

Lecture
5

Ch. 11 - Ethics & Terms of Audit Engagements

(5)	Audit Quality (SQC 1 & SA 220)
	❖ SQC 1 and SA 220 both deal with quality control. SQC 1 deals with all engagements (Audits, reviews, other assurance & related service engagements) at Firm Level; SA 220 applies to audit of F.S. at Engagement Level.
(6)	SQC 1 “Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”
	Purpose of SQC
	Firm should establish a system of QC designed to provide it with reasonable assurance that:
	(a) firm and its personnel comply with professional standards ; regulatory and legal Requirements; and
	(b) reports issued by firm or engagement partner(s) are appropriate .
	Elements of a System of Quality Control
	(a) Leadership responsibilities for quality within the firm.
	(b) Ethical requirements including independence.
	(c) Acceptance and continuance of client relationships and specific engagements.
	(d) Human resources.
	(e) Engagement performance.
	(f) Monitoring.
	Note: QC Policies & procedures should be documented & communicated to Firm’s Personnel.
	Leadership responsibilities for quality within the firm
	❖ Firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential.
	❖ Firm’s CEO or managing partners shall assume ultimate responsibility for firm’s system of QC.

	Ethical requirements
❖	Firm should establish policies and procedures designed to provide it with reasonable assurance that firm and its personnel comply with relevant ethical requirements.
❖	Code establishes fundamental principles of professional ethics, which include:
	(a) Integrity; (d) Confidentiality; and
	(b) Objectivity; (e) Professional behaviour.
	(c) Professional competence and due care;
	Policies and Procedures w.r.t. Independence
❖	Firm should establish policies and procedures designed to provide it with reasonable assurance that firm & its personnel maintain independence.
❖	Such policies and procedures should enable the firm to:
	(a) Communicate its independence requirements to its personnel.
	(b) Identify & evaluate circumstances & relationships that create threats to independence, and
	(c) to take appropriate action to eliminate those threats
	or
	reduce them to an acceptable level by applying safeguards
	or
	if considered appropriate, to withdraw from the engagement.
❖	All breaches of independence should be promptly notified to firm for appropriate action.
❖	At least annually, firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.
	Acceptance and Continuance of Client Relationships and Specific Engagements
❖	A firm before accepting an engagement should acquire vital information about the Client to decide:
	(a) Integrity of Client, promoters and key managerial personnel.
	(b) Competence (including capabilities, time & resources) to perform engagement.
	(c) Compliance with ethical requirements.

❖	If there is any conflict of interest between firm and client, it should be properly resolved before accepting engagement.
❖	Where firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, firm should consider:
	(a) professional & legal responsibilities to report to persons who made appointment or to regulatory authorities; and
	(b) possibility of withdrawing from engagement.

Considerations as to integrity of clients

With regard to the integrity of a client, matters that firm considers include, for example:

1. **Identity and business reputation** of the client's principal owners, key management, related parties and those charged with its governance.
2. **Nature of the client's operations**, including its business practices.
3. Information concerning **attitude of client's principal owners, key mngt. & TCWG** towards such matters as aggressive interpretation of ASs and IC environment.
4. Whether client is aggressively concerned with **maintaining firm's fees as low as possible**.
5. Indications of an **inappropriate limitation** in the scope of work.
6. Indications that client might be involved in **money laundering or criminal activities**.
7. **Reasons for proposed appointment** of firm and non-reappointment of previous firm.

Human resources

- | | |
|---|--|
| ❖ | Firm should establish policies & procedures designed to provide it with reasonable assurance that it has sufficient personnel with capabilities, competence and commitment to ethical principles necessary to perform its engagements in accordance with professional standards & regulatory & legal requirements, and to enable firm or EP(s) to issue reports that are appropriate. |
| ❖ | Such policies and procedures address following personnel issues: |
| | (a) Recruitment; |
| | (b) Performance evaluation; |
| | (c) Capabilities; |
| | (d) Competence; |
| | (e) Career development; |
| | (f) Promotion; |
| | (g) Compensation; and |
| | (h) Estimation of personnel needs. |

	Engagement Performance
	(a) Consultation
	<ul style="list-style-type: none"> • Consultation should take place in difficult matters & includes discussion with individuals within or outside firm who have specialized expertise. • Firm need to consult externally (for example, a firm without appropriate internal Resources) may take advantage of advisory services provided by other firms or professional & regulatory bodies.
	(b) Engagement Quality Control Review (EQCR)
	<ul style="list-style-type: none"> • Significant judgments should be reviewed by EQC reviewer for taking objective view before the report is issued. • Extent of review depends on complexity of engagement & risk that report might not be appropriate. Review does not reduce responsibilities of the EP. • EQCR is mandatory for all audits of F.S. of listed entities.
	(c) Differences of opinion
	<ul style="list-style-type: none"> • Difference of opinion may be within ET, with those consulted & between EP & EQC reviewer. Report should only be issued after resolution of such differences. • In case, recommendations of EQC reviewer are not accepted by EP & matter is not resolved to reviewer's satisfaction, matter should be resolved by consulting with another practitioner or firm, or a professional or regulatory body.
	(d) Engagement documentation
	<ul style="list-style-type: none"> • Firm should establish policies & procedures for assembly of final engagement files on timely basis after reports have been finalized. Engagement files should be completed in not more than 60 days after date of auditor's report. • Establish policies & procedures designed to maintain confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. • Unless otherwise specified by L & R, documentation is property of firm. Firm may, at its discretion, make portions of, or extracts from, documentation available to clients, provided such disclosure does not undermine validity of work performed or independence of firm or its personnel. • Documentation has to be retained for a sufficient period of time. In specific case of audit engagements, retention period ordinarily is no shorter than 7 years from date of auditor's report.

