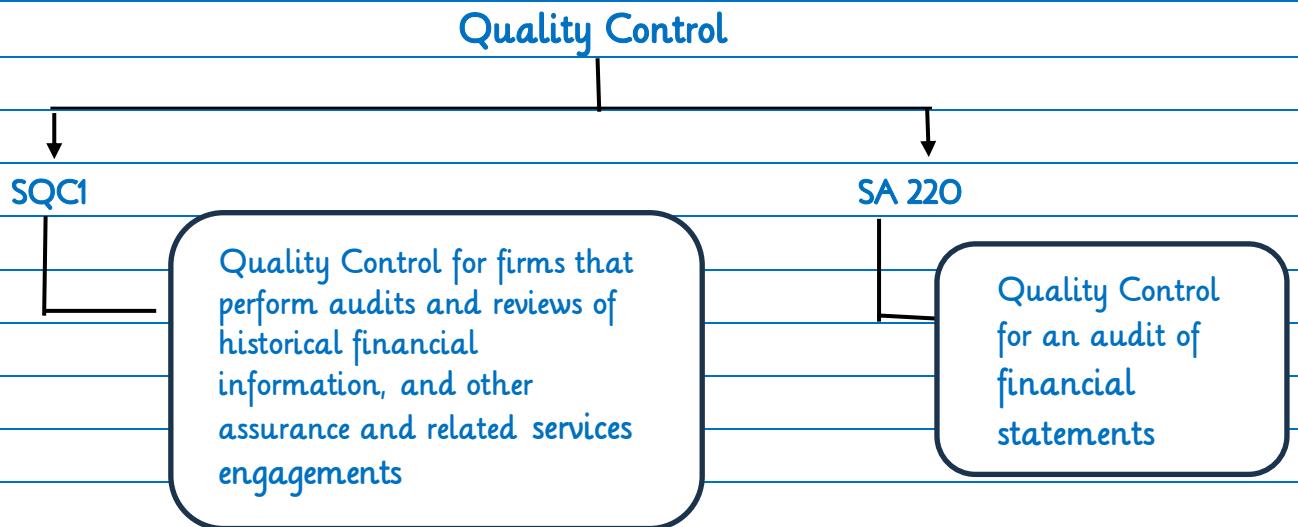


# Quality Control

## CHAPTER OVERVIEW



### 1. AUDIT QUALITY

- Audit quality involves application of a rigorous audit process by auditors and quality control procedures that comply with laws, regulations and applicable professional standards.
- SQC 1- Quality Control for firms that perform audits and reviews of historical financial information, and other assurance and related services engagements and SA-220- Quality Control for an audit of financial statements deal with this issue of establishing quality control systems and responsibilities of auditors in regard. Both the standards deal with framework of audit quality.
- SQC 1 applies to all engagements and deals with quality at level of firm. SA-220 deals with audit quality at individual audit engagement level.

### 2. SQC 1 – QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS.

SQC 1 requires that the firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and those reports issued by the firm or engagement partners are appropriate in the circumstances. Firm's system of

report.

## 2.1.6 Monitoring

The firm should ensure that policies and procedures relating to the system of quality control is relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Quality control of engagements has to be monitored taking into account following factors:

- ◆ Deciding whether quality control 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.

## 3. SA - 220 - QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS:

Based upon quality control system of firm, quality control policies pertaining to audit engagements are decided by engagement teams. Engagement partner of a team is responsible for quality control procedures of a particular audit engagement in accordance with SA-220.

Therefore, SA-220 is premised on the basis that the firm is subject to SQC 1. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and

provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise.

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

- (a) The audit complies with professional standards and regulatory and legal requirements and
- (b) The auditor's report issued is appropriate in the circumstances.

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

- (a) Leadership responsibilities for quality on audits.
- (b) Relevant ethical requirements.
- (c) Acceptance and continuance of client relationship and audit engagements.
- (d) Assignment of engagement teams.
- (e) Engagement performance.
- (f) Monitoring.

