

ethics while performing their duties. Service users of professionals should be able to feel secure that there exists a framework of professional ethics which governs the provision of those services.

It is in this spirit of things that the Institute of Chartered Accountants of India (ICAI) requires its members to comply with the principles of ethics while performing their duties. The ethics for Chartered Accountants have, therefore, been codified as ethical compliance has always been a philosophy of the profession. Chartered accountants, whether in practice or in service, are required to comply with the provisions of Code of Ethics.

Any deviation from the ethical responsibilities brings the disciplinary mechanism into action against the Chartered Accountants which may result into fines, suspension of membership, removal from membership or other disciplinary actions.

3. PRINCIPLES BASED APPROACH VS RULES BASED APPROACH TO ETHICS (ETHICAL OR LEGAL)

Ethical guidance may follow principles-based approach or rules-based approach.

* The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions.

* However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules-based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

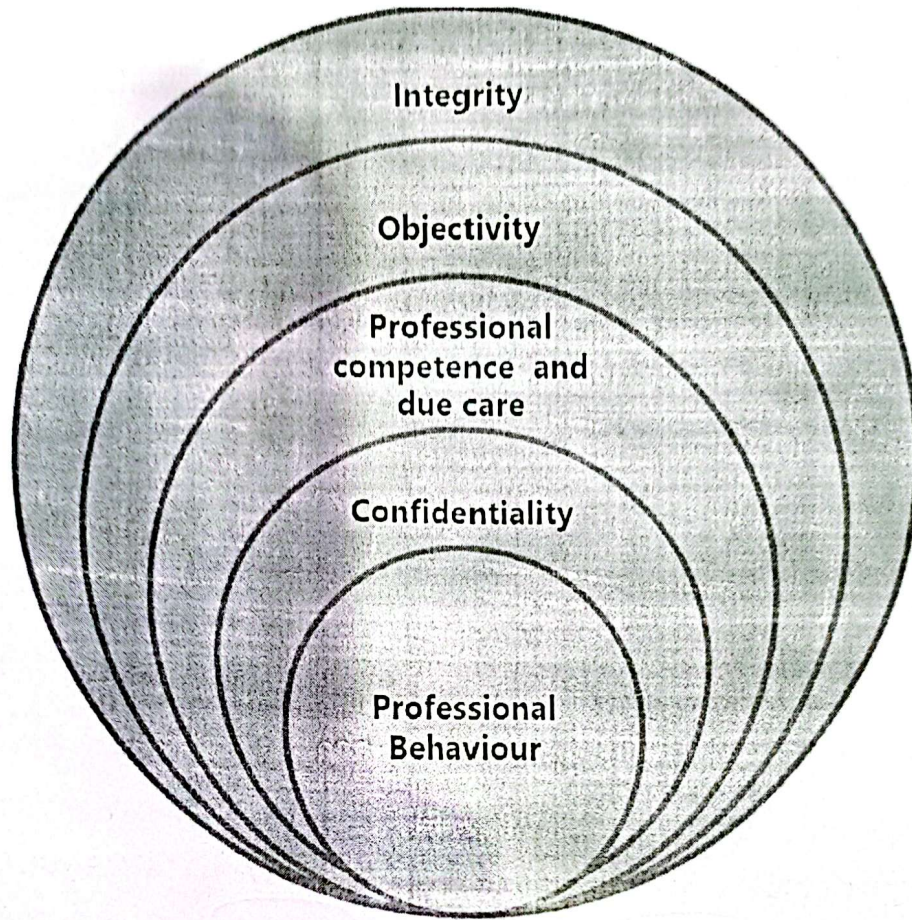
Therefore, it is necessary that spirit of code is followed.

4. FUNDAMENTAL PRINCIPLES OF PROFESSIONAL ETHICS

The fundamental principles of ethics establish the standard of behaviour expected

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of a professional accountant. A professional accountant shall comply with each of the fundamental principles. The fundamental principles of professional ethics are as under: -



1. integrity [इमनप्रर]

A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. [Integrity implies fair dealing and truthfulness]

A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information contains a (materially) false or misleading statement; contains statements or information provided negligently or omits or obscures required information where such omission or obscurity would be misleading.

