and ae.

- ag QC 10.33 indicates that an audit firm should establish policies and procedures requiring that the identity and role of the engagement partner be communicated to management and those charged with governance. This sentence provides appropriate documentation that the communication has been made.
- ah ET 1.279.010 addresses when a firm's independence from an attest client is considered impaired if a partner or employee leaves the firm and is employed by a client or considers potential employment with a client. Some firms choose to add language such as the following to aid the firm in maintaining independence in situations in which the client and firm personnel discuss employment:

To ensure that [Firm Name]'s independence is not impaired under the AICPA *Code of Professional Conduct*, you agree to inform the engagement partner before entering into any substantive employment discussions with any of our personnel.

- ai An auditor can attempt to have the statute of limitations for professional malpractice claims begin running at the end of a particular engagement by specifying the ending date or event in the engagement letter. For example, the following type of clause might be included in the letter:

Our audit engagement ends on delivery of our audit report. Any follow-up services that might be required will be a separate, new engagement. The terms and conditions of that new engagement will be governed by a new, specific engagement letter for that service.

The engagement letter may also specifically state that the engagement to prepare the return or returns will end upon the delivery of those returns.

- aj Such unexpected circumstances might include, for example, a greater than expected risk of material misstatement due to fraud. Section 402 of *PPC's Guide to Managing an Accounting Practice* discusses using the engagement letter as a collection tool and illustrates clauses relating to unexpected circumstances that might affect the fee estimate.
- ak Some auditors add language such as the following to address terms for payment of audit fees:

In accordance with our firm policies, work may be suspended if your account becomes [Number] days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have been completed even if we have not issued our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination.

Some auditors believe that the first sentence of the preceding paragraph provides some protection against liability for breach of contract should they not complete the engagement because of nonpayment.

- al Additional services may be added to an engagement after the engagement has begun. When clients request additional services, misunderstandings can be avoided by sending a letter to the client (1) detailing any agreed-upon changes in fees and services and (2) indicating that, except as provided therein, the terms of the original engagement letter apply. If the scope of agreed-upon services changes significantly, the auditor may consider issuing a separate engagement letter to cover the additional services. If significant other services, including nonattest services, are added to an engagement, the authors recommend issuing a new engagement letter to cover the additional services. At a minimum, the new engagement letter or workpapers should include documentation of the understanding with the client regarding performance of any nonattest services in accordance with ET 1.295, as discussed in practical considerations w and ae. (NPO-CX-1.2 provides a form auditors can use to meet the documentation requirement when additional other services are added after the engagement has begun.) The following paragraph can be used in an engagement letter to address the issue of requests for additional services:

You may request that we perform additional services not addressed in this engagement letter. If this occurs, we will communicate with you the scope of the additional services and the estimated fees. We also may issue a separate engagement letter covering the additional services. In the absence of any other written communication from us documenting such additional services, our services will continue to be governed by the terms of this engagement letter.

- am** If the entity requests a change in the level of service (for example, from an audit to a review) or another change in the terms of the engagement, and there is a reasonable justification for the change, the auditor should agree on the new terms and document that agreement in an engagement letter or other suitable form of written communication (AU-C 210.16). *PPC's Guide to Compilation and Review Engagements* includes engagement letters that can be used if there is a change in the level of service (for example, from an audit to a review) and a step-down checklist (Appendix 2F). Section 203 discusses changes in the terms of an audit engagement, including reasons why a change may or may not be reasonably justified and what to do if you determine there is not a reasonable justification for the change.
- an** Even though not specifically required by AU-C 210, the authors believe it is best practice to require management to sign the engagement letter to document that they acknowledge and understand their responsibilities. If the auditor is engaged by management, then only management needs to sign the engagement letter, even if it is also provided to those charged with governance. In that case, providing the letter to those charged with governance is primarily to satisfy the responsibility to communicate planned scope and timing to them, which is not required to be in writing, so the governance signature is not necessary. An exception to that may be when the external auditor plans on using internal auditors to provide direct assistance. In that case, the external auditor is required to obtain written acknowledgement from management or those charged with governance, as appropriate, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in their work. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), determine if those charged with governance also should sign this letter. (See practical consideration I.) If the auditor is engaged by those charged with governance, both management and those charged with governance need to sign the engagement letter. Those charged with governance would sign to evidence their agreement with the terms of the engagement, and management would sign to acknowledge its responsibilities as set forth in the engagement letter.

NPO-CL-1.2: Audit Engagement Letter—Single Audit^{a, b}

[CPA Firm's Letterhead]

[Date][Identify the body or individual(s) charged with governance.] and [Name of Management]^c[Client's Name and Address]

We are pleased to confirm our understanding of the services we are to provide for [Name of Nonprofit Organization] for the [period, year, OR years] ended [Date(s)].

We will audit the financial statements of [Name of Nonprofit Organization], which comprise the statement(s) of financial position as of [Period or Year End(s)], the related statements of [activities, functional expenses, and cash flows OR activities and cash flows]^d for the [period, year, OR years] then ended, and the related notes to the financial statements (the financial statements).^e Also, the following supplementary information accompanying the financial statements will be subjected to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, in accordance with auditing standards generally accepted in the United States of America, and we will provide an opinion on it in relation to the financial statements as a whole, [in a separate written report accompanying our auditor's report on the financial statements OR in a report combined with our auditor's report on the financial statements].^{f, g}

1. Schedule of expenditures of federal awards.

2. _____

Audit Objectives

The objective of our audit is the expression of an opinion about whether your financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles^h and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements as a whole. The objective also includes reporting on:

- Internal control related to the financial statements and compliance with the provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements in accordance with *Government Auditing Standards*.
- Internal control related to major programs and an opinion (or disclaimer of opinion) on compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The *Government Auditing Standards* report on internal control over financial reporting and on compliance and other matters will include a paragraph that states that (1) the purpose of the report is solely to describe the scope of testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance, and (2) the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. The OMB Circular A-133 report on internal control over compliance will include a paragraph that states that the purpose of the report on internal control over compliance is solely to describe the scope of testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Both reports will state that the report is not suitable for any other purpose.ⁱ

Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America; the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller

General of the United States; the Single Audit Act Amendments of 1996; and the provisions of OMB Circular A-133, and will include tests of accounting records, a determination of major program(s) in accordance with OMB Circular A-133, and other procedures we consider necessary to enable us to express such an opinion. We will issue written reports upon completion of our Single Audit. Our reports will be addressed to [Identify parties, such as “board of trustees.”] of [Name of Nonprofit Organization].^{j, k} We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion or add an emphasis-of-matter or other-matter paragraph. If our opinion on the financial statements or the Single Audit compliance opinion is other than unmodified, we will discuss the reasons with management in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or issue a report, or we may withdraw from this engagement.^l

Audit Procedures—General^m

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the Organization or to acts by management or employees acting on behalf of the Organization. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or on major programs. However, we will inform the appropriate level of management of any material errors, any fraudulent financial reporting, or misappropriation of assets that come to our attention.^{n, o, p, q} We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential, and of any material abuse that comes to our attention.^{p, r} We will include such matters in the reports required for a Single Audit. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions.^{s, t, u} We will also request written representations from the Organization’s attorneys as part of the engagement, and they may bill you for responding to this inquiry.^v At the conclusion of our audit, we will require certain written representations from you about your responsibilities for the financial statements; schedule of expenditures of federal awards; federal award programs; compliance with laws, regulations, contracts, and grant agreements; and other responsibilities required by generally accepted auditing standards.

Audit Procedures—Internal Control^m

Our audit will include obtaining an understanding of the Organization and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures.^w Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

As required by OMB Circular A-133, we will perform tests of controls over compliance to evaluate the effectiveness of the design and operation of controls that we consider relevant to preventing or detecting material noncompliance with compliance requirements applicable to each major federal award program. However, our tests will be less in scope than would be necessary to render an opinion on those controls and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to OMB Circular A-133.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards, *Government Auditing Standards*, and OMB Circular A-133.^x

Audit Procedures—Compliance^m

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of [Name of Nonprofit Organization] 's compliance with provisions of applicable laws, regulations, contracts, and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance, and we will not express such an opinion in our report on compliance issued pursuant to *Government Auditing Standards*.

OMB Circular A-133 requires that we also plan and perform the audit to obtain reasonable assurance about whether the auditee has complied with applicable laws and regulations and the provisions of contracts and grant agreements applicable to major programs. Our procedures will consist of tests of transactions and other applicable procedures described in the "OMB Circular A-133 Compliance Supplement" for the types of compliance requirements that could have a direct and material effect on each of the Organization's major programs. The purpose of these procedures will be to express an opinion on [Name of Nonprofit Organization] 's compliance with requirements applicable to each of its major programs in our report on compliance issued pursuant to OMB Circular A-133.

Other Services^y

We will prepare the Organization's federal and state information returns for the [period OR year] ended [Date(s)] for the [Identify jurisdictions.] based on information provided by you. We will also assist in preparing the financial statements, schedule of expenditures of federal awards, and related notes of the Organization in conformity with U.S. generally accepted accounting principles and OMB Circular A-133 based on information provided by you. These nonaudit services do not constitute an audit under *Government Auditing Standards* and such services will not be conducted in accordance with *Government Auditing Standards*.

We will perform the services in accordance with applicable professional standards, including the Statements on Standards for Tax Services issued by the American Institute of Certified Public Accountants. The other services are limited to the financial statement and tax services previously defined. We, in our sole professional judgment, reserve the right to refuse to perform any procedure or take any action that could be construed as assuming management responsibilities. We will advise management with regard to tax positions taken in the preparation of the tax return, but management must make all decisions with regard to those matters.

Management Responsibilities

Management is responsible for (1) establishing and maintaining effective internal controls, including internal controls over compliance, and for evaluating and monitoring ongoing activities to help ensure that appropriate goals and objectives are met; (2) following laws and regulations; (3) ensuring that there is reasonable assurance that government programs are administered in compliance with compliance requirements; and (4) ensuring that management is reliable and financial information is reliable and properly reported. Management is also responsible for implementing systems designed to achieve compliance with applicable laws, regulations, contracts, and grant agreements. You are also responsible for the selection and application of accounting principles; and for the preparation and fair presentation of the financial statements, schedule of expenditures of federal awards, and all accompanying information in conformity with U.S. generally accepted accounting principles;^z and for compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is also responsible for making all financial records and related information available to us, and for the accuracy and completeness of that information. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the organization from whom we determine it necessary to obtain audit evidence.^{aa}

Your responsibilities also include identifying significant vendor relationships in which the vendor has responsibility for program compliance and for the accuracy and completeness of that information. Your responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the Organization involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud affecting the Organization received in communications from employees, former employees, grantors, regulators, or others. In addition, you are responsible for identifying and ensuring that the Organization complies with applicable laws, regulations, contracts, agreements, and grants. Management is also responsible for taking timely and appropriate steps to remedy fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements, or abuse that we report. Additionally, as required by OMB Circular A-133, it is management's responsibility to follow up and take corrective action on reported audit findings and to prepare a summary schedule of prior audit findings and a corrective action plan. The summary schedule of prior audit findings should be available for our review on [Date].^{ab}

You are responsible for identifying all federal awards received and understanding and complying with the compliance requirements and for the preparation of the schedule of expenditures of federal awards (including notes and noncash assistance received) in conformity with OMB Circular A-133. You agree to include our report on the schedule of expenditures of federal awards in any document that contains and indicates that we reported on the schedule of expenditures of federal awards. You also agree to [include the audited financial statements with any presentation of the schedule of expenditures of federal awards that includes our report thereon OR make the audited financial statements readily available to intended users of the schedule of expenditures of federal awards no later than the date the schedule of expenditures of federal awards is issued with our report thereon]. Your responsibilities include acknowledging to us in the representation letter that (1) you are responsible for presentation of the schedule of expenditures of federal awards in accordance with OMB Circular A-133; (2) you believe the schedule of expenditures of federal awards, including its form and content, is fairly presented in accordance with OMB Circular A-133; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) you have disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the schedule of expenditures of federal awards.

You are also responsible for the preparation of the other supplementary information, which we have been engaged to report on, in conformity with U.S. generally accepted accounting principles.^h You agree to include our report on the supplementary information in any document that contains, and indicates that we have reported on, the supplementary information. You also agree to include the audited financial statements with any presentation of the supplementary information that includes our report thereon.^{ac} Your responsibilities include acknowledging to us in the representation letter that (1) you are responsible for presentation of the supplementary information in accordance with GAAP; (2) you believe the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) you have disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information.^h

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying and providing report copies of previous financial

audits attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or studies. You are also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as your planned corrective actions for the report, and for the timing and format for providing that information.^{ad}

You agree to assume all management responsibilities relating to the tax services, financial statements, schedule of expenditures of federal awards, related notes, and any other nonaudit services we provide. You will be required to acknowledge in the management representation letter the tax services provided and our assistance with preparation of the financial statements, the schedule of expenditures of federal awards, and related notes and that you have evaluated the adequacy of our services and have reviewed and approved the results of the services, the financial statements, the schedule of expenditures of federal awards, and related notes prior to their issuance and have accepted responsibility for them. Further, you agree to oversee the nonaudit services by designating an individual, preferably from senior management, with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.^{ae, af, ag}

Engagement Administration, Fees, and Other^{ah}

We may from time to time, and depending on the circumstances, use third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.^{ai, aj}

We understand that your employees will prepare all cash, accounts receivable, and other confirmations we request and will locate any documents selected by us for testing.^{ak}

At the conclusion of the engagement, we will complete the appropriate sections of the Data Collection Form that summarizes our audit findings. It is management's responsibility to submit the reporting package (including financial statements, schedule of expenditures of federal awards, summary schedule of prior audit findings, auditor's reports, and corrective action plan) along with the Data Collection Form to the federal audit clearinghouse. We will coordinate with you the electronic submission and certification. If applicable, we will provide copies of our report for you to include with the reporting package you will submit to pass-through entities. The Data Collection Form and the reporting package must be submitted within the earlier of 30 days after receipt of the auditor's reports or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

We will provide copies of our reports to the Organization; however, management is responsible for distribution of the reports and the financial statements. Unless restricted by law or regulation, or containing privileged and confidential information, copies of our reports are to be made available for public inspection.

The audit documentation for this engagement is the property of [CPA Firm's Name] and constitutes confidential information. However, subject to applicable laws and regulations, audit documentation and appropriate individuals will be made available upon request and in a timely manner to [Name of a Cognizant or Oversight Agency for Audit] or its designee, a federal agency providing direct or indirect funding, or the U.S. Government Accountability Office for purposes of a quality review of the audit, to resolve audit findings, or to carry out oversight responsibilities. We will notify you of any such request. If requested, access to such audit documentation will be provided under the supervision of [CPA Firm's Name] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to the aforementioned parties. These parties may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.^{al}

The audit documentation for this engagement will be retained for a minimum of five years after the report release date or for any additional period requested by the [Name of Cognizant Agency, Oversight Agency for Audit, or Pass-through Entity]. If we are aware that a federal awarding agency, pass-through entity, or auditee is contesting an audit finding, we will contact the party(ies) contesting the audit finding for guidance prior to destroying the audit documentation.

