

# Chapter-11 Ethics & Terms of Audit Engagement (8-10 marks)

Topics to cover

- i). Ethics
  - ii). Independence
  - iii). Professional Skepticism
  - iv). SA 210
  - v). SQC-1
  - vi). SA 220
- } MCQ + App Based Question

Saksham Jain

C ⇒  
P ⇒  
I ⇒  
P ⇒  
O ⇒

# Ethics

## \* Meaning

- Moral values that Professional Accountant to follow (PA)
- Comes from Intrinsicly

## \* Fundamental Principles of ethics

### i). Integrity

- PA should be - straightforward ] in all his Bus Dealings
  - truthful
  - Honesty
  - Fair Dealing
- PA should NOT be associated with any info, returns that is (NO-Material)
- a). Negligently Prepared
- b). Omit or Obscures vital info in a way that could mislead.
- c). Contain materially false or misleading info.

### ii). Professional competence & Due Care

- PA should [ Attain & Maintain ] → [ Skills & Knowledge ] Required to ensure client or employer Receives Competent Professional Services  
↓  
Based on Current Technical & Professional Standards & Relevant legislation

- PA should act Diligently  
↓  
Responsibility to Act - Carefully  
- Thoroughly  
- Timely Basis → as per requirement of Assignment

### Example

- Failing to update client about New Law & Regulation

### iii). Confidentiality

- It req. P.A. to Protect Confidentiality of Info

↓  
obtained through professional or Bus. Relations.

- It helps in Free Flow of Info

↓  
B/w PA or client/employer

} with assurance of no leakage of info to 3rd parties.

- specific circumstances where Disclosure of Info is Permitted

i). Disclosure is Mandated By LAW

ii). Disclosure is Permitted By law & Authorised by client/employer.

iii). When Professional Duty to Disclose exists, provided not prohibited by law.

### iv). Objectivity

- Principle requires "Professional Judgement" should not be compromised because of - Bias (B C & I)  
- conflict of interest  
- Undue Influence of Others

- Example

i). Receiving gift, hospitality from client

ii). Auditor sister working as Director in client Business.

### v). Professional Behaviour

- PA to comply with LAWS & REGULATIONS

+  
Avoid Conduct Bringing Discredit to Profession.

- PA not to engage in Any Activity that

- Impair integrity, objectivity or reputation of profession
- Is <sup>not</sup> compatible with fundamental principles.

- Example :- i) Failure to Reply to ICAI Notice

ii). Previous Auditor ignoring NOC req. of New Auditor

## \* Principal Based vs Rule Based Approach to ethics

- ↓
  - Require PA to apply Professional Judgement
  - Focuses on Adhering to spirit of ethics.

- ↓
  - often Rigid
  - can Result in Narrow outlook, where spirit of ethics may be overlooked.
  - Strict compliance with Defined Rules.

Saksham Jain



# Professional Skepticism

- Refers to
  - attitude includes Questioning Mind
  - Alert to condition indicating Possible Misstatement (error or fraud)
  - Critical Assessment of audit evidence

\* Professional skepticism Being alert to, eg

- Audit evidence that contradict other Audit evidence
- Condition indicating Possible Fraud
- Circumstances requiring need for Audit Procedure, in addition to those required by SA.
- Info that Brings into Question Reliability of Documents & Responses to inquiries to be used as Audit Evidence.