### **3.1 Leadership Responsibilities for Quality on Audits**

Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasis:

#### **a) The importance to audit quality of:-**

- I. Performing work that complies with professional standards and regulatory and legal requirements.
- II. Complying with the firm's quality control policies and procedures as applicable.
- III. Issuing auditor's reports that are appropriate in the circumstances and
- IV. The engagement team's ability to raise concerns without fear of reprisals.

b) The fact that quality is essential in performing audit engagements.

### 3.2 Relevant Ethical Requirements

The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement is as under: -

- ♦ Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.
- ♦ Reporting by engagement partner to the relevant persons within the firm 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.

### 3.3 Acceptance and Continuance of Client Relationships and Audit Engagements

The responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC 1 which requires the firm should obtain such information 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.

Information like integrity of principal owners, competence of engagement team and consideration of necessary capabilities including time and resources, compliance with relevant ethical requirements and significant matters arisen during current or previous audit engagement and their implications assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and Audit engagements are appropriate.

### 3.4 Assignment of Engagement Teams

It should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirements.

### 3.5 Engagement Performance

Engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements. He is responsible for auditor's report being appropriate in circumstances.

Further, review of audit documentation before issue of audit report is his responsibility. It has to be ensured that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for issuance of auditor's report.

Engagement partner is also responsible for ensuring undertaking 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.

### 3.6 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 engagement quality control review is required, the engagement partner shall:

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

**The engagement quality control reviewer shall perform an objective evaluation of the 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 financial statements 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 financial statements of listed entities, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

- (a) The 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 judgements made and supports the conclusions reached.

### Differences of Opinion

If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

## 3.7 Monitoring

An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The 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.

## 3.8 Documentation

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

- (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- (b) 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) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

Besides, the engagement quality control reviewer shall document, for the audit engagement reviewed that:

- (a) The procedures required by the firm's policies on engagement quality control review have been performed.
- (b) The engagement quality control review has been completed on or before the date of the auditor's report.
- (c) The 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.

#### 4. 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 quality control system consisting of policies and procedures for firm as a whole.	It deals with responsibilities of engagement teams to implement quality control procedures 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	It is premised on the basis that firm is subject to SQC 1. Therefore, SQC 1 is a <i>sine qua non</i> 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.

firm or engagement partners are appropriate in circumstances

## 5. MECHANISMS FOR REVIEW OF QUALITY CONTROL

### 5.1 Peer Review Board

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

The peer review is meant for 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 is 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.

### 5.2 Quality Review Board

Quality review Board has been set up by Central government. It consists of members nominated by Central govt and Council of ICSI. The 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.

### 53 National Financial Reporting Authority (NFRA)

NFRA has been constituted in terms of Section 132(1) of Companies Act,2013. Duties of NFRA also include the following: -

- ♦ Monitor and enforce compliance with accounting standards and auditing standards.
- ♦ 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.

It has power to monitor and 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

Therefore, 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.

## TEST YOURSELF:

**Q1** ABC & Associates, Chartered Accountants has a policy to accept the clients wherein the risk evaluation is conducted with respect to the Company and the promoter. XYZ Limited approached ABC & Associates. Promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited is in news in the previous year for certain inquiries from the regulatory authorities in relation to certain matters. The Existing auditor of XYZ Limited has resigned and has created a casual vacancy. XYZ Limited is ready to offer 25% more than the existing fees and has approached ABC & Associates for appointment as Auditor. Mr. A has strong recommendation to the Firm to accept the audit.

What is your understanding of the functioning of the tone at the top of the Firm ABC & Associates, Chartered Accountants? What are the considerations one should exercise to uphold Firm?

