

SQC 1 – QC for firms that performs audits and review of historical financial info, and other assurance and related service

SQC 1 requires that firm should establish a system of QC designed to provide it with **reasonable assurance** that firm and its personnel.

- o **comply** with professional standards and regulatory and legal requirements and
- o that **reports issued** by the firm or engagement partners are appropriate in the circumstances

This QC std. applies to all firms irrespective of their constitution.

Elements of System of Quality Control

Firm's system of QC 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

Leadership Responsibilities for Quality within the Firm

SQC 1 requires firms to **establish policies and procedures** designed to promote an internal culture.

Such policies and procedures should require **firm's CEO or managing partners** to assume ultimate responsibility for firm's system of QC.

Further, **persons assigned operational responsibilities** for firm's QC system should have sufficient and appropriate experience, ability, and the necessary authority to assume that responsibility.

It further requires that **firm's business strategy is subject to overriding requirement** of firm to achieve quality in all engagements.

Essentially, it implies that **audit quality is paramount in all engagements**. It is **non-negotiable**. In this regard, it should be ensured that: -

3. **Firm assigns its management responsibilities** so that commercial considerations don't override the quality of work performed.

1. **Firm's policies and procedures** addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel are designed to demonstrate the firm's overriding commitment to quality and
2. Firm devotes **sufficient resources** for the development, documentation and support of its QC policies and procedures.

Ethical Requirements

Firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel **comply with relevant ethical requirements**.

Fundamental principles include integrity, objectivity, professional competence & due care, confidentiality & professional behaviour.

Observance of "Independence" in all engagements is the founding requirement.

Firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and (including experts contracted by the firm and network firm personnel) **maintain independence** where required by the Code.

Such policies and procedures should enable the firm to: -

- (a) **Communicate** its independence requirements to its personnel.
- (b) Identify and evaluate circumstances and relationships that **create threats to independence**, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

All **breaches** of independence should be **promptly notified** to firm for appropriate action.

At least **annually**, firm should **obtain written confirmation of compliance** with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

SQC 1 lays special emphasis on familiarity threat. Using the **same senior personnel** on assurance engagements over a prolonged period may impair the quality of performance of the engagement.

Therefore, firm should establish criteria for determining the need for safeguards to address this threat.

In determining appropriate criteria, firm considers such matters as-

- (b) **nature** of the engagement, including the extent to which it involves a matter of public interest and

- (a) **length** of service of the senior personnel on the engagement

Examples of safeguards include

- rotating the senior personnel or
- requiring an engagement quality control review

Familiarity threat is particularly relevant in the context of FS audits of listed entities.

For these audits, **engagement partner should be rotated after a pre- defined period, normally not more than seven years (except in cases where audit of listed entities is conducted by a sole practitioner). (Rotation once in 7 years)**

There is a process for **mandatory peer review** of such firms.

Acceptance and Continuance of Client Relationships and Specific Engagements

A firm before accepting engagement should acquire vital information about the client. Such info should help firm to decide about: -

- **Integrity** of Client, promoters and key managerial personnel.
- **Competence** (including capabilities, time and resources) to perform engagement.
- **Compliance** with ethical requirements.

Firm should **obtain such info** as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to **continue** an existing engagement, and when considering **acceptance** of a new engagement with an existing client.

With regard to the integrity of a client, matters that the firm considers include, for example -

1. **Identity and business reputation** of the client's principal owners, key management, related parties and TCWG.
2. **Nature of client's operations**, including its business practices.
3. **Info concerning the attitude** of the client's principal owners, key management and TCWG towards such matters as **aggressive interpretation of AS and IC environment**
4. Whether the client is aggressively concerned with maintaining the **firm's fees as low as possible**.
5. Indications of an **inappropriate limitation** in the scope of work.
6. Indications that the client might be involved in money laundering or other criminal activities.
7. **Reasons** for the proposed appointment of the firm and non-reappointment of the previous firm. The extent of knowledge a firm will have regarding the integrity of a client will generally

In considering whether the firm has the capabilities, competence, time and resource undertake an engagement, following matters have to be taken into consideration: -

- Firm personnel have **knowledge** of relevant industries or subject matters;
- Firm personnel have **experience** with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- Firm has **sufficient personnel** with the necessary capabilities and competence;
- **Experts** are available, if needed;
- Firm would be able to **complete** the engagement within the **reporting deadline**.
- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and

If there is any **conflict of interest** between the firm and client - properly resolved before accepting the engagement

Where the firm obtains info. that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include **consideration** of:

- (a) **Professional & legal responsibilities** that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
- (b) **Possibility** of withdrawing from the engagement or from both the engagement and the client relationship.

