CHAPTER 1

QUALITY CONTROL



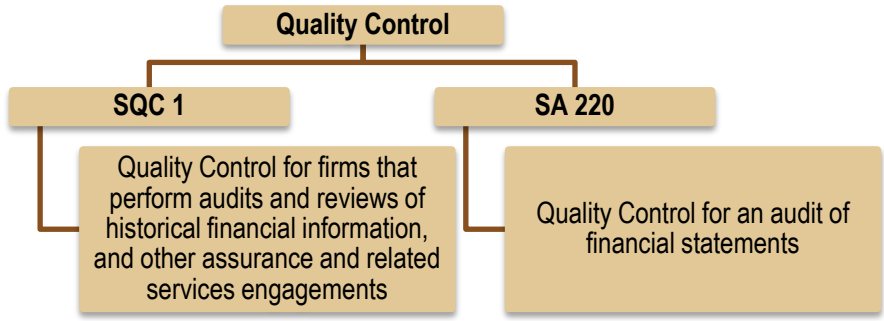
LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Gain the knowledge about importance of audit quality.
- Understand the importance of quality control system in a firm.
- Clearly grasp import of SQC 1 and SA 220.
- Apply requirements of SQC 1 and SA 220 in practical situations.
- Understand importance of ethics in engagements.
- Differentiate between SQC 1 and SA 220.
- Understand relationship between SQC 1 and SA 220.
- Know briefly about mechanisms for review of audit quality.

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CHAPTER OVERVIEW



CA Jagriti is working in a firm of Chartered Accountants in capacity of a paid employee. The firm consists of 7 partners and is handling varied types of professional work including audits. There is heavy load of professional work on her and she handles few audit clients also. The firm's business is growing rapidly and many new clients have been added to the client base of the firm in past 2-3 years. In hindsight, she is thinking whether it was proper on part of the firm to accept new clients without checking and verifying their backgrounds.

Besides, she also feels that firm is accepting audits of some companies which are engaged in technical and complex operations. The firm has no past experience for audits of such clients. The partners also seemed to be stingy in hiring experienced and capable staff to handle such work. In her mind, she always lamented about the same. Are commercial considerations deciding and overriding factors? She was brooding.

Increase in volume of professional work without commensurate hiring of capable and qualified staff is leading to many lapses. She had handled audit of a listed company. The audit was completed, report issued, and annual report published. She found to her horror that audit report issued under the Companies Act, 2013 referred to "profit" in financial statements. However, audited financial statements reflected a "loss." She developed cold feet and cursed lack of a proper quality control system in the firm.

Similarly, in another case, she found that issued audit report of the company referred to "cash flow statement" whereas audited financial statements didn't comprise of a cash flow statement as it was a "small company" within meaning of the Companies Act, 2013.

She had made up her mind to make senior partner listen to her. Inviting attention to such serious lapses in reporting, she politely told her that firm was inviting troubles from regulators. She underlined need for a proper and effective quality control system in the firm to ensure that work was carried out in accordance with professional standards and applicable legal and regulatory framework so that audit report that is appropriate is issued.

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1. AUDIT QUALITY

High audit quality is central to the auditing profession. It helps in creating trust in users of financial information. Industry, government and public at large are the stakeholders who rely upon assurance given by auditors. It is, therefore, necessary to ensure high audit quality throughout the audit process. Audit quality involves the 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" deals with issue of establishing quality control systems and responsibilities of auditors in this regard. Both the standards deal with framework of audit quality. SQC 1 applies to all engagements and deals with quality at the level of firm. SA 220 deals with audit quality at individual audit engagement level.

Besides the above two standards, other Standards on Auditing, Code of Ethics issued by ICAI and certain provisions of the Companies Act, 2013 facilitate quality control process. There also exists a mechanism for review of quality control through Peer Review Board, Quality Review Board and NFRA (National Financial Reporting Authority).

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 that reports issued by the firm or engagement partners are appropriate in the circumstances. The 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

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(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

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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 the 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.

TEST YOUR UNDERSTANDING 1

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. The promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited has been in the 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 a strong recommendation to the Firm to accept the audit.

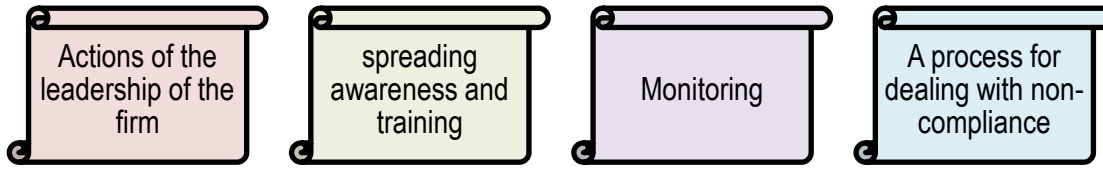
What is your understanding of the functioning of the tone at the top of the firm ABC & Associates, Chartered Accountants.? What are the considerations one should exercise to uphold Quality of the Firm?

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.

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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:



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 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 notify 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.