**Ans.** The given situation indicates that proposed client is a new one whose promoter is close associate and family friend of managing partner of M/s ABC & Associates. However, previous auditor of proposed client has resigned and company is offering hike in audit fees in comparison to audit fees paid to previous auditor. Besides, there are also regulatory inquiries against the company. In spite of all this, managing partner of firm Mr. A has recommended for acceptance of offered audit of the company.

It reflects poorly regarding functioning at top of the firm as regards to quality control. SQC 1 requires that firm should establish a system of quality control designed to provide it with reasonable assurance that firm and its personnel comply with professional standards and legal and regulatory requirements. It further requires that firm's business strategy is subject to overriding requirement of firm to achieve quality in all engagements. However, in the given situation, commercial considerations seem to be overriding factor.

The managing partner of firm is close associate and family friend of promoter. The matter should have been brought to knowledge of firm in accordance with requirements of SQC 1 as it involves issue of independence of managing partner of the firm with respect to proposed audit engagement. Further, matters of inquiries from regulators and resignation of previous auditor raise question about integrity of the proposed client. SQC 1 further requires firm to consider before acceptance of an engagement that client does not lack integrity. All

these factors need to be taken into consideration before accepting engagement.

Overall, such a situation reflects lack of proper establishment of quality control framework at top of the firm. Following considerations should be taken into account while upholding quality of firm: -

- (i) The firm assigns its management responsibilities so that commercial considerations do not override quality of work performed.
- (ii) The firm's policies and procedures in relation to its personnel are designed to demonstrate its overriding commitment to quality.
- (iii) The firm devotes sufficient resources for development and documentation of its quality control policies and procedures.
- (iv) A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about integrity of Client, promoters and key managerial personnel, competence (including capabilities, time and resources) to perform engagement and compliance with ethical requirements.

**Q2** MNP & Co, a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deputes one of its paid Chartered accountant employees, Sudhanshu, to conduct above said stock audit. He leverages it as an opportunity to prevail upon the client to get the accounts audited from their firm. He also assures the client of a clean stock audit report without adverse comments as a quid pro quo. Is approach of Sudhanshu proper? How does it reflect upon quality control system of firm?

**Ans.** Approach of Sudhanshu is not proper. Such practices blatantly violate code of ethics and its spirit. It reflects poorly upon quality control system of firm envisaged in SQC 1 which requires that quality control policies and procedures should be documented and communicated to the firm's personnel. It shows that firm's personnel are not properly sensitized regarding requirements of SQC 1.

**Q3** CA M is introduced to a prospective client in a social function. He assures to visit office of CA M very soon in relation to professional work. During discussions over a cup of coffee next week, it transpires that there was a search by Enforcement Directorate in his premises about a month back resulting in recovery of huge sum of cash. The income tax department had also searched his premises in relation to bogus capital gains on penny stocks. Lamenting poor quality of services provided by his Present auditor; he offers appointment as tax

quality control should consist of policies designed to achieve these objectives. This quality control standard applies to all firms irrespective of their constitution.

## 2.1 Elements of System of Quality Control

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

Quality control policies and procedures should be documented and communicated to the firm's personnel. By communicating, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

### 2.1.1 Leadership Responsibilities for Quality within the Firm

SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of Quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality Audit Work. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief Executive officer or managing partners should have sufficient and appropriate experience, ability, and the necessary authority to assume that responsibility.

It has been laid down clearly that firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Essentially, it implies that audit quality is Paramount in all engagements. It is non-negotiable. In this regard, it should be ensured that: -

- (a) The firm assigns its management responsibilities so that commercial considerations do

auditor of his five family- owned firms to CA M in lieu of handsome fees. What are the factors to be evaluated by CA M if he wants to take up the engagement?

**Ans.** As per SQC 1, before accepting a new engagement, integrity of client should be considered including matters that indicate involvement in money laundering or criminal activities. There has been search of ED on the said party leading to recovery of huge amount of cash. The above coupled with actions of income tax department relating to bogus capital gains on penny stocks indicates that client might be involved in money laundering activities. Therefore, offer should not be accepted.

