

Final → Sec 1949.

Date	/ /	100 of 100
Page		100 of 100

SA 210.

## Ethics & Terms of Audit Engagements

meaning of ethics — A state of mind ☺

- ① 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.
- ② It is a state of mind to act & perform in accordance with moral principles. Ethics is the science of morals in human conduct.
- ③ Ethics is something which comes from an individual intrinsically. It has to be inculcated in the habit & temperament of individual.

Need for Professional ethics ☺

- ① Professions like law, medicine have their codes of ethics. In the profession of auditing, requirement of ethics is manifold.
- ② 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.
  - as it is <sup>किन्ना पत्रिका</sup> Sincerely & CAI <sup>अनु</sup>
  - <sup>अनु</sup> Auditor should follow <sup>अनु</sup> the
- ③ The respect & confidence enjoyed by a profession, to a great extent, is dependent on the strictness & scrupulousness with which such ethics are adhered to by self-discipline.
- ④ 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 & act as a shield that enables us to command respect & comply.
- ⑤ A CA, 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.
- ⑥ Service users of professionals should be able to feel secure that there exists a framework of professional ethics which governs the provision of those ethics.

\* ⑦ ICAI requires its members to comply with the principles of ethics while performing their duties.

⑧ Any deviation from the ethical responsibilities being the disciplinary mechanism into action against the CA's which may result into fines, suspension of membership or other disciplinary actions.

MCOs

Principles Based Approach vs Rules Based Approach to ethics  
(Ethical or legal) :-

Principles Based.	Rules Based
Principles Based Approach to ethics that requires compliance with <u>spirit of ethics</u> . It requires accounts to exercise <u>professional judgement</u> in every situation based upon their <u>professional knowledge</u> , <u>skill &amp; expertise</u> . It requires that accountant should use <u>professional judgement</u> to evaluate every situation to arrive at conclusion.	Rules Based Approach to ethics <u>strictly follows</u> clear established <u>rules</u> . It may lead to <u>narrow outlook</u> & <u>spirit of ethics</u> may be overlooked while strictly adhering to rules. It is somewhat <u>rigid</u> as it may not be possible to deal with every practical situation relying upon rules.

Compliance

Accountant shall comply as per spirit of ethics.

Accountant shall strictly follow the clearly defined rules.

use of judgement

Accountant shall act as per their professional judgement based on their professional knowledge, skill, expertise

No use of judgement

Flexibility

It is more flexible

It is rigid approach & will not be suitable for every practical situation

Scope

It provides a broader outlook.

It provides a narrow outlook as it ~~can~~ can overlook spirit of ethics while complying rules

NOV 19

Professional Skepticism

(a) Professional skepticism refers to an attitude that includes a "questioning mind", "being alert to conditions" which may indicate possible MS due to fraud or errors, and a "critical assessment" of AE obtained.

(b) Should remain alert forever. (while planning & performing audit)

(c) Challenging the evidence

(d) Auditor should remain alert in following situations :-

- (i) when AE are inconsistent i.e. they contradict with other AEs.
- (ii) Conditions that may indicate possible fraud.
- (iii) Info that brings into question - reliability of documents or responses to inquiries to be used as AE.
- (iv) Circumstances that suggest the need for AP in addition to those required by the SA's.

(e) Maintaining Professional skepticism throughout the audit is necessary if auditor wants to reduce the following risks :-

- (i) Overlooking Unusual Circumstances
- (ii) Overgeneralising when drawing conclusion from audit observation i.e. evidence.
- (iii) Using inappropriate assumptions while determining NTs of the AP of evaluating the results thereof.
- (iv) Auditor should not disregard the past experience of honesty & integrity of mgmt & TCWG. However, this experience does not relieve the auditor from the need to maintain Professional skepticism.

Examples

identity theft करपा रोज

assumption

ignore respect

Final  
+  
inter

May 24

Jan 21  
Q → GC

Jan 21

Date	/ /
Page	

## Fundamental Principles of Professional Ethics :-

ICAI code of ethics include following fundamental principles which should be complied with each professional accountants

do's  
&  
don'ts

### (a) Integrity :-

and by eg. auditor, reviewer, SRS, .... etc

(i) Professional accountant should be straightforward honest in all his professional business relationship & should be fair dealing & truthfulness.

(ii) Professional accountant should not be knowingly associated with such - reports, returns, communication or other info<sup>n</sup>.

• where the accountant believes that the info<sup>n</sup> contains a materially false / misleading statement / ~~error~~

• where the account believes that the info<sup>n</sup> provided with negligently / omits / obscures required info<sup>n</sup> ~~where~~ such omission / obscurity would be misleading.