	Monitoring
	<ul style="list-style-type: none"> Firm should establish policies and procedures designed to provide it with reasonable assurance that <i>policies & procedures relating to system of QC are relevant, adequate, operating effectively and complied with in practice.</i> Such policies & procedures should include <i>ongoing consideration</i> & evaluation of firm's system of QC, including a periodic inspection of selection of completed engagements.
(7)	SA 220 "Quality Control for an Audit of Financial Statements"
	Objectives of auditor
	To <i>implement QC procedures at engagement level</i> that provide auditor with reasonable assurance that:
	(a) <i>Audit complies with professional standards & regulatory & legal requirements;</i> &
	(b) <i>Auditor's report issued is appropriate in the circumstances.</i>
	Responsibilities of EP
	SA 220 is modelled on lines of SQC 1. It describes responsibilities of EP in relation to following matters:
	(a) <i>Leadership responsibilities for quality on audits</i>
	(b) <i>Relevant ethical requirements</i>
	(c) <i>Acceptance and continuance of client relationships and audit engagements</i>
	(d) <i>Assignment of engagement teams</i>
	(e) <i>Engagement performance</i>
	(f) <i>Monitoring</i>
	Leadership Responsibilities for Quality on Audits
	EP shall take responsibility for overall quality on each audit engagement to which that partner is assigned and should emphasize following to the engagement Team (ET):
	➤ <i>Compliance with professional Standards and legal requirements.</i>
	➤ <i>Compliance with firm's QC Policies & procedures.</i>
	➤ <i>Issuance of appropriate audit report.</i>
	➤ <i>Ability to raise concerns without fear.</i>
	➤ <i>Quality is essential & indispensable in engagement performance.</i>

	Meaning of Engagement partner
	<i>Partner or other person in firm who is a member of ICAI & is in full time practice & is responsible for engagement & its performance, & for report that is issued on behalf of firm, and who, has appropriate authority from a professional, legal or regulatory body.</i>
	Relevant Ethical requirements
	<i>EP is responsible for identifying a threat to independence that safeguards may not be able to eliminate or reduce to an acceptable level.</i>
	Acceptance and Continuance of Client Relationship & Audit Engagement
	❖ <i>Firm should obtain such information as it considers necessary</i>
	<i>(a) before accepting an engagement with a new client,</i>
	<i>(b) when deciding whether to continue an existing engagement, &</i>
	<i>(c) when considering acceptance of a new engagement with an existing client.</i>
	❖ <i>Be satisfied that appropriate procedures regarding acceptance & continuance of client relationships & audit engagements have been followed, and determine that conclusions reached in this regard are appropriate.</i>
	❖ <i>If EP obtains information that would have caused firm to decline audit engagement had that information been available earlier, EP shall communicate that information promptly to the firm, so that firm and the EP can take necessary action.</i>
	Examples of Information which may cause firm to withdraw
	<i>(a) Integrity of principal owners, key management and TCWG;</i>
	<i>(b) Competency of ET to perform audit engagement and availability of necessary capabilities, including time and resources;</i>
	<i>(c) Compliance with relevant ethical requirements by firm and ET; and</i>
	<i>(d) Significant matters that have arisen during current or previous audit engagement, and their implications for continuing relationship.</i>
	Assignment of engagement teams
	<i>EP should ensure that ET and auditor's experts who are not part of ET, have appropriate competence & capabilities to perform engagement in accordance with professional standards & regulatory and legal requirements.</i>

	Engagement Performance
	EP has the responsibility for the following:
	(a) Direction, supervision & performance of audit engagement.
	(b) Auditor's report being appropriate.
	(c) Review of audit documentation before issue of audit report.
	(d) Ensuring that SAAE has been obtained to support the conclusions reached.
	(e) Undertaking appropriate consultation on difficult matters.
	Engagement Quality Control Review (EQCR)
	For audits of F.S. of listed entities, EP shall:
	(a) Determine that EQC reviewer has been appointed.
	(b) Discuss significant matters arising during the audit engagement.
	(c) Not date the auditor's report until completion of EQCR.
	Differences of opinion
	If differences of opinion arise within ET, with those consulted or between EP & EQC reviewer, follow firm's policies & procedures to dealing with & resolving differences of opinion.
	Monitoring
	Effective system of QC includes a monitoring process designed to provide firm with reasonable assurance that its policies & procedures relating to QC system are relevant, adequate, and operating effectively.
	Documentation
	EP should document following matters pertaining to an audit engagement:
	❖ Issues identified w.r.t. compliance with relevant ethical requirements & how they were resolved.
	❖ Conclusions on compliance with applicable independence requirements.
	❖ Conclusions reached regarding acceptance & continuance of client relationships.
	❖ Nature and scope of, and conclusions resulting from, consultations undertaken.
	DO PRACTICE - Questions from Cracker (Question Bank)