**Q.4** GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issue pertaining to a particular Ind AS applicable to the company. They have framed a query and sent to ICAI for expert opinion on the matter. The issue was resolved upon receipt of expert opinion. Since expert opinion was provided by ICAI, engagement team was of the view that appointment of engagement quality control reviewer has lost its relevance. Do you agree?

**Ans.** Engagement quality control review in listed entities is a mandatory requirement. Expert opinion of ICAI pertains to issue of interpretation. The appointment of reviewer is a separate and mandatory requirement in audits of listed companies.

**Q.5** RST & Co, a firm of Chartered accountants, are auditors of a listed company engaged in manufacturing of heavy machinery components. The audit report for year 2021-22 also included report on matters listed in CARO,2020. While reporting under clause vii(a) of the said order relating to regularity of undisputed statutory dues by the company, the auditors have commented that company is "generally regular" in depositing statutory dues to appropriate authorities. Is above reporting qualitative and in line with requirements of SA-220?

**Ans.** Such type of reporting is not qualitative. It is not in accordance with SA 220. One of the objectives of the auditor, as per SA 220, is to implement quality control procedures at the engagement level that provides the auditor with reasonable assurance that the audit complies with professional standards and regulatory and legal requirements. The reporting under CARO, 2020 is not proper. Hence, the audit does not comply with regulatory and legal requirements.

# GENERAL AUDITING PRINCIPLES AND AUDITOR'S RESPONSIBILITIES

1. SA 240 – The Auditor's Responsibilities Relation to Fraud in an Audit of Financial Statements
2. SA 250 – Consideration of Laws and Regulations in an Audit of Financial Statements
3. SA 260 – Communication with Those Charged with Governance (TCWG)
4. SA 299 – Joint Audit of Financial Statements
5. SA 402 – Audit Considerations Relating to an entity using a Service Organisation

# "SA 240" - The Auditor's Responsibilities relating to Fraud in an Audit of FS

## Q1. On what matters Auditor discuss Among the Engagement Team?

Discussion among the team members and members who are not part of engagement team to update about suspect areas of fraud. Discussion to be on matters viz:

- An exchange of ideas among engagement team members
- A consideration of earnings MGT and the practices that might be followed by MGT to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure
- A consideration of MGT's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- A consideration of any unusual or unexplained changes in behaviour or lifestyle of MGT or employees which have come to the attention of the engagement team
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for MM due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of MGT override of controls.

## Q2 What are RAP and Related Activities in case of a fraud?

Inquiries from MGT and Others within the Entity

The auditor shall make inquiries of MGT regarding:

- MGT's assessment of the risk
- MGT's process for identifying and responding to the risks of fraud in the entity
- MGT's communication, if any, to TCWG.
- MGT's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Frauds noticed by MGT during the year.
- Communication with Internal Auditor, if any

## TCWG

Unless all of TCWG are involved in managing the entity, the auditor shall obtain an understanding of how TCWG exercise oversight of MGT's processes.

## Unusual or Unexpected Relationships identified

The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures

## Other Information

The auditor shall consider whether other information obtained by the auditor indicates ROMM due to fraud like information acquired during acceptance of audit, while rendering other services to the client like review of interim financial reports, etc.

## Evaluation of Fraud Risk Factors

Fraud risk factors relate to the undue pressures, lack of ICs and personal bias/interest of the company and or its employees, heavy expectations of stakeholders, granting significant bonuses etc that lead to possibilities of misstatements in FS. Though fraud risk factors do not necessarily imply that fraud exists but they give the auditor suspicion that frauds might exist.

Fraud risk factors which primarily arises on account of following reason:

- An incentive or pressure to commit fraud.
- A perceived opportunity to commit fraud.
- An ability to rationalize the fraudulent action.

