

## CHAPTER 1 - QUALITY CONTROL

### CHAPTER OVERVIEW – QUALITY CONTROL

#### ▣ Standards

- **SQC 1** – QC for firms (audits, reviews, assurance, related services)
- **SA 220** – QC for audit of FS (engagement level)

#### □ Case (Jagruti scenario)

- Firm: 7 partners, growing fast, new clients w/o background check
- Accepted audits of complex cos. w/o expertise
- No experienced staff hired → lapses
- Errors:
  - Report mentioned “profit” vs FS showing “loss”
  - Report mentioned “cash flow stmt” though FS didn’t have (small co.)
- Lacked **QC system** → regulatory risk
- Need: Proper QC to ensure compliance with standards & law

### 1 ▣ AUDIT QUALITY

- High audit quality = trust for stakeholders (industry, govt, public)
- Requires: rigorous audit process + QC procedures (laws, regs, stds)
- **SQC 1** – QC at firm level (all engagements)
- **SA 220** – QC at audit engagement level
- Support: Other SAs, ICAI Code of Ethics, Cos. Act, 2013
- Review bodies: **Peer Review Board, Quality Review Board, NFRA**

### 2 ▣ SQC 1 – QC for Firms

- Firm must establish QC system → **reasonable assurance**:
  - Compliance with stds, laws, regs
  - Reports issued appropriate in circumstances
- Applies to all firms (any constitution)

### 2.1 Elements of QC System

- (a) Leadership responsibility
- (b) Ethical reqs
- (c) Acceptance & continuance of clients/engagements
- (d) Human resources
- (e) Engagement performance
- (f) Monitoring

- Policies/procedures must be **documented & communicated**
- Personnel encouraged to give feedback

### 2.1.1 Leadership Responsibilities

- Internal culture: **quality essential**
- CEO/Managing Partner → **ultimate responsibility**
- Assigned personnel → **experience, ability, authority**
- Business strategy **subordinate to audit quality**
- Key points:
  - (a) Mgmt responsibilities → commercial factors not override quality
  - (b) Performance eval, compensation, promotion → show QC commitment
  - (c) Sufficient resources for QC policies, documentation, support

### ▣ TEST YOUR UNDERSTANDING 1

Case: **ABC & Associates**

- Policy: client acceptance based on risk eval (company + promoter)
- New client: **XYZ Ltd**
  - Promoter = close associate/family friend of Managing Partner
  - Under regulatory inquiries, previous auditor resigned
  - Offers 25% ↑ fees
- Risk: Independence threat, reputation risk, regulator scrutiny

- **Tone at the top:** Should uphold integrity, avoid commercial bias, ensure independence, follow client acceptance procedures

## 2.1.2 Ethical Requirements

**📌 Code of Ethics (ICAI)** → Integrity, Objectivity, Competence & Due care, Confidentiality, Professional behavior

- Firm policies → ensure compliance with ethics + independence
- Emphasis via: Leadership actions, Training, Awareness, Monitoring, Non-compliance process

### ☐ Independence

- Firm policies → ensure independence for all personnel, experts, network firm staff
- Must:
  - (a) Communicate independence reqs
  - (b) Identify & evaluate threats, apply safeguards/withdraw if req.
- Mechanism: Partners provide client info; personnel report threats; breaches promptly notified
- Annual **written confirmation** of independence compliance from all req. personnel

### 📌 Familiarity Threat

- Long use of same senior personnel may impair audit quality
- Safeguards: Rotate senior staff / EQCR
- **Listed entities:** Partner rotation ≤ 7 yrs (except sole practitioners)
- Mandatory **peer review** for sole practitioner audits of listed cos.

### ☐ Test Your Understanding 2

- **MNP & Co. – Sudhanshu** misused stock audit → promised clean report + lured client → **unethical**, independence breach, reflects weak QC system

## 2.1.3 Acceptance & Continuance of Client/Engagements

### ✳️ ☐ Pre-acceptance checks → Info on:

- Client/promoter **integrity**
- Firm competence/resources
- **Ethical compliance**

### ✳️ Integrity factors:

- Reputation of owners, mgmt, related parties, governance
- Nature of ops/business practices
- Attitude to accounting standards, IC environment
- Aggressive on fees
- Scope limitations
- Indications of ML/illegal activities
- Reason for appointment / prev. auditor resignation