2. Objectivity [अपनी राय न बदले]

The principle of objectivity requires an auditor (not) to compromise professional judgment because of bias, conflict of interest or undue influence of others.

1. MEANING OF ETHICS – A STATE OF MIND

The term "Ethics" means moral principles which govern a person's behaviour or his conducting of an activity. It is the branch of knowledge that deals with moral principles. Ethics is something which comes from an individual intrinsically. It has to be inculcated in the habit and temperament of an individual, so that there is an overall culture of ethics; the force has to be strong enough to withstand any selfish motive or temptation. It is a state of mind to act and perform in accordance with moral principles. Ethics is the science of morals in human conduct. Such moral principles and rules of conduct impose obligations upon individuals.

2. NEED FOR PROFESSIONAL ETHICS

Professions like law, medicine have their code of ethics. Auditing profession is no exception. Rather, in the profession of auditing, requirement of ethics is manifold. It is due to the reason that society in general, governments, clients, taxing authorities, employees, investors, the business and financial community in particular, have reposed tremendous trust in services rendered by Chartered Accountants.

The purpose of assurance engagements is to enhance confidence of the intended users. Therefore, users need to trust the person who is providing such services.

Professional ethics are based on morality. Human nature being what it is, a man, often, places his personal gain above service. Therefore, persons who as individuals and as a class, are willing to place public good above their personal gain have enjoyed respect and honour. But such a relationship can be maintained or enhanced only if the professional body to which they belong would interpret the concept of public interest as broadly as possible. The respect and confidence enjoyed by a profession, to a great extent, is dependent on the strictness and scrupulousness with which such ethics are adhered to by self-discipline.

A distinguishing feature of the accountancy profession is its acceptance of the responsibility to act in the public interest. Professional ethics seek to protect the interests of the profession as a whole and act as a shield that enables us to command respect.

A Chartered Accountant, either in practice or in service, has to abide by ethical behaviours. They are expected to follow the fundamental principles of professional

It requires that a professional accountant ^{Accept} (shall not) undertake a professional activity if a circumstance or relationship (unduly) influences the accountant's professional judgment regarding that activity.

3. Professional competence and due care

A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and act diligently and in accordance with applicable technical and professional standards.

✶ Diligence (includes) responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.

4. Confidentiality

Confidentiality principle requires a professional accountant to respect the (confidentiality) of information acquired as a result of professional or business relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the information will not be disclosed to a third party.

However, such confidential information (may) be disclosed, for example, when it is required by (law) when it is permitted by (law) and is authorised by the client or employer or there is a professional duty or right to disclose when not prohibited by law. → चर्चा & Disclose only

5. Professional Behaviour

It requires an accountant to (comply) with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

Test Your Understanding 1

CA P. Suryakantam has conducted audit of accounts of an entity for a particular year. ICAI has issued a letter to him relating to certain matters concerning audit. He didn't even bother to reply to the letter despite reminders. Discuss which fundamental principle governing professional ethics is disregarded by him. [Professional Behaviour]

Test Your Understanding 2

A Chartered accountant in practice issued a certificate showing original cost of plant and machinery installed in premises of a client for Rs. 9 crores to save some regulatory fees for his client. However, original cost of plant and machinery was Rs.15 crore as per records of client. Which fundamental principle governing professional ethics is violated in this case? → Integrity

5. INDEPENDENCE OF AUDITORS

Professional integrity and independence are essential characteristics of all the professions but are more so in the case of accountancy profession. Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him, or to his own self-interest.

It is not possible to define "independence" precisely. Rules of professional conduct dealing with independence are framed primarily with a certain objective. The rules, by themselves, cannot create or ensure the existence of independence.

→ Independence is a (condition) of mind as well as personal character and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law. These legal standards may be relaxed or strengthened but the quality of independence remains unaltered.

There are two interlinked perspectives of independence of auditors, one, independence of mind and two, independence in appearance.