## Q3 What are the Auditor's Response to Assessed Risk?

### Response at Overall Level

In determining overall responses due to fraud at the FS level, the auditor shall:

- Assign and supervise personnel – As per the knowledge, skill and ability
- Selection of accounting policies.
- Surprise Checks – Incorporate unpredictability in nature, timing and extent of audit procedures.

### Response at Assertion Level

The auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed ROMM due to fraud at the assertion level

### Response to Risk related to MGT Override Controls

- The auditor shall determine whether the auditor needs to perform extra audit procedures.
- Test the appropriateness of journal entries recorded in the general ledger & other adjustments made in the preparation of the FS. In designing and performing audit procedures for such tests, the auditor shall:
- Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and

other adjustments

- Select journal entries and other adjustments made at the end of a reporting period.
- Review accounting estimates for biases. In performing this review, the auditor shall:
- Evaluate whether the judgments and decisions made by MGT, indicate a possible bias.
- Perform a retrospective review of MGT judgments and assumptions related to significant accounting estimates reflected in the FS of the prior year.
- For significant transactions that are outside the normal course of business for the entity and MGT has not discussed its business rationale, are overly complex like with web subsidiaries, relating to related parties, etc

#### Q.4 Evaluation of Audit Evidence?

- Evaluate whether analytical procedures consistent with the auditor's understanding of entity
- When the auditor identifies a misstatement, evaluate whether fraud
- Evaluate implications in relation to other aspects of the audit, particularly the reliability of MGT representations.
- Re-evaluate the assessment of the ROMM due to fraud and its resulting impact on the nature, timing and extent of audit procedures.

#### Q.5 Auditor unable to continue the Engagement

The auditor shall:

1. Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities
2. Consider whether it is appropriate to withdraw from the engagement.
3. If the auditor withdraws:
  - Discuss with the appropriate level of MGT and TCWG; and.
  - Determine whether there is a professional or legal requirement to report to appointing authority or to regulatory authorities

#### Q.6 What are the responsibilities to communicate to MGMT/TCWG?

The auditor shall make inquiries of MGT regarding:

- If the auditor has identified a fraud or has indication of fraud, the auditor shall communicate these matters on a timely basis to the appropriate level of MGT.
- The auditor shall communicate with TCWG any other matters related to fraud that are, in the auditor's judgment, relevant to their

The auditor's legal responsibilities may override the duty of confidentiality in some circumstances.

## Q.7 Explain Fraud Risk Factor – Imp

### Fraudulent Financial Reporting

- Incentives/Pressures
- Financial stability or profitability is threatened
- Excessive pressure exists for MGT
- Personal financial situation of MGT or TCWG is threatened
- Opportunities
- Nature of the industry or the entity's operations
- The monitoring of MGT is not effective
- There is a complex or unstable organizational structure
- IC components are deficient
- Attitudes/Rationalizations
- Communication, implementation, support, or enforcement of the entity's values
- Management practice of making large commitments
- Low morale / initiative among senior MGT
- The relationship between MGT and the current or predecessor auditor is strained

### Misappropriation Of Assets

- Incentives/Pressures
- Personal financial obligations may create pressure on MGT or employees
- Adverse relationships between the entity and employees with access to cash
- Opportunities
- Inadequate IC over assets may increase the susceptibility of misappropriation of those assets
- Nature of business activities / exposure to such assets highly susceptibility of misappropriation
- Attitudes/Rationalizations
- Disregard for the need for monitoring / IC over misappropriation of assets
- Behaviour indicating displeasure or dissatisfaction

## Q.8 Audit procedures to address the assessed ROMM due to fraud resulting from both fraudulent financial reporting and misappropriation of assets at assertion level? – IMP

The following are specific examples of responses:

- Visiting locations
- Performing certain tests on a surprise or unannounced basis
- Requesting that inventories be counted at the end of the reporting period
- Altering the audit approach in the current year
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries
- For significant and unusual transactions, investigating the possibility of related

not override the quality of work performed.