SQC 1 lays special emphasis on *familiarity threat.* Using the same senior personnel on assurance engagements over a prolonged period may impair the quality of performance of the engagement. Therefore, the firm should establish criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm considers such matters as-

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

(b) the length of service of the senior personnel on the engagement.

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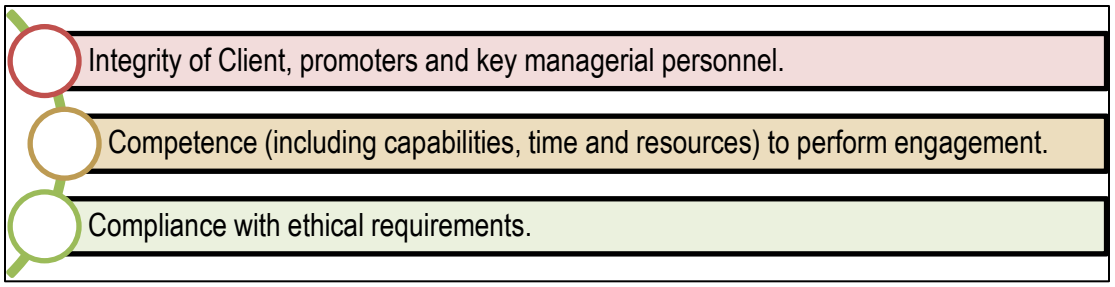
Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review. The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years (except in cases where audit of listed entities is conducted by a sole practitioner). However, to ensure quality control exists in such firms and appropriate reports are issued, there is a process for mandatory peer review of such firms.

TEST YOUR UNDERSTANDING 2

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 the quality control system of firm?

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: -



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.

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- 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 other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm. The extent of knowledge a firm will have regarding the integrity of a client will generally 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.

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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 engagement, 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.

TEST YOUR UNDERSTANDING 3

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 the 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. Complaining about the poor quality of services provided by his present auditor, he offers appointment as tax 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?

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 the firm's personnel.

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

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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 groom them for their role. The firm should assess the 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 have 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.

A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies. Complete and proper documentation should be maintained on issues involved and results of consultation.

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.

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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 includes 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 judgments 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.

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Where the nature and extent of the consultations become significant, however, care is taken by both the engagement team and the reviewer to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person is appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement. The firm's policies should provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired.

Differences of Opinion: *There* might be differences 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 is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

Engagement documentation: 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 the date of auditor's report in case of audit engagements and in other cases within the limits appropriate to engagements.

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

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(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 are 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 the 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.

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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. The 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 provide 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.

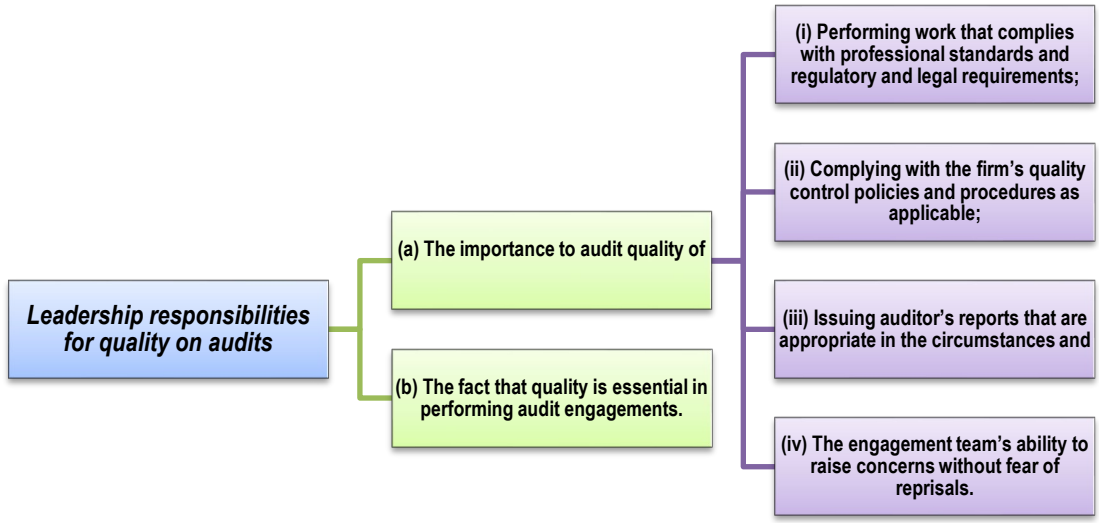
SA 220 is modelled on lines of SQC 1. It describes responsibilities of engagement partner in relation to following matters: -

(a) Leadership responsibilities for quality on audits.	**(b) Relevant ethical requirements.**
(c) Acceptance and continuance of client relationships 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:

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(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 are 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.

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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 the 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 the issuance of the auditor's report.

The 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:

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(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 judgments 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.

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TEST YOUR UNDERSTANDING 4

GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issues 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?

