

## Chapter - 11 " Ethics and Terms of Audit Engagement "

- (3) Professional Skepticism: SA 200 defines the term professional skepticism as an attitude that includes a questioning mind,  
↓  
being alert to <sup>★</sup> conditions that may indicate possible misstatements, due to error or fraud  
↓ and, includes  
Critical assessment of audit evidences.

- ★ (a) Contradictory audit evidences;
- (b) Reliability of documents;
- (c) Conditions indicating possibility of fraud;
- (d) Circumstances suggesting need for additional audit procedures.

### Other Requirements:

- (i) Auditor shall plan and perform the audit with professional skepticism.
- (ii) Professional skepticism reduces risk of
  - (a) Overlooking Unusual circumstances;
  - (b) Overgeneralising when drawing conclusion;
  - (c) Using inappropriate assumptions in determining nature, timing and extent of audit procedures.
- (iii) Professional skepticism also includes consideration of sufficiency and appropriateness of audit evidences.

Note: A belief that Mngt. and TCWG (Those charged with Governance) are honest and have integrity, does not relieve auditor of need to maintain professional skepticism.

(4) SA-210 "Agreeing the Terms of Audit Engagement" :

At beginning of Audit

During the course of audit

(A) Initial Audit - Prior period f.s.  
 (a) unaudited; or  
 (b) Audited by predecessor auditor.

(B) Recurring Audit  
Prior period f.s.  
audited by same auditor

Mngt. request for changes in terms  
 ↓  
 Determine reasonable justification for change.

Ensure Existence of Preconditions  
 (Acceptable FRF + Mngt. responsibilities)

Exist

Not Exist

Accept the audit if no limitations imposed by Mngt.

Do not accept the audit.

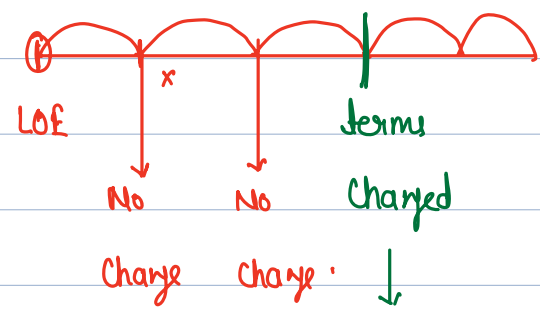
Issue Letter of Engagement to Mngt / TCWG and obtain a copy of acknowledgement.

Determine need to  
 (a) remind the terms to Mngt.  
 (b) revise the terms of Engagement.

If satisfied, make necessary changes in letter of engagement.  
 ↓  
 If not satisfied, refuse for changes.

↓ If yes  
 Issue Letter of Engagement in recurring audit

If Mngt. is not allowing to continue with original terms  
 ↓  
 withdraw from Engagement.



Issue new letter of engagement

(A) Objectives of Auditor: To accept or continue an audit engagement when the basis upon which audit is to be performed has been agreed with the client through:

- (a) Establishing the existence of pre-conditions for an audit; and
- (b) Common understanding of the terms between auditor and the client.

Imp Pre-conditions for an audit:

(a) Acceptable financial reporting framework.

It is based on following attributes - Relevance, Completeness, Reliability, Neutrality and Understandability.

(b) Acknowledgement by management of their responsibilities as to:

(i) Prep<sup>n</sup> of f.s. as per applicable FRF;

(ii) Selection and consistent application of accounting policies;

(iii) Making reasonable estimates and judgements;

(iv) Exercising necessary internal controls to enable the prep<sup>n</sup> of f.s. that are free from material misstatements.

(v) Providing the auditor with:

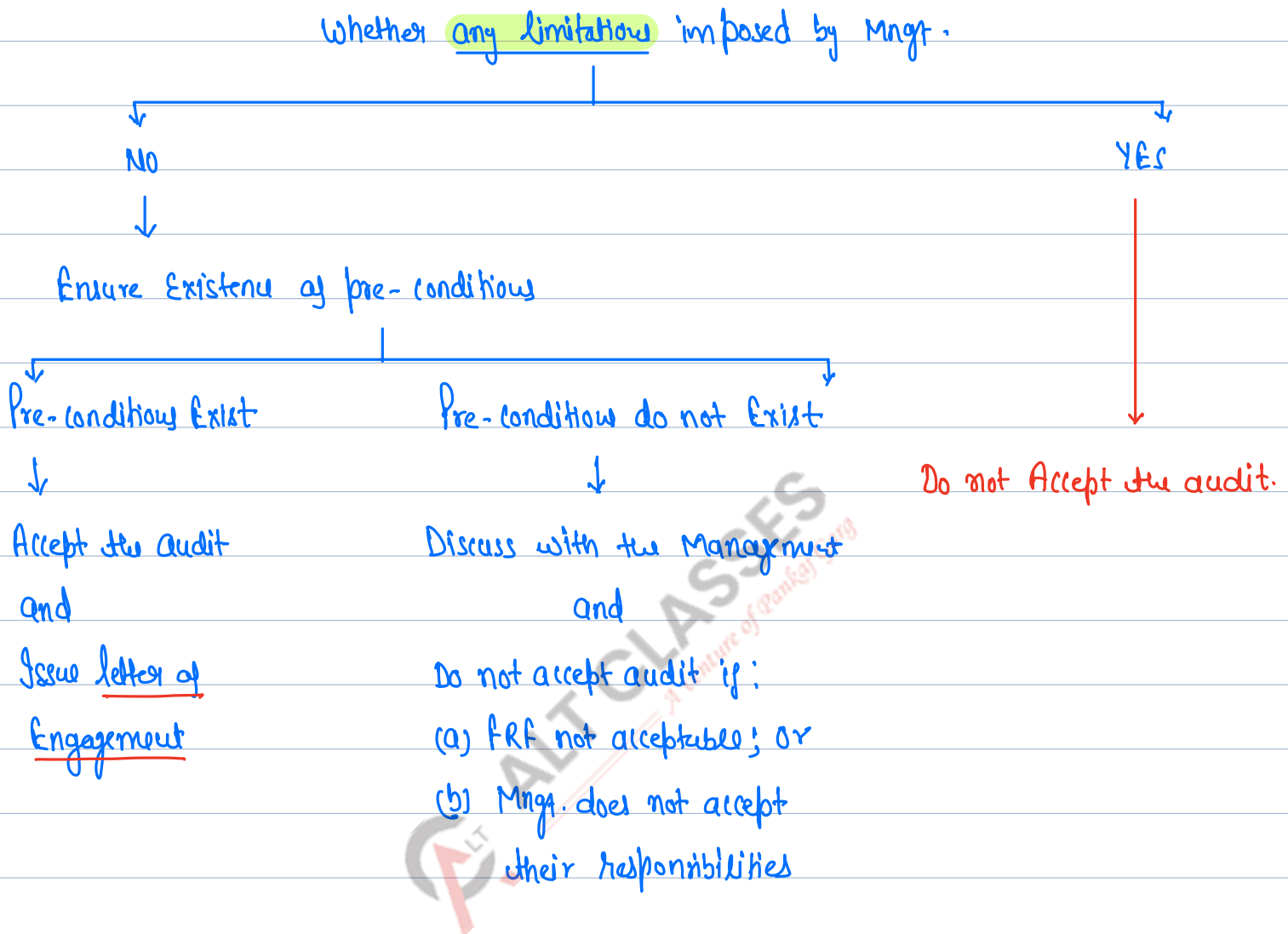
(a) All relevant information required for the purpose of audit.

(b) Additional information required; and

(c) Unrestricted access to the persons within the entity.

(B) Requirements of SA-210:

i) At beginning of audit in case of Initial Audit Engagement:



Letter of Engagement: A letter that signifies acceptance of audit and is sent by auditor to client and includes:

- ✓ (a) Objective and scope of audit of financial statements;
- ✓ (b) Responsibilities of auditor;
- ✓ (c) " " Management;
- ✓ (d) Identification of applicable FRF for prep<sup>n</sup> of f.s.; and
- ✓ (e) Reference to expected form and content of audit Report.

(ii) At beginning of audit in case of recurring audit:

Assess whether Circumstances <sup>\*</sup> requires (a) Revision of terms of audit Engagement

Or

(b) Reminding the Existing terms of audit Engagement

↓  
Requirement Exist

↓

Issue New letter of Engagement

Or

Record revised terms in letter of Engagement

↓  
Requirement does not Exist

↓

No need to issue any new letter of engagement.

Circumstances in which there exist requirement of issue of new letter of Engagement in case of recurring audit:

- (i) Any indication that entity misunderstand the objective and scope of audit engagement.
- (ii) Any revised or special terms of audit engagement.
- (iii) changes in Senior Management
- (iv) " " Ownership
- (v) " " Nature and size of Entity's business
- (vi) " " legal and regulatory requirements
- (vii) " " financial reporting framework
- (viii) " " Other reporting requirements.

(iii) Mngt. request for changes in terms of audit Engagement, during course of audit:

(A) Request for change in terms of audit Engagement

Auditor shall not agree to a change in terms of audit Engagement where there is no reasonable justification for doing so

If a request for change is not considered reasonable, Auditor should deny the Mngt. as to changes requested.

Note: A request is considered not reasonable, if it appears that the changes are related to information that is incomplete, incorrect or unsatisfactory.

Management is not permitting the Auditor to continue with the Original terms.

Auditor shall:

- Withdraw from Engagement; and
- Determine whether there is any obligation to report the circumstances to TCG, Owners or Regulatory authorities.

(B) Request for change to a Review of F.S. or Related Services - Compilation

Management request for changes that conveys a lower level of assurance or no assurance.

Auditor - Assess legal and contractual implications for the changes; and Determine reasonable justification for doing so.

Auditor satisfied with the Mngt. request for change of audit to review or related services.

Work performed till time - remains relevant work to be performed and report to be issued - as appropriate to revised engagement (Review / related service)

Note: In order to avoid confusion, report on revised engagement should not include reference to (a) Original Engagement; and (b) Procedures performed in audit Engagement.

Circumstances in which mngt. may request for changes in terms of audit Engagement:

- (a) Changes in Circumstances affecting the need for the service;
- (b) Misunderstanding as to nature of audit Engagement originally requested; or
- (c) Restriction on scope of audit engagement, whether imposed by mngt. or caused by circumstances.

Practice Questions - Q.13 to Q.23 + MCQ