(b) The 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

(c) The firm devotes sufficient resources for the development, documentation and support of its quality control policies and procedures.

## 2.1.2 Ethical Requirements.

The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI.

The Code establishes the fundamental principles of professional ethics which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Fundamental principles should be emphasized by

- ◆ Actions of the leadership of the firm
- ◆ Spreading awareness and training
- ◆ Monitoring
- ◆ A process for dealing with non-compliance.

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

There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm promptly notifies firm of circumstances and relationships that create a threat to independence. All

breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.

At least annually, the 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.

### 2.1.3 Acceptance and Continuance of Client Relationships and Specific Engagements

A firm before accepting an engagement should acquire vital information about the client. Such an information 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.

The firm should obtain such information 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. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

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

The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.

- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or another criminal activities.
- The reasons for the proposed appointment of the firm and non-appointment of the previous firm. The extent of knowledge a firm will have regarding the integrity of a

client will generally grow within the context of an ongoing relationship with that client.

**In considering whether the firm has the capabilities, competence, time and resources to 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.
- The firm has sufficient personnel with the necessary capabilities and competence.
- Experts are available, if needed.
- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable and
- The firm would be able to complete the engagement within the reporting deadline.

If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. Where the firm obtains information 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) The professional and 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) The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

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

- Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the 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 from the management, or from both the engagement and the client relationship, together with the reasons for the withdrawal to regulatory authorities.
- Documenting significant issues, consultations, conclusions and the basis for the conclusions.

## 2.1.4 Human Resources

The 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. There should be emphasis on the continuing professional development of firm's personnel.

The firm should assign responsibility for each engagement to an engagement partner.

**The firm should establish policies and procedures requiring that:**

- (a) The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance;
- (b) The engagement partner has the appropriate capabilities, competence, authority and time to perform the role; and
- (c) The responsibilities of the engagement partner are clearly defined and communicated to that partner

Each engagement team should be able to carry out its responsibilities with necessary competence competence and skill. Therefore, the firm should ensure suitable people are available and also groom them for their role. The firm should assess performance of their partners and team members keeping in mind their commitment towards quality.

## 2.1.5 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.

Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who has specialized expertise, to resolve a 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.

**Engagement quality control review:** Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued.

The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.

Engagement quality control review is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.

**An engagement quality control review for audits of financial statements of listed entities include considering the following: -**

- The engagement team's evaluation of the firm's independence in relation to the specific engagement.
- Significant risks identified during the engagement and the responses to those risks.
- Judgments made, particularly with respect to materiality and significant risks.
- 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.

- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- Whether working papers selected for review reflect the work performed in relation to the significant judgement and support the conclusions reached.
- The appropriateness of the report to be issued.

Engagement quality control reviewer is a partner, other person in the firm (who should be member of ICAI), suitably qualified external person, or a team made up of such individuals. In this regard, suitably qualified external person refers to an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner or an employee (with appropriate experience) of another firm. In addition, the engagement quality control reviewer for an audit of the financial statements of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities. It is necessary to maintain objectivity of such reviewer. Therefore, participation in engagement or making decisions for engagement team is to be avoided at all costs. However, engagement partner may consult engagement quality control reviewer during the engagement so as not to compromise his objectivity and eligibility to perform the role.

**Differences of Opinion:** There might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer. The report should only be issued after resolution of such differences. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter are not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner of firm, or a professional or regulatory body.

**Engagement documentation:** The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have 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 engagement.

Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files should be considered for each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

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

Care should be taken that policies and procedures on documentation of the engagement quality control review should require documentation that: -

- (a) The procedures required by the firm's policies on engagement quality control review have been performed.
- (b) The engagement quality control review has been completed before the report is issued and
- (c) The 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.

Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Engagement documentation has to be retained for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

In the specific case of audit engagements, the retention period ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's