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:

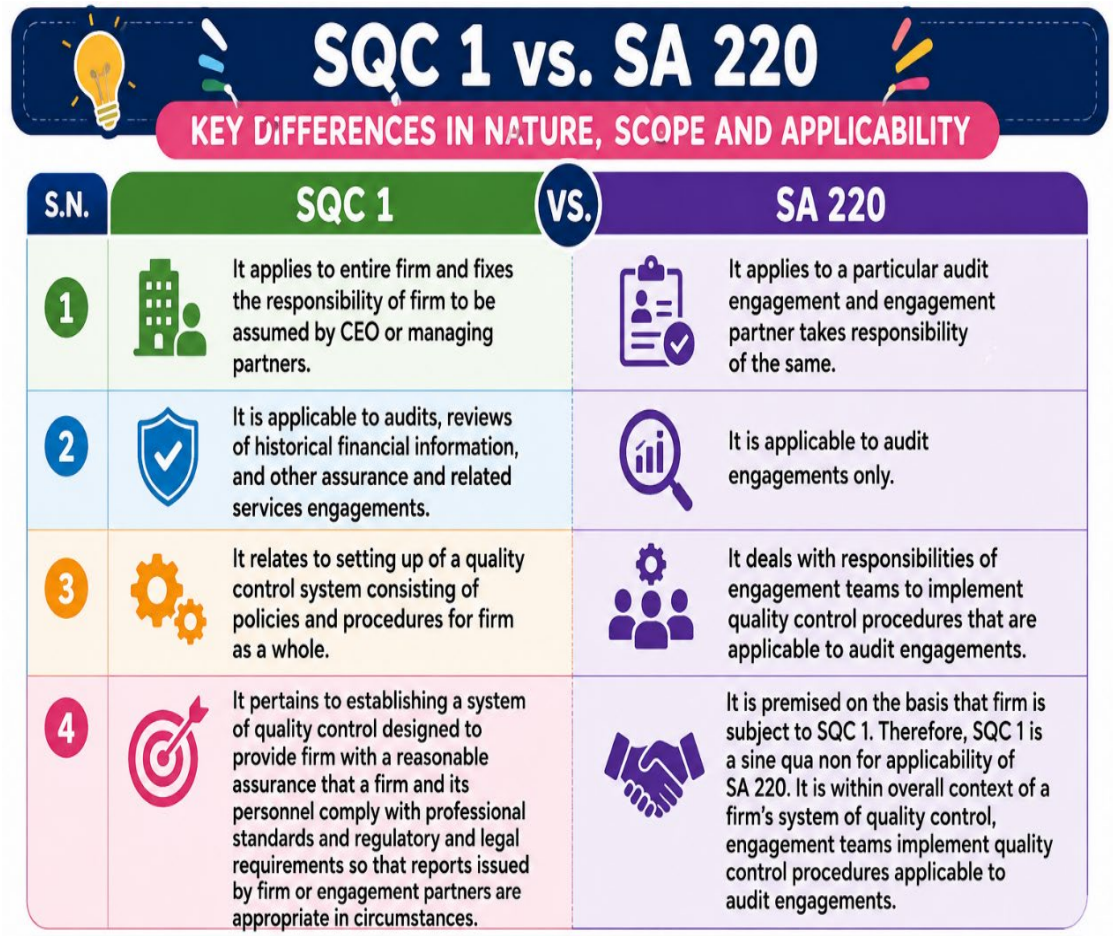
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(a) The procedures required by the firm's policies on engagement quality control review have been performed.

(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



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TEST YOUR UNDERSTANDING 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 the year 2025-26 also included reports 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 the above reporting qualitative and in line with the requirements of SA 220?

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 demonstrates quality of assurance services provided by members.

Peer review is meant for the purpose of enhancing the quality of professional work resulting in more reliable and useful audit reports.

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

Once a Practice Unit is subjected to Peer review, its assurance engagement records pertaining to the Peer review period are subject to examination and review by the Peer Reviewer. On completion of this exercise, a "peer review certificate" is issued in case of unqualified report issued by Peer Reviewer. In case of a qualified report, it is informed to the Practice Unit that same cannot be issued along with the reasons therefor as well as inform about the due date for conducting a follow-on review as may be decided by the Board.

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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 ICAI. The functions of QRB are: -

(a) To make recommendations to the Council regarding the quality of services provided by the members of the Institute;

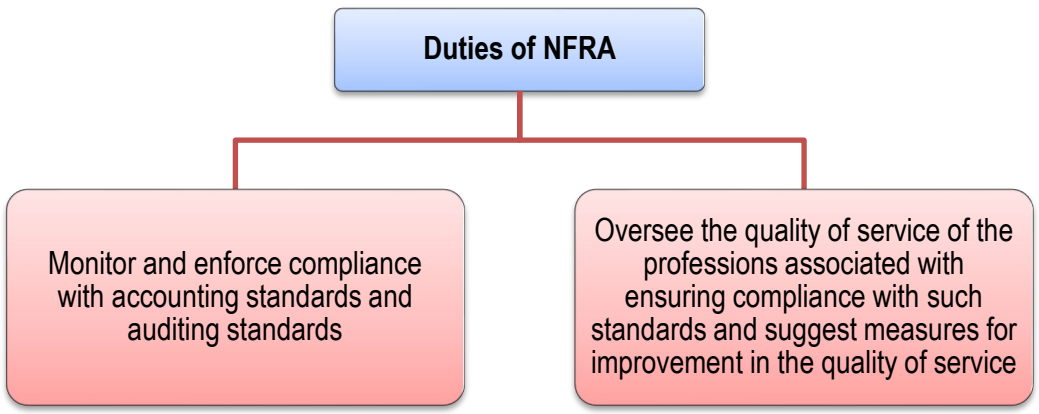
(b) To review the quality of services provided by the members of the Institute including audit services and

(c) To guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

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

5.3 National Financial Reporting Authority (NFRA)

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



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 the NFRA Rules, 2018.

