

*Commercial's*



# A HANDBOOK ON **ADVANCED AUDITING, ASSURANCE** and **PROFESSIONAL ETHICS**

**CA FINAL - Group-1, Paper-3  
(NEW SYLLABUS)**

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and onwards Examination**

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**MAIN BOOK**

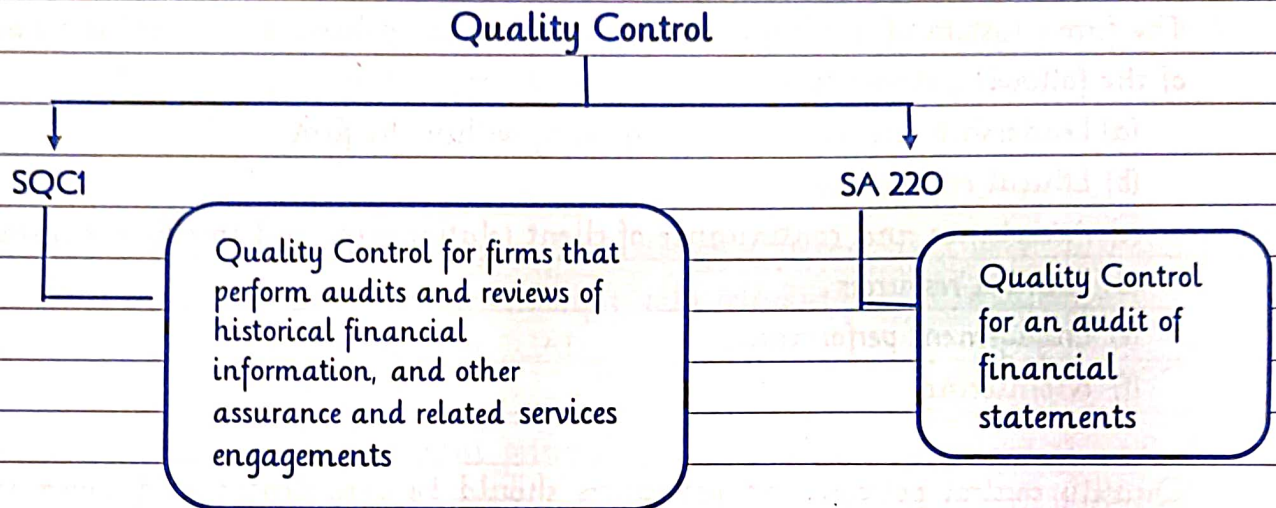
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# Quality Control

## 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.

## 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

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

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.

## 2.12 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 in 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.

### 2.13 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 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

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**