

ETHICS AND TERMS OF AUDIT ENGAGEMENTS

Meaning of Ethics

The term Ethics means moral principles which govern a person's behaviour or his conducting of an activity

Needs for Professional Ethics

- 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 ethics while performing their duties
- 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

Principles based approach v/s Rules based approach to Ethics [Ethical (or) Legal]

- The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics
- Rules-based approach to ethics strictly follows clearly established rules it may lead to a narrow outlook & spirit of ethics may be overlooked while strictly adhering to rules further rules-based approach is somewhat rigid

Fundamental Principles of Professional Ethics

- > Integrity
- > Objectivity
- > professional competence & due care
- > Confidentiality
- > professional behaviour

Independence of Auditor

(a). independence of mind

Allowing an individual to act with integrity & exercise objectivity & professional skepticism

(b). independence in appearance.

A member of the assurance team's integrity, objectivity or professional skepticism had been compromised

Threats to independence

Types

I. Self - interest threats

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

II. 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

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

Familiarity threats

Familiarity threats are self-evident & occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests

Intimidation threats

Intimidation threats occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism

Safeguards to independence

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

- * He must not accept the work
- * An auditor must conscientiously consider whether it involves threats
- * It is essential that auditors should always be & appear to be independent
- * 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 levels

Professional Skepticism

It refers to an attitude that includes a questioning mind being alert to conditions which may indicate possible misstatement due to error (or) fraud & a critical assessment of audit evidence

Professional Skepticism includes being alert to for example

- * Audit evidence that contradicts other audit evidence obtained
- * Information that brings into question the reliability of documents
- * Conditions that may indicate possible fraud
- * Circumstances that suggest the need for audit procedures

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

- * Overlooking unusual unusual circumstances
- * Over generalising when drawing conclusions
- * Using inappropriate assumption

Agreeing the terms of audit Engagements

SA - 210 deals with the auditor's responsibilities

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

- b). Obtain the agreement of management
- i For the preparation of the financial statements
 - ii For such internal control as mgt considers necessary
 - iii To provide the auditor with

- > Access to all information
- > Additional information
- > Unrestricted access to persons within the entity

9B. Agreement on audit engagement terms

Such a letter includes

- a. The Objective & Scope of the audit of the financial statement
- b. The responsibilities of the auditor
- c. The responsibilities of management
- d. Identification of the applicable financial reporting framework
- e. Reference to the expected form & content of any reports to be issued

12. Limitation on scope prior to audit engagement acceptance

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 change in circumstances affecting the need for the 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

13.2

What should auditor consider before agreeing to change the audit engagement to the engagement providing lower level of assurance.

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.

In order to avoid confusing the reader, the report on the related service should not include reference to

(a) The original audit engagement

(b) Any procedures that may have been performed in the original audit engagement, except engagement to undertake agreed-upon procedures

13.3

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

a) Withdraw from the audit engagement

b). Determine whether there is any obligation, either contractual or otherwise.

14. Terms of Engagement in recurring Audits.

Following factors may make it appropriate to revise the terms of the audit engagement

- Any indication that the entity misunderstands the objective & scope of the audit
- Any revised or special terms of the audit engagement
- A recent change of senior mgmt
- A significant change in ownership
- A significant change in nature or size of the entity's business
- A change in legal or regulatory requirement
- A change in the financial reporting framework adopted in the preparation of the FS
- A change in other reporting requirements

15. Audit Quality

SQC 1 & SA 220 both deals with quality control

16. SQC - 1

Quality control for firms that perform audits & Reviews of historical financial info & other assurance & related Services Engagements

17. Elements of System of Quality Control

- > Ethical requirements
- > Human resources
- > Monitoring

- > Engagement Performance
- > Leadership responsibilities for quality within the firm
- > Acceptance & continuance of client relationship & specific engagement

A Leadership responsibilities for quality within the firm

Such policies & procedures should require the firm's chief Executive Officer or the firm's managing partner to assume ultimate responsibility for the firm's system of quality control

B Ethical requirements

Such policies & procedures should enable the firm to

- a) Communicate its independence requirements to its personnel
- b) Identify & evaluate circumstances & relationships that create threats
- c) There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagement
- d) At least annually, the firm should obtain written confirmation of compliance

Acceptance & continuance of client relationship & specific engagements

Such an information should help firm to decide about

- Integrity of client
- Compliance with ethical requirements
- Competence to perform engagement

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

- > The identity & his reputation
- > The nature of the clients operations
- > Information concerning the attitude of the clients principal owners
- > Aggressively concerned with maintaining the firms fees as low as possible
- > Indications of an inappropriate limitation in the scope of work
- > Indications that the client might be involved in money laundering
- > The reasons for the proposed appointment

policies & procedures on the continuance of the Engagement

- > The professional & legal responsibilities that apply to the circumstances
- > The possibility of withdrawing from the Engagement

17D

Human Resources

Recruitment, compensation, training, career development, performance Evaluation etc...

17E

Engagement Performance

- * Consistency in quality of engagement performance is briefing, complying, supervision & training, methods of reviewing performance of work, appropriate documentation
- * Consultation should take place in difficult (or) contentious matters

- * Significant judgments made in an engagement should be reviewed by an engagement quality control review.
- * Engagement quality control review is mandatory for all audits of financial statement of listed entities.

17F. Monitoring

Policies & procedures relating to the system of quality control are relevant.

18 SA - 220

Quality control for an audit of financial statement

18A Leadership responsibilities for quality on audits

a) The importance to audit quality of

- * Performing work that complies with professional standards

- * complying with the firm's quality control policies & procedures

- * Issuing auditor's reports

- * 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

- Identifying a threat to independence regarding the audit engagement

- Reporting by engagement partner to the relevant persons within the firm

18C

Acceptance & continuance of client Relationships & audit Engagement

The responsibility of an Engagement partner in this regard in an audit engagement is on lines of SQC 1

18D

Assignment of Engagement teams

Collectively have the appropriate competence & capabilities

18E

Engagement Performance

For audit of financial Statements of listed entities, & those other audit Engagement, if any for which the firm has determined that an engagement quality control review is required, the Engagement partner shall:

- determine that an engagement quality control reviewer has been appointed
- discuss significant matters arising during the audit engagement
- Not date the auditor's report until the completion of the engagement quality control review

18F

Monitoring

The Engagement partner should document following matters

- Conclusions on compliance with independence requirements
- Conclusions reached regarding the acceptance & continuance
- Issues identified with respect to compliance with relevant ethical requirements
- The nature & scope of and conclusions resulting from consultation