\* Maintaining Professional skepticism throughout audit is necessary to REDUCE RISK OF [Inappropriate Over<sup>2</sup>]

- i). Overlooking Unusual Transaction
- ii). Overgeneralising Conclusion from Audit Observation
- iii). Using Inappropriate Assumptions in Determining  
N - Nature } of Audit Procedures & evaluating results thereof.  
T - Timing }  
E - Extent }

\* Auditor's Duties

- Assess Reliability of info used as Audit evidence
- Investigate further if Doubt about Reliability of info
- Modify Procedures if required

\* NOTE → Trust in Mgmt Honesty Does not eliminate need for professional skepticism

# Independence

## \* Meaning

Implies judgement of Person is not subordinate

↓  
To wishes or Direction of Another Person, who might have engaged him or to his own self interest

## \* Interlinked Perspective of Independence

i). Independence by Appearance

- Avoiding any facts & circumstances that made 3rd party to believe, engagement team

↓  
Reasonably well informed party

- I → Integrity  
- P → Professional Skepticism  
- D → Objectivity

} Has Been compromised

ii). Independence of Mind

- State of mind, allowing individual to act with

- Integrity
- Exercise objectivity
- Professional Skepticism

without being affected by influences that compromise "Professional Judgement"

## \* Threat to Independence

a). Intimidation Threat

- When auditor are Discouraged from Acting "Objectively"  
+  
Maintaining "Professional Skepticism"

- Examples

i). Threat of Replacement over Disagreement

ii). Threat of litigation

b). Advocacy Shares

- Arise when auditor promote or perceived to promote 'client Position' to extent that it compromise auditor objectivity.

## - Examples

- i). Dealing in shares / securities of client.
- ii). Acting as Advocate for client in litigation.

## c). Familiarity Threat

- They are self evident & occur when

↓  
Auditor form relationship with client

↓  
ending being too sympathetic about client interest

## - Example

- i). Receiving gift, hospitality from client.
- ii). Close relative of audit team working in senior position in client company
- (\*) iii). Former Partner of audit team being Director of client company.
- iv). long association b/w auditor & client.

Note:- Rotation of Auditor is a safeguard measure against familiarity threat.

## D) Self interest Threat

- Occur when 

Auditing firm, Partner, Associate	→ could benefit from financial interest
	↓
	in an audit client.

## - Examples

- (\*) i). Potential employment with client
- ii). Contingent Fees for audit engagement
- iii). Undue Dependence on client Buz eg. 40% Fees from single client
- iv). Direct Financial Interest or Materially Significant indirect Financial interest in client
- v). loan or Guarantee to / from, client.
- vi). close Buz Relationship with audit client.

## E). Self Review Threat

Occur when

Case-i) → When Team member was previously Director or senior employee of company.

Case-ii) → When Auditor Review Judgement or conclusions, made in prior audit or non audit engagement

Example of Non-Audit Services

- Management consultancy, Internal Audit, Investment Advisory.

— x — x — x —

## \* Safeguard against Threat to Independence

→ For Public confidence in Quality of Audit

↓  
Auditor should always be independent + appears to be independent

→ Before taking any work :- auditor must conscientiously consider whether it involves threat to independence.

→ When such threat exists, auditor should

i). Either Desist from task

or

ii). Eliminate Threat

or

iii). at very least, put in place safeguards which reduce threat to an acceptable level.

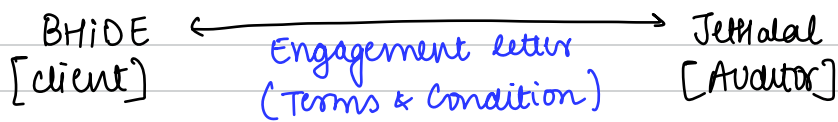
→ All such safeguard need to be "DOCUMENTED"