[Name of Engagement Partner] is the engagement partner and is responsible for supervising the engagement and signing the reports or authorizing another individual to sign them.^{am, an} We expect to begin our audit on approximately [Date] and to complete your information returns and issue our reports no later than [Date].^{ao}

We estimate that our fees for the audit and other services other than the preparation of the information returns will range from \$_____ to \$_____ and from \$_____ to \$_____ for the information returns. You will also be billed for travel and other out-of-pocket costs such as report production, word processing, postage, etc. Additional expenses are estimated to be \$_____. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the audit.^{ap} If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation.^{aq}

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.^{ar, as}

Very truly yours,

[CPA Firm's Name]

RESPONSE:

This letter correctly sets forth the understanding of [Name of Nonprofit Organization].^{at}

Management signature: _____

Title: _____

Date: _____

Governance signature: _____

Title: _____

Date: _____

Practical Considerations:

- ^a **Caution:** This letter is for use in audits conducted under OMB Circular A-133. It should *not* be used for audits conducted under the OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), which significantly changes the requirements for federal award recipients and their auditors. The audit requirements in the Uniform Guidance become effective for audits of fiscal years beginning on or after December 26, 2014; early implementation is prohibited. Thus, the first audits that should be performed under the Uniform Guidance will be those for entities with years ending December 31, 2015. Until that time, auditors will continue to perform their audits in accordance with OMB Circular A-133. After that time, auditors will follow the guidance in Subpart F—Audit Requirements of the Uniform Guidance and updated audit guidance that is expected to be released by the AICPA. Auditors may also refer to the 2015 edition of *PPC's Guide to Single Audits*, which will be updated for the Uniform Guidance and other related audit developments and issues. (See Chapter 14 of this *Guide*.)

This letter should be used at the outset of each engagement to communicate and document the understanding with the client about the services to be performed. This letter should be used for drafting

engagement letters for Single Audits of nonprofit organizations in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and *Government Auditing Standards*. The letter at NPO-CL-1.3 should be used for audits to be performed in accordance with *Government Auditing Standards* only (but not OMB Circular A-133). The auditor needs to be familiar with the discussion of engagement letters at section 203.

The authors believe that in most circumstances it is a best practice to obtain an engagement letter each year, rather than issuing a multi-year engagement letter.

Auditors occasionally find that management of a small nonprofit organization does not understand some of the provisions of this agreement. As a result, small nonprofit clients may resist signing the letter. The discussion at section 203 discusses steps auditors can take in that situation.

- b** Chapter 2 of *PPC's Guide to Audits of Nonpublic Companies* and Chapter 10 of *PPC's Guide to Managing an Accounting Practice* discuss some other clauses auditors might use to limit their exposure to legal liability and other losses. The authors recommend that auditors consult their legal counsel and insurance carrier when assessing such language in an engagement letter. Examples of clauses relating to the following matters are included (see also practical consideration ao):

- Loss limitation and indemnification.
- Time limitations.
- Undertaking to be truthful.
- Statute of limitations.
- Collection of fees relating to client litigation when the auditor is not a party.
- Reliance on oral advice or the absence of advice.
- Obtaining a retainer.
- Compensation for employees hired by clients.
- Notification of report reproduction.
- Alternative dispute resolution.

- c** The authors recommend that the engagement letter be addressed to management, those charged with governance, and the individual or group who retains the auditor, usually the audit committee or the legislative committee that has oversight. This is because the auditor is required to communicate with those charged with governance the auditor's responsibilities with regard to the audit and an overview of the planned scope and timing.

The letter at NPO-CL-5.1 can be used instead of the engagement letter to communicate with those charged with governance during planning. However, regardless of whether the engagement letter or NPO-CL-5.1 is used for that purpose, the authors recommend also having a face-to-face discussion with those charged with governance during planning to encourage appropriate two-way communication. If the auditor communicates with a subgroup of those charged with governance, such as an audit committee, the engagement letter may explicitly state that the auditor retains the right to communicate with the full governing body.

- d** For a voluntary health and welfare organization, use the wording "activities, functional expenses, and cash flows." For an organization other than a voluntary health and welfare organization, use the wording "activities and cash flows." In addition, any other financial statements that are to be audited should be identified (such as separate financial statements of a branch or a special purpose presentation).
- e** In a recurring audit engagement where comparative financial statements will be presented, the authors believe it is appropriate for the engagement letter to refer only to the period being audited (that is, the current period). Reference to prior periods may be necessary, however, when the auditor is engaged in the current period to audit both the current and one or more prior periods.
- f** List any supplementary information (in addition to the schedule of expenditures of federal awards), on which you have been engaged to report, that will accompany the basic financial statements (for example, a special purpose presentation for a grant or program presented as supplementary information). The report under AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, which applies when the

auditor is engaged to report on supplementary information, may be a separate report or included as an other-matter paragraph following the opinion paragraph of the report on the financial statements. If the supplementary information will not accompany the basic financial statements, delete the phrase “accompanying the financial statements.” If you have not been engaged to report on all of the supplementary information that will accompany the audited financial statements, add the following language:

The following information accompanying the financial statements will not be subjected to the auditing procedures applied in our audit of the financial statements and our auditor’s report will not provide an opinion or any assurance on that information:

1. _____
2. _____
3. _____

g AU-C 720, *Other Information in Documents Containing Audited Financial Statements*, requires you to communicate your responsibility with respect to such other information to those charged with governance during planning. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1) and you are aware that other information will be included in a document containing the audited financial statements and your report thereon, include the following:

- A statement that your responsibility for other information included in documents containing the Organization’s audited financial statements and auditor’s report does not extend beyond the financial information identified in the report.
- A statement that you have no responsibility for determining whether such other information contained in these documents is properly stated.

Additional information should be communicated at or near the conclusion of the audit, as illustrated at NPO-CL-5.2.

- h** If the financial statements are prepared in conformity with a special purpose framework, modify this paragraph to refer to the special purpose framework used (for example, modified cash basis of accounting). Also, the titles of the financial statements should differ from those for financial statements prepared in accordance with GAAP so that there is no implication that the statements are presented in conformity with GAAP. If the financial statements are prepared in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board, modify this paragraph to refer to IFRS.
- i** This paragraph may be revised as appropriate. Paragraph 4.03 of the Yellow Book states that “auditors should communicate pertinent information that in the auditors’ professional judgment needs to be communicated to individuals contracting for or requesting the audit, and to cognizant legislative committees when auditors perform the audit pursuant to a law or regulation, or they conduct the work for the legislative committee that has oversight of the audited entity.”
- j** This sentence should identify any funding source audit requirements the engagement is intended to meet.
- k** In an audit of group financial statements (group audit), the following sentences may be added as necessary, depending on the significance of the components and the relationship between the client and the components (AU-C 600.A28):

If making reference to a component auditor in the auditor’s report:

We will make reference to [Name of Component Auditor]’s audit of [Name of Component] in our report on your financial statements.

If assuming responsibility for the work of component auditors:

Our audit will also include performing procedures on the financial information of [Name of Component(s)] (or requesting other auditors to perform procedures on the financial information of [Name of Component(s)]) to enable us to express such an opinion.

You may also consider changes in language throughout the letter to include the terms *group* and *component* as appropriate.

- l This sentence is recommended by the authors to mitigate the firm's exposure to a breach of contract claim, should it withdraw from the engagement prior to completion, disclaim an opinion, or decline to issue a report. For example, if a significant risk of material misstatements due to fraud exists and the auditor is not satisfied with the integrity of management and the diligence and cooperation from management in investigating the circumstances and taking the appropriate action to mitigate or resolve such risks, the auditor may consider withdrawing from the engagement. Auditors may want to replace this sentence with the following language to further clarify the auditor's right to withdraw from the engagement:

If circumstances occur related to the condition of your records, the availability of sufficient, appropriate audit evidence, or the existence of a significant risk of material misstatement of the financial statements caused by error, fraudulent financial reporting, or misappropriation of assets, which in our professional judgment prevent us from completing the audit or forming an opinion on the financial statements, we retain the right to take any course of action permitted by professional standards, including declining to express an opinion or issue a report, or withdrawing from the engagement.

- m Paragraph 4.03 of the Yellow Book states that the auditor should communicate, orally or in written form, during the planning stage of an engagement, certain information to officials of the audited entity and to the individuals contracting for or requesting the audit (if the audit is being performed under a contract with a party other than the officials of the audited entity). Officials of the audited entity include the head of the audited organization, those charged with governance, and the individual who has the authority and responsibility for the financial reporting process (such as the finance director or the CFO). The discussion "Communications Required by *Government Auditing Standards*" at section 203 expands on those required communications. This illustrative engagement letter provides all of the required communications. If the auditor or the Organization wants to exclude certain proprietary information in the required communications to certain parties, a separate letter can be drafted. The separate letter could be the same as the engagement letter except the introduction could be changed and the "Engagement Administration, Fees, and Other" section could be omitted. The introduction to the separate letter might be as follows:

Government Auditing Standards require that we communicate, during the planning stage of an audit, certain information to officials of the audited entity and certain other parties. That information follows.

- n Some CPA firms like to mention to their clients that extended procedures designed to detect fraud can be performed at the client's option, but would be beyond the scope of the audit. The following wording can be used in those situations:

We have advised you of the limitations of our audit regarding the detection of fraud and the possible effect on the financial statements (including misappropriation of cash or other assets). We have offered to perform, as a separate engagement, extended procedures specifically designed to detect fraud and you have declined to engage us to do so at this time.

- o If there is evidence that fraud may exist, the auditor is required to bring it to the attention of the appropriate level of management, even if the matter is considered inconsequential. If the fraud involves management (regardless of materiality) or is material to the financial statements, the auditor is required to report it directly to the audit committee or others charged with governance (such as the governing board). AU-C 240.A69 also indicates that auditors may consider it appropriate to reach an understanding with those charged with governance about the nature and extent of communication about misappropriations committed by lower-level employees. Absent such an agreement, the authors recommend reporting all fraud matters both to the

appropriate level of management and to those charged with governance. Section 1116 provides a discussion concerning communicating evidence of fraud.

- p Professional standards do not require the auditor to address these communications in the engagement letter. Some firms omit these sentences because they believe they may increase a firm's liability. They believe the auditor may be left in a position of proving why a fraudulent act or a violation of law or regulation did not come to his or her attention.
- q The Yellow Book indicates that information about abuse could come to the auditor's attention during the course of the audit. If the abuse could be material to the financial statements, the auditor is required to apply procedures specifically directed to ascertain the potential effect on the financial statements or other financial data significant to the audit objectives. However, the auditor has no responsibility under *Government Auditing Standards* to seek indicators of abuse. The Yellow Book definition of abuse indicates abuse does not necessarily involve fraud, or violations of laws, regulations, or provisions of a contract or grant agreement. Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse. Paragraph 4.25 of the Yellow Book states that auditors should report relevant information about material abuse that has occurred or is likely to have occurred. See the discussion in section 1116 concerning communications about violations of laws and regulations.
- r In a group audit, this and the preceding sentence may be modified to refer to communications with group management and those charged with governance of the group, as appropriate.
- s This sentence needs to be modified to exclude tests of the physical existence of inventories if no significant inventories exist due to the nature of the organization's activities.
- t In a group audit, if the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), the following matters should be communicated to those charged with governance of the group (AU-C 600.49):
 1. An overview of the type of work to be performed on the financial information of components, including the basis for a decision to make reference to a component auditor in the auditor's report.
 2. An overview of the engagement team's planned involvement in the work of component auditors on the financial information of significant components.

The communication may be oral or written. If made orally, the communication should be documented.

- u AU-C 610.19 and AU-C 610.28 state that the auditor should communicate with those charged with governance the planned use of the work of the internal audit function and the nature and extent of any planned use of internal audit personnel to provide direct assistance on the audit. Prior to using the internal auditors to provide direct assistance, AU-C 610.30 requires the external auditor to obtain written acknowledgement from management or those charged with governance, as appropriate, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in their work. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), that communication and acknowledgment should be made in this letter. The following may be used to communicate the planned use of the work of internal audit:

We plan to use the work of [Describe the internal audit function.] of [Name of Nonprofit Organization] to assist us in obtaining audit evidence [Describe the planned use of internal audit's work.].

The following may be used to communicate the planned use of internal audit personnel to provide direct assistance and to obtain the required acknowledgment from management or those charged with governance:

We plan to use personnel from [Describe the internal audit function.] of [Name of Nonprofit Organization] to provide direct assistance to us during the audit in [Describe the planned use of internal audit personnel for direct assistance.]. You acknowledge that those personnel will be allowed to follow our instructions and you will not intervene in their work.

As discussed in section 1412, in 2014, the AICPA issued SAS No. 128, *Using the Work of Internal Auditors*, which supersedes the existing guidance related to consideration of the internal audit function in an audit of financial statements in AU-C 610. The SAS is effective for audits of financial statements for periods ending on or after December 15, 2014. This *Guide* has been updated for SAS No. 128.