### (b) Objectivity :-

quality

unbiased

(i) This principle requires that a professional accountant should not be compromise on his professional judgement because of bias, conflict of interest or undue influence.

(ii) If a professional accountant comes across any circumstances or relationship which can unduly influence his judgement then he should not accept such an engagement or withdraw if it is already accepted.

### (c) Confidentiality :-

secrecy

sept 24

(i) This principle requires a professional accountant should respect or maintain confidentiality of info<sup>n</sup> i.e. acquired as a result of professional or business relationship.

• This principle serves the public interest because it facilitates free flow of info<sup>n</sup> from client or employee to accountant with the understanding that info<sup>n</sup> will not be disclosed to 3rd party.

Branch  
Account

money laundering + black money.

negligently - intentionally ignore.

Date	/ /
Page	100 of 100

### Exception

(ii) However, such confidential info<sup>n</sup> may be disclosed :-

14.3(12)

- (a) when it is required by law or permitted by law or
- (b) authorised by the client / employer.

(d) Professional Competence & due care :-

(i) This principle requires the accountant to <sup>achieve</sup> attain & maintain professional knowledge & skills <sup>& experience</sup> at the level required to insure that a client or employing org<sup>n</sup> can receive a competent professional service. [Based on current technical, professional std, relevant legislation & diligently & in accordance with applicable technical & professional std].

Professional Competence

+

due care

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

(e) Professional Behaviour :-

(i) This principle requires an accountant to comply with relevant L&R avoid any conduct & activity that accountant knows or should know might discredit the profession.  
(Reputation Law for the ICAI).

(ii) A professional accountant shall not knowingly engaged in any employment / occupation / activity that may impair his integrity, objectivity, reputation of the profession.

-vely

Be ~~appear~~ to be independent  
meaning → two

Date / /  
Page  
dependent or influenced

### Independence

- Independence implies that 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.
- Independence depends upon <sup>state of</sup> mind & character of person.
- Rules cannot create or ensure independence.
- Independence is a condition of mind & personal character & it should not be confused with superficial & visible standards imposed by law.
- Independence is a subjective term. One person might be independent in some circumstances & other might not feel independent in similar circumstances.
- It is the duty of every CA to determine whether he can act independently in given circumstances (apart from legal rules)
- He should not place himself in a position which compromises his independence.

Independence can be interpreted using following two conditions (types) → Interlinked

#### (a) Independence of mind → <sup>स्वतंत्रता</sup> <sub>स्थिति</sub>

- It is the state of mind that allows the provision of an opinion without being affected by influences <sup>→ exposure</sup> which ~~compromises the professional judgement~~
- It shall ~~allowing an individual~~ <sup>allowing an individual</sup>

Therefore, ~~integrity~~ → able to act with integrity  
 if <sup>competence</sup> Professional <sup>integrity</sup> → Exercise objectivity & Professional skepticism → Right Question, Right time to the Right person  
 Then his state of mind can be assumed to be independent.



(b) Independence <sup>in</sup> Appearance <sup>3rd party</sup>  $\rightarrow$  test

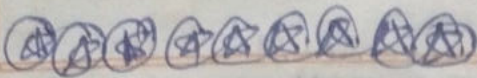
The avoidance of facts or circumstances that are so significant that a "reasonable & informed 3rd party", having knowledge of all relevant info" (including any safeguards applied) would reasonably conclude that a audit firm / member of audit team has compromised their integrity, objectivity & professional skepticism.

Jan 25  
Q2C

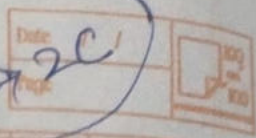
Safeguards <sup>controls</sup> to Independence  $\rightarrow$  By Auditor to reduce or eliminate threat

- safeguards are actions (IC's) either individually or in combination that an auditor can take to effectively reduce the impact of threats to comply with fundamental principles to an acceptable level.
- To address these issues following guiding principles should be applied by the audit firm:
  - ① Before accepting any work auditor must conscientiously consider whether it involves any threat to his independence. Because users will have confidence in audit quality, only if auditor should always be appears to be independent.
  - ② When such threat exists auditor should either refuse / avoid such task or eliminate the threat before accepting such task. Safeguards can be used to reduce the impact of threat to an acceptable level.
  - ③ If auditor is unable to fully implement credible & adequate safeguards then he must not accept such an engagement.
    - ② if he has already accepted the engagement then he must inform to TC or CF should withdraw.

