

Standard on Quality

Control (SQC) 1

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PURPOSE OF SQC1

Purpose of SQC1

The purpose of the SQC is to

- ▶ Establish standards and provide guidance regarding
- ▶ A firm's responsibilities for its SQC
- ▶ For audits and reviews of historical financial information and for other assurance and related services engagements (not applicable to tax and other consultation services?)

Requires a firm

- ▶ to establish an SQC
- ▶ designed to provide it (ie the firm) with reasonable assurance that the firm and its personnel
- ▶ comply with professional standards and regulatory and legal requirements, and
- ▶ that the reports issued by the firm or engagement partners are appropriate in the circumstances
- ▶ Nature of SQC would depend on various factors including size and operating characteristics of the firm

ELEMENTS OF AN SQC

Elements of an SQC

A firm's SQC should include policies and procedures addressing each of the following elements

- ▶ Leadership responsibilities for quality within the firm
- ▶ Ethical Requirements (including specific focus on Independence)
- ▶ Acceptance and continuance of client relationships and specific engagements
- ▶ Human Resources
- ▶ Engagement Performance (comprises performance, consultation, dealing with differences of opinion, engagement quality reviews and engagement documentation)
- ▶ Monitoring

Requires the SQC policies and procedures **to be documented and communicated** to the firm's personnel

LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM

Leadership responsibilities for quality within a firm

- ▶ Firm should design policies and procedures designed to promote an internal culture based on the recognition **that quality is essential in performing engagements**
 - ▶ Requires the CEO or managing partners to assume ultimate responsibility for firm's SQC
 - ▶ Firm's leadership and examples they set, influence the culture within a firm
 - ▶ Should encourage a culture that recognises and rewards high quality work
 - ▶ Can be communicated by trainings, internal memos, informal discussions, newsletters, mission statements
 - ▶ Are incorporated in the firm's internal documentation, training material, partner and staff appraisal procedures to reinforce the firm's view on importance on quality
 - ▶ Needs the firm leadership to recognise that the business strategy is subject to the overriding requirement to achieve quality. Accordingly,
 - ▶ Firm assigns its management responsibilities so that commercial considerations do not override quality
 - ▶ Firm's policies, performance evaluations compensation and promotions are designed to demonstrate commitment to quality
 - ▶ Firm devotes sufficient resources for development, documentation and support of its SQC
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Leadership responsibilities for quality within a firm

- ▶ Persons assigned operational responsibility for SQC should have sufficient experience and ability, and the necessary authority to assume that responsibility
- ▶ Sufficient experience and ability – how demonstrated?
- ▶ Authority how demonstrated?

ETHICAL REQUIREMENTS (INCLUDING INDEPENDENCE)

Ethical requirements

- ▶ Requires firm to establish policies and procedures to enable it to ensure that the firm and its personnel comply with ethical requirements
- ▶ The firm's policies should emphasise the fundamental ethical principles as per ICAI's code of ethics (integrity, objectivity, professional competence and due care, confidentiality and professional behaviour) which are reinforced by
 - ▶ Firm leadership
 - ▶ Education and training
 - ▶ Monitoring
 - ▶ Process for dealing with non compliance

Independence

- ▶ Requires firm to establish policies and procedures to enable it to ensure that its personnel, and where applicable, others (including external experts used by the firm) maintain independence as per the Code
- ▶ Such policies and procedures should enable the firm to
 - ▶ Communicate its independence requirements to its personnel and others
 - ▶ Identify and evaluate circumstances and relationships that create a threat to independence and take appropriate action to mitigate the threat, reduce it to an acceptable level or withdraw from the engagement
- ▶ SQC1 specifically requires such procedures to include
 - ▶ Procedures to enable partners to provide firm with relevant information on client engagements
 - ▶ Personnel to promptly notify firm of circumstances & relationships that create an independence threat
 - ▶ Accumulation & communication of information to personnel so that the firm and its personnel – can determine if they satisfy independence requirements, firm can maintain and update its independence records and can take appropriate action regarding identified threats to independence

