

Quality Control for Audit Work

[SA 220 read with SQC 1]

By:
CA. Kamal Garg

System of Quality Control and Role of Engagement Teams

- Quality control systems, policies and procedures are the responsibility of the audit firm.
- Under SQC 1, the **firm has an obligation to establish and maintain a system of quality control** to provide it with reasonable assurance that:
 - a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and
 - b) The reports issued by the firm or engagement partners are appropriate in the circumstances

Firm

- a sole practitioner/ proprietor, partnership, or any such entity of professional accountants, as may be permitted by law

Personnel

- partners and staff

Staff

- professionals, other than partners, including any experts which the firm employs.

Quality Control Policies

- **What are the various Quality Control Policies:**

- a) Leadership Responsibilities for Quality on Audits
- b) Relevant Ethical Requirements
- c) Independence ~ 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 of Ethics
- d) Acceptance and Continuance of Client Relationships and Audit Engagements ~ client's integrity, EP competence, Ethical requirements, Fees, reason for appointment, RPT, client's limitation on scope.
- e) Assignment of Engagement Teams/ Human Resources
- f) Direction, Supervision and Performance/ Engagement Performance
- g) Review of the audit documentation and discussion with the engagement team ~ on or before the date of auditor's report
- h) Consultation with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter

Case Study: Leadership Responsibilities

- Jain & Jain Associates – 2 partners, 6 audit staff;
- Jain & Jain was expanding quickly, taking on multiple small company audits.
- To meet tight deadlines, staff often skipped review checklists;
- Partners rarely discussed audit quality, focusing instead on timelines and client satisfaction;
- There were no written quality control policies, and staff evaluations were based purely on speed and client feedback.

Challenges Noticed Internally

- Errors in audit reports due to rushed work.
- Inconsistent documentation across files.
- Juniors unsure when to escalate issues.
- No clear accountability for quality control.

Issues identified

- **Para 9:** The firm lacked a culture where quality was clearly recognized as essential.
- **Para 10:** Leadership wasn't actively promoting or communicating the importance of audit quality.
- **Para 11:** Commercial deadlines were placed above audit thoroughness.
- **Para 12:** No one was clearly tasked with responsibility for quality systems.
- **Para 13:** The firm lacked someone with sufficient experience and authority to manage quality.

Actions taken

- **Cultural Shift (Para 9):** Partners began every weekly meeting by emphasizing quality goals.
- **Consistent Messaging (Para 10):** A short, one-page "Audit Quality Focus" was circulated monthly.
- **Balanced Strategy (Para 11):** Job deadlines were adjusted to allow time for internal review.
- **Responsibility Assigned (Para 12):** A senior team member, CA. Mehta, was appointed as Quality Coordinator.
- **Authority and Experience (Para 13):** CA. Mehta was given the right to delay sign-offs if quality steps were missed.

Case Study: Ethical Requirements

- Mehra & Associates – 1 partner, 4 audit staff;
- A junior staff member at Mehra & Associates accepted a small Diwali gift from a long-standing audit client;
- Another team member disclosed confidential client data during an informal discussion with a peer from a different firm;
- The partner was unaware of these incidents, and no formal ethical training had ever been provided;
- There was also no documented policy on professional behavior or independence.

Ethical Tensions

- No clarity among staff on what constituted a breach of confidentiality.
- Staff were unaware that accepting even small gifts could affect independence or perception of objectivity.
- Ethical behavior was assumed, not taught or reinforced.

Issues identified

- **Para 14:** No policies to ensure compliance with ethical requirements;
- **Para 15:** No reinforcement or awareness of fundamental principles like confidentiality or integrity;
- **Para 16:** No conceptual understanding of threats to independence or required safeguards;
- **Para 17:** No systems in place for monitoring ethics, addressing breaches, or leadership-led reinforcement

Actions Taken

- **Policy Development:** Drafted a simple “Ethics and Independence Policy” referencing ICAI Code of Ethics;
- **Training Sessions:** Monthly short sessions introduced, using case examples to teach integrity, confidentiality, and professional behavior;
- **Clear Boundaries:** Staff were instructed to report gifts, and all client interactions were logged;
- **Culture Building:** Partner began weekly stand-ups reinforcing ethical expectations and real-life situations;
- **Breaches Handling:** A simple two-step (i) reporting and (ii) resolution protocol was created for ethical concerns