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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 the NFRA Rules, 2018 and those referred to QRB by NFRA under relevant rules.

Key Takeaways

- 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 that reports issued by the firm or engagement partners are appropriate in the circumstances.
- SQC 1 is applicable to audits, reviews of historical financial Information, and other assurance and related services engagements. It is applicable to all firms irrespective of their constitution.
- Elements of system of quality control envisaged in SQC 1 include establishing leadership responsibilities for quality within the firm, complying with ethical requirements, acceptance and continuance of client relationships and specific engagements, establishing policies and procedures addressing issues of capabilities, competence, and commitment of human resources in firm to carry out engagements, engagement performance and monitoring.
- In respect of difficult or contentious matters, consultation may be required at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.
- 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 review does not reduce the responsibilities of the engagement partner.
- Engagement quality control review is mandatory in respect of listed entities.
- 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 engagements.
- 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.

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- 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.
- SA 220 is applicable to audit engagements only. It deals with responsibilities of engagement teams to implement quality control procedures that are applicable to audit engagements.
- SA 220 is premised on the basis that firm is subject to SQC 1. It is within the overall context of a firm's system of quality control, engagement teams implement quality control procedures applicable to audit engagements.
- Besides SQC 1 and SA 220, other Standards on Auditing, Code of Ethics issued by ICAI and certain provisions in the Companies Act, 2013 facilitate quality control process. There also exists mechanism for review of quality control through Peer Review Board, Quality Review Board and NFRA (National Financial Reporting Authority).

For a concise revision of the key concepts covered in this chapter, students may refer to the Saransh Booklet for Paper 3: Advanced Auditing, Assurance and Professional Ethics, which serves as a useful last-mile revision resource for examination preparation. Saransh Booklet can be accessed at https://boslive.icai.org/AAAPE_SARANSH.pdf

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *PQR & Associates are statutory auditors of a listed company. There arose an issue during the course of audit relating to related party transactions. The engagement partner wants to consult an engagement quality control reviewer on this matter during the course of audit process itself. Can he consult with engagement quality control reviewer? Discuss.*
2. *Beta Private Limited has approached a firm of Chartered accountants to assist them in preparation of financial statements and issue a compilation report in this regard. Does CA firm have responsibility in relation to quality control for above said engagement? Discuss with reasons.*
3. *Ramanujan, a CA final student, feels that engagement file in audit engagement should be ready prior to issue of audit report. Discuss whether Ramanujan's view is in order.*
4. *BNE & Co. are in midst of audit process of a listed company. During the audit, an issue arose relating to revenues from contracts with customers in terms of Ind AS 115. The engagement partner took a certain stand. However, engagement quality control reviewer recommended*

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otherwise after review. The engagement partner is not willing to accept recommendations of reviewer. How can this conflict be resolved?

5. *MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1.*

6. *SPS & Associates, Chartered Accountants, are statutory auditors of Grec Limited for the last two years. Grec Limited is engaged in the manufacturing and marketing of pharmaceutical goods in India. During the year 2025-26, the company has diversified and commenced providing software solutions in "e-commerce" in India as well as in certain African countries. SPS & Associates, while carrying out the audit, noticed that the company has expanded its operations into a new segment as well as in a new country. SPS & Associates does not possess the necessary expertise and infrastructure to carry out the audit of these diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.*

7. *PQR Associates are the statutory auditors of a large un-listed company, which is engaged in manufacturing of auto components. Subsequent to reappointment of auditors in the Annual General Meeting, the Company shared the appointment letter with PQR Associates, seeking acknowledgement and acceptance letter. CA R is the engagement partner and is planning to issue the acceptance letter. During the current financial year, there was a search by the Income-tax Authorities on the company, and certain accounting records were seized for verification. Based on the information available on social media, CA R noted that the promoters' brother is contemplating to contest in the ensuing elections, under the banner of a political party. One of the current senior engagement team manager, who has been doing the audit engagement till last year, has left PQR Associates and is planning to provide some accounting services to one of the associate companies. PQR Associates are yet to recruit another senior manager having adequate experience in the audits of clients engaged in the automotive sector. Elaborate the matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships considering the above issues.*

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8. *CA Giri is a senior partner of M/s TSV Associates. M/s TSV Associates is a reputed firm of Chartered Accountants which has been in practice for more than five decades. The firm undertakes statutory audits of large listed companies across various industry sectors and has more than fifty qualified experienced professionals. CA Giri has been assigned as an Engagement Quality Control Reviewer for an audit engagement of a listed company. What are the aspects which would be looked into by CA Giri as an EQCR in relation to the engagement?*

   Upon completion of the review, CA Giri has identified certain issues with respect to revenue recognition and adequacy of provisions relating to onerous contracts. The views of CA Giri are not accepted by the Engagement Partner. Suggest ways of resolving the differences of opinion between CA Giri and the engagement partner.