- v This sentence is optional. It is added to avoid negative reactions from clients if they are billed by an attorney for responding to a legal representation letter. Legal representation letters are discussed in section 1103.
- w In a group audit, this sentence may be modified to refer to the auditor's responsibilities related to group-wide controls.
- x In a group audit, this sentence may be modified, as appropriate, to refer to the auditor's communication with group management and those charged with governance of the group, related to material weaknesses or significant deficiencies in group-wide controls. AU-C 265 establishes requirements regarding communication of internal control related matters in a GAAS audit. AU-C 265 is discussed in section 1114. Reporting on internal control related matters in a Single Audit is discussed at section 1307.
- y The auditor should identify the return or returns that will be prepared (e.g., IRS Form 990, 990-PF, or 990-T) and list the other services, including nonattest services, to be provided, such as preparation of a registration report for filing with a state charities regulatory agency. Before performing nonattest services under ET 1.295 or nonaudit services under *Government Auditing Standards* (referred to as nonaudit services in this letter), ET 1.295 and the Yellow Book, Paragraph 3.39, require the auditor to establish and document in writing the understanding with the client regarding the objective of the nonattest/nonaudit engagement, the service to be performed, the practitioner's responsibility, the client's acceptance of its responsibilities, and any limitations of the nonattest/nonaudit engagement. Those items can be documented in the engagement letter or in NPO-CX-1.2 and NPO-CX-1.3. (If the engagement letter incorporates the understanding requirements of ET 1.295 and the Yellow Book, make reference to the letter at the applicable steps in NPO-CX-1.2 and NPO-CX-1.3.) As previously stated, the auditor is required to document both the service to be performed and the objective of the engagement. However, in some cases, the authors believe that, depending upon the nature of the nonattest/nonaudit services, listing the service to be performed will also be stating the objectives. For example, in this letter, stating that the auditor will assist in preparing the financial statements in accordance with GAAP helps satisfy the requirement to document the objective of the engagement and the service to be performed. NPO-CX-1.2 and NPO-CX-1.3 provide additional space to document the understanding with the entity about the objectives of each nonattest/nonaudit service to be provided, the auditor's responsibilities, and any limitations of the engagement. The client's acceptance of its responsibility is included in the last paragraph of the "Management Responsibilities" section of this engagement letter (see practical consideration aj). It is recommended that separate fee estimates be stated for each additional service to be rendered. Alternatively, a separate detailed engagement letter may be used for the other services. A separate engagement letter for tax services is illustrated in *PPC's 990 Deskbook*. See also practical consideration aj. (Revise the language in this section, as appropriate, for the specific services being provided. Omit this section if the auditor is not providing any other services.)
- z If the financial statements are prepared in conformity with a special purpose framework or IFRS, modify this paragraph to refer to the special purpose framework used or to IFRS. AU-C 800.11 states that the auditor should obtain management's agreement that it acknowledges and understands its responsibility to include all appropriate informative disclosures in special purpose framework financial statements. The following additional paragraph can be used in those situations:

Management is responsible for including all informative disclosures that are appropriate for the [Name of Special Purpose Framework]. Those disclosures will include (1) a description of the [Name of Special Purpose Framework], including a summary of significant accounting policies, and how the [Name of Special Purpose Framework] differs from GAAP, (2) informative disclosures similar to those required by GAAP, and (3) additional disclosures beyond those specifically required that may be necessary for the financial statements to achieve fair presentation.

In a group audit, the last sentence of this paragraph may be modified as necessary to also address responsibility for the selection and application of accounting principles for the group.

- aa In a group audit, this sentence may be modified as necessary to also address access (or arrangements to facilitate access) to component information, instructions issued by group management to components related to the consolidation process, persons at components (including management and those charged with governance), or component auditors.
- ab In order to coordinate the auditor's report date, management representation letter date, and the subsequent events evaluation note disclosure date, the auditor may want to discuss the dating requirements with management before starting the audit. Additionally, the auditor may include in the engagement letter a provision that management will not date the subsequent event note earlier than the date of their management representation letter (also the date of the auditor's report). (See sections 1104, 1105, and 1113.) The following type of clause might be included in the letter:

You are required to disclose in the financial statements the date through which subsequent events have been evaluated and whether that date is the date the financial statements were issued or were available to be issued. You agree that you will not date the subsequent event note earlier than the date of the management representation letter.

- ac This letter assumes supplementary information will accompany the financial statements and the auditor has been engaged to report on that information in relation to the financial statements as a whole. If you have been engaged to report on supplementary information, AU-C 725.06 requires you to obtain management's agreement that it acknowledges and understands its responsibility for the supplementary information. If the supplementary information is prepared in conformity with criteria other than U.S. GAAP, replace the reference to U.S. GAAP with the criteria used for the preparation of the supplementary information. If you have been engaged to report on supplementary information but it will not accompany the audited financial statements, replace the last sentence with the following:

You also agree to make the audited financial statements readily available to users of the supplementary information no later than the date the supplementary information is issued with our report thereon.

- ad Some nonprofit organizations may publish their financial statements and the related auditor's report in an electronic site, such as the organization's website. AU-C 720.A4 clarifies that, for GAAS purposes, information contained on an entity's website is not considered to be "other information" and, accordingly, is not subject to the requirements of AU-C 720. Thus, auditors are not responsible for reading information in electronic sites containing audited financial statements or for considering the consistency of other information in those sites with the original document. Because of the potential security issues surrounding audited financial statements published electronically, and to avoid any misconceptions clients may have about the auditor's responsibility for those statements, auditors may want to consider adding a clause such as the following to their engagement letter when a client publishes financial statements electronically:

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on the Organization's website, management understands that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document.

- ae Paragraph 2.12 of the Yellow Book indicates that *Government Auditing Standards* do not apply to professional services other than audits or attestation engagements. Therefore, nonaudit services are not reported as having been conducted in accordance with such standards. When the auditor performs nonaudit services for an entity for which it also performs audit services under *Government Auditing Standards*, the auditor should communicate with the Organization and those charged with governance to clarify that the scope of the nonaudit services does not constitute an audit conducted under *Government Auditing Standards*.
- af The Yellow Book identifies specific nonaudit services that always impair independence and that auditors are prohibited from providing to audited entities. If a nonaudit service is not specifically prohibited, the auditor is required to assess its impact on independence using the conceptual framework. According to Paragraph 3.40 of the Yellow Book, activities such as preparing financial statements, converting cash basis financial statements to accrual basis, and preparing reconciliations are nonaudit services that are to be evaluated using

the conceptual framework. Paragraph 3.59 of the Yellow Book requires the auditor to document threats to independence that require the application of safeguards and the safeguards applied (i.e., the auditor's application of the conceptual framework), the auditor's consideration of management's ability to effectively oversee nonaudit services, the understanding with the entity about the nonaudit service to be provided, the objectives of the service, any limitations of the service, the entity's acceptance of its responsibilities, and the auditor's responsibilities. The authors believe that, depending upon the nature of the nonaudit services, listing the nonaudit services will also be stating the objectives. For example, in this letter, listing that we will provide tax services and assist with preparation of the financial statements, schedule of expenditures of federal awards, and related notes, helps satisfy the requirement to establish and document the understanding with management about both the nonaudit services to be provided and the objectives of those services. NPO-CX-1.3, Part III, step 5, provides additional space to document the understanding with the entity about the objective(s) of each nonaudit service to be provided, any limitations of the services, and the auditor's responsibilities. The Yellow Book independence rules are discussed in section 202.

This paragraph and the Other Services paragraph address the common situation in which the auditor provides tax services and assists with drafting the financial statements, schedule of expenditures of federal awards, and related notes. If the auditor does not provide tax services or assist with drafting the financial statements, schedule of expenditures of federal awards, and related notes, this paragraph and the Other Services paragraph would be modified to delete items that the auditor does not perform or draft. Similarly, if the auditor also performs other nonaudit services (e.g., assists with the trial balance, performs certain reconciliations, etc.), those services should also be listed. The authors believe it is necessary to list all nonaudit services to be provided.

- ^{ag} If the auditor provides nonattest services to an attest client, the auditor should comply with ET 1.295 as well as the Yellow Book independence standards. ET 1.295.040 requires practitioners providing nonattest services to their attest clients to establish and document in writing an understanding with the client about the nonattest services. See practical consideration y. A separate engagement letter may be used for the nonattest services or they may be listed here and in the Other Services paragraph. If listed here and in the Other Services paragraph, the authors believe that the list should include all nonattest services to be provided. Part of the understanding is the client's acceptance of its responsibilities for the nonattest services. The Other Services paragraph and this paragraph list the specific nonattest and nonaudit services provided.

ET 1.295 incorporates by reference the independence requirements of other authoritative bodies. It states that failure to meet more restrictive independence requirements of regulatory bodies (such as the SEC, GAO, DOL, and state boards of accountancy) to which the member is subject constitutes a violation of ET 1.295. The GAO's *Government Auditing Standards* is more restrictive with respect to provision of nonattest services (referred to as *nonaudit services* in the Yellow Book) that impair the independence of auditors of entities that are subject to the Yellow Book. ET 1.295 and GAO standards are discussed in section 202.

If the auditor is not providing nonattest services, ET 1.295 does not apply. In that case, if the auditor is also not providing nonaudit services under *Government Auditing Standards*, this paragraph and the Other Services section should be omitted.

Some auditors may prefer to have the client *specifically designate* in the engagement letter the individual(s) responsible for overseeing the nonattest services. In that case, the last sentence of this paragraph can be replaced by:

Further, you agree to oversee the nonaudit services by designating an individual, [Name of Designated Individual, Preferably from Senior Management], with suitable skill, knowledge, or experience; evaluate the adequacy and results of those services; and accept responsibility for them.

- ^{ah} Additional services may be added to an engagement after the engagement has begun. When clients request additional services, misunderstandings can be avoided by sending a letter to the client (1) detailing any agreed-upon changes in fees and services and (2) indicating that, except as provided therein, the terms of the original engagement letter apply. If the scope of agreed-upon services changes significantly, the auditor may consider issuing a separate engagement letter to cover the additional services. If significant other services,

including nonattest services, are added to an engagement, the authors recommend issuing a new engagement letter to cover the additional services. At a minimum, the new engagement letter or workpapers should include documentation of the understanding with the client regarding performance of any nonattest services in accordance with ET 1.295 and the Yellow Book's independence standards, as discussed in practical considerations y and ag. (NPO-CX-1.2 provides a form auditors can use to meet the documentation requirements when other services are added after the engagement has begun.) The following paragraph can be used in an engagement letter to address the issue of requests for additional services:

You may request that we perform additional services not addressed in this engagement letter. If this occurs, we will communicate with you the scope of the additional services and the estimated fees. We also may issue a separate engagement letter covering the additional services. In the absence of any other written communication from us documenting such additional services, our services will continue to be governed by the terms of this engagement letter.

- ai ET 1.150.040 requires that clients be informed, preferably in writing, if the audit firm will outsource professional services to third-party service providers (see section 202). If a third-party service provider is not used to perform professional services, this paragraph can be omitted.
- aj Auditors may want to add an additional paragraph such as the following to address the confidentiality privilege related to certain written or oral tax advice. See also practical consideration y.

Certain communications involving tax advice are privileged and not subject to disclosure to the IRS. By disclosing the contents of those communications to anyone, or by turning over information about those communications to the government, you, your employees, or agents may be waiving this privilege. To protect this right to privileged communication, please consult with us or your attorney prior to disclosing any information about our tax advice. Should you decide that it is appropriate for us to disclose any potentially privileged communication, you agree to provide us with written, advance authority to make that disclosure.

- ak The auditor may wish to add the words "and schedules" after "confirmations" and attach to the engagement letter a list of such schedules to be prepared by the client, for example, a copy of NPO-CL-12.10, "Client Assistance Request Letter." Some firms expand the paragraph about client assistance by including the following:

We will schedule the engagement based in part on deadlines, working conditions, and the availability of your key personnel. We will plan the engagement based on the assumption that your personnel will cooperate and provide assistance by performing tasks such as preparing requested schedules, retrieving supporting documents, and preparing confirmations. If, for whatever reason, your personnel are unavailable to provide the necessary assistance in a timely manner, it may substantially increase the work we have to do to complete the engagement within the established deadlines, resulting in an increase in fees over our original fee estimate.

If the client has insufficient personnel to assist with these items, it is advisable to include a fee provision for preparation of these items by the audit staff. Some firms add the following language noting that the firm will request written permission from the client before performing additional procedures necessitated by the client's failure to provide the agreed-upon level of assistance:

We will not undertake any accounting services (including but not limited to reconciliation of accounts and preparation of requested schedules) without obtaining approval through a written change order for such additional work.

If the services added are nonattest services, the auditor should follow the requirements of ET 1.295. See practical considerations y and ag.

- al The Yellow Book, Paragraph 4.16, states that contractual arrangements may provide for full and timely access to the audit documentation for reviews of audit quality and reliance by others on the auditor's work. In certain situations this information may be communicated orally; however, the authors recommend that this information be included in the engagement letter of all Single Audit engagements. If the information is

communicated orally, it should be documented in the workpapers. Section 804 contains additional discussion on providing regulators access to workpapers.

- am QC 10.33 indicates that an audit firm should establish policies and procedures requiring that the identity and role of the engagement partner be communicated to management and those charged with governance. This sentence provides appropriate documentation that the communication has been made.
- an ET 1.279.010 addresses when a firm's independence from an attest client is considered impaired if a partner or employee leaves the firm and is employed by a client or considers potential employment with a client. Some firms choose to add language such as the following to aid the firm in maintaining independence in situations in which the client and firm personnel discuss employment:

To ensure that [Firm Name] 's independence is not impaired under the AICPA Code of Professional Conduct, you agree to inform the engagement partner before entering into any substantive employment discussions with any of our personnel.

- ao An auditor can attempt to have the statute of limitations for professional malpractice claims begin running at the end of a particular engagement by specifying the ending date or event in the engagement letter. For example, the following type of clause might be included in the letter:

Our audit engagement ends on delivery of our audit report. Any follow-up services that might be required will be a separate, new engagement. The terms and conditions of that new engagement will be governed by a new, specific engagement letter for that service.

Both AICPA auditing standards and *Government Auditing Standards* require auditors to communicate, in writing, their understanding of the services to be performed *for each engagement*. The engagement letter may also specifically state that the engagement to prepare the return or returns will end upon the delivery of those returns.

- ap Such unexpected circumstances might include, for example, a greater than expected risk of material misstatement due to fraud. Section 402 of *PPC's Guide to Managing an Accounting Practice* discusses using the engagement letter as a collection tool and illustrates clauses relating to unexpected circumstances that might affect the fee estimate.
- aq Some auditors add language such as the following to address terms for payment of audit fees:

In accordance with our firm policies, work may be suspended if your account becomes [Number] days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have been completed even if we have not issued our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination.

Some auditors believe that the first sentence of the preceding paragraph provides some protection against liability for breach of contract should they not complete the engagement because of nonpayment.

- ar *Government Auditing Standards* require audit organizations to provide a copy of their most recent external peer review report and any subsequent review reports to the party contracting for the audit, if requested by the client. The Yellow Book states the report(s) may accompany the engagement letter or be transmitted separately. In the instance the report(s) accompany this letter, the following paragraph can be use preceding the final paragraph of this letter:

You have requested that we provide you with a copy of our most recent external peer review report and any subsequent reports received during the contract period. Accordingly, our 20XX peer review report accompanies this letter.

In the instance the peer review report(s) will be transmitted separately, see NPO-CL-12.8 for a sample transmittal letter. (See section 108.)