Case Study: Independence

- Verma & Associates – 2 partners, 5 staff, regular clients include family-owned and mid-sized businesses;
- One of the partners, CA Verma, had been auditing a manufacturing company for 9 consecutive years. He had become personally familiar with the company's finance manager, even advising informally on some internal controls;
- Meanwhile, a trainee's cousin joined a client company as CFO, but this connection was never disclosed;
- The firm had no formal system to track such relationships or independence compliance.

Issues Identified

- **Paras 18–19:** No documented process to identify or act on threats to independence (e.g., long tenure, family links)
- **Para 20:** No structured way for staff to report breaches or relationships that threaten independence
- **Para 21–22:** No evaluation or communication of possible threats; no action plans or formal safeguards
- **Para 23–24:** No annual independence declarations or tracking
- **Paras 25–27:** Same partner on audit for 9 years; no rotation or criteria to address familiarity threats

Actions Taken by the Firm

- **Policy Drafted (Para 18–20):** Created a one-page "Independence Declaration" form. Introduced a checklist to assess potential threats before accepting or continuing engagements
- **Awareness & Reporting (Para 21–22):** Added a section in monthly team meetings to discuss independence examples and concerns. Staff encouraged to report conflicts or close relationships directly to the partner in confidence
- **Annual Compliance (Para 23–24):** Every April, all team members now submit an independence compliance form (digitally)
- **Rotation Criteria (Para 25–27):** Set internal rules that if any partner audits the same client for more than 5 years, review is triggered. For larger clients or where familiarity risk is higher, a second partner now reviews key audit decisions.

Case Study: Acceptance and Continuance of Client Relationships and Specific Engagements

- Khanna & Mehta & Co. – 2 partners, 4 staff auditors
- Khanna & Mehta & Co., a small CA firm, was approached by a new client who is a growing unlisted company in the hospitality sector
- The client offered an attractive fee but requested that the audit be completed within five days due to upcoming investor meetings
- They were unwilling to explain why the previous auditor resigned, and avoided questions about internal controls
- One partner, CA. Mehta, felt uneasy about the pressure and the vague responses, but the firm's current slow business period made CA. Khanna lean toward accepting the work quickly

Issues identified

- **Paras 28–30:** No integrity evaluation of the client or inquiry into the prior auditor's exit
- **Para 31:** No review of the firm's capacity or timeline feasibility was conducted
- **Para 32:** Conflict of interest and ethical risks were not considered
- **Paras 33–35:** No structured client acceptance checklist or documentation process was followed

Actions Taken

- **Integrity Verification (Para 28-30):** CA. Mehta reached out to a known industry contact and conducted a basic background check; concerns were flagged about the client's financial ethics. Firm requested written permission to speak with the previous auditor, which the client declined
- **Competence & Resources Review (Para 31-33):** Internal analysis showed completing the audit in five days would require compromising review procedures
- **Withdrawal Decision Framework (Paras 34–35):** The firm established a protocol to document red flags and formalize exit procedures in case of future risk discoveries post-engagement
- **New Policy:** Partners developed a Client Acceptance Form covering client background, independence, timeline viability, and integrity questions. Annual reviews of existing clients were added to the firm's workflow.

Case Study: Human Resources

- Desai & Kapadia – 2 partners, 6 audit staff, 1 article assistant
- Desai & Kapadia began facing quality issues in audits. Junior staff made errors in basic audit documentation and failed to detect obvious misstatements.
- There was no formal training calendar, and staff were chosen mostly based on referrals.
- Appraisals were informal and focused mainly on speed of task completion, not quality or ethics.
- Article assistants felt directionless, unsure how their work was evaluated or how they could progress.