Policies & procedures on withdrawal from an engagement or from both engagement and client relationship address issues that include:

- **Discussing** with the appropriate level of the client's management and TCWG **regarding the appropriate action** that the firm might take based on the relevant facts and circumstances.
- If firm determines that **it's appropriate to withdraw**, discussing with the appropriate level of the client's management and TCWG withdrawal from the engagement or from both engagement and the client relationship, and the reasons for the withdrawal.
- **Considering** whether there is a **professional, regulatory or legal requirement** for the firm to remain in place, or for the firm to report the withdrawal, together with the reasons for the withdrawal, to regulatory authorities.
- **Documenting** significant issues, consultations, conclusions and the basis for the conclusions.

Human Resources

Firm should establish policies and procedures designed to provide it with **reasonable assurance** that it has **sufficient personnel** with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements and to enable the firm or engagement partners to **issue reports** that are appropriate in the circumstances.

Such policies and procedures should **address** relevant HR issues including recruitment, compensation, training, career development, performance evaluation etc.

Firm should establish policies and procedures requiring that:

- (a) **Identity and role** of the engagement partner are **communicated** to key members of the client's management and TCWG;
- (b) Engagement partner has the **appropriate capabilities, competence, authority and time** to perform the role; and
- (c) **Responsibilities** of the engagement partner are clearly defined communicated to that partner.

Engagement Performance

Consistency in quality of engagement performance is achieved through briefing of engagement teams of their objectives, processes for complying with engagement standards, processes of engagement supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.

Consultation in difficult or contentious matters:

- Consultation should take place in **difficult or contentious matters** pertaining to an engagement.
- It includes **discussion**, with individuals within or outside the firm who have specialized expertise, to resolve difficult or contentious matter
- It helps to promote quality and improves the application of professional judgment.
- **Consultation procedures** require consultation with those having appropriate knowledge, seniority and experience within the firm (or outside the firm) on significant technical, ethical and other matters and appropriate documentation and implementation of conclusions resulting from consultations.
- A firm needing to **consult externally**, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms.

Engagement quality control review (EQCR):

Significant judgments made in an engagement should be **reviewed by an EQC reviewer** for taking an objective view before the report is issued.

Review **doesn't reduce responsibilities** of the engagement partner.

EQCR is **mandatory** for all audits of FS of listed entities.

An EQCR for audits of FS of listed entities includes considering the following: -

1. Engagement team's evaluation of the firm's **independence** in relation to the specific engagement
2. **Significant risks identified** during the engagement and the **responses** to those risks.
3. **Judgments** made particularly w.r.t. materiality & significant risks
4. Whether **appropriate consultation** has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
5. **Matters to be communicated** to management and TCWG and, where applicable, other parties such as regulatory bodies.
6. **Appropriateness of the report** to be issued.
7. Whether **working papers selected** for review reflect the work performed in relation to the significant judgments and support the conclusions reached.

EQC reviewer - is a partner, other person in the firm (who should be member of ICAI), suitably qualified external person (partner or experienced employee from another firm) or a team made up of such individuals.

Listed Entity Audits: EQC reviewer for listed entity financial statement audits must have sufficient experience and authority as an audit engagement partner.

Objectivity Maintenance:

- Maintain objectivity of the EQC reviewer.
- Participation in engagement or decision for team should be avoided

Replacement Protocols:

- Firm policies should outline procedures for replacing the EQC reviewer if objectivity is compromised.
- Another individual within the firm or a suitably qualified external person may be appointed in such cases.

Differences of Opinion:

There might be difference of opinion within engagement team, with those consulted and between engagement partner and EQC reviewer.

Report should only be issued **after resolution** of such differences.

In case, **recommendations** of EQC reviewer **are not accepted** by engagement partner and **matter is not resolved** to reviewer's satisfaction, the matter **should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.**

Engagement documentation:

Firm should establish policies & procedures to complete **assembly of final engagement files** on timely basis after report has been finalized

Engagement files should be completed **in not more than 60 days after date of auditor's report** in case of **audit engagements** and in **other cases** within the limits appropriate to engagements.

Where **2 or more different reports** are issued in respect of the same subject matter information of an entity, time limits for the assembly of final engagement files should be **considered for each report as if it were for a separate engagement.**

Policies and procedures should be designed to maintain confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

Care should be taken that policies and procedures on documentation of EQCR should require documentation that: -

- Procedures required by the firm's policies on EQCR have been performed.
- EQCR has been completed before the report is issued and
- Reviewer is not aware of any unresolved matters that would cause the reviewer to believe that significant judgments the engagement team made and the conclusions they reached were not appropriate.