### ✳️ Competence/resources:

- Industry knowledge, regulatory expertise
- Sufficient qualified personnel
- Access to experts
- Eligible EQCR reviewers
- Ability to meet reporting deadline

☐ **Conflict of Interest** → must be resolved before acceptance

### 📌 Continuance policies:

- If new adverse info arises → reassess/withdraw
- Withdrawal steps:
  - Discuss with client mgmt/governance
  - If withdraw → reasons documented + may report to regulators
  - Document significant issues, consultations, conclusions

### ☐ Test Your Understanding 3

- CA M prospective client → faced ED/IT searches (cash recovery, bogus gains)

- Factors before acceptance:
  - **Integrity of client** questionable
  - Possible legal/regulatory risks
  - Reputation risk
  - Compliance with ethical reqs
  - Firm competence/resources to handle case

#### 2.1.4 Human Resources

✘ □ Firm policies → ensure **sufficient personnel** with competence, capabilities, ethical commitment

- Covers: Recruitment, Training, Career dev., Perf. eval., CPD (continuing prof. dev.)
- Each engagement → assigned to **Engagement Partner (EP)**
- Requirements:
  - (a) EP identity/role communicated to mgmt/governance
  - (b) EP has competence, authority, time
  - (c) EP responsibilities clearly defined
- Perf. eval. of partners/team → focus on **quality commitment**

#### 2.1.5 Engagement Performance

✦ **Consistency** → Briefing teams, supervision, training, review of work, proper documentation

##### □ Consultation

- For **difficult/contentious matters** → consult internal/external experts
- Document issues + conclusions
- If no internal resources → use other firms/prof. bodies

##### ▣ EQCR (Engagement Quality Control Review)

- Indep. review of **significant judgments** before report issued
- Mandatory → **listed co. audits**
- Firm sets criteria for other cases
- EQCR covers: Independence eval., Risk assessment, Materiality judgments,

Misstatements, Matters to mgmt/govt, Work papers, Appropriateness of report

- Reviewer = Partner/qualified ICAI member/external person with authority & experience
- Reviewer must maintain **objectivity** (not involved in engagement decisions)
- If objectivity impaired → replace reviewer

##### □ Differences of Opinion

- Must resolve before report issued
- If unresolved → consult another practitioner/firm/regulator

##### ▣ Engagement Documentation

- Final files → completed ≤60 days after auditor's report
- Separate files if multiple reports on same subject matter
- Policies → ensure confidentiality, integrity, accessibility, retrievability
- Must document:
  - (a) EQCR procedures performed
  - (b) Review completed before report issued
  - (c) No unresolved matters left
- Retention: **≥7 yrs** from audit report (or group report, whichever later)
- Docs = property of firm (extracts may be shared without compromising independence)

#### 2.1.6 Monitoring

✘ □ Firm must ensure QC policies → relevant, adequate, effective, complied in practice

Key monitoring aspects:

- Design & implementation of QC system appropriate
- New laws/prof. stds reflected in policies
- Monitoring done by partner/person with sufficient experience & authority
- Complaints/allegations of non-compliance (internal/external) → investigated

- Remedial action vs. personnel violating QC policies
- Correct deficiencies in design/operation/non-compliance of QC system

## SA 220 – Quality Control for Audit of FS

- Based on **SQC 1** – Firm QC system → Engagement team relies unless contrary info
- **Objective** → Reasonable assurance that:
  - (a) Audit complies with **prof. stds + legal req.**
  - (b) **Auditor’s report appropriate**

## Engagement Partner Responsibilities

### 3.1 Leadership

- Overall **audit quality responsibility**
- Emphasis on:
  - (i) Work complies with stds & law
  - (ii) Follow firm QC policies
  - (iii) Appropriate auditor’s report
  - (iv) Team can raise concerns freely
- Quality = essential

### 3.2 Ethical Requirements

- Identify **independence threats** not reduced by safeguards
- Report threat → Firm mgmt → action: remove activity/interest or **withdraw**

### 3.3 Acceptance & Continuance

- Before accept/continue → obtain info:
  - **Integrity** of owners
  - **Team competence** + time/resources
  - **Ethical compliance**
  - Significant matters from prior/current audits
- Decide appropriateness of acceptance/continuance