Issues identified

- **Para 36:** No structured policy to ensure staff have the right skills and ethical orientation
- **Para 37:** Gaps in recruitment evaluation, performance tracking, and estimating personnel needs
- **Para 38–39:** No formal training or coaching system; no support for professional development
- **Para 40:** Advancement was based on seniority or client handling, not on competence or ethics
- **Para 41:** Informal evaluation process lacked transparency and direction

Actions Taken

- **Recruitment Policy (Para 36–37):** Implemented a checklist for new hires to assess not just skills but also ethical awareness and willingness to learn. Began maintaining a projected workload vs. staffing chart for estimating future needs.
- **Training & Development (Para 38–39):** Scheduled monthly internal learning sessions and occasional ICAI webinar viewings. Senior staff assigned as informal “mentors” for coaching articles on client work.
- **Performance & Growth (Para 40):** Created a quarterly feedback form discussing technical skills, ethical behavior, and improvement areas. Promotions now tied to audit quality review outcomes and client feedback on professionalism.
- **Tailored for Small Firm (Para 41):** Instead of complex HR systems, partners hold semi-annual one-on-one reviews with each staff member to discuss performance, growth, and expectations.

Case Study: Assignment of Engagement Teams

- Rao & Bhatt LLP – 3 partners, 7 audit staff, 2 article trainees
- The firm had recently taken on the audit of a mid-sized IT company. Due to scheduling constraints, the partner assigned the engagement informally to a junior manager, without assessing whether he had enough time or prior industry experience.
- The engagement was not communicated clearly to the client's senior management, and the junior manager struggled to manage the assignment.
- There were delays, technical oversights, and confusion over who was responsible for client queries. Additionally, staff assigned were unfamiliar with software licensing audits, a major area of risk in the client's business

Issues identified

- **Para 42:** No formal communication of engagement partner's role to client management
- **Para 43:** No workload monitoring system to check partner and manager availability
- **Para 44:** Staff lacked the competence and experience for the specific industry
- **Para 45:** No structured evaluation of team capabilities before assignment

Actions Taken

- **Engagement Partner Assignment (Para 42):** Firm made it mandatory to send a formal engagement communication letter naming the partner and outlining their role.
- **Workload Monitoring (Para 43):** Created a simple Excel-based monthly workload chart for each partner to prevent over-assignment.
- **Staff Matching (Para 44):** Implemented a project planner to align staff with engagements based on prior experience and industry familiarity.
- **Skills Assessment (Para 45):** Introduced a “Skills & Experience Matrix” for each team member, updated quarterly. Assignments are now preceded by a short internal meeting to discuss the team’s suitability and supervision requirements.

Case Study: Engagement Performance

- Shah & Shah – 2 partners, 5 staff members, 2 article assistants
- The firm conducted an audit for a retail chain client. Although the fieldwork was completed on time, the audit file lacked clarity.
- Some critical inventory judgments were undocumented, and the partner review occurred just before report finalization, with no structured supervision during the engagement.
- Junior staff said they were unclear about their roles and didn't receive engagement-specific training or formal briefings.
- Review notes were handwritten and not maintained properly, creating inconsistency and gaps in documentation.

Issues identified

- **Para 46–47:** No structured engagement process; missing briefings, inconsistent documentation and lack of quality checks
- **Para 48:** Team members didn't fully understand the engagement objectives
- **Para 49:** Supervision during fieldwork was informal and untracked
- **Para 50:** Review was rushed; key judgments and evidence adequacy were not critically evaluated or documented

Actions taken

- **Engagement Consistency (Para 46–47):** Developed a basic engagement manual with checklists for common audit areas (e.g. inventory, debtors). Introduced an audit planning meeting format including partner briefings and written audit programs.
- **Clear Communication (Para 48):** Engagement teams now receive a one-page job summary outlining objectives, timelines, and key risks.
- **Effective Supervision (Para 49):** Each audit file has a supervision tracker showing who reviewed what and when. Weekly check-ins during fieldwork are conducted and documented.
- **Structured Review (Para 50):** Partner reviews are now documented using a standard review sheet covering compliance, judgments, consultation points, and documentation adequacy. Engagement partners ensure that all conclusions are supported by sufficient and appropriate audit evidence.