Nov 20



Jan 25  
Q → 2C



Threats to Independence → 5 types :-

(a) Self Interest Threats :-

(i) ~~These threats will occur when an auditor's firm, its partner or associate could benefit from a financial interest in an audit client.~~ These threats will occur when an auditor's firm, its partner or associate could benefit from a financial interest in an audit client.

(ii) Examples :-

- direct financial interest or materially significant indirect financial interest in a client.
- loan or guarantee to or from the concerned client.
- Undue dependence on client's fees & ∴ concern about losing engagement.
- Close business relationship with an audit client.
- Potential employment with the client &
- Contingent fees for the audit engagement (Auditor's % of Profit)

(b)

Self Review Threats :-

make & check u. should be diff

(i) These threats will occur when auditor review an judgement which ~~are drawn by auditor himself~~ reached in a previous audit or non-audit engagement, when a member of the audit team was previously a director or senior employee of client.\*

eg. mgmt services, internal audit, investment advisory services etc. Includes any professional services provided to an entity by an auditor, other than audit or review of FS.

(ii) Instance where such threats comes into play :-

director → auditor

a) [when an auditor having recently been a director or senior offices of co]\* within period = 2 yrs responsible for books & records

b) when auditors perform services that are themselves subject matters of audit [eg - valuation report or ICG prepared by CA should not be audited by same CA]

(c) Advocacy Threats →

(Interpret)

- (i) ~~Adv~~ These threat occurs 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. objectivity  
judgement
- (ii) Auditor can be perceived as backing & championing causes of auditee client & it may lead to belief that auditor is not acting & working objectively. supporting

Examples

- when auditor deals with share/securities of audited co.
- Auditor becomes client's advocate in ~~the~~ litigation and 3rd party disputes.

(d) familiarity Threats → <sup>visible</sup>

(i) These are self-evident, & occur when auditors ~~form~~ <sup>form</sup> relationships with the client where they end up being too sympathetic to the client's interest.

(ii) This may occur in many ways: (Examples):

Present → Director  
future

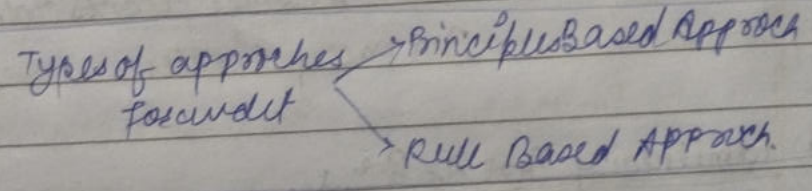
- Close relative of the audit team working in a senior position in the client co.
- former partner of the audit firm being a director or senior employee of the client.
- long association betw" specific auditors & their specific client counterparts &
- acceptance of significant gifts or hospitality from client Co, its directors or employees.
- Gifts from client.

(iii) Relation of auditor as per sec 139(2) mainly addresses these very familiarity threat.

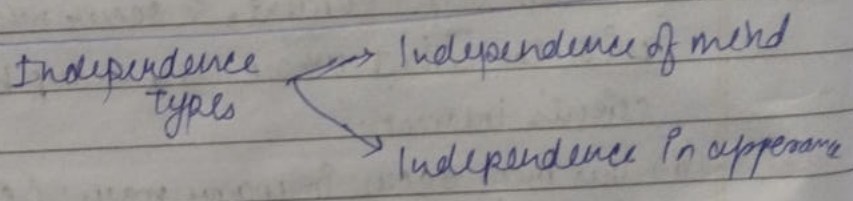
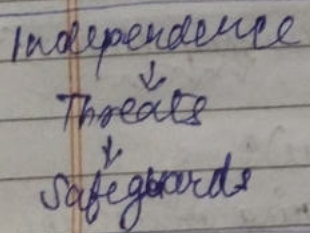
Gift

9. Intimidation Threats <sup>of estab</sup>
- (i) It occurs when auditors are deterred from acting objectively, with an adequate degree of professional skepticism.
  - (ii) These could happen because of threat of replacement over disagreement with the application of going policy or pressure to discontinue reduce work in response to reduced audit fees or being threatened with litigation.
  - (iii) Threats attempt to intimidate auditors to deter them from acting objectively.

SUMMARY



Professional Skepticism



Fundamental Principles of Professional Ethics

- ① Integrity
  - ② Objectivity
  - ③ Professional Competence (due care)
  - ④ Professional Behaviour
  - ⑤ Confidentiality
- +
- Independence

Threat to Independence types

- ① Self Interest threat
- ② Self Review threat
- ③ Advocacy threat
- ④ Familiarity threat
- ⑤ Intimidation threat