→ If auditor is unable to fully implement credible & adequate safeguards

↓

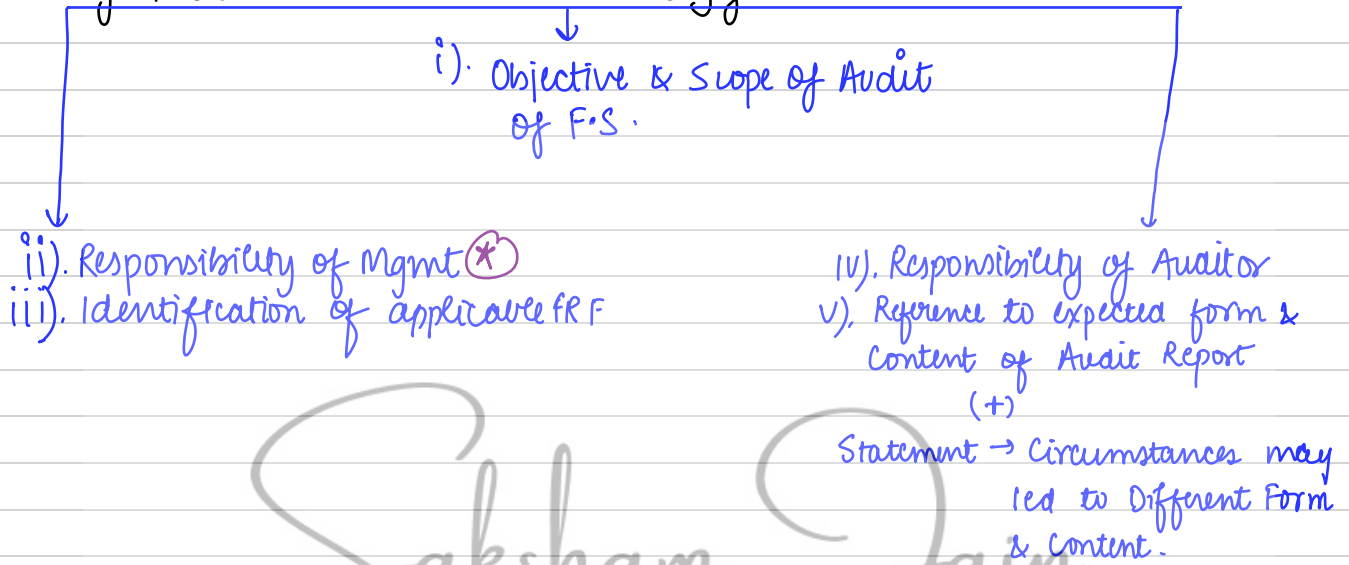
Auditor not to accept such work.

# SA-210 Agreeing terms of Audit Engagement



## \* Engagement letter

- Writing
- Issued to avoid misunderstanding
- Auditor sends E.L. to client [MCQ]
- Key Areas to be included in Engagement letter



Note - If Law or Regulation prescribe sufficient detail about terms of Audit engagement

↓  
Auditor need not record them in written agreement  
EXCEPT - Law & Regulation applies &  
- Mgmt acknowledge & understands its  
its responsibility

## - Responsibility of Management

i) Preparation & Presentation of F.S. as per applicable FRF

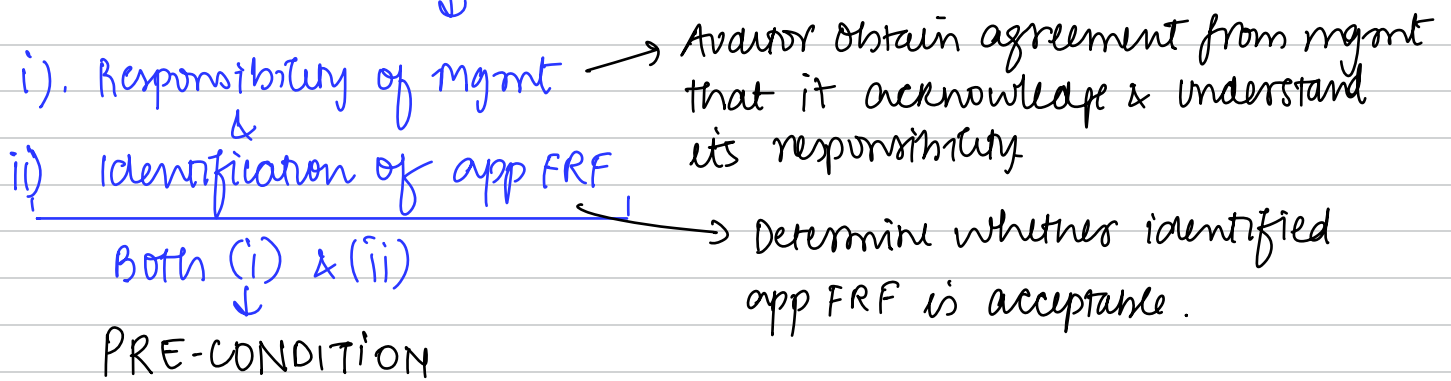
ii). Designing Internal Control necessary for P & P of F.S. as per app FRF