Case Study: Consultation

- Iyer & Naik – 2 partners, 6 staff members, including 2 senior CAs and 4 article assistants.
- While auditing a small logistics company, a complex situation arose, i.e., freight income was netted off against vendor charges, with unclear treatment in books.
- The junior team hesitated to raise the issue, thinking they'd be seen as inexperienced. The engagement partner, pressed for time, skipped in-depth review.
- No formal consultation was sought with anyone more experienced (internal or external). Later, during internal review, it was found that the revenue recognition treatment could have led to material misstatement.

Issues identified

- **Para 51–52:** No formal consultation occurred on a contentious matter
- **Para 53:** No encouragement or system for staff to treat consultation as a quality measure
- **Para 54–55:** No internal or external consultation mechanism defined
- **Para 56:** No documentation of the issue or how it was resolved

Actions taken

- **Formalize Consultation Policy (Para 51):** Created a simple “Consultation Trigger List” that mandates consultation in certain audit conditions (e.g., new accounting treatment, disagreement within team, complex estimates). Defined who to approach within the firm (partner or technical reviewer) based on issue type.
- **Encourage Open Culture (Para 53):** During staff briefings, partners now highlight past examples where consultation improved judgment. Consultation is now discussed as part of team learning, not fault-finding.
- **Internal & External Support (Para 52 & 55):** Identified an external ICAI fellow member with technical experience in revenue recognition for industry-specific matters. Formalized engagement with this expert on-call basis for complex issues.
- **Documentation Practice (Para 56):** Created a standard “Consultation Memo” template covering the issue, advice sought, guidance provided, and actions taken. Both the consulting staff and consulted person sign off on the memo, which is kept in the audit file.

Case Study: Monitoring

1/2

- Desai & Jindal, a two-partner firm with 6 audit staff, managed audit engagements primarily for private companies. Until recently, they did not have a formal system to review whether quality control procedures were being followed post-engagement. Their assumption was that “partner involvement during audit” guaranteed compliance.
- During a bank loan renewal, a client was asked by the banker to provide clarification on a disclosed contingent liability of ₹25 lakhs. The client contacted the firm, but the audit file lacked any documentation to support that note. This incident prompted internal concern.

Case Study: Monitoring

2/2

- An informal check of three other audit files showed:
 - Missing independence declarations
 - Inconsistent documentation of audit judgments
 - Outdated audit programs not aligned with revised CARO

Issues identified

Para	Issue Identified
86	No structured policy existed to assess the operation or relevance of the quality control system.
87	No formal evaluation of adherence to standards or whether policies were implemented in practice.
88	No designated person responsible for internal monitoring or post-engagement inspections.
89	No mechanism to track developments in standards or ensure training compliance. Independence confirmations and client acceptance documentation were missing.
90	No engagement file had ever been reviewed after completion.

Issues identified

Para	Issue Identified
91	No defined scope or system for cyclical inspection. Staff were never informed of potential file checks.
92	No plan to use external resources, though the firm lacked technical expertise in some sectors.
93	No classification of deficiencies. Repeated documentation issues weren't addressed.
94	No communication of deficiencies to staff; informal observations stayed undocumented.
95	No remedial action or documentation of training or disciplinary steps.

Issues identified

Para	Issue Identified
96	When unsupported disclosure was identified, the firm took no immediate corrective action or client communication.
97	No <u>annual summary or report</u> on monitoring findings had ever been shared with partners or staff.
98	No process for anonymous or trend-based reporting; any feedback was partner-specific and verbal.
99	Not applicable – the firm wasn't part of a network.
100	No documentation of monitoring process, results, or actions taken existed in any form.
101	Documentation requirements were missing.

Actions taken

1/2

- **Assigning Responsibility (Para 88):** Partner Jindal was designated as the monitoring lead, independent from the files selected.
- **Monitoring System Introduced (Paras 86, 87, 90, 91):** The firm introduced a policy to inspect **two completed files every year**, selecting one per partner. A **three-year cycle** was created to cover all engagement partners. File inspections were **unannounced**, and staff were informed that such reviews would be routine going forward.
- **Deficiency Tracking & Evaluation (Paras 93–95):** Found deficiencies were categorized:
 - **Isolated lapses:** Addressed through counseling.
 - **Systemic issues (e.g., unsupported disclosures):** Triggered checklist updates and team-wide training.
- A memo was issued where one article missed three critical steps. A corrective note was sent to the client on the previous unsupported contingent liability disclosure.