Independence

- ▶ Firm should also establish procedures which enable it to be notified of independence breaches and should include requirements that
 - ▶ All those subject to independence notify firm of breaches which they become aware of
 - ▶ Firm communicates identified breaches to the engagement partner who needs to address the breach and other personnel who need to take action in respect thereof
 - ▶ Communication by the above people to communicate back to the firm of the actions taken
 - ▶ Appropriate action comprises – **elimination of the independence threat**, **reducing it to an acceptable level** (eg changing personnel on an engagement if certain team members are not independent, altering scope of other services which may pose an independence threat to assurance services) or **withdrawing from the engagement**
 - ▶ Requires the firm to obtain **at least** annually a written confirmation of compliance with independence from all relevant personnel
 - ▶ The policy should **address the familiarity threat** by setting criteria to mitigate threat by using the same senior personnel on an assurance engagement and **requiring audit partner rotation** for listed entities (currently rotation required every 7 years; sole practitioners excluded)
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ACCEPTANCE & CONTINUANCE OF
CLIENT RELATIONSHIPS &
ENGAGEMENTS

Acceptance & Continuance of Client Relationships and Engagements

- ▶ Requires firm to establish policies and procedures to enable it to ensure it will undertake client relationships and engagements only where
 - ▶ It has considered integrity of the client and does not have information that leads it to believe client lacks integrity
 - ▶ Is competent to perform the engagement and has the time and resources to do so (eg complex industries, highly regulated entities, etc)
 - ▶ Can comply with ethical requirements
- ▶ Firm should obtain such information as considered necessary and if client is accepted after issues have been identified during acceptance, should document how the issues were resolved.

Acceptance & Continuance of Client Relationships and Engagements

- ▶ Matters to be considered for considering client integrity
 - ▶ Identity/business reputation of the owners, KMP, related parties & those charged with governance
 - ▶ Nature of client operations (eg gambling companies, etc) and its business practices
 - ▶ Information regarding attitude of owners, KMP & those charged with governance towards matters such as aggressive interpretation of accounting standards and attitude to internal control
 - ▶ Whether the client is aggressively concerned with maintaining fees at a low level
 - ▶ Indications of inappropriate limitation on scope of work
 - ▶ Indications that client may be involved in money laundering or other criminal activities (business environment in India v/s requirements in overseas countries for MNC client – FCPA, UK Corrupt Practices Act)
 - ▶ Reasons for proposed appointment of firm v/s continuation of the earlier firm
- ▶ Such information can be obtained from previous accountancy service providers, third parties, inquiry of firm personnel, bankers, legal counsel, industry peers and background searches

Acceptance & Continuance of Client Relationships and Engagements

In evaluating whether firm has capability, competence, time and resources to undertake the new client/engagement following to be considered

- ▶ Knowledge of firm personnel for the relevant industry/subject matter
- ▶ Experience with relevant regulatory/reporting requirements or ability to gain the necessary skills and knowledge
- ▶ Availability of sufficient personnel with necessary capability and competence
- ▶ Availability of experts as needed

These matters may generally be complied with but the SQC now requires the ability to demonstrate compliance with these matters. May require/increase documentation requirements

In case firm obtains information after commencement of work which would have caused it to decline the engagement policies on continuance of engagement should include consideration of the professional and legal responsibilities that apply and whether there are any external reporting requirements and possibility of withdrawal from the engagement

HUMAN RESOURCES

Human Resources

- ▶ Requires firm to establish policies and procedures to enable it to ensure that it has sufficient personnel with
 - ▶ Capabilities
 - ▶ Competence and
 - ▶ Commitment to ethical principles to enable it to perform its engagements
- ▶ Such policies address the following issues (SQC does not say should but inclusion of these matters would enable demonstration of compliance with SQC requirements)
 - ▶ Recruitment
 - ▶ Performance evaluation
 - ▶ Capabilities, competence
 - ▶ Career development, promotion and compensation and
 - ▶ Estimation of personnel needs

Human Resources

- ▶ Capabilities and competence are developed through professional education, continuing professional development including training, work experience and coaching by more experienced members
- ▶ Can be achieved by training and states where internal technical training resources are unavailable suitably qualified external persons could be used (eg ICAI's training on IND AS, external professional development courses, etc)