Independence is:

- (a) **Independence of mind** – the (state) of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

- (b) **Independence in appearance** – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons. The relationship between the auditor and his client should be such that firstly, he is himself satisfied about his independence and secondly, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances, there is likely to be an abridgement of the auditors' independence.

Independence of an auditor assumes significance in context of providing confidence to users of financial statements. As statutory auditor of a listed company, for example, the Chartered Accountant would cease to perform any useful function if the persons who rely upon the accounts of the company do not have any faith in the independence and integrity of the Chartered Accountant. In such cases, he is expected to be objective in his approach, fearless, and capable of expressing an honest opinion based upon the performance of work such as his training and experience enables him to do so.

Independence is dependent on the state of mind and character of a person and is a very subjective matter. One person might be independent in a particular set of circumstances, while another person might feel he is not independent in similar circumstances. It is therefore the duty of every Chartered Accountant to determine for himself whether or not he can act independently in the given circumstances of a case and quite apart from legal rules, in no case to place himself in a position which would compromise his independence.

6. THREATS TO INDEPENDENCE

Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist requiring the application of different safeguards.

Following five types of threats to independence of auditors are discussed below: -

1. Self-interest threats [जहाँ पैसों की बात आये]

Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include

- (i) direct financial interest or materially significant indirect financial interest in a client
- (ii) loan or guarantee to or from the concerned client
- (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement
- (iv) close business relationship with an audit client
- (v) potential employment with the client and [सबसे ज्यादा fees वाला]
- (vi) contingent fees for the audit engagement

2. Self-review threats

Self-review threats occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. (Non audit services) include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service etc. Instances where such threats come into play are: -

- (i) when an auditor having recently been a director or senior officer of the company.
- (ii) when auditors perform services that are themselves subject matters of audit.

3. Advocacy threats

Advocacy threats occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g., when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. In such situations, auditor can be perceived

as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively.

4. Familiarity threats

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways including:

- (i) close relative of the audit team working in a senior position in the client company
- (ii) former partner of the audit firm being a director or senior employee of the client
- (iii) long association between specific auditors and their specific client counterparts and
- (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.

IMP Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats. Such provisions prescribe that auditor is rotated after a certain number of years so that auditors do not become too familiar with their clients.

5. Intimidation threats

[जी भी बीग वी करे]

डराना

Intimidation threats occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation. Such threats attempt to intimidate auditors to deter them from acting objectively.



7. SAFEGUARDS TO INDEPENDENCE

Chartered Accountants have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to address the threats.

Safeguards are actions, individually or in combination, that the professional

accountant takes that effectively reduce threats to comply with the fundamental principles to an acceptable level.

SafeGuard
To Independence

To address the issue, the following guiding principles are to be applied: -

1. For the public to have confidence in the quality of audit, it is essential that auditors should always be and appear to be independent of the entities that they are auditing.
2. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence. *इमानदारी*
3. When such threats exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. All such safeguards measures need to be recorded in a form that can serve as evidence of compliance with due process. *जोड़ देना*
4. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work. *सच्ची*

8. PROFESSIONAL SKEPTICISM

Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. *IMP*

It signifies that auditor has to remain alert forever. The auditor's attitude should be of questioning mind- of challenging the things in light of available evidence.

The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.

Professional skepticism includes being alert to, for example:

1. Audit evidence that contradicts other audit evidence obtained.
2. Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. *[Same challan No in No. of Invoices]*
3. Conditions that may indicate possible fraud.
4. Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:

- 1 Overlooking unusual circumstances.
- 2 Over generalising when drawing conclusions from audit observations.
- 3 Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Professional skepticism is necessary to the critical assessment of audit evidence. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary.

Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

IMP
अपमान
The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. अपमान
अपमान
Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism. सुकर

Test Your Understanding 3

CA Raman Gupta is offered appointment as auditor of a company. One of his distant uncles held some shares in the same company. Holding of such shares, by a distant relative, is not prohibited under provisions of law nor does it affect his independence. Before he could accept appointment, he received unfortunate news of death of his uncle who had died without any children. He came to know that he was nominee of these shares having substantial value. It landed him in a tricky situation. What should be proper course of action for him? Yes

Test Your Understanding 4

A Chartered accountant receives about 40% of his total audit fees from a single client. Discuss how it could affect independence of Chartered accountant as auditor of this client. What are such types of threats referred to as? Self Interest

Test Your Understanding 5

CA Murli Madhavan provides accounting and book keeping services to a leading NGO engaged in environmental protection work. He is also offered audit of the accounts of NGO. Identify and discuss what kind of threat to independence may be involved in accepting such an engagement. Self Review

Test Your Understanding 6

The auditors of a company have only relied upon management representation letter regarding treatment of certain tax matters under appeal by the company. The auditors have not carried out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditors in such a situation? → Professional Skepticism

AUDIT ENGAGEMENT AND TERMS OF AUDIT ENGAGEMENT

An audit engagement involves engaging an auditor by a client for audit of its financial statements. Audit engagement terms can include matters such as objective and scope of audit of financial statements, responsibilities of auditor, responsibilities of management, identification of applicable financial reporting framework for preparation of financial statements and reference to expected form and contents of report to be issued by auditor.

9. AGREEING THE TERMS OF AUDIT ENGAGEMENTS

SA 210 deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those

charged with *governance*, are present.

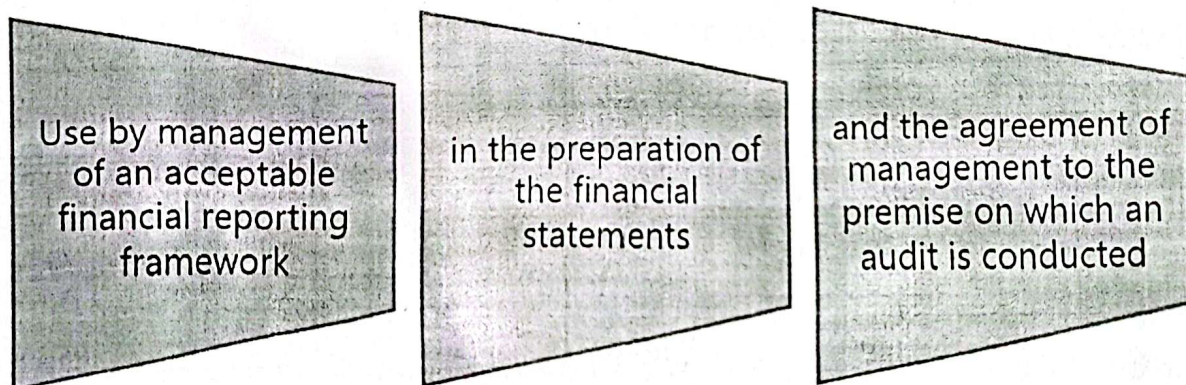
The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- (A) Establishing whether the preconditions for an audit are present and
- (B) Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

9A Preconditions for an audit

As per SA 210 "Agreeing the Terms of Audit Engagements", preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

Preconditions for an audit



In order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) **Determine whether the financial reporting framework is acceptable** and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) **For the preparation of the financial statements in accordance with the applicable financial reporting framework including where relevant their fair representation;**

- (ii) For such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (iii) To provide the auditor with:
 - Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

9B. Agreement on audit engagement terms

Except in the cases where it is required under law to get accounts audited (for example in case of companies), audit is a matter of contract between auditor and client. It is, therefore, important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.

The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit *engagement letter* or other suitable form of written agreement.

The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. Such a letter includes:-

- (a) The objective and scope of the audit of the financial statements
- (b) The responsibilities of the auditor
- (c) The responsibilities of management
- (d) Identification of the applicable financial reporting framework for the preparation of the financial statements and

- (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

If law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

10. EXAMPLE OF AN ENGAGEMENT LETTER

Given below is example of an engagement letter: -

PJ Shrimali & Co.

24, MG Road,

Chartered Accountants

Mumbai

10th August XXXX

To the Board of Directors of Pristine Products Limited

The objective and scope of the audit

You have requested that we audit the financial statements of Pristine Products Limited, which comprise the Balance Sheet as at March 31st, 20XX, the Statement of Profit & Loss, Cash Flow Statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Standards on Auditing (SAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

11. WHAT HAPPENS IF PRECONDITIONS FOR AN AUDIT ARE NOT PRESENT?

If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement: -

- (a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- (b) If the agreement of management is not obtained on matters relating to understanding of responsibility of management, on preparation of financial statements, internal controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.