- as** If the entity requests a change in the level of service (for example, from an audit to a review) or another change in the terms of the engagement, and there is a reasonable justification for the change, the auditor should agree on the new terms and document that agreement in an engagement letter or other suitable form of written communication (AU-C 210.16). *PPC's Guide to Compilation and Review Engagements* includes engagement letters that can be used if there is a change in the level of service (for example, from an audit to a review) and a step-down checklist (Appendix 2F). Section 203 discusses changes in the terms of an audit engagement, including reasons why a change may or may not be reasonably justified and what to do if you determine there is not a reasonable justification for the change.
- at** Even though not specifically required by AU-C 210, the authors believe management always needs to sign the engagement letter to document that they acknowledge and understand their responsibilities. If the auditor is engaged by management, then only management needs to sign the engagement letter, even if it is also provided to those charged with governance. In that case, providing the letter to those charged with governance is primarily to satisfy the responsibility to communicate planned scope and timing to them, which is not required to be in writing, so the governance signature is not necessary. An exception to that may be when the external auditor plans on using internal auditors to provide direct assistance. In that case, the external auditor is required to obtain written acknowledgement from management or those charged with governance, as appropriate, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in their work. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), determine if those charged with governance also should sign this letter. (See practical consideration u.) If the auditor is engaged by those charged with governance, both management and those charged with governance need to sign the engagement letter. Those charged with governance would sign to evidence their agreement with the terms of the engagement, and management would sign to acknowledge its responsibilities as set forth in the engagement letter.

NPO-CL-1.3: Audit Engagement Letter—Yellow Book^{a, b}

[CPA Firm's Letterhead]

[Date][Identify the body or individual(s) charged with governance.] and [Name of Management] ^c[Client's Name and Address]

We are pleased to confirm our understanding of the services we are to provide for [Name of Nonprofit Organization] for the [period, year, OR years] ended [Date(s)].

We will audit the financial statements of [Name of Nonprofit Organization], which comprise the statement(s) of financial position as of [Period or Year End(s)], and the related statements of [activities, functional expenses, and cash flows OR activities and cash flows] ^d for the [period, year, OR years] ended [Date(s)], and the related notes to the financial statements (the financial statements).^e Also, the following supplementary information accompanying the financial statements will be subjected to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, in accordance with auditing standards generally accepted in the United States of America, and we will provide an opinion on it in relation to the financial statements as a whole [in a separate written report accompanying our auditor's report on the financial statements OR in a report combined with our auditor's report on the financial statements].^{f, g}

1. _____
2. _____
3. _____

Audit Objectives

The objective of our audit is the expression of an opinion about whether your financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles ^h [and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements as a whole]. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and will include tests of your accounting records and other procedures we consider necessary to enable us to express such an opinion. We will issue a written report upon completion of our audit of [Name of Nonprofit Organization]'s financial statements. Our report will be addressed to [Identify parties, such as "board of trustees."] of [Name of Nonprofit Organization].^{i, j} We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion or add an emphasis-of-matter or other-matter paragraph. If our opinion on the financial statements is other than unmodified, we will discuss the reasons with management in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or issue reports, or we may withdraw from this engagement.^k

We will also provide a report (which does not include an opinion) on internal control related to the financial statements and compliance with the provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements as required by *Government Auditing Standards*. The report on internal control and on compliance and other matters will include a paragraph that states that (1) the purpose of the report is solely to describe the scope of testing of internal control and compliance, and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control on compliance and (2) the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. The paragraph will also state that the report is not suitable for any other purpose.^l If during our audit we become aware that [Name of Nonprofit

Organization is subject to an audit requirement that is not encompassed in the terms of this engagement, we will communicate to management and those charged with governance that an audit in accordance with generally accepted auditing standards established by the Auditing Standards Board (United States) and the standards for financial audits contained in *Government Auditing Standards* may not satisfy the relevant legal, regulatory, or contractual requirements.

Audit Procedures—General^m

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the Organization or to acts by management or employees acting on behalf of the Organization. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements. However, we will inform the appropriate level of management of any material errors, fraudulent financial reporting, or misappropriation of assets that come to our attention.^{n, o, p, q} We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential, and of any material abuse that comes to our attention.^{p, r} Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions.^{s, t, u} We will also request written representations from the Organization's attorneys as part of the engagement, and they may bill you for responding to this inquiry.^v At the conclusion of our audit, we will require certain written representations from you about your responsibilities for the financial statements; compliance with laws, regulations, contracts, and grant agreements; and other responsibilities required by generally accepted auditing standards.

Audit Procedures—Internal Control^m

Our audit will include obtaining an understanding of the Organization and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures.^w Tests of controls may be performed to test the effectiveness of certain controls that we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

An audit is not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards and *Government Auditing Standards*.^x

Audit Procedures—Compliance^m

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of [Name of Nonprofit Organization] 's compliance with the provisions of applicable laws, regulations, contracts, agreements, and grants. However, the objective of our audit will not be to provide an opinion on overall compliance and we will not express such an opinion in our report on compliance issued pursuant to *Government Auditing Standards*.

Other Services^y

We will prepare the Organization's federal and state information returns for the [period OR year] ended [Date(s)] for the [Identify jurisdictions.] based on information provided by you. We will also assist in preparing the financial statements and related notes of the Organization in conformity with U.S. generally accepted accounting principles based on information provided by you. These nonaudit services do not constitute an audit under *Government Auditing Standards* and such services will not be conducted in accordance with *Government Auditing Standards*.

We will perform the services in accordance with applicable professional standards, including the Statements on Standards for Tax Services issued by the American Institute of Certified Public Accountants. The other services are limited to the financial statement and tax services previously defined. We, in our sole professional judgment, reserve the right to refuse to perform any procedure or take any action that could be construed as assuming management responsibilities. We will advise management with regard to tax positions taken in the preparation of the tax return, but management must make all decisions with regard to those matters.

Management Responsibilities

Management is responsible for (1) establishing and maintaining effective internal controls, including monitoring ongoing activities and for helping to ensure that appropriate goals and objectives are met; (2) following laws and regulations; and (3) ensuring that management is reliable and financial information is reliable and properly reported. Management is also responsible for implementing systems designed to achieve compliance with applicable laws, regulations, contracts, and grant agreements. You are also responsible for the selection and application of accounting principles; for the preparation and fair presentation of the financial statements and all accompanying information in conformity with U.S. generally accepted accounting principles;^z and for compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is also responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the organization from whom we determine it necessary to obtain audit evidence.^{aa}

Your responsibilities include adjusting the financial statements to correct material misstatements and for confirming to us in the representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the organization involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud affecting the Organization received in communications from employees, former employees, grantors, regulators, or others. In addition, you are responsible for identifying and ensuring that the Organization complies with applicable laws, regulations, contracts, agreements, and grants and for taking timely and appropriate steps to remedy fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse that we report.

You are responsible for the preparation of the supplementary information, which we have been engaged to report on, in conformity with U.S. generally accepted accounting principles.^h You agree to include our report on the

supplementary information in any document that contains, and indicates that we have reported on, the supplementary information. You also agree to include the audited financial statements with any presentation of the supplementary information that includes our report thereon.^{ab} Your responsibilities include acknowledging to us in the written representation letter that (1) you are responsible for presentation of the supplementary information in accordance with GAAP; (2) you believe the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) you have disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information.^h

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying and providing report copies of previous financial audits, attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to us corrective actions taken to address significant findings and recommendations resulting from those audits, attestation engagements, performance audits, or other engagements or studies. The Organization is also responsible for providing management's views on our current findings, conclusions, and recommendations, as well as your planned corrective actions for the report, and for the timing and format for providing that information.^{ac}

You agree to assume all management responsibilities relating to the tax services, financial statements, related notes, and any other nonaudit services we provide. You will be required to acknowledge in the management representation letter the tax services provided and our assistance with the preparation of the financial statements and related notes and that you have evaluated the adequacy of our services and have reviewed and approved the results of the services, the financial statements, and related notes prior to their issuance and have accepted responsibility for them. Further, you agree to assume all management responsibilities for the tax services, financial statement preparation services, and any other nonattest services we provide; you agree to oversee the nonaudit services by designating an individual, preferably from senior management, with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.^{ad, ae, af, ag}

Engagement Administration, Fees, and Other^{ah}

We may from time to time, and depending on the circumstances, use third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.^{ai, aj}

We understand that your employees will prepare all cash, accounts receivable, and other confirmations we request and will locate any documents selected by us for testing.^{ak}

We will provide copies of our reports to the Organization; however, management is responsible for distribution of the reports and the financial statements. Unless restricted by law or regulation, or containing privileged and confidential information, copies of our reports are to be made available for public inspection.

The audit documentation for this engagement is the property of [CPA Firm's Name] and constitutes confidential information. However, subject to applicable laws and regulations, audit documentation and appropriate individuals will be made available upon request and in a timely manner to [Name of a Regulator] or its designee, a federal agency providing direct or indirect funding, or the U.S. Government Accountability Office for purposes of a quality review of the audit, to resolve audit findings, or to carry out oversight responsibilities. We will notify you of any such request. If requested, access to such audit documentation will be provided under the supervision of [CPA Firm's Name] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to the

aforementioned parties. These parties may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.^{al}

The audit documentation for this engagement will be retained for a minimum of five years after the report release date or for any additional period requested by the [Name of a Regulator]. If we are aware that a federal awarding agency or auditee is contesting an audit finding, we will contact the party(ies) contesting the audit finding for guidance prior to destroying the audit documentation.

[Name of Engagement Partner] is the engagement partner and is responsible for supervising the engagement and signing the reports or authorizing another individual to sign them.^{am, an} We expect to begin our audit on approximately [Date] and to complete your information returns and issue our report no later than [Date].^{ao}

We estimate that our fees for the audit and other services other than the preparation of the information returns will range from \$_____ to \$_____ and from \$_____ to \$_____ for the preparation of the information returns. You will also be billed for travel and other out-of-pocket costs such as report production, word processing, postage, etc. Additional expenses are estimated to be \$_____. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the audit.^{ap} If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation.^{aq}

We appreciate the opportunity to be of service to [Name of Nonprofit Organization] and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.^{ar, as}

Very truly yours,

[CPA Firm's Name]

RESPONSE:

This letter correctly sets forth the understanding of [Name of Nonprofit Organization].^{at}

Management signature: _____

Title: _____

Date: _____

Governance signature: _____

Title: _____

Date: _____

Practical Considerations:

- ^a This letter should be used at the outset of each engagement to communicate and document the understanding with the client about the services to be performed. This letter may be used for drafting engagement letters for audits of nonprofit organizations in accordance with *Government Auditing Standards* only (not OMB Circular A-133). The letter at NPO-CL-1.2 should be used for audits that are performed in accordance with *Government Auditing Standards* and OMB Circular A-133. The auditor needs to be familiar with the discussion of engagement letters at section 203.

The authors believe that in most circumstances it is a best practice to obtain an engagement letter each year, rather than issuing a multi-year engagement letter.

Auditors occasionally find that management of a small nonprofit organization does not understand some of the provisions of this agreement. As a result, small nonprofit clients may resist signing the letter. The discussion at section 203 discusses steps auditors can take in that situation.

- b Chapter 2 of *PPC's Guide to Audits of Nonpublic Companies* and Chapter 10 of *PPC's Guide to Managing an Accounting Practice* discuss some other clauses auditors might use to limit their exposure to legal liability. The authors recommend that auditors consult their legal counsel and insurance carrier when assessing such language in an engagement letter. Examples of clauses relating to the following matters are included (see also practical consideration ao):

- Loss limitation and indemnification.
- Time limitations.
- Statute of limitations.
- Undertaking to be truthful.
- Collection of fees relating to client litigation when the auditor is not a party.
- Reliance on oral advice or the absence of advice.
- Obtaining a retainer.
- Compensation for employees hired by clients.
- Notification of reproduction.
- Alternative dispute resolution.

- c The authors recommend that the engagement letter should be addressed to management, those charged with governance, and the individual or group who retains the auditor, usually the audit committee or the legislative committee that has oversight. This is because the auditor is required to communicate with those charged with governance the auditor's responsibilities with regard to the audit and an overview of the planned scope and timing.

The letter at NPO-CL-5.1 can be used instead of the engagement letter to communicate with those charged with governance during planning. However, regardless of whether the engagement letter or NPO-CL-5.1 is used for that purpose, the authors recommend also having a face-to-face discussion with those charged with governance during planning to encourage appropriate two-way communication. If the auditor communicates with a subgroup of those charged with governance, such as an audit committee, the engagement letter may explicitly state that the auditor retains the right to communicate with the full governing body.

- d For a voluntary health and welfare organization, use the wording "activities, functional expenses, and cash flows." For an organization other than a voluntary health and welfare organization, use the wording "activities and cash flows." In addition, any other financial statements that are to be audited should be identified (such as separate financial statements of a branch or a special purpose presentation).
- e In a recurring audit engagement where comparative financial statements will be presented, the authors believe it is appropriate for the engagement letter to refer only to the period being audited (that is, the current period). Reference to prior periods may be necessary, however, when the auditor is engaged in the current period to audit both the current and one or more prior periods.
- f List any supplementary information, on which you have been engaged to report, that will accompany the basic financial statements (for example, schedule of functional expenses presented as supplementary information by an organization not required to present one as a basic financial statement, or a special purpose presentation for a grant or program presented as supplementary information). The report under AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, which applies when the auditor is engaged to report on supplementary information, may be a separate report or included as an other-matter paragraph following the opinion paragraph of the report on the financial statements. If there is no supplementary information, delete this sentence and the following list. If the supplementary information will not accompany the basic financial statements, delete the phrase "accompanying the financial statements." If you have not been engaged to report on all of the supplementary information that will accompany the audited financial statements, (1) replace this sentence with the following language or (2) add the following language with a listing of the applicable information, depending on the circumstances:

Also, the following information accompanying the financial statements will not be subjected to the auditing procedures applied in our audit of the financial statements, and our auditor's report will not provide an opinion or any assurance on that information:

1. _____
2. _____
3. _____

9 AU-C 720, *Other Information in Documents Containing Audited Financial Statements*, requires you to communicate your responsibility with respect to such other information to those charged with governance during planning. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1) and you are aware that other information will be included in a document containing the audited financial statements and your report thereon, include the following:

- A statement that your responsibility for other information included in documents containing the Organization's audited financial statements and auditor's report does not extend beyond the financial information identified in the report.
- A statement that you have no responsibility for determining whether such other information contained in these documents is properly stated.

Additional information should be communicated at or near the conclusion of the audit, as illustrated at NPO-CL-5.2.

- h If the financial statements are prepared in conformity with a special purpose framework, modify this paragraph to refer to the special purpose framework used (for example, modified cash basis of accounting). Also, the titles of the financial statements should differ from those for financial statements prepared in accordance with GAAP so that there is no implication that the statements are presented in conformity with GAAP. If the financial statements are prepared in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board, modify this paragraph to refer to IFRS.
- i This sentence should identify any other audit standards required to be followed; e.g., by reference to a grantor agency's audit guide.
- j In an audit of group financial statements (group audit), the following sentences may be added as necessary, depending on the significance of the components and the relationship between the client and the components (AU-C 600.A28):

If making reference to a component auditor in the auditor's report:

We will make reference to [Name of Component Auditor] 's audit of [Name of Component] in our report on your financial statements.