Human Resources

- ▶ Firm's performance evaluation, compensation and promotion procedures give due recognition to and reward the development and maintenance of competence and commitment of ethical principles
- ▶ States a firm
 - ▶ Makes personnel aware of its expectations regarding performance and ethical principles
 - ▶ Provides personnel with evaluation of and counselling on performance, progress and career development and
 - ▶ Helps personnel to understand that advancement to positions of greater responsibility depend upon performance quality and adherence to ethical principles.
- ▶ Recognises that smaller firms may have less formal procedures in this area

Assignment of Engagement Teams

- ▶ Responsibility of each engagement team to be with an engagement partner whose identity and role are communicated to key client personnel and those charged with governance, requires that the partner have necessary capability, competence, authority and time to perform the role and partner's responsibilities are clearly defined and communciated.
- ▶ Policies and procedures should include systems to monitor workload and availability of engagement partners
- ▶ Assignment of appropriate staff to the engagement. Following criteria considered for the same
 - ▶ Understanding and experience with similar engagements through training and participation (in past engagements)
 - ▶ Understanding of professional standards, regulatory and legal requirements and appropriate technical knowledge
 - ▶ Ability to apply professional judgement
 - ▶ Understanding of the firm's SQC

ENGAGEMENT PERFORMANCE

Engagement Performance

This section of the SQC covers

- ▶ Engagement Performance, Supervision and Review
- ▶ Consultation requirements
- ▶ Differences of opinion (how handled)
- ▶ Engagement Quality Review Requirements (EQR) covering
 - ▶ Nature timing and extent of EQR
 - ▶ Eligibility of engagements to be covered in EQR
 - ▶ Engagement Documentation comprising
 - ▶ Completion of files
 - ▶ Confidentiality and safe custody of files
 - ▶ Retention of records

Engagement Performance

- ▶ Requires firm to establish policies and procedures to enable it to ensure that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or partner issues appropriate reports
 - ▶ States that firms seek to achieve consistency in engagement performance and this can be achieved through manuals (written or electronic), software tools or other standardized documentation and industry and subject matter-specific guidance materials. The policy could address matters such as
 - ▶ How engagement teams are briefed on understanding their work objectives
 - ▶ Process for complying with applicable standards
 - ▶ Processes for engagement supervision, training and coaching
 - ▶ Methods of reviewing work performed, significant judgements made
 - ▶ Appropriate documentation of work performed
 - ▶ How policies and procedures are updated and kept current
 - ▶ Supervision policies would cover inter alia how engagement progress is tracked, considering competencies of team, addressing significant issues and identifying consultation matters
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Engagement Performance

- ▶ Review responsibilities are determined on the basis that more experienced engagement team members review work performed by lesser experienced members.
- ▶ Most of the requirements articulated here would be followed in most cases. Challenges may arise in demonstrating that these have been executed.
- ▶ Could be done by various means – eg sign off of hard copy working papers by preparer or reviewer to evidence work done and review, writing down or identifying items checked and findings thereon on specific areas, memos on how significant issues were identified and addressed
- ▶ Most of these are covered in detail in the Standards on Auditing

Engagement Performance - Consultation

- ▶ Requires establishment of policies and procedures that
 - ▶ Appropriate consultation takes place on difficult or contentious matters
 - ▶ Sufficient resources are available to enable appropriate consultation to take place
 - ▶ Nature and scope of such consultations are documented
 - ▶ Conclusions from those consultations are documented and implemented
- ▶ Consultation could be external or internal, uses overall firm experience, to ensure that persons consulted have all relevant facts
- ▶ Documentation of consultation with other professionals is agreed by both the individual seeking the consultation and the individual consulted. Documentation sufficiently detailed and complete to enable an understanding of the issue and the results (including the decision and basis thereof) of the consultation.