iii). Provide Auditor with

- Access to All Info, mgmt aware, necessary for P & P of F.S.
- Additional Info, auditor may req. → for purpose of audit.
- Unrestricted access to persons within entity, from which audit evidence will be obtained, as per auditor's.

- Identification of app FRF → who does? "Mgmt"

# CONNECT THE DOTS



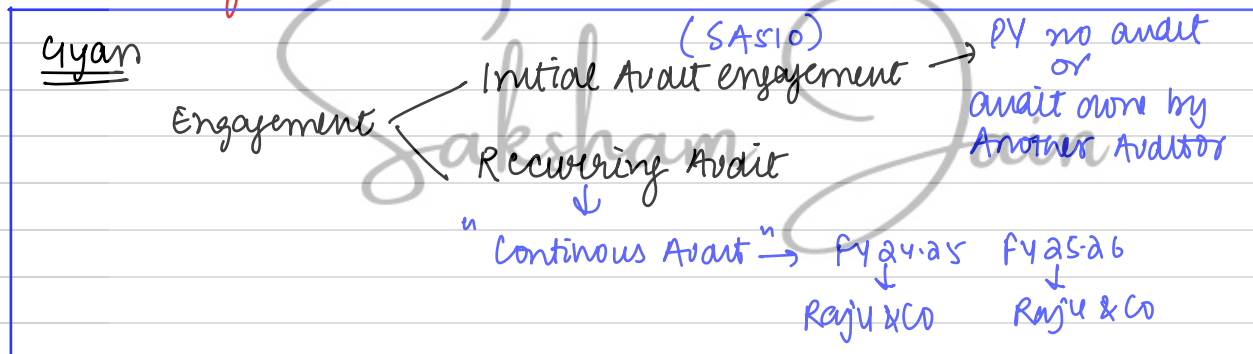
★ If Pre-condition not satisfied → Communicate with Mgmt & Discuss

↓

(Both cond. need to be satisfied)

→ Don't accept engagement unless req. by Law or Regulation.

## ★ Recurring Audit



☺ Auditor to send Engagement letter every year in case of Recurring Audit?

↓

- May not be sent every year.

- However, in following circumstances, appropriate to revise or remind existing terms.

- |  |  |  |
|--|--|--|
| ↓  | ↓                                      | ↓  |
| - Δ of Senior Mgmt                                   | - Δ in FRF                             | - Indication mgmt misunderstood objective & scope of Audit |
| - Significant Δ in Ownership                         | - Δ in legal or regulatory requirement | - Any revised or special terms of engagement               |
| - Significant Δ in Nature or Size of Bus. operations | - Δ in other reporting requirements    |  |



## \* Acceptance of change in terms of Audit Engagement

i). Req. from entity to change, When Reasonable Justification exists

case (a) - Change in Circumstances affecting needs for service.

case (b) - Misunderstanding as nature of audit as originally requested

case (c) - Restriction on Scope of Audit engagement, imposed by  
• mgmt or  
• other Circumstances.