If assuming responsibility for the work of component auditors:

Our audit will also include performing procedures on the financial information of [Name of Component(s)] (or requesting other auditors to perform procedures on the financial information of [Name of Component(s)]) to enable us to express such an opinion.

You may also consider changes in language throughout the letter to include the terms *group* and *component* as appropriate.

- k This sentence is recommended by the authors to mitigate the firm's exposure to a breach of contract claim, should it withdraw from the engagement prior to completion, disclaim an opinion, or decline to issue a report. For example, if a significant risk of material misstatement due to fraud exists and the auditor is not satisfied with the integrity of management and the diligence and cooperation from management in investigating the

circumstances and taking appropriate action to mitigate or resolve such risks, the auditor may consider withdrawing from the engagement. Auditors may want to replace this sentence with the following language to further clarify the auditor's right to withdraw from the engagement:

If circumstances occur related to the condition of your records, the availability of sufficient, appropriate audit evidence, or the existence of a significant risk of material misstatement of the financial statements caused by error, fraudulent financial reporting, or misappropriation of assets, which in our professional judgment prevent us from completing the audit or forming an opinion on the financial statements, we retain the right to take any course of action permitted by professional standards, including declining to express an opinion or issue a report, or withdrawing from the engagement.

- l This paragraph may be revised as appropriate. Paragraph 4.03 of the Yellow Book states that "auditors should communicate pertinent information that in the auditors' professional judgment needs to be communicated to individuals contracting for or requesting the audit, and to cognizant legislative committees when auditors perform the audit pursuant to a law or regulation, or they conduct the work for the legislative committee that has oversight of the audited entity."
- m Paragraph 4.03 of the Yellow Book states that the auditor should communicate, orally or in written form, during the planning stage of an engagement, certain information to officials of the audited entity and to the individuals contracting for or requesting the audit (if the audit is being performed under a contract with a party other than the officials of the audited entity). Officials of the audited entity include the head of the audited organization, those charged with governance and the individual who has the authority and responsibility for the financial reporting process (such as the finance director or the CFO). The discussion "Communications Required by *Government Auditing Standards*" at section 203 expands on those required communications. This illustrative engagement letter provides all of the required communications. If the auditor or the Organization wants to exclude certain proprietary information in the required communications to certain parties, a separate letter can be drafted. The separate letter could be the same as the engagement letter except the introduction could be changed and the "Engagement Administration, Fees, and Other" section could be omitted. The introduction to the separate letter might be as follows:

Government Auditing Standards require that we communicate, during the planning stage of an audit, certain information to officials of the audited entity and certain other parties. That information follows.

- n Some CPA firms like to mention to their clients that extended procedures designed to detect fraud can be performed at the client's option, but would be beyond the scope of the audit. The following wording can be used in those situations:

We have advised you of the limitations of our audit regarding the detection of fraud and the possible effect on the financial statements (including misappropriation of cash or other assets). We have offered to perform, as a separate engagement, extended procedures specifically designed to detect fraud and you have declined to engage us to do so at this time.

- o If there is evidence that fraud may exist, the auditor is required to bring it to the attention of the appropriate level of management, even if the matter is considered inconsequential. If the fraud involves management (regardless of materiality) or is material to the financial statements, the auditor is required to report it directly to the audit committee or others charged with governance (such as the governing board). AU-C 240.A69 also indicates that auditors may consider it appropriate to reach an understanding with those charged with governance about the nature and extent of communication about misappropriations committed by lower-level employees. Absent such an agreement, the authors recommend reporting all fraud matters both to the appropriate level of management and to those charged with governance. Section 1116 provides a discussion concerning communicating evidence of fraud.
- p Professional standards do not require the auditor to address these communications in the engagement letter. Some firms omit these sentences because they believe they may increase a firm's liability. They believe the auditor may be left in a position of proving why a fraudulent act or a violation of law or regulation did not come to his or her attention.

- q The Yellow Book indicates that information about abuse could come to the auditor's attention during the course of the audit. If the abuse could be material to the financial statements, the auditor is required to apply procedures specifically directed to ascertain the potential effect on the financial statements or other financial data significant to the audit objectives. However, the auditor has no responsibility under *Government Auditing Standards* to seek indicators of abuse. The Yellow Book definition of abuse indicates abuse does not necessarily involve fraud, or violations of laws, regulations, or provisions of a contract or grant agreement. Because the determination of abuse is subjective, auditors are not required to detect abuse. Paragraph 4.25 of the Yellow Book states that auditors should report relevant information about material abuse that has occurred or is likely to have occurred. See the discussion in section 1116 concerning the communications about violations of laws and regulations.
- r In a group audit, this and the preceding sentence may be modified to refer to communications with group management and those charged with governance of the group, as appropriate.
- s This sentence needs to be modified to exclude tests of the physical existence of inventories if no significant inventories exist due to the nature of the organization's activities.
- t In a group audit, if the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), the following matters should be communicated to those charged with governance of the group (AU-C 600.49):
1. An overview of the type of work to be performed on the financial information of components, including the basis for a decision to make reference to a component auditor in the auditor's report.
 2. An overview of the engagement team's planned involvement in the work of component auditors on the financial information of significant components.

The communication may be oral or written. If made orally, the communication should be documented.

- u AU-C 610.19 and AU-C 610.28 state that the auditor should communicate with those charged with governance the planned use of the work of the internal audit function and the nature and extent of any planned use of internal audit personnel to provide direct assistance on the audit. Prior to using the internal auditors to provide direct assistance, AU-C 610.30 requires the external auditor to obtain written acknowledgement from management or those charged with governance, as appropriate, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in their work. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), that communication and acknowledgment should be made in this letter. The following may be used to communicate the planned use of the work of internal audit:

We plan to use the work of [Describe the internal audit function.] of [Name of Nonprofit Organization] to assist us in obtaining audit evidence [Describe the planned use of internal audit's work.].

The following may be used to communicate the planned use of internal audit personnel to provide direct assistance and to obtain the required acknowledgment from management or those charged with governance:

We plan to use personnel from [Describe the internal audit function.] of [Name of Nonprofit Organization] to provide direct assistance to us during the audit in [Describe the planned use of internal audit personnel for direct assistance.]. You acknowledge that those personnel will be allowed to follow our instructions and you will not intervene in their work.

As discussed in section 1412, in 2014, the AICPA issued SAS No. 128, *Using the Work of Internal Auditors*, which supersedes the existing guidance related to consideration of the internal audit function in an audit of financial statements in AU-C 610. The SAS is effective for audits of financial statements for periods ending on or after December 15, 2014. This *Guide* has been updated for SAS No. 128.

- v This sentence is optional. It is added to help avoid negative reactions from clients if they are billed by an attorney for responding to a legal representation letter. Legal representation letters are discussed in section 1103.

- w In a group audit, this sentence may be modified to refer to the auditor's responsibilities related to group-wide controls.
- x In a group audit, this sentence may be modified, as appropriate, to refer to the auditor's communication with group management and those charged with governance of the group, related to material weaknesses or significant deficiencies in group-wide controls. AU-C 265 establishes requirements regarding communication of internal control related matters in a GAAS audit. AU-C 265 is discussed in section 1114. Reporting on internal control related matters in a Yellow Book audit is discussed at section 1306.
- y The auditor should identify the return or returns that will be prepared (e.g., IRS Form 990, 990-PF, or 990-T) and list the other services, including nonattest services, to be provided, such as preparation of a registration report for filing with a state charities regulatory agency. Before performing nonattest services under ET 1.295 or nonaudit services under *Government Auditing Standards* (referred to as nonaudit services in this letter), ET 1.295 and the Yellow Book, Paragraph 3.39, require the auditor to establish and document in writing the understanding with the client regarding the objective of the nonattest/nonaudit engagement, the service to be performed, the practitioner's responsibility, the client's acceptance of its responsibilities, and any limitations of the nonattest/nonaudit engagement. Those items can be documented in the engagement letter or in NPO-CX-1.2 and NPO-CX-1.3. (If the engagement letter incorporates the understanding requirements of ET 1.295 and the Yellow Book, make reference to the letter at the applicable steps in NPO-CX-1.2 and NPO-CX-1.3.) As previously stated, the auditor is required to document both the service to be performed and the objective of the engagement. However, in some cases, the authors believe that, depending upon the nature of the nonattest/nonaudit services, listing the service to be performed will also be stating the objectives. For example, in this letter, stating that the auditor will assist in preparing the financial statements in accordance with GAAP helps satisfy the requirement to document the objective of the engagement and the service to be performed. NPO-CX-1.2 and NPO-CX-1.3 provide additional space to document the understanding with the entity about the objectives of each nonattest/nonaudit service to be provided, the auditor's responsibilities, and any limitations of the engagement. The client's acceptance of its responsibility is included in the last paragraph of the "Management Responsibilities" section of this engagement letter (see practical consideration ag). It is recommended that separate fee estimates be stated for each additional service to be rendered. Alternatively, a separate detailed engagement letter may be used for the other services. A separate engagement letter for tax services is illustrated in *PPC's 990 Deskbook*. See also practical consideration ai. (Revise the language in this section, as appropriate, for the specific services being provided. Omit this section if the auditor is not providing any other services.)
- z If the financial statements are prepared in conformity with a special purpose framework or IFRS, modify this paragraph to refer to the special purpose framework used or to IFRS. AU-C 800.11 states that the auditor should obtain management's agreement that it acknowledges and understands its responsibility to include all appropriate informative disclosures in special purpose framework financial statements. The following additional paragraph can be used in those situations:

Management is responsible for including all informative disclosures that are appropriate for the [Name of Special Purpose Framework]. Those disclosures will include (1) a description of the [Name of Special Purpose Framework], including a summary of significant accounting policies, and how the [Name of Special Purpose Framework] differs from GAAP, (2) informative disclosures similar to those required by GAAP, and (3) additional disclosures beyond those specifically required that may be necessary for the financial statements to achieve fair presentation.

In a group audit, the last sentence of this paragraph may be modified as necessary to also address responsibility for the selection and application of accounting principles for the group.

- aa In a group audit, this sentence may be modified as necessary to also address access (or arrangements to facilitate access) to component information, instructions issued by group management to components related to the consolidation process, persons at components (including management and those charged with governance), or component auditors.
- ab This letter assumes supplementary information will accompany the financial statements and the auditor has been engaged to report on that information in relation to the financial statements as a whole. If you have been

engaged to report on supplementary information, AU-C 725.06 requires you to obtain management's agreement that it acknowledges and understands its responsibility for the supplementary information. If the supplementary information is prepared in conformity with criteria other than U.S. GAAP, replace the reference to U.S. GAAP with the criteria used for the preparation of the information. If there is no supplementary information, or you have not been engaged to report on the information, delete the preceding three sentences. If you have been engaged to report on supplementary information but it will not accompany the audited financial statements, replace the last sentence with the following:

You also agree to make the audited financial statements readily available to users of the supplementary information no later than the date the supplementary information is issued with our report thereon.

- ac** Some nonprofit organizations may publish their financial statements and the related auditor's report in an electronic site, such as the organization's website. AU-C 720.A4 clarifies that, for GAAS purposes, information contained on an entity's website is not considered to be "other information" and, accordingly, is not subject to the requirements of AU-C 720 or AU 550. Thus, auditors are not responsible for reading information in electronic sites containing audited financial statements or for considering the consistency of other information in those sites with the original document. Because of the potential security issues surrounding audited financial statements published electronically, and to avoid any misconceptions clients may have about the auditor's responsibility for those statements, auditors may want to consider adding a clause such as the following to their engagement letter when a client publishes financial statements electronically:

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on your website, management understands that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document.

- ad** Paragraph 2.12 of the Yellow Book indicates that *Government Auditing Standards* do not apply to professional services other than audits or attestation engagements. Therefore, nonaudit services are not reported as having been conducted in accordance with such standards. When the auditor performs nonaudit services for an entity for which it also performs audit services under *Government Auditing Standards*, the auditor should communicate with the Organization and those charged with governance to clarify that the scope of the nonaudit services does not constitute an audit conducted under *Government Auditing Standards*.
- ae** The Yellow Book identifies specific nonaudit services that always impair independence and that auditors are prohibited from providing to audited entities. If a nonaudit service is not specifically prohibited, the auditor is required to assess its impact on independence using the conceptual framework. According to Paragraph 3.40 of the Yellow Book, activities such as preparing financial statements, converting cash basis financial statements to accrual basis, and preparing reconciliations are nonaudit services that are to be evaluated using the conceptual framework. Paragraph 3.59 of the Yellow Book requires the auditor to document threats to independence that require the application of safeguards and the safeguards applied (i.e., the auditor's application of the conceptual framework), the auditor's consideration of management's ability to effectively oversee nonaudit services, the understanding with the entity about the nonaudit service to be provided, the objectives of the service, any limitations of the service, the entity's acceptance of its responsibilities, and the auditor's responsibilities. The authors believe that, depending upon the nature of the nonaudit services, listing the nonaudit services will also be stating the objectives. For example, in this letter, listing that we will provide tax services and assist with preparation of the financial statements and related notes helps satisfy the requirement to establish and document the understanding with management about both the nonaudit services to be provided and the objectives of those services. NPO-CX-1.3, Part III, step 5, provides additional space to document the understanding with the entity about the objective(s) of each nonaudit service to be provided, any limitations of the services, and the auditor's responsibilities. The Yellow Book independence rules are discussed in section 202.

This paragraph and the Other Services paragraph address the common situation in which the auditor provides tax services and assists with drafting the financial statements and related notes. If the auditor does not provide tax services or assist with drafting the financial statements and related notes, this paragraph and the Other

Services paragraph would be modified to delete items that the auditor does not perform or draft. Similarly, if the auditor also performs other nonaudit services (e.g., assists with the trial balance, performs certain reconciliations), those services should also be listed. The authors believe it is necessary to list all nonaudit services to be provided.

- af In order to coordinate the auditor's report date, management representation letter date, and the subsequent events evaluation note disclosure date, the auditor may want to discuss the dating requirements with management before starting the audit. Additionally, the auditor may include in the engagement letter a provision that management will not date the subsequent event note earlier than the date of their management representation letter (also the date of the auditor's report). (See sections 1104, 1105, and 1113.) The following type of clause might be included in the letter:

You are required to disclose in the financial statements the date through which subsequent events have been evaluated and whether that date is the date the financial statements were issued or were available to be issued. You agree that you will not date the subsequent event note earlier than the date of the management representation letter.