Engagement Performance – Differences of opinion

- ▶ Requires establishment of policies and procedures for dealing with and resolving difference of opinion
 - ▶ within the engagement team
 - ▶ with those consulted and
 - ▶ between the engagement partner and EQR reviewer.
- ▶ Conclusions should be documented and implemented. Report should not be issued till the matter is resolved
- ▶ In practice this situation may be rare but policies need to be in place to address these matters in case these arise

Engagement Performance – EQR

- ▶ EQR is “a process designed to provide an objective evaluation, before the report is issued, of the significant judgements the engagement team made and the conclusions reached in formulating the report”
 - ▶ Performed by an EQR reviewer who is “a partner, other person (member of ICAI) in the firm, **suitably qualified external person**, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgements the engagement team made and the conclusion they reached in formulating the report.”. In case of an EQR review team, it should be headed by an ICAI member.
 - ▶ SQC requires firm to formulate policies that **for appropriate engagements** provide an objective evaluation of the significant judgements made by the engagement team and should
 - ▶ Require an EQR review of audits of financial statements of all listed entities
 - ▶ Set out the criteria against which all other engagements should be evaluated whether EQR needed
 - ▶ Require performance of EQR for all such engagements
 - ▶ EQR to be completed before issuance of the report
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Engagement Performance – EQR

Criteria to be considered for considering EQR for other than listed entities include

- ▶ Nature of the engagement including the extent to which it involves matters of public interest (eg a private insurance company, a oil block, a private telecom company, banks, etc).
- ▶ Identification of unusual circumstances or risks (significant litigation, going concern issues, etc) in an engagement (eg revenue recognition in infa, real estate companies, claim accounting for insurance), or class of judgements (warranty, environment liability provisions)
- ▶ Whether laws and regulations require an EQR

Firm should

- ▶ Set out the nature, timing and extent of an EQR (ie requirements could be more strict than the SQC)
- ▶ Criteria for eligibility of an engagement quality reviewer
- ▶ Documentation requirements for them

Engagement Performance – EQR (Nature, timing and extent)

- ▶ EQR involves **discussion with the engagement partner**, **review of the financial statements, other information**, the **report** and **review of selected workpapers** relating to the significant judgements made by the engagement team
 - ▶ EQR for listed entities includes
 - ▶ Engagement team's evaluation of the firm's independence for the engagement
 - ▶ Significant risks (as defined in SA 315) identified during the engagement and responses thereto
 - ▶ Judgements especially w. r. t. materiality and significant risks
 - ▶ Whether appropriate consultations has taken place – difficult or contentious matters or differences of opinion
 - ▶ Significance and disposition of misstatements during the audit (corrected or uncorrected). Eg corrected may be required to be reported to those charged with governance, uncorrected to be included in management representation
 - ▶ Whether working papers reviewed support the conclusion on the related risk
 - ▶ Appropriateness of the report to be issued
 - ▶ EQR is conducted to the **reviewer's satisfaction** before the report is issued
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Engagement Performance – EQR (Criteria for EQR reviewer)

- ▶ Firm's policies should address the appointment of EQRs and establish their eligibility through
- ▶ Technical qualifications required to perform the role including necessary **experience and authority**
- ▶ Degree to which EQR can be consulted without compromising objectivity
- ▶ Other matters to maintain objectivity of the EQR reviewer could need to cover
 - ▶ That he is not selected by the engagement partner
 - ▶ He does not otherwise participate in the engagement
 - ▶ Does not make decisions for the engagement team
- ▶ **For sole practitioners suitably qualified external persons contracted to perform EQR review.**
Rotation like exception does not seem to be available for sole practitioners.

Engagement Performance – EQR (Documentation of EQR review)

Firm's policies should require that the following be documented to evidence performance of EQR

- ▶ Documentation to demonstrate the procedures required by the firm's policies on quality review have been performed
- ▶ The process is completed before issuance of the report
- ▶ Reviewer not aware of any unresolved matters

Engagement Performance – Engagement Documentation

- ▶ Policies and procedures should be set out for completion and assembly of final audit files after completion of engagement on a timely basis (specifies maximum time limit of 60 days)
- ▶ Two reports issued for same subject matter – eg group reporting for consolidation into parent and stat audit

Confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation

- ▶ Whether documentation is in hard copy or electronic, integrity could be compromised if it can be altered, added to or deleted without the firm's knowledge and hence the firm should
- ▶ Enable the determination of when and by whom engagement documentation was created, changed or reviewed
- ▶ Protect its integrity (including when it is shared within the engagement team or transmitted to other parties via the internet)
- ▶ Prevent unauthorised changes and
- ▶ Allow required access to the same by the appropriate personnel in discharge of their duties

Greater difficulty in ensuring these with paper documentation

Engagement Performance – Engagement Documentation

- ▶ Firm should ensure policies for retention of documentation as required by laws and regulation. Currently this is required to be retained for 7 years
- ▶ Ownership of documentation – property of the firm unless otherwise specified by law or regulation

MONITORING

Monitoring

- ▶ Requires firm to establish policies and procedures to enable it to obtain reasonable assurance that the SQC is relevant, adequate, operating effectively and complied with in practice
 - ▶ Include an ongoing consideration and evaluation of the firms SQC and a periodic inspection of a selection of completed engagements
 - ▶ Monitoring the process of quality control is entrusted to a partner with sufficient and appropriate experience and authority in the firm. Covers both the appropriateness of the design and effectiveness of the operation of the system of quality control
 - ▶ Evaluation of the SQC includes matter such as
 - ▶ Analysis of new developments (professional, regulatory & legal requirements) and how reflected in firm policies & procedures, written confirmation of independence compliance, continuing professional development including training (could include internal training) and decisions related to acceptance an continuance of clients and engagements
 - ▶ Determination of corrective actions to be taken (including to firm systems)
 - ▶ Communication to appropriate firm personnel of weaknesses identified
 - ▶ Follow up to ensure required modifications are made
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Monitoring

- ▶ Inspection of completed engagements performed on a cyclical basis
- ▶ But requires at least one engagement for each partner over an inspection cycle (which ordinarily should not exceed 3 years)
- ▶ Inspection cycle is organized based on
 - ▶ Size of the firm
 - ▶ Number of geographical locations of offices
 - ▶ Results of previous monitoring activities
 - ▶ Nature and complexity of firm's practice and organization and risks associated with firm clients
- ▶ Smaller firms and sole practitioners could use suitably qualified external persons or another firm to carry out the inspection or share resources with other firms.

Monitoring (Required procedures)

- ▶ The firm should evaluate the effect of the deficiencies and determine whether they are
 - ▶ Instances that do not necessarily indicate that the firm's SQC is insufficient or that
 - ▶ The deficiencies are systemic, repetitive or other deficiencies that require corrective action
- ▶ It should communicate to relevant engagement partners and other relevant personnel (engagement team for engagement specific issues or senior members of the firm for generic issues) deficiencies noted and recommendations for remedial action
- ▶ Recommendations should result in one or more of
 - ▶ Taking appropriate remedial action in relation to an engagement or personnel
 - ▶ Communication of findings to those responsible for training and professional development
 - ▶ Changes to the SQC procedures and policies
 - ▶ Disciplinary action for repeated non compliance cases
- ▶ At least annually, the firm should communicate the results of the monitoring of its quality control system to engagement partners and other persons

Monitoring-Complaints and allegations

- ▶ The firm should establish policies & procedures to ensure it deals appropriately with
 - ▶ Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
 - ▶ Allegations of non-compliance with the firm's system of quality control
- ▶ To ensure compliance with these requirements the firm
 - ▶ establishes clearly defined channels for personnel to raise concerns (in a manner which enables them to come forward without fear of reprisals
 - ▶ Investigates these in accordance with its policies and procedures (supervised by a partner with sufficient appropriate experience and authority in the firm). Legal counsel may be used as deemed necessary.

DOCUMENTATION

Documentation

- ▶ The firm should document the policies and procedures to provide evidence of the operation of each element of its SQC.
- ▶ Documentation depends on the size, complexity, geographical spread of the firm and the complexity of its clients, etc. This can be in hard copy or electronic or otherwise in a manner to disseminate and make available the documentation to all personnel of the firm.

Questions and concluding thoughts?

Thank you