Ownership: Engagement documentation is the **property of the firm** unless otherwise specified by L/R. Firm can, at its discretion, share portions or extracts with clients.

Retention Period:

- Documentation must be retained for monitoring compliance evaluation.
- Longer retention if required by law or regulation.
- For audit engagements**, the retention period is typically **not less than 7** from the auditor's report date or, if later, the group auditor's report date.

Monitoring

QC of engagements has to be monitored taking into account **following factors:**

- Deciding whether QC system of the firm has been appropriately **designed and effectively implemented.**
- Examining whether **new developments** in the professional standards, legal and regulatory requirements have been reflected in the quality control policies.
- Conducting monitoring** by entrusting responsibility of monitoring process to a partner or other persons with sufficient and appropriate experience and authority in the firm.
- Dealing with **complaints and allegations** against the firm or any employees of it of non-compliance with professional standards or appropriate regulatory requirements by a person within or outside the firm.
- Taking appropriate **remedial actions** against the personnel who did not conform to quality control policies.
- Taking action when **deficiencies** in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control are identified.

SA-220 – Quality control for an audit of FS

Engagement partner of a team is responsible for quality control procedures of a particular audit engagement as per SA-220.

Hence, SA 220 is premised on the basis that firm is subject to SQC 1

As per SA-220, the objective of the auditor is to implement quality control procedure the engagement level that provides the auditor with reasonable assurance that:

- Audit complies with professional standards and regulatory and legal requirements and;
- Auditor's report issued is appropriate in the circumstances.

SA 220 is modelled on lines of SQC 1. It describes the responsibilities of engagement partner in relation to following matters:

- Leadership responsibilities for quality on audits.
- Relevant ethical requirements.
- Acceptance and continuance of client relationships and audit engagements.
- Assignment of engagement teams.
- Engagement performance.
- Monitoring.

Leadership Responsibilities for Quality on Audits

Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement.

In taking responsibility for the overall quality on each audit engagement, emphasis:

- Importance to audit quality of: -
 - Performing work that **complies** with professional standards and regulatory and legal requirements;
 - Complying** with firm's quality control policies and procedures as applicable.
 - Engagement team's **ability to raise concerns** without fear of reprisals.
 - Issuing auditor's reports** that are appropriate in the circumstances.
- Fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements

Responsibilities of an engagement partner in relation to ethical requirements are -

- o **Identifying a threat to independence** that safeguards may not be able to eliminate or reduce to an acceptable level.
- o **Reporting** by engagement partner to the relevant persons to **determine appropriate action**, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

Acceptance and Continuance of Client Relationships and Audit Engagements

SAME AS SQC 1

Assignment of Engagement Teams

Engagement partner to ensure that engagement team and any auditor's experts, who are not part of the engagement team, have **appropriate competence and capabilities** to perform the engagement in accordance with professional standards and regulatory and legal requirements

Engagement Performance

Engagement partner has the **responsibility for direction, supervision & performance of audit engagement** in accordance with professional standards and regulatory and legal requirements.

He is responsible for **review of audit documentation before issue of audit report** is his responsibility.

It has to be ensured that **SAAE has been obtained** to support the conclusions reached and for issuance of auditor's report.

He is also responsible for **ensuring undertaking the appropriate consultation on difficult or contentious matters** by engagement team not only within the team but also with others at appropriate level within or outside the firm.

Engagement Quality Control Review

For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has **determined that an EQCR is required**, the engagement partner shall:

- (a) Determine that an **EQC reviewer has been appointed**
- (b) Discuss **significant matters** arising during the audit engagement, including those identified during the EQCR, with the EQC reviewer
- (c) **Not date the auditor's report until the completion of EQCR.**

EQCR shall perform an **objective evaluation of significant judgments** made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:

- (a) Discussion of **significant matters** with the engagement partner
- (b) **Review** of the FS and the proposed auditor's report.
- (c) **Review of selected audit documentation** relating to the significant judgments the engagement team made and the conclusions it reached and
- (d) **Evaluation of the conclusions reached** in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate

For audits of FS of listed entities, **EQC reviewer, on performing an EQCR, shall also consider the following:**

- (a) Engagement team's **evaluation of the firm's independence** in relation to the audit engagement;
- (b) Whether **appropriate consultation** has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations;
- (c) Whether **audit documentation selected for review** reflects the work performed in relation to the significant judgments made and supports the conclusions reached.