12. LIMITATION ON SCOPE PRIOR TO AUDIT ENGAGEMENT ACCEPTANCE

If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

13. ACCEPTANCE OF A CHANGE IN THE TERMS OF THE AUDIT ENGAGEMENT

The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

13.1 Request from Entity to change the Terms of Audit Engagement-When Reasonable Justification Exists?

A request from the entity for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the

① service, a misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement.

② A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.

In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion. [Mgt. इच्छा है कहे] → opinion न है

③ 13.2 What should auditor consider before agreeing to change the audit engagement to the engagement providing lower level of assurance? Audit से → Review में जाना

If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

Imp Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may also need to assess any legal or contractual implications of the change.

If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement. However, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

- Imp
- The original audit engagement or
 - Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an

engagement to undertake [agreed-upon procedure] and thus reference to the procedures performed is a normal part of the report.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement. [क्या लिखे पास]

13.3 Recourse available to auditor in situation of non-agreement to a change in terms of engagement and lack of permission from management to continue original audit engagement

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

- Withdraw from the audit engagement where possible under applicable law or regulation and
- Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

14. TERMS OF ENGAGEMENT IN RECURRING AUDITS

Recurring audit is an audit which is performed by an auditor over years. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.

- (iii) A recent change of senior management.
- (iv) A significant change in ownership.
- (v) A significant change in nature or size of the entity's business.
- (vi) A change in legal or regulatory requirements.
- (vii) A change in the financial reporting framework adopted in the preparation of the financial statements.
- (viii) A change in other reporting requirements.

Test Your Understanding 7

Chirag, as part of articled training, is part of an engagement team conducting audit of a company. He has read somewhere that engagement letter issued by auditor to client also includes expected form and content of the auditor's report. He was at a loss to understand how could an auditor include form and content of the report beforehand. Try to help Chirag by making things clear to him.

Test Your Understanding 8

The management of an entity feels that it is not necessary for it to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. Discuss, whether, it is necessary for the management to do so. In case management refuses, why should an auditor not accept the proposed engagement?

15. AUDIT QUALITY

The purpose of an independent audit is to provide confidence to users of audited financial statements. Therefore, high audit quality is essential to maintain confidence in the independent assurance provided by the auditors. It is the responsibility of auditor to maintain high audit quality.

SQC 1 and SA 220 both deal with quality control. [Whereas SQC 1 deals with all engagements including audits, reviews and other assurance and related service engagements.] [SA 220 applies to audit engagements only.]

Further, SQC 1 applies to entire firm. However, SA 220 applies to a particular audit engagement.

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16. SQC 1 – “QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS”

SQC 1 requires that the firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and that reports issued by the firm or engagement partners are appropriate in the circumstances. Firm's system of quality control should consist of policies designed to achieve these objectives.

↓ ये सभी policies है

17. ELEMENTS OF SYSTEM OF QUALITY CONTROL [for firm]

The firm's system of quality control should include policies and procedures addressing each of the following elements: -

H E MALE

- (A) Leadership responsibilities for quality within the firm
- (B) Ethical requirements
- (C) Acceptance and continuance of client relationships and specific engagements
- (D) Human resources
- (E) Engagement performance
- (F) Monitoring

Imp Quality control policies and procedures should be documented and communicated to the firm's personnel. By communicating, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

Elements of a System of Quality Control: The firm's system of quality control should include policies and procedures addressing each of the following elements:



17A. Leadership responsibilities for quality within the firm

- ① SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

17B. Ethical requirements

The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI.

The Code establishes the fundamental principles of professional ethics which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

Observance of "Independence" in all engagements is the basic requirement. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and (including experts contracted by the firm and network firm personnel) maintain independence where required by the Code. Such policies and procedures should enable the firm to: -

- (a) Communicate its independence requirements to its personnel
- (b) Identify and evaluate circumstances and relationships that create threats to independence, and 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.