- ag If the auditor provides nonattest services, such as consulting services, information return preparation, financial statement preparation, or other bookkeeping services, to an attest client, the auditor should comply with ET 1.295 as well as the Yellow Book independence standards. ET 1.295.040 requires practitioners providing nonattest services to their attest clients to establish and document in writing an understanding with the client about the nonattest services. A separate engagement letter may be used for the nonattest services or they may be listed here and in the Other Services section. If listed here and in the Other Services section, the authors believe that the list should include all nonattest services to be provided. See practical consideration y. Part of the understanding is the client's acceptance of its responsibilities for the nonattest services. The Other Services paragraph and this paragraph list specific nonattest and nonaudit services provided. (See the discussion "Nonattest Services" in section 202.)

ET 1.295 incorporates by reference the independence requirements of other authoritative bodies. It states that failure to meet more restrictive independence requirements of regulatory bodies (such as the SEC, GAO, DOL, and state boards of accountancy) to which the member is subject constitutes a violation of ET 1.295. The GAO's *Government Auditing Standards* is more restrictive with respect to provision of nonattest services (referred to as *nonaudit services* in the Yellow Book) that impair the independence of auditors of entities that are subject to the Yellow Book. ET 1.295 and GAO standards are discussed at section 202.

If the auditor is not providing nonattest services, ET 1.295 does not apply. In that case, if the auditor is also not providing nonaudit services under *Government Auditing Standards*, this paragraph and the Other Services paragraph should be omitted.

Some auditors may prefer to have the client *specifically designate* in the engagement letter the individual(s) responsible for overseeing the nonattest services. In that case, the last sentence of this paragraph can be replaced by:

Further, you agree to oversee the nonaudit services by designating an individual, [Name of Designated Individual, Preferably from Senior Management], with suitable skill, knowledge, or experience; evaluate the adequacy and results of those services; and accept responsibility for them.

- ah Additional services may be added to an engagement after the engagement has begun. When clients request additional services, misunderstandings can be avoided by sending a letter to the client (1) detailing any agreed-upon changes in fees and services and (2) indicating that, except as provided therein, the terms of the original engagement letter apply. If the scope of agreed-upon services changes significantly, the auditor may consider issuing a separate engagement letter to cover the additional services. If significant other services, including nonattest services, are added to an engagement, the authors recommend issuing a new engagement letter to cover the additional services. At a minimum, the new engagement letter or workpapers should include documentation of the understanding with the client regarding performance of any nonattest services in accordance with ET 1.295 and the Yellow Book's independence standards, as discussed in

practical considerations y and ag. (NPO-CX-1.2 provides a form auditors can use to meet the documentation requirements when other services are added after the engagement has begun.) The following paragraph can be used in an engagement letter to address the issue of requests for additional services:

You may request that we perform additional services not addressed in this engagement letter. If this occurs, we will communicate with you the scope of the additional services and the estimated fees. We also may issue a separate engagement letter covering the additional services. In the absence of any other written communication from us documenting such additional services, our services will continue to be governed by the terms of this engagement letter.

- ai Auditors may want to add an additional paragraph such as the following to address the confidentiality privilege related to certain written or oral tax advice. See also practical consideration y.

Certain communications involving tax advice are privileged and not subject to disclosure to the IRS. By disclosing the contents of those communications to anyone, or by turning over information about those communications to the government, you, your employees, or agents may be waiving this privilege. To protect this right to privileged communication, please consult with us or your attorney prior to disclosing any information about our tax advice. Should you decide that it is appropriate for us to disclose any potentially privileged communication, you agree to provide us with written, advance authority to make that disclosure.

- aj ET 1.150.040 requires that clients be informed, preferably in writing, if the audit firm will outsource professional services to third-party service providers (see section 202). If a third-party service provider is not used to perform professional services, this paragraph can be omitted.

- ak The auditor may wish to add the words “and schedules” after “confirmations” and attach to the engagement letter a list of such schedules to be prepared by the client, for example, a copy of NPO-CL-12.10, “Client Assistance Request Letter.” Some firms expand the paragraph about client assistance by including the following:

We will schedule the engagement based in part on deadlines, working conditions, and the availability of your key personnel. We will plan the engagement based on the assumption that your personnel will cooperate and provide assistance by performing tasks such as preparing requested schedules, retrieving supporting documents, and preparing confirmations. If for whatever reason your personnel are unavailable to provide the necessary assistance in a timely manner, it may substantially increase the work we have to do to complete the engagement within the established deadlines, resulting in an increase in fees over our original fee estimate.

If the client has insufficient personnel to assist with these items, it is advisable to include a fee provision for preparation of these items by the audit staff. Some firms add the following language noting that the firm will request written permission from the client before performing additional procedures necessitated by the client’s failure to provide the agreed-upon level of assistance:

We will not undertake any accounting services (including but not limited to reconciliation of accounts and preparation of requested schedules) without obtaining approval through a written change order for such additional work.

If the services added are nonattest services, the auditor should follow the requirements of ET 1.295. See practical considerations y and ag.

- al The Yellow Book, Paragraph 4.16, states that contractual arrangements may provide for full and timely access to audit documentation for reviews of audit quality and reliance by others on the auditor’s work. In certain situations this information may be communicated orally; however, the authors recommend that this information be included in the engagement letter of all engagements performed in accordance with *Government Auditing Standards*. Information communicated orally should be documented in the workpapers. Section 804 contains additional discussion on providing regulators access to audit documentation.

- am QC 10.33 indicates that an audit firm should establish policies and procedures requiring that the identity and role of the engagement partner be communicated to management and those charged with governance. This sentence provides appropriate documentation that the communication has been made.
- an ET 1.279.010 addresses when a firm's independence from an attest client is considered impaired if a partner or employee leaves the firm and is employed by a client or considers potential employment with a client. Some firms choose to add language such as the following to aid the firm in maintaining independence in situations in which the client and firm personnel discuss employment:

To ensure that [Firm Name]'s independence is not impaired under the AICPA Code of Professional Conduct, you agree to inform the engagement partner before entering into any substantive employment discussions with any of our personnel.

- ao An auditor can attempt to have the statute of limitations for professional malpractice claims begin running at the end of a particular engagement by specifying the ending date or event in the engagement letter. For example, the following type of clause might be included in the letter:

Our audit engagement ends on delivery of our audit report. Any follow-up services that might be required will be a separate, new engagement. The terms and conditions of that new engagement will be governed by a new, specific engagement letter for that service.

Both AICPA auditing standards and *Government Auditing Standards* require auditors to communicate, in writing, their understanding of the services to be performed *for each engagement*.

- ap Such unexpected circumstances might include, for example, a greater than expected risk of material misstatement due to fraud. Section 402 of *PPC's Guide to Managing an Accounting Practice* discusses using the engagement letter as a collection tool and illustrates clauses relating to unexpected circumstances that might affect the fee estimate.
- aq Some auditors add language such as the following to address terms for payment of audit fees:

In accordance with our firm policies, work may be suspended if your account becomes [Number] days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have been completed even if we have not issued our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination.

Some auditors believe that the first sentence of the preceding paragraph provides some protection against liability for breach of contract should they not complete the engagement because of nonpayment.

- ar *Government Auditing Standards* require audit organizations to provide a copy of their most recent external peer review report and any subsequent review reports to the party contracting for the audit, if requested by the client. The Yellow Book states the report(s) may accompany the engagement letter or be transmitted separately. In the instance the report(s) accompany this letter, the following paragraph can be used preceding the final paragraph of this letter:

You have requested that we provide you with a copy of our most recent external peer review report and any subsequent reports received during the contract period. Accordingly, our 20XX peer review report accompanies this letter.

In the instance the peer review reports(s) will be transmitted separately, see NPO-CL-12.8 for a sample transmittal letter. (See section 108.)

- as If the entity requests a change in the level of service (for example, from an audit to a review) or another change in the terms of the engagement, and there is a reasonable justification for the change, the auditor should agree on the new terms and document that agreement in an engagement letter or other suitable form of written communication (AU-C 210.16). *PPC's Guide to Compilation and Review Engagements* includes engagement letters that can be used if there is a change in the level of service (for example, from an audit to a review) and

a step-down checklist (Appendix 2F). Section 203 discusses changes in the terms of an audit engagement, including reasons why a change may or may not be reasonably justified and what to do if you determine there is not a reasonable justification for the change.

- at** Even though not specifically required by AU-C 210, the authors believe management always needs to sign the engagement letter to document that they acknowledge and understand their responsibilities. If the auditor is engaged by management, then only management needs to sign the engagement letter, even if it is also provided to those charged with governance. In that case, providing the letter to those charged with governance is primarily to satisfy the responsibility to communicate planned scope and timing to them, which is not required to be in writing, so the governance signature is not necessary. An exception to that may be when the external auditor plans on using internal auditors to provide direct assistance. In that case, the external auditor is required to obtain written acknowledgement from management or those charged with governance, as appropriate, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in their work. If the engagement letter is used to communicate with those charged with governance during planning (rather than by using the letter at NPO-CL-5.1), determine if those charged with governance also should sign this letter. (See practical consideration u.) If the auditor is engaged by those charged with governance, both management and those charged with governance need to sign the engagement letter. Those charged with governance would sign to evidence their agreement with the terms of the engagement, and management would sign to acknowledge its responsibilities as set forth in the engagement letter.

Index _____

NPO-CX-1.2: Engagement Independence Compliance and Nonattest Services Documentation Form

Organization: _____ Date: _____

Instructions: This form can be used to document conclusions on compliance with independence requirements applicable to the engagement, including the identification of any threats to independence and safeguards that were applied. In addition, this form can be used to satisfy the documentation requirements pertaining to permissible nonattest services to be performed. You should be familiar with the matters discussed in section 202 before completing this form.

In forming a conclusion on compliance with independence requirements that apply to the engagement, AU-C 220.13 requires the engagement partner to (1) identify and evaluate circumstances and relationships that create threats to independence, (2) evaluate any identified breaches of the firm's independence policies and procedures to determine if they represent threats to independence, and (3) take appropriate action to eliminate threats or reduce them to an acceptable level, or when appropriate, withdraw from the engagement when permissible. Also, AU-C 220.25 requires audit documentation to include conclusions on compliance with independence requirements along with relevant discussions with the firm supporting the conclusions.

ET 1.295 of the AICPA revised *Code of Professional Conduct* provides guidance on the performance of allowable nonattest services for an attest client. Before performing nonattest services, the practitioner is required to establish and document in writing the understanding with the client regarding (1) the objectives of the engagement, (2) the services to be performed, (3) the client's acceptance of its responsibilities, (4) the practitioner's responsibilities, and (5) any limitations of the engagement. This form can also be used to meet documentation requirements for nonattest services that are added to an attest engagement after the attest engagement has begun.

This form addresses AICPA independence requirements. Auditors performing Yellow Book audits should also complete NPO-CX-1.3, "Evaluating Independence—*Government Auditing Standards*, 2011 Revision."

Part I—Consideration of Independence Threats (Other Than Those Relating to Nonattest Services)

1. With respect to the engagement, have we obtained information from the firm (and network firms, where applicable) to identify and evaluate any circumstances and/or relationships that create threats to independence? (If threats to independence are identified, list the circumstances and/or relationships creating the threats in Part III.)

___ Yes ___ No

Explanation: _____

Practical Considerations:

- Document the information that was obtained and used to identify and evaluate any circumstances and/or relationships that create threats to independence along with any other explanation of the procedures performed.
- QC 10.21–26 provides quality control requirements relating to a firm's policies and procedures pertaining to independence. *PPC's Guide to Quality Control* provides in-depth guidance on designing and implementing an effective quality control system under the AICPA Statements on Quality Control Standards.
- Among other guidance, *PPC's Guide to Quality Control* provides a questionnaire that covers the independence, integrity, and objectivity guidance in the AICPA revised *Code of Professional Conduct*.

Index _____

2. Have we identified any breaches in our firm's independence policies and procedures that create a threat to independence for the engagement? (If "Yes," list the identified threats and the circumstances and/or relationships creating threats in Part III.)

___ Yes ___ No

Explanation: _____

Practical Consideration:

- If situations are identified that may represent potential threats to independence but are not specifically addressed in the independence rule of the AICPA revised *Code of Professional Conduct*, consider the conceptual framework guidance for independence in ET 1.210.010 and apply professional judgment.

Part II—Nonattest Services

1. List allowable nonattest services to be performed for the entity, the objectives for those engagements, firm responsibilities for the services, and any limitations on the services to be provided.

Nonattest service to be provided ^a	Document the understanding regarding the: ^{b, c}		
	Engagement objectives	Firm responsibilities for the nonattest service	Limitations, if any, of the nonattest services to be provided

Notes:

- ^a Practitioners are not permitted to assume management responsibilities for an attest client. Certain activities performed as part of a nonattest service are considered to be management responsibilities and, therefore, impair independence regardless of whether the practitioner establishes an understanding with the entity and obtains the entity's agreement to assume responsibility for the services as documented in item 2. Section 202 lists common nonattest services and notes whether they are or are not considered to impair independence. Make sure any nonattest services listed on this form are permitted to be performed for an attest client under ET 1.295.

For engagements covering periods beginning on or after December 15, 2014, ET 1.295.010.06 indicates that services such as financial statement preparation, cash to accrual conversions, and reconciliations are outside the scope of the attest engagement and represent nonattest services. The performance of these services would not impair independence if other requirements of ET 1.295 are met.

- ^b Document the understanding or provide a reference to where the understanding is documented (such as an engagement letter).
- ^c Under ET 1.295, the practitioner is required to document the practitioner's/firm's responsibilities and any limitations of the engagement. For example, documentation of the responsibilities of the firm and the limitations of the nonattest service in connection with tax services might include language such as the following:

We will perform the services in accordance with applicable professional standards, including the Statements on Standards for Tax Services issued by the American Institute of Certified Public Accountants.

Index _____

We, in our sole professional judgment, reserve the right to refuse to do any procedure or take any action that could be construed as assuming management responsibilities. We will advise management with regard to tax positions taken in the preparation of the tax return, but management must make all decisions with regard to those matters.

2. List each of the nonattest services to be performed as noted in item 1. Based on the understanding established with the client, indicate if the client agrees to perform the following functions in connection with the engagement to perform each of the nonattest services: (Answer each question as “Yes” or “No.” To reduce threats to an acceptable level for independence to not be impaired for the performance of each nonattest service, all of the functions must be answered “Yes.”)

Nonattest service to be provided	Does the client agree, and is the client able, to perform the following functions for each nonattest service: (Yes or No) ^{a, b, c}			
	Assume all management responsibilities?	Oversee services by designating an individual with suitable SKE?	Evaluate the adequacy and results of the service?	Accept responsibility for the results of the service?

