

WT 2 (Ch. 11 – Ethics and Terms of Audit Engagement)

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

- Q.1 (b) (2 Marks)
Q.2 (c) (2 Marks)
Q.3 (b) (1 Mark)
Q.4 (c) (1 Mark)
Q.5 (b) (1 Mark)

Part B (Descriptive Questions)

Q.1 (a) Statement is Incorrect.

- Integrity requires an auditor to be straight forward and honest in all professional and business relationships. It implies fair dealing and truthfulness.
- Confidentiality principle requires an auditor to respect the confidentiality of information acquired as a result of professional or business relationships. **(2 Marks)**

(b) Statement is Incorrect.

As per SA 210 “Agreeing the Terms of Audit Engagements”, the Audit engagement letter is sent by the auditor to his client. **(2 Marks)**

- Q.2 (a) (i) Self Interest Threats **(1 Mark)**
(ii) Self review Threats **(1 Mark)**
(b) (i) Professional Behaviour **(1 Mark)**
(ii) Integrity **(1 Mark)**
(c) **Elements of a System of Quality Control:**

As per SQC 1 “Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”, the firm’s system of quality control should include policies and procedures addressing each of the following elements:

- (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.

(0.5 Mark for each element)

Q.3 (a) **Information assisting auditor in accepting and continuing of relationship with the client:**

As per SA 220 “Quality Control for an Audit of F.S.” the information which assists the auditor in accepting and continuing of relationship with the client may include the following:

- (1) The **Integrity** of the principal owners, key management and TCWG of the entity;
- (2) **Competency of engagement team** to perform the audit engagement and availability of necessary capabilities, including time and resources;
- (3) Compliance with **relevant ethical requirements** by firm and the engagement team; and
- (4) **Significant matters** that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

(1 Mark for each Correct Point – 4 Marks)

(b) **Principles Based Approach Vs Rules Based Approach to Ethics:**

- Ethical guidance may follow principles-based approach or rules-based approach.
- 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. (1.5 Marks)

- 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.

Rules-based approach is somewhat **rigid as it may not be possible to deal with every practical situation** relying upon rules. (1.5 Marks)

Q.4 (a) **Preconditions for an Audit:**

As per SA 210 “Agreeing the terms of Audit Engagement” before accepting an audit engagement auditor is required to ensure existence of preconditions. Accordingly, preconditions to be examined are:

- (a) Determine whether the **FRF to be applied in the preparation of financial statements is acceptable**; and **(1 Mark)**
- (b) Obtain the agreement of **management that it acknowledges and understands its responsibilities** for followings: **(1 Mark for each correct Point – Any three)**
- (i) the preparation of the F.S. in accordance with the applicable FRF.
- (ii) exercising necessary internal control to enable the preparation of F.S. that are free from material misstatement, whether due to fraud or error.
- (iii) to provide the auditor with:
- (a) access to all relevant information such as records, documentation and other matters;
- (b) additional information that the auditor may request from management for the purpose of the audit; and
- (c) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

(b) **Safeguards to Independence:**

- When threats to independence exist, 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.** **(1 Mark)**
- Holding of shares involves financial interest in the company and is in nature of **self-interest threat.** He has come to hold shares due to nomination made by his distant relative before accepting the appointment. **(1 Mark)**

Conclusion: Considering above, **CA Raman should take steps to eliminate the threat by selling shares immediately before accepting appointment.** Holding of shares of the same company for which he is offered appointment as auditor constitutes threat to his independence. **(1 Mark)**



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