Differences of Opinion - follow the firm's policies and procedures for dealing with and resolving differences of opinion.

Monitoring

Monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of QC are relevant, adequate, and operating effectively.

Engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement.

Documentation

Engagement partner should document following matters pertaining to an audit engagement: -

- (e) **Issues identified** with respect to compliance with relevant ethical requirements and how they were resolved.
- (f) **Conclusions** on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.

- (c) **Conclusions** reached regarding the acceptance and continuance of client relationships and audit engagements.
- (d) Nature & scope of, and conclusions resulting from, **consultations undertaken** during the course of the audit engagement.

Besides, the **EQC reviewer shall document**, for the audit engagement reviewed, that:

- (a) **Procedures** required by the firm's policies on EQCR have been **performed.**
- (b) EQCR has been **completed on or before the date of auditor's report.**
- (c) Reviewer is not aware of any **unresolved matters** that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

SQC 1 vs. SA 220- Key Differences In Nature, Scope and Applicability

| S.N | SQC 1 | SA 220 |
|-----|---|---|
| 1 | It applies to entire firm and fixes the responsibility of firm to be assumed by CEO or managing partners | It applies to a particular audit engagement and engagement partner takes responsibility of the same. |
| 2 | It is applicable to audits, reviews of historical financial information, and other assurance and related services engagements. | It is applicable to audit engagements only. |
| 3 | It relates to setting up of a QC system consisting of policies and procedures for firm as a whole. | It deals with <u>responsibilities of engagement teams to implement QC procedures</u> that are applicable to audit engagements |
| 4 | It pertains to establishing a system of quality control designed to provide firm with a reasonable assurance that a firm and its personnel comply with professional standards and regulatory and legal requirements so that reports issued by firm or engagement partners are appropriate in circumstances. | It is premised on the basis that firm is subject to SQC 1. Therefore, SQC 1 is a sine qua non for applicability of SA 220. It is within overall context of a firm's system of quality control, engagement teams implement quality control procedures applicable to audit engagements. |

Mechanism for Review of QC

Peer Review Board

Peer review Board is **constituted by Council of ICAI**.

Main objective of Peer review Board is to **ensure** that, in carrying out assurance assignments:

- Technical, professional and ethical standards including regulatory requirements are complied with by members of ICAI
- **Proper systems are in place including documentation** thereof which amply demonstrate quality of assurance services provided by members

Purpose of enhancing quality of professional work resulting in more reliable and useful audit reports

Peer review means an examination and review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the technical, professional and ethical Standards or any other regulatory requirements.

Once a Practice Unit is subjected to Peer review, its assurance engagement records pertaining to the Peer review period are subject to examination and review by the Peer Reviewer.

On completion of this exercise, a "**peer review certificate**" is issued in case of **unqualified report** issued by Peer Reviewer.

In case of a **qualified report**, it is **informed to the Practice Unit that same cannot be issued along with the reasons** therefor as well as inform about the due date for conducting a follow-on review as may be decided by the Board.

Quality Review Board

Quality review Board **has been set up by CG**. It consists of members **nominated by CG and Council of ICAI**.

Functions of QRB are:-

- (a) To make **recommendations to the Council** regarding the quality of services provided by the members of the Institute;
- (b) To **review the quality of services provided by the members of the Institute** including audit services and
- (c) To **guide the members** of the Institute to **improve the quality of services and adherence to the various statutory and other regulatory requirements**;

Statutory auditors in respect of the companies are identified for their audit quality review based upon risk-based approach. The review is carried out by technical reviewers who are empanelled by QRB on engagement basis from across the country.

National Financial Reporting Authority (NFRA)

NFRA has been constituted in terms of **Sec 132(1) of Co. Act, 2013**

Duties -

- Monitor and enforce compliance with AS and SA.
- Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service

Power to -

- Monitor & Enforce compliance with accounting standards and auditing standards and oversee the quality of service under **section 132(2)** or
- Undertake investigation under section 132(4) of the auditors of certain class of companies

Such companies include listed companies, insurance companies, banking companies and other companies as provided for in **rule 3 of NFRA Rules, 2018**

QRB VS NFRA -

- **Overseeing quality of audit services of listed companies falls under the purview of NFRA**
- **QRB can review quality of audit services** provided by the members of the Institute only in respect of entities other than those specified under Rule 3 of NFRA Rules, 2018 and those referred to QRB by NFRA under relevant rules.

Telegram - t.me/CA_Rakesh_Auditclasses

YouTube - https://www.youtube.com/@CA_Rakesh_Auditclasses