### 3.4 Assignment of Teams

- Ensure **team + experts** → competence, capabilities, legal/prof. compliance

## 3.5 Engagement Performance

- EP responsible for **direction, supervision, performance**
- Ensure:
  - Report appropriate
  - Review docs before report issue
  - **Sufficient audit evidence** obtained
  - **Consultation** for contentious/difficult matters → internal/external

## 3.6 EQCR (Engagement Quality Control Review)

- Mandatory for **listed co. audits** + others decided by firm
- EP ensures:
  - (a) Reviewer appointed
  - (b) Discuss significant matters with reviewer
  - (c) Report not dated before review completed
- Reviewer evaluates:
  - Significant judgments, FS + report, audit docs, conclusions appropriateness
- For listed audits → reviewer also checks:
  - Independence evaluation
  - Proper consultations on differences/difficult matters
  - Docs reviewed support judgments & conclusions
- **Differences of Opinion** → follow firm’s policy for resolution

## Case – GVN & Associates

- Expert opinion from ICAI ≠ substitute for EQCR
- EQCR **still mandatory** for listed co. audits

## 3.7 Monitoring

- EP considers results of firm’s **QC monitoring process**
- Check if deficiencies affect audit engagement

## 3.8 Documentation

- EP must document:
  - (a) Ethical compliance issues + resolution
  - (b) Independence conclusions + firm discussions
  - (c) Acceptance/continuance conclusions
  - (d) Consultations – nature, scope, conclusions
- EQCR reviewer documents:
  - Firm policies on EQCR complied
  - Review completed before report date
  - No unresolved matters → judgments/conclusions appropriate

- Reporting “**generally regular**” in CARO = vague, not qualitative
- **Not in line with SA 220** (requires precise, appropriate reporting)

## ▣ SQC 1 vs SA 220 – Key Differences

### 1 □ Applicability

- **SQC 1** → Entire firm, responsibility with CEO/MP
- **SA 220** → Particular **audit engagement**, responsibility with **EP**

### 2 □ Scope

- **SQC 1** → Audits, reviews of historical FS, other assurance & related services
- **SA 220** → Audit engagements only

### 3 □ Nature

- **SQC 1** → QC system = firm-wide **policies & procedures**
- **SA 220** → EP ensures **team implements QC procedures** for audit

### 4 □ Objective

- **SQC 1** → Establish QC system → reasonable assurance firm complies with prof./legal stds, reports appropriate
- **SA 220** → Premised on SQC 1 → team implements QC in engagement context

## ▣ Mechanisms for Review of QC

### 5.1 Peer Review Board (ICAI)

- Ensures compliance with **tech., prof., ethical stds + regulatory req.**
- Examines systems/procedures of **Practice Unit (PU)**
- Issues:
  - **Peer Review Certificate** if unqualified
  - **Qualified report** → PU informed, follow-on review scheduled

### 5.2 Quality Review Board (QRB)

- Set up by **Central Govt + ICAI**
- Functions:
  - (a) Recommend to ICAI Council on quality of services
  - (b) Review members’ services incl. audits
  - (c) Guide members for improvement
- Audit quality review = **risk-based**
- Conducted by empanelled **technical reviewers**
- Covers entities **other than NFRA-specified cos.**

### 5.3 NFRA (Sec. 132, CA 2013)

- **Duties:**
  - Monitor/enforce compliance with **AS & SA**
  - Oversee quality of services
  - Suggest measures for improvement
- **Powers:**
  - Investigate auditors of **listed, insurance, banking, large cos. (Rule 3, NFRA Rules 2018)**
- **Listed co. audits** → NFRA jurisdiction
- QRB reviews audits of **non-NFRA cos.** or those referred by NFRA

□ Case – RST & Co.

## 💡 Key Takeaways

- **SQC 1** → Firm-wide QC system; applicable to audits, reviews, assurance, related services; applies to all firms
  - **Elements** → Leadership, Ethics, Acceptance/Continuance, HR competence, Perf., Monitoring
  - **Consultation** → Needed for contentious/difficult matters
  - **EQCR** → Mandatory for **listed entities**; independent review of significant judgments
  - **Engagement files** → Complete  $\leq 60$  days after report; retain  $\geq 7$  yrs
  - **SA 220** → Audit engagements only; EP ensures QC implementation; based on SQC 1
  - **QC Review Mechanisms** → Peer Review Board (ICAI), QRB (CG + ICAI), NFRA (statutory, listed & large cos.)
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