9. ***M/s JinKushal & Co. has been appointed as an auditor of SC Ltd. for the financial year 2025-26. CA Jin, one of the partners of M/s JinKushal & Co., completed entire routine audit work by 19th June, 2026. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA Kushal, another partner of M/s JinKushal & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA Jin. State with reasons whether CA Kushal is right in expressing an opinion on financial statements, the audit of which is performed by another auditor.***

10. ***SDC & Associates, a medium-sized audit firm, is appointed as an auditor of Neuronix Ltd., a listed pharmaceutical company engaged in extensive R&D with complex global operations. CA Rashi an engagement partner of SDC & Associates is leading the audit team for the audit of the same. Neuronix Ltd. was earlier audited by a Big 4 firm that withdrew from the engagement citing scope limitations. During the audit planning, CA Rashi realises that while her team is skilled in standard manufacturing audits, they lack experience in pharma R&D and associated regulatory frameworks. The firm is under pressure to complete the audit in time to meet the listing obligations of Neuronix Ltd. The Managing Partner insists on continuing the audit and advises CA Rashi to rely on the firm's standard procedures to ensure timely delivery.***

    In light of SQC 1 and SA 220, analyse the quality control considerations CA Rashi must evaluate before continuing with the engagement. What actions should she take to uphold audit quality and professional standards?

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11. ***RBC & Co., Chartered Accountants, is a large audit firm engaged in audits and assurance services across various sectors. The firm currently maintains audit documentation in both electronic and physical (hard copy) formats. However, during audit it was observed that physical files are neither scanned and incorporated into the electronic files nor cross-referenced with them. As a result, the documentation remains scattered with no integrated or centralised audit file for the engagement. Additionally, several audit working papers lack clarity on whether the information was obtained from the client or prepared internally by the engagement team. This ambiguity raises concerns regarding the reliability and origin of audit evidence. How do you view the above situation from the point of view of quality control system in audit firm? Analyse.***

12. ***M/s KRM & Associates, Chartered Accountants, is the statutory auditor of Velocity Engineering & Projects Ltd., a listed company engaged in execution of large-scale infrastructure projects under Engineering, Procurement and Construction (EPC) contracts across India and overseas.***

    The firm has an experienced partner designated as Engagement Quality Control Reviewer for listed entity audits.

    During the audit for the year ended 31st March 2026, the engagement team noticed the following matters:

    - ***Revenue of ₹ 1,250 crores recognised under long-term EPC contracts using percentage of completion method based on cost-to-cost input method under Ind AS 115. Significant variation claims and escalation clauses were included in transaction price based on management's assessment of "high probability of recovery".***
    - ***Impairment testing of investments in step-down foreign subsidiaries executing overseas EPC contracts, where cash flow projections were based on aggressive assumptions about future contract awards.***
    - ***Disagreement between the senior member of the audit team and the engagement partner regarding inclusion of variation claims as part of transaction price, with the senior member recommending external technical consultation.***
    - ***The firm did not have internal infrastructure specialists. However, external consultation was obtained, and the matter was resolved without formal documentation of consultation process.***
    - ***The Engagement Quality Control Reviewer was informed about the audit but:***
        - ***The review was conducted only at a summary level.***

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- *Detailed evaluation of significant judgments relating to revenue recognition and impairment was not performed.*
- *The audit report was signed before completion of formal EQCR documentation.*
- *Differences of opinion, if any, were not formally documented or resolved.*

- *The working papers contain general review notes but no detailed documentation evidencing depth of consultation or completion of objective EQCR procedures prior to issuance of the audit report.*

You are required to examine compliance with requirements relating to Engagement Performance, Consultation and Engagement Quality Control Review as per SQC 1.

13. *STA and Associates, Chartered Accountants, is an upcoming firm and its good professional services are hired by diverse clients for assurance services. With a standing of seven years in practice, the firm has clients in various industries like health care, education, hospitality, manufacturing and many more. With the increasing assignments, changes in regulatory compliances and appointment of new personnel, the senior partner CA T is concerned with the proper functioning of the system of Quality control within the firm. He wants to ensure that policies and procedures relating to the system of quality control of the firm are complied with properly. CA T suggests that a proper monitoring of quality control will be the right approach. Discuss the factors that are to be considered by CA T for monitoring the quality control of engagements to ensure that they comply with SQC.*

14. *XYZ and Associates, Chartered Accountants, is an audit firm, giving services to the various types of clients in the field of auditing, taxation and management consultancy. It has been doing statutory audit of B Ltd., a listed entity since last seven years. CA X who has been the engagement partner for the company since beginning has a complete idea about the strengths and weaknesses of the internal controls of the company. He maintains good relations with the management and those charged with the governance. Every year audit is completed in a cordial and healthy manner. During current year the quality control reviewer insisted to change the engagement partner for the company saying that continuation of same engagement partner poses certain audit risk and threats to the organization and advises to review the firm's policies and procedures in relation to the engagement partner. The management of the company does not wish to change the engagement partner. How do you view the above situation from the viewpoint of quality control system in audit firm in terms of requirements of*

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SQC 1? Guide the firm in establishing the policies and procedures in respect of an engagement partner.