Notes:

- ^a ET 1.295 indicates that the performance of nonattest services may introduce threats to independence. However, the performance of permissible nonattest services would not impair independence if the client agrees to perform *all* of the functions listed in this step. Also, the practitioner needs to be satisfied that management will (1) perform the listed functions, (2) make an informed judgment on the results of the practitioner’s nonattest services, and (3) accept responsibility for making significant judgments and decisions that are the responsibility of management. If management is unwilling or unable to assume such responsibilities, the performance of the nonattest service(s) would impair independence.

In addition, before performing nonattest services, the practitioner is required to establish and document in writing the understanding with the client regarding (1) the objectives of the engagement, (2) the services to be performed, (3) the client’s acceptance of its responsibilities, (4) the practitioner’s responsibilities, and (5) any limitations of the engagement.

- ^b Document the understanding or provide a reference to where the understanding is documented (such as an engagement letter).
- ^c ET 1.295 states that management should oversee the practitioner’s nonattest services by designating an individual that has suitable skill, knowledge, and/or experience (SKE). The practitioner should assess and be satisfied that the individual adequately understands the services to be performed in order to oversee them. However, the designated individual does not need to have the expertise to perform (or reperform) the practitioner’s nonattest services.

3. Before accepting a nonattest service, if multiple nonattest services will be performed, have we evaluated whether the performance of multiple services will create, in the aggregate, a significant threat that will not be reduced to an acceptable level through the safeguards in item 2? (If “Yes,” document the significant threat in Part III.)

___ Yes ___ No

Index _____

Explanation: _____

Practical Considerations:

- For engagements covering periods beginning on or after December 15, 2014, ET 1.295.020 requires the practitioner to evaluate whether the performance of multiple nonattest services in the aggregate would create a threat to independence. The evaluation should be performed before the practitioner agrees to perform the nonattest service(s).
- Practitioners are not required to consider potential threats to independence of nonattest services performed by other network firms in the firm's network.

Part III—Identified Threats and Safeguards

1. For threats to independence identified in Parts I and II, list (a) the circumstances and/or relationships, breaches in firm policy, or the cumulative effect of multiple nonattest services that created the threat, (b) a description of the nature of the threat, (c) safeguards applied to reduce the threat to an acceptable level, and (d) whether the safeguards eliminated the threat or reduced it to an acceptable level.

Circumstances contributing to the identified threat	Nature of the threat	Specific (or additional) safeguards that were applied ^a	Was the threat eliminated or reduced to acceptable level? (Y/N)	Comments ^b

Notes:

- ^a If a threat was identified in item 3 of Part II that would arise from the performance of multiple nonattest services, identify additional safeguards that were applied in addition to those identified in item 2 of Part II.
- ^b Provide additional explanation for your conclusion in the previous column.

Part IV—Conclusion

1. Considering independence requirements applicable to the engagement and any identified threats to independence, along with applicable safeguards applied, conclude whether we are independent on the engagement:

- ☐ Yes; we are independent with respect to the engagement.
- ☐ No; we are not independent with respect to the engagement.

Explanation: _____

Practical Considerations:

- The engagement partner is required to promptly notify the firm of any instances that cannot be resolved.
- If a threat cannot be reduced to an acceptable level by applying safeguards, it may be necessary to eliminate the activity or interest that contributed to the threat or withdraw from the engagement when withdrawal is possible under law or regulation.

Index_____

2. Document any relevant discussions with the firm regarding the above conclusion.

Practical Consideration:

- Document the individuals who participated in the discussions along with the dates of their occurrence.

Engagement Partner: _____ Date: _____

Engagement Quality Control Reviewer: _____ Date: _____

The Engagement Quality Control Reviewer would sign this form if required by firm policy.

NPO-CR-3.1: Illustrative Engagement Letter—Compilation^{a, b, c}

[Date]

[Name and Address of Management or Body or Individual(s) Charged with Governance]

We are pleased to confirm our understanding of the services we are to provide for the year ended June 30, 20XX.

We will prepare the annual financial statements of [Name of Organization] (a nonprofit organization), which comprise the statement of financial position as of June 30, 20XX, and the related statements of [activities, functional expenses, and cash flows OR activities and cash flows] for the year then ended^{d, e} and the related notes to the financial statements,^{f, g} and perform a compilation engagement with respect to those financial statements.^h

We will assist your bookkeeper in adjusting the books of accounts so that he (she) will be able to prepare a working trial balance from which financial statements can be prepared. Your bookkeeper will provide us with a detailed trial balance and any supporting schedules we require.ⁱ

Our Responsibilities

The objective of our engagement is to—

1. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and
2. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's *Code of Professional Conduct*, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our procedures that fraud may have occurred. In addition, we will inform you of any evidence or information that comes to our attention during the performance of our compilation procedures regarding any wrongdoing within the entity or noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.^j We have no responsibility to identify and communicate deficiencies or material weaknesses in your internal control as part of this engagement.^k

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.^l

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles

generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARS:

1. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements.
2. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America, if applicable.
3. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements.
4. The prevention and detection of fraud.
5. To ensure that the entity complies with the laws and regulations applicable to its activities.
6. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement.
7. To provide us with—
 - access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - additional information that we may request from you for the purpose of the compilation engagement.
 - unrestricted access to persons within the Organization of whom we determine it necessary to make inquiries.
8. Including our compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our bookkeeping services and the preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.^m

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.ⁿ

Other Relevant Information^o

[Name of Engagement Partner] is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign it.^p

We estimate that our fees for these services will range from \$_____ to \$_____ for the financial statement preparation and compilation and \$_____ to \$_____ for [List other service to be provided.]. You will also be billed for out-of-pocket costs such as report production, word processing, postage, travel, etc. Additional expenses are estimated to be \$_____. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the work performed.^q If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.^r Our invoices for these fees will be rendered each month as work progresses and are payable on presentation.^{s, t}

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you acknowledge and agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.^{u, v}

Sincerely,

[CPA Firm's Signature] ^w

ACKNOWLEDGED:

[Name of Nonprofit Organization] ^w

Executive Director

Date

Practical Considerations:

- ^a This letter is adapted from AR-C 80.A42, Illustration 1, and is intended to be used when the accountant will prepare the financial statements and has been engaged to compile those financial statements. Under SSARS No. 21 (AR-C 80.10–.11), the terms of the compilation engagement should be documented in an engagement letter or other form of written agreement signed by both the accountant and management or those charged with governance. Those signing on behalf of the Organization will depend on the structure of the entity. The terms of the engagement letter should include the items listed at AR-C 80.10.

This illustrative engagement letter complies with the requirements of the SSARS both prior to, and subsequent to, the implementation of SSARS No. 21. That is, it is acceptable to include the additional items required by SSARS No. 21 in engagement letters for financial statements for periods prior to the implementation of SSARS No. 21. SSARS No. 21 is effective for engagements for financial statements for periods ending on or after December 15, 2015, with early implementation allowed.

- ^b This letter should be used at the outset of each annual period. The authors believe in most circumstances that it is a best practice to obtain an engagement letter each year, rather than issuing one engagement letter to cover the services performed in the current year and the services performed in subsequent years.
- ^c ET 1.150.040 of the AICPA revised *Code of Professional Conduct* requires that clients be informed, preferably in writing, if the accountant will outsource professional services to third-party service providers. In cases where the accountant chooses to provide written disclosure that a third-party service provider will be used, the following paragraph may be included in the engagement letter.

We may from time to time, and depending on the circumstances, use certain third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.

ET 1.150.040 is discussed in section 202.

- d The financial statements listed should correspond to those being prepared and compiled.
- e In a recurring engagement where comparative financial statements will be presented, the authors believe the engagement letter should refer only to the period being prepared and compiled (that is, the current period). Reference to prior periods may be necessary, however, when the accountant is engaged in the current period to prepare and compile both the current and one or more prior periods.
- f If management has elected to omit substantially all disclosures from the financial statements, the authors suggest rewording this paragraph as follows:

We will prepare the annual financial statements of [Name of Organization] (a nonprofit organization), which comprise the statement of financial position as of June 30, 20XX, and the related statements of [activities, functional expenses, and cash flows OR activities and cash flows] for the year then ended. Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America.

- g For a voluntary health and welfare organization, use the wording “activities, functional expenses, and cash flows.” For an organization that is not a voluntary health and welfare organization, use the wording “activities and cash flows.” In addition, any other financial statements that are to be compiled should be identified (such as separate financial statements of a branch or a special purpose presentation).
- h If supplementary information will not be compiled and will be included with the compiled financial statements, practitioners may add language such as the following to the engagement letter:

The supplementary information accompanying the compiled financial statements will be presented for purposes of additional analysis. We will not compile the supplementary information. We will not express an opinion, a conclusion, or provide any assurance on such supplementary information.

If supplementary information will be compiled and included with the compiled financial statements, practitioners may add language such as the following to the engagement letter:

The supplementary information accompanying the compiled financial statements will be presented for purposes of additional analysis. The supplementary information will be compiled from information that is the representation of management. We will not audit or review the supplementary information. We will not express an opinion, a conclusion, or provide any assurance on such supplementary information.

- i If CPAs wish to maintain their independence, all accountant-proposed standard, adjusting, or correcting journal entries to be reflected in the financial statements should be discussed with the client to ensure the client understands their nature and the impact the entries have on the financial statements.
- j Many accountants are troubled by the notion that they are not required to communicate noncompliance with laws and regulations that is clearly inconsequential because they believe it imposes on them a responsibility to assess the legal implications of such matters. However, this language is intended only to clarify that accountants are not required to communicate noncompliance with laws and regulations that is clearly inconsequential. The authors believe the term *clearly inconsequential* refers to an amount that is so obviously immaterial that its insignificance cannot be questioned. This language is discussed further in section 203 of *PPC’s Guide to Compilation and Review Engagements*.
- k Some accountants prefer to clarify that they have no responsibility in a SSARS engagement to identify and communicate deficiencies in their client’s internal control. Therefore, to reduce misconceptions by clients and the potential for litigation due to such misconceptions, the authors recommend that this language be added to the engagement letter.
- l This sentence is recommended by the authors to mitigate the firm’s exposure to a breach of contract claim should the firm withdraw from the engagement prior to completion.
- m Accountants who provide nonattest services (such as tax return preparation, financial statement preparation, or other bookkeeping services) to their attest clients should comply with the requirements of ET 1.295,

“Nonattest Services,” of the AICPA revised *Code of Professional Conduct* for those nonattest services. Before performing nonattest services, ET 1.295 requires the accountant to establish and document in writing the understanding with the client regarding the objective of the nonattest engagement, the service to be performed, the practitioner’s responsibility, the client’s acceptance of its responsibilities, and any limitations of the nonattest engagement. Those items can be documented in the engagement letter or in NPO-CX-1.2. (If the engagement letter incorporates the understanding requirements of ET 1.295, make reference to the letter at the applicable steps in NPO-CX-1.2.) As previously stated, the auditor is required to document both the service to be performed and the objective of the engagement. However, in some cases, the authors believe that, depending upon the nature of the nonattest services, listing the service to be performed will also be stating the objectives. For example, in this letter, stating that the auditor will prepare (or assist in preparing) the financial statements in accordance with GAAP helps satisfy the requirement to document the objective of the engagement and the service to be performed. NPO-CX-1.2 provides additional space to document the understanding with the entity about the objectives of each nonattest service to be provided, the auditor’s responsibilities, and any limitations of the engagement. The client’s acceptance of its responsibility is included in the last paragraph of the “Your Responsibilities” section of this engagement letter. This paragraph should be modified to refer to all nonattest services provided. The Code’s requirement to establish an understanding with the client must be met or the accountant’s independence in regard to attest services is impaired. In addition, failure to comply with the Code’s requirement to document that understanding is a violation of ET 1.310.001 of the AICPA revised *Code of Professional Conduct*. Nonattest services are discussed in section 202.

- n If the accountant is not independent, the following sentences should be added to the end of this paragraph:

We are not independent with respect to [Name of Organization]. We will disclose that we are not independent in our compilation report.

- o ET 1.279 of the AICPA revised *Code of Professional Conduct* addresses when a firm’s independence from an attest client is considered impaired if a partner or employee leaves the firm and is employed by a client or considers potential employment with a client. The following optional paragraph may be added to aid the firm in maintaining independence in situations in which the client and firm personnel discuss employment:

To ensure that [Firm Name]’s independence is not impaired under the AICPA *Code of Professional Conduct*, you agree to inform the engagement partner before entering into any substantive employment discussions with any of our personnel.

- p Statement on Quality Control Standards (SQCS) No. 8, *A Firm’s System of Quality Control*, indicates that firms with an accounting practice (which includes compilations and reviews) should establish policies and procedures requiring that the identity and role of the engagement partner be communicated to management and those charged with governance. This sentence provides appropriate documentation that the communication has been made.
- q Section 402 of *PPC’s Guide to Managing an Accounting Practice* discusses using the engagement letter as a collection tool and illustrates clauses relating to unexpected circumstances that might affect the fee estimate.
- r If this sentence is included in the engagement letter, the engagement team member in charge of billing the client should monitor the engagement and follow through in a timely fashion. Oftentimes in practice, the work is done and the fee overage is dealt with much later, resulting in unnecessary write-offs and/or a deterioration of client relations.
- s Some accountants choose to add language such as the following to provide protection against liability for breach of contract should they not complete the engagement because of nonpayment:

In accordance with our firm policies, work may be suspended if your account becomes [XX] days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have been completed upon written notification of termination, even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination.

- ^t Some firms choose to charge interest on late payments. If the firm is going to charge interest, most state laws require notification of the rate. However, typically this notification must be in the form of a separate letter. CPAs who charge interest should comply with state laws and make proper notification.
- ^u Additional services may be added to an engagement after the engagement has begun. When clients request additional services, misunderstandings can be avoided by sending a letter to the client detailing any agreed-upon changes in fees and services. The letter should indicate that the terms of the engagement letter apply to the additional services. If the scope of agreed-upon services changes significantly, the accountant may want to consider issuing a separate engagement letter to cover the additional services. The following paragraph can be used in an engagement letter to address the issue of requests for additional services:

You may request that we perform additional services not contemplated by this engagement letter. If this occurs, we will communicate with you regarding the scope of the additional services and the estimated fee. We also may issue a separate engagement letter covering the additional services. In the absence of any other written communication from us documenting such additional services, our services will continue to be governed by the terms of this engagement letter.

When considering clients' requests for additional services, the accountant should consider the requirements of ET 1.295 of the AICPA revised *Code of Professional Conduct*. In addition, if services that are covered by the current engagement letter are no longer required, the CPA should send an amendment to the engagement letter to clarify exactly what services will be performed.

- ^v Section 203 of *PPC's Guide to Compilation and Review Engagements* and section 1005 of *PPC's Guide to Managing an Accounting Practice* discuss some other clauses practitioners might use to limit their exposure to legal liability and other losses.
- ^w AR-C 80.11 requires that the engagement letter be signed by both the accountant or accountant's firm and management or those charged with governance, as appropriate.