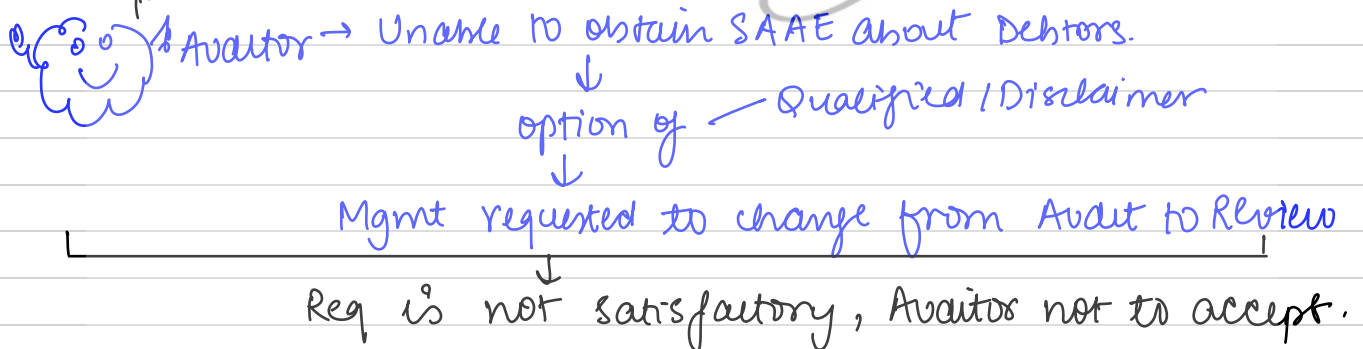
Case (A) & case (B) → Auditor may considered R.J.

Case (C) → Auditor particularly considered implication of restriction on scope of audit engagement.

Note -

Change may not to be considered reasonable if it appears that change relating to info is - Incorrect,  
- Incomplete,  
- Not Satisfactory.

Example



ii). Consideration before agreeing to change from Audit to Review or Related Services.

- Auditor to Determine whether Reasonable Justification exists.
- Before agreeing, Assess any legal or contractual implications.
- If R.J. exists, change may be accepted.

11/12/2025 — 30/12/2025 — 31/3/2026  
old engagement — Revised engagement

↓  
- old work if Relevant can be used

↓  
New work to Be Done as per revised engagement.

[New or Revised E.L.]

• Masala on Report of Related Services" → DONT CONFUSE USERS

AUDIT —————→ RELATED SERVICES



Report on Related Services would not include reference of  
a). Original Audit Procedures

OR

b). Any procedure performed in Original Audit engagement  
[EXCEPT → when shift is Audit to Agreed upon procedures]



Because Reference to procedure performed  
is a normal part.

iii). Non-Agreement to change in terms of engagement  
&  
lack of permission from mgmt to continue original  
audit engagement.

Auditor shall

- a). Withdraw from audit engagement
  - b). Determine whether there is any obligation either  
to report circumstances to  
Other parties such as - TCW or  
- Owners  
- Regulators
- └ Contractual or  
└ Legal

### \* Objective of SA 210

To accept or continue audit engagement when

- i). Pre-Conditions are satisfied
- ii). Confirm that there is common understanding b/w  
Auditor & Mgmt/TCW. , of terms of audit engagement

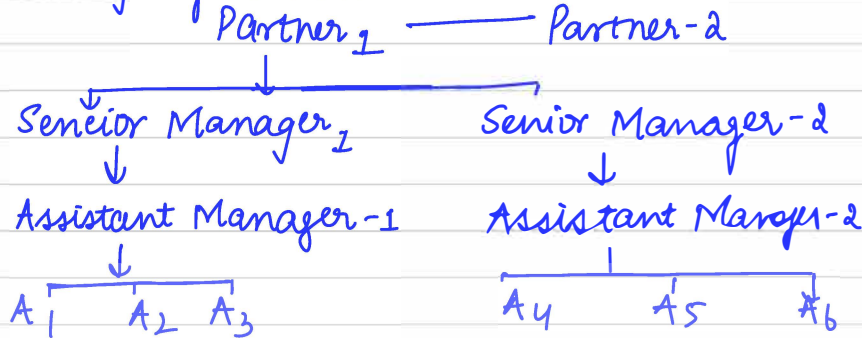


## SQC-1 Quality control for Firms that perform

- Audit ] Historical Financial Information
- Review ]
- Assurance
- Related services

Gyan

### Hierarchy of CA Firm



CA Firm - Resources

- Partner<sub>1</sub>
- Manager<sub>2</sub> (CA)
- Article 17

Three Assignment needs to be accepted

- Reliance Audit → ] whole team engaged
- Tata Review → ]
- HDFC Audit → Should HDFC Bank Audit be accepted?