15. *During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.*

16. *XYZ & Co., a mid-sized audit firm, has recently expanded its operations and taken on several large clients. To manage the growing workload, the firm's CEO has delegated operational responsibilities for the firm's quality control system to two senior partners. However, certain concerns have been raised:*

    (1) One of the partners, though commercially successful in bringing in new clients, has limited experience in audit quality oversight.

    (2) The firm's new incentive system heavily rewards partners and staff based on revenue generation and client acquisition, with little emphasis on audit quality or compliance with professional standards.

    (3) Due to rapid expansion, the firm has allocated most of its resources towards marketing and client development.

    The aforesaid concerns reflect on which element of quality control within the firm as per SQC1? What are the considerations one should exercise to achieve quality in all the engagements that the firm performs?

17. *Rajni Ltd., a listed company, has appointed M/s Amit & Co. as its statutory auditor. CA Sunil, who recently joined the firm, has been appointed as the engagement partner for the first time. While preparing for the audit, he realises the importance of ensuring the audit team's independence, as required by standard audit practices. However, when reviewing the firm's framework, he is unable to find any documented policies or procedures addressing independence compliance.*

    What steps should CA Sunil take to ensure compliance with independence requirements for the audit engagement? Why is it necessary for an audit firm to have

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well-documented policies and procedures to maintain independence? Discuss with reference to the relevant Standards on Auditing.

18. ***Alex & Associates is the statutory auditor of VC Ltd., a listed company and started its operations 6 years ago. The fieldwork for the audit of the financial statements of the company for the year ended 31st March, 2026 was completed on 5th May, 2026. The auditor's report was dated 19th May, 2026. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on 22nd May, 2026. The engagement partner had completed his reviews in its entirety by 16th May, 2026. Comment.***

19. ***Loyal & Co., a Chartered Accountant firm, has recently experienced significant growth and started auditing several large corporate entities. During a periodic internal assessment of the firm's quality control system, the following observations were made:***

- ***Loyal & Co. often accept new audit engagements based on referrals from existing clients, without conducting a proper evaluation of the client's reputation, integrity of management, or potential risks associated with the engagement.***
- ***The firm is following the same quality control policies for several years without updating them for recent changes in professional standards and regulatory requirements.***

Identify the elements of the system of quality control under SQC 1 that are affected in the above situation and briefly explain how these elements contribute to ensuring quality in audit engagements performed by the firm.

Answers to Test your Understanding

1. 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, the 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 inquires against the company. In spite of all this, managing partner of firm Mr. A has recommended for acceptance of offered audit of the company.

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It reflects poorly regarding functioning at the top of the firm as regards quality control. SQC 1 requires that the firm 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 the firm's business strategy is subject to overriding the requirement of firm to achieve quality in all engagements. However, in the given situation, commercial considerations seem to be an 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.

2. Approach of Sudhanshu is not proper. Such practices clearly violate Code of Ethics and its spirit. It reflects poorly upon the 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.

3. 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

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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.

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

5. 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 provide 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.

Hints /Answers to Theoretical Questions

1. It is necessary to maintain objectivity of 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.

2. Such kind of services fall in category of "related services". SQC 1 is applicable to all type of engagements including engagement pertaining to "related services".

3. 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. Thus, view of Ramanujan is not in order.

4. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body. The audit report should be issued only after resolution of the matter.

5. As per SQC 1, 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

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continue the client relationship or a specific engagement, it should document how the issues were resolved.

Refer "With regard to the integrity of a client, matters that the firm considers include, for example" described under Para 2.1.3

6. As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, SPS & Associates, Chartered Accountants, statutory auditors of Grec Limited for the last two years, came to know that the company has expanded its operations into a new segment as well as in new country. SPS & Associates does not possess the necessary expertise for the same, therefore, SPS & Associates wish to withdraw from the engagement and 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 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 engagement, 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.

SPS & Associates should address the above issues before deciding to withdraw.

7. Acceptance and Continuance of Client Relationships: As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other

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Assurance and Related Services 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.

Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence.

In view of the above, PQR Associates should:

- ✓ follow their firm's policies and procedures for client acceptance and continuance. This includes evaluating the integrity of the client, assessing potential risks associated with the engagement, and ensuring the firm has the necessary resources and expertise to perform the engagement effectively. The engagement team, should assess, whether the company is involved in any funding activities, to the political parties, and if so enquire and assess the risks related to such transactions.
- ✓ communicate clearly with the client regarding the scope of the engagement, the responsibilities of both parties, and any limitations on the services to be provided. This helps manage expectations and ensures alignment between the firm and the client.
- ✓ independence and objectivity throughout the engagement. Any potential threats to independence, such as relationships with the client's affiliates or involvement in political activities by related parties, should be evaluated and mitigated appropriately. Since the senior manager who was on this engagement is providing certain accounting services, to one of the group companies, the engagement partner, should assess,

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whether it would have any impact on the audit and examine the relevant ethical/independence requirements.