Actions taken

2/2

- **Remediation & Communication (Paras 94–97):** Partners shared a **Monitoring Report Summary** during the annual planning meeting:
 - Common issues
 - Staff training needs
 - Policy adjustments (e.g., mandatory use of updated checklists)
- Client acceptance and independence confirmations were made part of the “file opening” checklist.
- **Ongoing Improvements (Para 89):** CARO and Schedule III updates were compiled quarterly and circulated. A 30-minute monthly learning session was initiated for all audit staff. Independence declarations were made mandatory during planning phase.
- **Documentation (Para 100–101):** A binder titled “**Internal Monitoring File**” was created to house:
 - Monitoring policy
 - Reviewed file checklists
 - Deficiency memos
 - Training session logs
 - Yearly summary reports

Case Study: Complaints and Allegations

- Agarwal & D'Souza – 2 partners, 4 staff members, 2 article assistants
- Following an audit of a transport logistics company, the firm received an anonymous email alleging that key expenses were not properly verified, and that the audit manager ignored concerns raised by the article assistant.
- Internally, the article later confirmed she had flagged questionable diesel claims but was told to “let it go.” The audit file had no notes or consultation documentation. The firm had no complaint policy, and staff were unsure how to report concerns safely.

Issues identified

- **Para 101–102:** No system to receive and address complaints from inside or outside the firm. No policy existed to guide such situations
- **Para 103:** Staff didn't know how to raise concerns, and feared backlash if they did
- **Para 104:** No defined process for impartial investigation; no documentation was maintained
- **Para 105:** The firm had no procedure to take action or learn from the issue once a complaint was substantiated

Actions taken

- **Complaint Framework Introduced (Paras 101–102):** Created a written “**Complaints and Allegations Policy**”, defining what constitutes a valid complaint. Enabled both internal and external stakeholders to email or submit concerns anonymously or directly.
- **Safe Internal Reporting Channel (Para 103):** Appointed a partner (not involved in the engagement) as the **Ethics Contact**. Shared a poster and WhatsApp announcement that **staff can raise issues safely** without fear of punishment.
- **Formal Investigation Process (Para 104):** The non-engagement partner investigated the diesel claim matter and found **no documentation of audit skepticism or review**. Engaged a **peer CA** to independently assess the file handling and provide a second opinion. All steps were documented in a newly created **complaint register**.
- **Action Based on Findings (Para 105):** Gave a **written advisory** to the audit manager on the importance of listening to team inputs and documenting responses. Updated the **audit completion checklist** to include documentation of staff-raised concerns and resolution steps. Shared learnings in a partner-staff monthly review to build openness around quality and ethics.

Case Study: Engagement partner taking over an audit

- Client: BHEL
- Audit Firm: XYZ & Co., Chartered Accountants
- Engagement Partner: Mr. Y was given the responsibility to look after audit of BHEL
- Mr. Y died/ resigned while the audit was in progress and the responsibility was handed over to Mr. X.
- What should Mr. X do now
- **Ans:** _____

Procedures to be applied by engagement partner taking over an audit during the engagement

The taking over partner should **review the following:**

- Compliance of **regulatory and professional standards;**
- **Significant matters** requiring further consideration;
- **Appropriateness of documentation** made by the preceding partner;
- Need to **redefine Nature, Timing and Extent of audit procedures;**
- **Sufficiency and appropriateness of audit evidence** obtained by preceding partner

- Client: BHEL
- Audit Firm: XYZ & Co., Chartered Accountants
- Engagement Partners: Mr. X and Mr. Y were given the responsibility to look after audit of BHEL
- Mr. Y is of the view that inventory of BHEL should be valued on FIFO basis whereas Mr. X is of the view that it should be on weighted average cost basis. Whose view should be considered while finalizing the audit report of BHEL.
- **Ans:** This could be Mr. X or Y or Z or any other person who is designated by the firm as “Engagement Quality Control Reviewer” – see the next slide