→ Quality Focus

## Elements of System of Quality Control

(A). Acceptance & continuance of client relationship

- Before accepting, Firm should obtain vital info about client & evaluate
  - [ Integrity of client
  - [ Competence to perform [ capability, time, resources ]
  - [ Compliance with ethical requirements

• Matters to considered to evaluate integrity of client

- a). Indication of client involved in Money laundering, Illegal Activities
- b). Identity & Buy Reputation of Owners, TCWOr, Related Parties.
- c). Nature of client operations, including its Buy practises.

D). Info Concerning client attitude towards

- Aggressive Interpretation of A.S.
- Internal Control Environment

E). Indication of inappropriate limitation in Scope of work.

F). Reason for Proposed appointment of firm & Non-Appointment of previous auditor.

G). whether client aggressively maintaining firm's fees low as possible.

- If firm obtain info, if obtainable earlier, would have caused to decline engagement, Firm policy to consider -

- Professional & legal responsibility to Report to Person made appointment  
Regulators
- Possibility of withdrawing from engagement.

B) Ethical Requirements

Define Independence

Reference of 5 Fundamental Principles

Firms to establish Policy & Procedures

↳ Maintaining Independence

↳ Comply with Code of ethics.

- Communicate Independence Requirement to personnel.

- Identify threats to Independence.

- Applying Safeguards, eliminating threat or withdrawal from engagement.

Note → Annually, all personnel must give Written Confirmation about compliance with Firm's Policies.

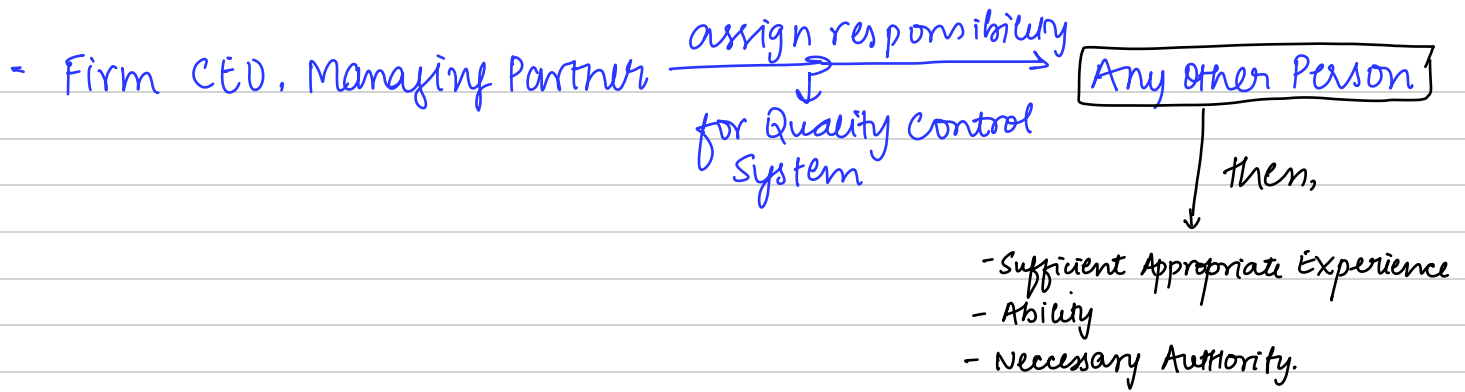
C). Leadership Responsibility for Quality within firm

- Firm to establish policy & procedures → to promote Internal culture

Recognised Quality Essence in performing engagement.