- ✓ continually monitor the client relationship for any changes or developments that may impact the firm's ability to provide services effectively. This includes staying informed about significant events such as the income-tax search, changes in client management, or potential conflicts of interest. Since there was an income-tax raid on the organisation, the engagement partner should evaluate the risks of material misstatements, and non-disclosure of tax disputes and liabilities.
- ✓ ensure that their engagement team possesses the necessary competence and capabilities to perform the audit effectively. The departure of a senior manager and the need to recruit a replacement with specific industry experience should be addressed promptly to maintain audit quality. Since one of the senior engagement team members has left PQR Associates, the engagement partner should assess, whether he would be in a position to devote adequate time on the engagement or whether to recruit another resource, before commencement of the audit.

8. As per SA 220, "Quality Control for an Audit of Financial Statements", for audits of financial statements of listed entities, CA Giri, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

(i) The engagement team's evaluation of the firm's independence in relation to the audit engagement;

(ii) 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;

(iii) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached.

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," 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 is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

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In the given situation, under completion of review, CA Giri, Engagement Quality Control Reviewer has identified certain issues. However, the view of CA Giri, the EQCR are not accepted by the Engagement Partner. This difference of opinion among the CA Giri and Engagement Partner should be resolved with abovementioned manner as per SQC 1.

9. ***Relying on Work Performed by Another Auditor: As per SA 220 "Quality Control for an Audit of Financial Statements", an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration; appropriate consultations have taken place and the resulting conclusions have been documented and implemented; there is a need to revise the nature, timing and extent of work performed; the work performed supports the conclusions reached and is appropriately documented; the evidence obtained is sufficient and appropriate to support the auditor's report; and the objectives of the engagement procedures have been achieved.***

Further, as per the Code of Ethics, it is the auditor's professional responsibilities and should be complied with that when the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.

However, the auditor should carefully direct, supervise and review the work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA Jin. However, the report could not be signed by him due to his unfortunate death. Later on, CA Kushal signed the report relying on the work performed by CA Jin. Here, CA Kushal is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA Jin provided he further exercises adequate skill and due care and review the work performed by him.

10. ***As per SQC 1, "Quality Control for firms that perform audits and reviews of historical financial information, and other assurance and related services engagements", CA Rashi, as the engagement partner, is required to evaluate whether the firm has the***

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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.***

Under SA 220, "Quality Control for an audit of financial statements", 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.

In the given case:

- ***SDC & Associates lacks experience in pharmaceutical R&D audits, a highly regulated and technical field.***
- ***The previous auditor's withdrawal citing scope limitations is a warning sign that must be evaluated.***
- ***The engagement team lacks relevant expertise, and there is pressure from the managing partner to proceed regardless.***

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- *Proceeding without addressing these issues would violate the requirements of SQC 1 and SA 220.*

CA Rashi must not proceed with the engagement unless satisfied that all conditions under SQC 1 and SA 220 are met. She should:

- *Assess the firm's capability and consider engaging external experts.*
- *Understand the reason for previous auditor's withdrawal.*
- *Ensure that a qualified EQCR reviewer is appointed and review is completed before issuing the audit report.*

This will help maintain audit quality, ensure compliance with professional standards, and protect the firm from regulatory repercussions.

11. *In accordance with SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" the firm should establish policies and procedures designed to maintain confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.*

In the given situation, the physical files are neither scanned and incorporated in the electronic files nor cross-referenced to the electronic files. Inability to do so shows that firm has not established policies and procedures to maintain integrity of engagement documentation. Lack of ensuring the same makes it difficult to demonstrate completeness of audit files and whether these were assembled within 60 days timeframe stipulated in SQC 1.

Where engagement documentation is in paper, electronic, or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. One of the reasons for designing and implementing appropriate controls for engagement documentation in this regard is the protection of the integrity of information at all stages of engagement.

For the practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm implements appropriate procedures requiring engagement teams to:

(i) Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;

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(ii) Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and

(iii) Enable the scanned copies to be retrieved and printed as necessary.

It has also been stated that there are many instances where audit working papers do not contain details as to whether information was obtained from the client or prepared by the engagement team. It is important to identify the source of the document and the information used as audit evidence to ensure its reliability. It could have potential risks of non-compliance with Standards on Auditing.

12. In the given case, the auditor is required to examine compliance with requirements relating to Engagement Performance, Consultation and Engagement Quality Control Review as per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" as follows:

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.

In the given case, though complex and high-risk areas such as revenue recognition under long-term EPC contracts and impairment of overseas investments were involved, adequate documentation and supervision procedures are not evidenced.

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 have 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.

A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies. Complete and proper documentation should be maintained on issues involved and results of consultation.

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In the given case, disagreement existed within the engagement team regarding inclusion of variation claims, and the firm lacked internal infrastructure specialists. In the absence of above, external consultation was obtained to resolve the matter. Though matter got resolved, no documentation for consultation process was maintained. This indicates non-compliance with consultation requirements.

Engagement Quality Control Review (EQCR): 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.