NPO-CR-3.2: Illustrative Engagement Letter—Review^{a, b, c}

[Date]

[Name and Address of Management or Body or Individual(s) Charged with Governance]

We are pleased to confirm our understanding of the services we are to provide for the year ended June 30, 20XX.

We will prepare the annual financial statements of [Name of Organization] (a nonprofit organization), which comprise the statement of financial position as of June 30, 20XX, and the related statements of [activities, functional expenses, and cash flows OR activities and cash flows] for the year then ended,^{d, e} and the related notes to the financial statements,^f and perform a review engagement with respect to those financial statements.

Our Responsibilities

The objective of our engagement is to—

1. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and
2. obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's *Code of Professional Conduct*, including the ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or other examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.^g

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the Organization or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will inform you of any evidence or information that comes to our attention during the performance of our review procedures regarding any wrongdoing within the Organization or noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.^h We have no responsibility to identify and communicate deficiencies or material weaknesses in your internal control as part of this engagement.ⁱ

If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.^j

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with

accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARS:

1. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements.
2. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America.
3. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements.
4. The prevention and detection of fraud.
5. To ensure that the Organization complies with the laws and regulations applicable to its activities.
6. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement.
7. To provide us with—
 - access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - additional information that we may request from you for the purpose of the review engagement.
 - unrestricted access to persons within the Organization of whom we determine it necessary to make inquiries.
8. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
9. Including our review report in any document containing financial statements that indicates that we have performed a review engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.^k

Our Report

We will issue a written report upon completion of our review of [Name of Organization] 's financial statements. Our report will be addressed to [Identify parties, such as "board of trustees."] of [Name of Organization] . We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from accounting principles generally accepted in the United States of America, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Other Relevant Information^l

[Name of Engagement Partner] is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign it.^m

We estimate that our fees for these services will range from \$_____ to \$_____ for the financial statement preparation and review and \$_____ to \$_____ for [List other service to be provided.]. You will also be billed for out-of-pocket costs such as report production, word processing, postage, travel, etc. Additional expenses are estimated to be \$_____. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the work performed.ⁿ If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.^o Our invoices for these fees will be rendered each month as work progresses and are payable on presentation.^{p, q}

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you acknowledge and agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.^{r, s}

Sincerely,

[CPA Firm's Signature] ^t

ACKNOWLEDGED:

[Name of Nonprofit Organization] ^t

Executive Director

Date

Practical Considerations:

- ^a This letter is adapted from AR-C 90.A145, Illustration 1, and is intended to be used when the accountant will both prepare the financial statements and has been engaged to review those financial statements. Under SSARS No. 21 (AR-C 90.11–12), the terms of the review engagement should be documented in an engagement letter or other form of written agreement signed by both the accountant and management or those charged with governance. Those signing on behalf of the Organization will depend on the structure of the entity. The terms of the engagement letter should include the items listed at AR-C 90.11.

This illustrative engagement letter complies with the requirements of the SSARS both prior to, and subsequent to, the implementation of SSARS No. 21. That is, it is acceptable to include the additional items required by SSARS No. 21 in engagement letters for financial statements for periods prior to the implementation of SSARS No. 21. SSARS No. 21 is effective for engagements for financial statements for periods ending on or after December 15, 2015, with early implementation allowed.

- ^b This letter should be used at the outset of each annual period. The authors believe in most circumstances that it is a best practice to obtain an engagement letter each year, rather than issuing one engagement letter to cover the services performed in the current year and the services performed in subsequent years.
- ^c ET 1.150.040 of the AICPA revised *Code of Professional Conduct* requires that clients be informed, preferably in writing, if the accountant will outsource professional services to third-party service providers. In cases where the accountant chooses to provide written disclosure that a third-party service provider will be used, the following paragraph may be included in the engagement letter:

We may from time to time, and depending on the circumstances, use certain third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements

with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers.

ET 1.150.040 is discussed in section 202.

- d The financial statements listed should correspond to those being prepared and reviewed.
- e In a recurring engagement where comparative financial statements will be presented, the authors believe the engagement letter should refer only to the period being prepared and reviewed (that is, the current period). Reference to prior periods may be necessary, however, when the accountant is engaged in the current period to prepare and review both the current and one or more prior periods.
- f For a voluntary health and welfare organization, use the wording “activities, functional expenses, and cash flows.” For an organization that is not a voluntary health and welfare organization, use the wording “activities and cash flows.” In addition, any other financial statements that are to be compiled should be identified (such as separate financial statements of a branch or a special purpose presentation).
- g If supplementary information will be reviewed and included with the reviewed financial statements, practitioners are required to reference supplementary information in the engagement letter. Language such as the following may be used:

The supplementary information accompanying the financial statements will be presented for purposes of additional analysis and will be subjected to the inquiry and analytical procedures applied in the review of the basic financial statements.

If supplementary information will be compiled and included with the reviewed financial statements, practitioners are required to reference supplementary information in the engagement letter. Language such as the following may be used:

The supplementary information accompanying the financial statements will be presented for purposes of additional analysis and will not be subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but will be compiled from information that is the representation of management, without audit or review. We will not express an opinion, a conclusion, or provide any assurance on such supplementary information.

- h Many accountants are troubled by the notion that they are not required to communicate noncompliance with laws and regulations that is clearly inconsequential because they believe it imposes on them a responsibility to assess the legal implications of such matters. However, this language is intended only to clarify that accountants are not required to communicate noncompliance with laws and regulations that is clearly inconsequential. The authors believe the term *clearly inconsequential* refers to an amount that is so obviously immaterial that its insignificance cannot be questioned. This language is discussed further in section 203 of *PPC’s Guide to Compilation and Review Engagements*.
- i Some accountants prefer to clarify that they have no responsibility in a SSARS engagement to identify and communicate deficiencies in their client’s internal control. Therefore, to reduce misconceptions by clients and the potential for litigation due to such misconceptions, the authors recommend that this language be added to the engagement letter.
- j This sentence is recommended by the authors to mitigate the firm’s exposure to a breach of contract claim should the firm withdraw from the engagement prior to completion.
- k Accountants who provide nonattest services (such as tax return preparation, financial statement preparation, or other bookkeeping services) to their attest clients should comply with the requirements of ET 1.295, “Nonattest Services,” of the AICPA revised *Code of Professional Conduct* for those nonattest services. Before

performing nonattest services, ET 1.295 requires the accountant to establish and document in writing the understanding with the client regarding the objective of the nonattest engagement, the service to be performed, the practitioner's responsibility, the client's acceptance of its responsibilities, and any limitations of the nonattest engagement. Those items can be documented in the engagement letter or in NPO-CX-1.2. (If the engagement letter incorporates the understanding requirements of ET 1.295, make reference to the letter at the applicable steps in NPO-CX-1.2.) As previously stated, the auditor is required to document both the service to be performed and the objective of the engagement. However, in some cases, the authors believe that, depending upon the nature of the nonattest services, listing the service to be performed will also be stating the objectives. For example, in this letter, stating that the auditor will prepare (or assist in preparing) the financial statements in accordance with GAAP helps satisfy the requirement to document the objective of the engagement and the service to be performed. NPO-CX-1.2 provides additional space to document the understanding with the entity about the objectives of each nonattest service to be provided, the auditor's responsibilities, and any limitations of the engagement. The client's acceptance of its responsibility is included in the last paragraph of the "Your Responsibilities" section of this engagement letter. This paragraph should be modified to refer to all nonattest services provided. The Code's requirement to establish an understanding with the client must be met or the accountant's independence in regard to attest services is impaired. In addition, failure to comply with the Code's requirement to document that understanding is a violation of ET 1.310.001 of the AICPA revised *Code of Professional Conduct*. Nonattest services are discussed in section 202.

- l ET 1.279 of the AICPA revised *Code of Professional Conduct* addresses when a firm's independence from an attest client is considered impaired if a partner or employee leaves the firm and is employed by a client or considers potential employment with a client. The following optional paragraph may be added to aid the firm in maintaining independence in situations in which the client and firm personnel discuss employment:

To ensure that [Firm Name]'s independence is not impaired under the AICPA *Code of Professional Conduct*, you agree to inform the engagement partner before entering into any substantive employment discussions with any of our personnel.

- m Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control*, indicates that firms with an accounting practice (which includes compilations and reviews) should establish policies and procedures requiring that the identity and role of the engagement partner be communicated to management and those charged with governance. This sentence provides appropriate documentation that the communication has been made.
- n Section 402 of *PPC's Guide to Managing an Accounting Practice* discusses using the engagement letter as a collection tool and illustrates clauses relating to unexpected circumstances that might affect the fee estimate.
- o If this sentence is included in the engagement letter, the engagement team member in charge of billing the client should monitor the engagement and follow through in a timely fashion. Oftentimes in practice, the work is done and the fee overage is dealt with much later, resulting in unnecessary write-offs and/or a deterioration of client relations.
- p Some accountants choose to add language such as the following to provide protection against liability for breach of contract should they not complete the engagement because of nonpayment:

In accordance with our firm policies, work may be suspended if your account becomes [XX] days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have been completed upon written notification of termination, even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination.

- q Some firms choose to charge interest on late payments. If the firm is going to charge interest, most state laws require notification of the rate. However, typically this notification must be in the form of a separate letter. CPAs who charge interest should comply with state laws and make proper notification.

- r Additional services may be added to an engagement after the engagement has begun. When clients request additional services, misunderstandings can be avoided by sending a letter to the client detailing any agreed-upon changes in fees and services. The letter should indicate that the terms of the engagement letter apply to the additional services. If the scope of agreed-upon services changes significantly, the accountant may want to consider issuing a separate engagement letter to cover the additional services. The following paragraph can be used in an engagement letter to address the issue of requests for additional services:

You may request that we perform additional services not contemplated by this engagement letter. If this occurs, we will communicate with you regarding the scope of the additional services and the estimated fee. We also may issue a separate engagement letter covering the additional services. In the absence of any other written communication from us documenting such additional services, our services will continue to be governed by the terms of this engagement letter.

When considering clients' requests for additional services, the accountant should consider the requirements of ET 1.295 of the AICPA revised *Code of Professional Conduct*. In addition, if services that are covered by the current engagement letter are no longer required, the CPA should send an amendment to the engagement letter to clarify exactly what services will be performed.

- s Section 203 of *PPC's Guide to Compilation and Review Engagements* and section 1005 of *PPC's Guide to Managing an Accounting Practice* discuss some other clauses practitioners might use to limit their exposure to legal liability and other losses.
- t AR-C 90.12 requires that the engagement letter be signed by both the accountant or accountant's firm and management or those charged with governance, as appropriate.

202.39 During an audit engagement, the auditor will often communicate with management about issues related to the engagement. The following discussions are considered a normal part of an audit engagement and would not be subject to ET 1.295:

- The client's selection and application of accounting standards or policies and financial statement disclosure requirements.
- Whether the client's accounting and financial reporting methods are appropriate.
- Adjusting journal entries proposed by the auditor.
- The form or content of the financial statements.

The auditor is cautioned to consider whether the level of involvement constitutes a separate nonattest service. For example, activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of an attest engagement and are, instead, nonattest services.⁶ However, such activities would not impair independence, provided the requirements of ET 1.295 are met.

202.40 Under ET 1.295.030, independence is considered to be impaired if an auditor (or his or her firm) assumes management responsibilities for an attest client. However, the auditor may assist management in those responsibilities. For the auditor to remain independent, before the start of the nonattest engagement, the attest client and its management should agree to perform all of the following functions in connection with the nonattest services (ET 1.295.040):

- Assume all management responsibilities.
- Oversee the services by designating an individual, preferably within senior management, who has suitable skill, knowledge, or experience.
- Evaluate the adequacy and results of the services performed.
- Accept responsibility for the results of the services.

202.41 In addition, the auditor should be satisfied that management will be able to meet all these criteria, make an informed judgment on the results of the nonattest services, and be responsible for making the significant judgments and decisions that are management's responsibility. In cases in which the client is unable or unwilling to assume its responsibilities, the auditor's performance of the nonattest services would impair independence.

202.42 ET 1.295.040 also requires the auditor to *establish* and *document in writing* before performing the nonattest service, his or her understanding with the client regarding the following:

- Objectives of the engagement (i.e., the nonattest services).
- Services to be performed.
- Client's acceptance of its responsibilities.
- Auditor's responsibilities.
- Any limitations of the engagement.

⁶ These activities are considered nonattest services effective for engagements covering periods beginning on or after December 15, 2014.

202.43 ET 1.295 does not specify how the understanding is to be documented, so the auditor has flexibility. For example, the understanding might be documented in a separate engagement letter⁷, in the workpapers, in an internal memo, or in the engagement letter obtained in conjunction with an audit engagement. The authors believe it is common in many smaller audit engagements for auditors to also provide nonattest services, such as tax or information return preparation or bookkeeping services. The auditor may choose to document the understanding with the client about the performance of nonattest services in the checklist at NPO-CX-1.2, "Engagement Independence Compliance and Nonattest Services Documentation Form."

202.44 Certain activities performed as part of a nonattest service are considered to be management responsibilities and, therefore, impair independence regardless of whether the auditor complies with the other requirements of ET 1.295. In addition, if an auditor assumes a management responsibility for an attest client, the management participation threat created would be so significant that no safeguards could reduce the threat to an acceptable level. ET 1.295 identifies common nonattest service activities and provides guidance on considerations as to whether they are or are not considered to impair independence. ET 1.295.030 specifically states that performance of the following activities would be considered a management responsibility, and would therefore impair an auditor's independence (that is, they would preclude the auditor from being independent):

- Setting policies or strategic direction for the client.
- Directing or accepting responsibility for the actions of the client's employees, except to the extent permitted when using internal auditors.
- Exercising authority on behalf of a client, such as authorizing, executing, or consummating transactions, or having the authority to do so.
- Preparing source documents, in electronic or other form, that evidence the occurrence of a transaction.
- Having custody of client assets.
- Deciding which of the auditor's or other third parties's recommendations to implement or prioritize.
- Reporting to those charged with governance on behalf of management.
- Serving as a client's general counsel, or its equivalent.
- Accepting responsibility for the management of a client's project.
- Accepting responsibility for the preparation and fair presentation of the client's financial statements.
- Accepting responsibility for designing, implementing, or maintaining internal controls.
- Performing ongoing evaluations of the client's internal control as part of its monitoring activities.

202.45 Exhibit 2-4 provides a table that lists various types of nonattest services an auditor may perform and addresses the impact of those services on the auditor's independence.

⁷ PPC's 990 Deskbook provides an illustration of a separate detailed engagement letter for tax return preparation services.