- CEO, Managing Partner → Ultimate Responsibility for Firm System of Quality Control.

Example set → Encourage Inner Culture that recognise High Quality of Firm.



### \* Human Resources

- Firm should establish P&P to ensure it has SUFFICIENT COMPETENT PERSONNEL which will
  - a). meet Professional, legal & Regulatory Requirements
  - b). Issue appropriate reports.
- Such P&P should address H.R issues like
  - Recruitment
  - Training
  - Performance Evaluation
  - Compensation
- Focus on Continuing Professional Development of Firm's Personnel.

### \* Monitoring

- To ensure Firm Policy & Procedures relating to Quality Control are
  - Relevant
  - Operating (ROLE)
  - Complied
  - effective.
- To Include ONGOING CONSIDERATION & EVALUATION of system of Quality Control, including periodic inspection of completed engagements.

### \* Engagement Performance

- Consistency in Quality  $\rightarrow$  achieved through Briefing of Engagement team
  - About Objectives
  - Process of complying with professional standards
  - Engagement Supervision & Training
  - Methods of Reviewing performance of work
  - Appropriate Documentation.
- Difficult matter  $\rightarrow$  Consult with expert  $\swarrow$  within or o/s entity.

## a). Engagement Quality control Reviewer

### "APPOINTMENT"

- Mandatory in listed entity
- May also appoint in other entities.



E.P. to

→ Determine EQCR has been appointed



EQCR

Engagement Partner

→ Discuss significant matters arising during engagement, including matters identified in EQCR

→ No Signing of Audit Report, until EQCR Review is completed.

'Note' - If Difference of opinion arise b/w EP & EQCR.

↓  
Discuss to Resolve

↓  
if not resolved, follow firm policy & procedure for dealing & resolving Difference of opinion.

## b). Documentation

- Timely completion of final engagement file : 60 days from Date of A.R.
- Retention for audit work : 7 years (atleast) from Date of Audit Report  
or  
Group Audit Report, if later.
- Ownership → Auditor

# SA 220 Quality Control for Audit of F.S.

SQC-1	SA 220
→ Applies to <ul style="list-style-type: none"><li>• audit</li><li>• review</li><li>• assurance</li><li>• Related</li></ul>	→ apply only to <ul style="list-style-type: none"><li>• Audit engagement</li></ul>
→ Apply at Firm level	→ Apply at engagement level
→ Responsibility of <ul style="list-style-type: none"><li>- Firm CEO</li><li>- Managing Partner</li></ul>	→ Responsibility of <ul style="list-style-type: none"><li>- Engagement Partner</li></ul>

Note - SA 220 is premised on Basis that firm is subject to SQC-1.

## \* Objective of SA 220

TO IMPLEMENT Quality Control Procedures  
at ENGAGEMENT LEVEL

- a). To ensure Audit Report complies with
- Professional Standard
  - Regulatory
  - legal Requirement

- b). To Issue appropriate report.

## \* Leadership Responsibility for Quality on Audit

- Engagement Partner to take ultimate responsibility for overall quality of audit.

- It emphasise

- a). Importance to Audit Quality of

- i). Objective-1 of SA 220
- ii). Objective-2 of SA 220
- iii). Complying with Firm Quality Control Policy & Procedures
- iv). Engagement team ability to Raise Concern without fear of reprisals.

- b). Fact that Quality is essential in performing audit engagements.

## Imp Note

\* For other elements, even if Question give ref of SA 220, write content of SQC-1.

\* Documentation as per SA 220 by Engagement Partner

- i). Issues Identified with respect to compliance with ethical requirement & How they were resolved.
- ii). Conclusion Reached Regarding Acceptance & Continuance of client relationship & engagement
- iii). Conclusions on compliance with Independence Requirements that apply to audit engagement.
- iv). Nature & Scope of, & Conclusions resulting from, Consultations During course of audit engagements.

Saksham Jain