In the present case, although the firm had an Engagement Quality Control Reviewer, the review was not adequately performed, significant judgments were not objectively evaluated in depth, and the audit report was issued before completion of proper EQCR procedures. This indicates non-compliance with the requirements relating to Engagement Quality Control Review.

Conclusion: In the given case, the audit involved significant judgments relating to revenue recognition under long-term EPC contracts and impairment of foreign investments, which constitute difficult and contentious matters requiring consultation at an appropriate professional level. Failure to document such consultation indicates non-compliance with engagement performance requirements.

Further, since Velocity Engineering & Projects Ltd. is a listed entity, Engagement Quality Control Review was mandatory. Though an Engagement Quality Control Reviewer existed in the firm, the review was not properly performed and was not completed before issuance of the audit report. Hence, the firm has failed to comply with the requirements relating to Engagement Performance, Consultation and Engagement Quality Control Review.

13. *Factors considered for Monitoring Quality Control Engagements: As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," factors to be considered by CA T for monitoring the quality control of engagements to ensure that they comply with SQC: Refer Para 2.1.6*

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14. Quality control system in an audit firm (SQC 1): SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," lays special emphasis on familiarity threat. Using the same senior personnel on assurance engagements over a prolonged period may impair the quality of performance of the engagement.

Therefore, the firm should establish criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm considers such matters as:

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

(ii) the length of service of the senior personnel on the engagement.

The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years (except in cases where audit of listed entities is conducted by a sole practitioner). However, to ensure quality control exists in such firms and appropriate reports are issued, there is a process for mandatory peer review of such firms.

In the given situation, XYZ and Associates, Chartered Accountants, has been conducting the statutory audit of B Ltd., a listed company, for the past seven years. CA X served as the engagement partner throughout this period. CA X has developed an in-depth understanding of the company's internal controls and maintains a strong, cordial relationship with the management and those charged with governance. However, during the current year, the firm's quality control reviewer raised concerns about the continued involvement of CA X, citing the continuation of the same engagement partner poses certain audit risk and threats to the organisation, and advised reviewing the firm's policies regarding engagement partner rotation.

In view of SQC 1, the continued involvement of the same engagement partner, CA. X with a listed entity for an extended period, i.e., more than 7 years, poses a familiarity threat, potentially impairing audit quality and independence. Therefore, the firm should implement a policy of mandatory partner rotation and review its quality control procedures to ensure compliance with professional standards and maintain the integrity of the audit process.

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The firm should establish policies and procedures requiring that:

(I) The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance;

(II) The engagement partner has the appropriate capabilities, competence, authority, and time to perform the role; and

(III) The responsibilities of the engagement partner are clearly defined and communicated to that partner.

15. As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

- *Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;*
- *Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and*
- *Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.*

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

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16. *SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," 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.*

It has been laid down clearly that the 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 the given situation, XYZ & Co., a mid-sized audit firm, has recently undergone rapid expansion and taken several large clients. In order to manage the increased workload, the firm's CEO has delegated operational responsibilities for the firm's system of quality control to two senior partners. However, concerns have emerged regarding the competence of the personnel entrusted with quality oversight, the firm's incentive structure being heavily revenue-oriented, and the disproportionate allocation of resources towards marketing activities. These issues raise questions about the firm's commitment to audit quality and compliance with professional standards and primarily reflect weaknesses in the "Leadership responsibilities for quality within the firm" element of quality control as per SQC 1.

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 the quality of work performed.

(ii) 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

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

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17. *As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code. Such policies and procedures should enable the firm to:*

    (i) Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and

    (ii) 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.

    Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement.

    In doing so, the engagement partner shall:

    (i) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

    (ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

    (iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

18. *As per SA 220, "Quality Control for an Audit of Financial Statement", the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:*

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

Further, SA 700, "Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be dated not earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In this case, the audit of VC Ltd. for the year ending on 31st March 2026 was conducted by Alex & Associates and was completed on 5th May, 2026. Subsequently, the engagement partner reviewed the audit by 16th May, 2026. The audit report issued by Alex and Associates was dated 19th May, 2026. However, the engagement quality control review was finalized on 22nd May, 2026, which is later than the date of the audit report. In view of above, the date of auditors' report before the completion of the engagement quality control review, is not correct.

19. *As per SQC 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", a 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 that reports issued by the firm or engagement partners are appropriate in the circumstances.*

In the given situation, the following specific elements of quality control are affected:

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(i) 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.*

In the present case, Loyal & Co. often accepts new engagements based solely on referrals without proper evaluation, which is a clear deficiency in this element.

(ii) Monitoring: The firm should ensure that policies and procedures relating to the system of quality control are 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. In this case, the firm has been following the same quality control policies for several years without updating them for changes in professional standards and regulatory requirements, indicating a lapse in monitoring.

Therefore, accepting engagements without properly assessing client integrity and continuing with outdated quality control policies by Loyal & Co. highlights deficiencies in the acceptance and continuance of client relationships and monitoring elements of SQC 1. These elements are crucial to ensure that the firm undertakes only appropriate engagements and its quality control framework remains updated, effective, and compliant with professional and regulatory standards. Strengthening these areas will help the firm in maintaining consistent audit quality, especially in view of its recent growth and engagement with large corporate clients.

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