There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.

EN At least annually, the 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. *↓ still*

17C. Acceptance and Continuance of Client Relationships and Specific Engagements [client लेना चाहिए की नहीं]

A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about: -

- Integrity of Client
- Competence (including capabilities, time and resources) to perform engagement
- Compliance with ethical requirements

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding

whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

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

- 1 The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- 2 The nature of the client's operations, including its business practices.
- 3 Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- 4 Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- 5 Indications of an inappropriate limitation in the scope of work.
- b Indications that the client might be involved in money laundering or other criminal activities.
- 7 The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. [Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:

- (a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
- (b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

17D. Human resources

The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances. Such policies and procedures should address relevant HR issues including recruitment, compensation, training, career development, performance evaluation etc. There should be emphasis on the continuing professional development of firm's personnel.

17E. Engagement Performance

Firm

Consistency in quality of engagement performance is achieved through briefing of engagement teams of their objectives, processes for complying with engagement standards, processes of engagement supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.

↳ कर्म उभरी है।
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 Consultation should take place in difficult or contentious matters pertaining to an engagement. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.

↳ A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies.

बाह्य से सहायता ले सकते हैं।

↳ Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued. The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.

* Engagement quality control review is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.

EP की Responsibility कम नहीं होती

- * There might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer. The report should only be issued after resolution of such differences. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter (should be) resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.
- * Besides, the firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. The assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements and in other cases within the limits appropriate to engagements.
- * Policies and procedures should be designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.
- * Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.
- * Engagement documentation has to be retained for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.
- * In the specific case of audit engagements, the retention period ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

17F. Monitoring

The firm should ensure that policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

18. SA 220- "QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS" *FS of Audit of Acc*

Based upon quality control system of firm, quality control policies pertaining to audit engagements are decided by engagement teams. Engagement partner of a team is responsible for quality control procedures of a particular audit engagement in accordance with SA 220.

Therefore, SA 220 is premised on the basis that the firm is subject to SQC 1. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

As per SA 220, the objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that: -

- (a) The audit complies with professional standards and regulatory and legal requirements and
- (b) The auditor's report issued is appropriate in the circumstances.

SA 220 is modelled on lines of SQC 1. It describes responsibilities of engagement partner in relation to following matters: -

- (A) Leadership responsibilities for quality on audits
- (B) Relevant ethical requirements
- (C) Acceptance and continuance of client relationships and audit engagements
- (D) Assignment of engagement teams
- (E) Engagement performance
- (F) Monitoring

18A. Leadership responsibilities for quality on audits

Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner

and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise

- (a) The importance to audit quality of: -
- (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals.
- (b) The fact that quality is essential in performing audit engagements.

18B. Relevant ethical requirements

The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under: -

- 1 Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.
- 2 Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

18C. Acceptance and Continuance of Client Relationships and audit Engagements

The responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC 1 which requires the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

Information like integrity of principal owners, competence of engagement team and consideration of necessary capabilities including time and resources, compliance with relevant ethical requirements and significant matters arisen during

current or previous audit engagement and their implications assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate.

18D. Assignment of engagement teams

It should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirements.

18E. Engagement Performance

Auditor

Engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements. He is responsible for auditor's report being appropriate in circumstances. Further, review of audit documentation before issue of audit report is his responsibility. It has to be ensured that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for issuance of auditor's report.

JMP Engagement partner is also responsible for ensuring undertaking appropriate consultation on difficult or contentious matters by engagement team (not only within the team but also with others at appropriate level within or outside the firm.

For audits of financial statements of listed entities and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall: EP की Responsibility है

- Determine that an engagement quality control reviewer has been appointed.
- Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
- Not date the auditor's report until the completion of the engagement quality control review.
 ↓ EP Audit Report की Date नहीं देगा

If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

18F. Monitoring

An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement.

The engagement partner should document following matters pertaining to an audit engagement: -

- (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- (b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- (c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- (d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

Test Your Understanding 9

CA PK Nair is offered appointment as auditor of a company engaged in providing tourism services. While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits. It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him?