Engagement Quality Control Reviewer

- Partner of the firm or the person engaged by the firm
- Vested with the responsibility
- To objectively evaluate
 - significant judgments made by the engagement team
 - conclusions made by audit team in formulating the report

Engagement Partner

- Partner of CA Firm
- Engaged in performance of
 - Audit functions
 - For reporting on behalf of the CA 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 engagement quality control review is required, the engagement partner shall:
 - a) Determine that an engagement quality control reviewer has been appointed ~ suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews;
 - b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
 - c) Not date the auditor's report until the completion of the engagement quality control review

Rotation of Engagement Partner

- Para 25(b) of SQC 1 provides that the firm should establish policies and procedures all audits of financial statements of **listed entities**, requiring the rotation of the engagement partner after a specified period in compliance with the Code of Ethics;
- Para 27 of SQC 1 provides that in the context of financial statement audits of listed entities, the engagement partner should be rotated after a pre-defined period, normally **not more than seven years**.
- **Note:**
 - a) The provision of rotation of partners shall **not be applicable in case the audit of listed entities is being done by a sole practitioner/ proprietor**.
 - b) However, in order to ensure that appropriate system of quality control exists in the firm and that appropriate reports are issued in the circumstances by sole practitioners/ proprietors, such practice unit(s) shall be **compulsorily reviewed under the process of peer review**.

Question 1

- Listed Company ~ Reliance Industries Limited
- The Statutory Auditors are XYZ and Co. Chartered Accountants, having 3 partners viz. X, Y and Z
- Question:
 1. Whether rotation of CA Firm mandatory
 2. Whether rotation of EP mandatory
 3. Whether appointment of EQCR mandatory
 4. Suppose that Mr. X and Mr. Y were looking after the audit but they have difference of opinion on treatment of depreciation, then who can act as EQCR:
 - a) CA. X
 - b) CA. Y
 - c) CA. Z
 - d) CA. L, another CA in practice

Question 2

- Unlisted Co. ~ Sarvana Bhawan Ltd. (Turnover Rs. 3,000 crores)
- The Statutory Auditors are XYZ and Co. Chartered Accountants, having 3 partners viz. X, Y and Z. Their Quality Control Manual says that they will appoint EQCR for statutory audits of those unlisted companies which are having turnover > Rs. 1,000 crores
- Question:
 1. Whether rotation of CA Firm mandatory
 2. Whether rotation of EP mandatory
 3. Whether appointment of EQCR mandatory
 4. Suppose that Mr. X and Mr. Y were looking after the audit but they have difference of opinion on treatment of depreciation, then who can act as EQCR:
 - a) CA. X
 - b) CA. Y
 - c) CA. Z
 - d) CA. L, another CA in practice

Certain Definitions

Engagement team

- all **personnel** performing an engagement, including any experts contracted by the firm in connection with that engagement

Personnel

- partners and **staff**

Staff

- professionals, other than partners, including any experts which the firm employs

Monitoring and Inspection

- The purpose of **monitoring compliance with quality control policies and procedures** is to provide an evaluation of:
 - a) **Adherence to professional standards**, regulatory & legal requirements;
 - b) Whether the **quality control system has been appropriately designed** and effectively implemented; and
 - c) Whether the firm's **quality control policies and procedures have been appropriately applied**, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
- The **inspection of a selection of completed engagements** is ordinarily performed on a cyclical basis. Engagements selected for inspection include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years.
- At least **annually, the firm should communicate the results of the monitoring** of its quality control system to EP, MP, CEO (if any), Other appropriate individuals

Question 3

- XYZ and Co., a CA Firm having three partners, conducted the following audits:
- CA. X
 1. Audit of Reliance Industries Limited
- CA. Y
 1. Audit of Lanco
 2. Audit of Dabur
 3. Audit of ITC
- CA. Z
 1. Tax Audit of Dabur
 2. Tax Audit of ITC
- Advise how many audit files atleast will be inspected from above
 1. CA. X
 2. CA. Y
 3. CA. Z