

Standard on Quality Control (SQC)-1 Need for Documentaton

By

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AVA



Audit Scenario

- World over auditors are hauled up before courts and faced with huge punitive damages where they could not conclusively “prove” that they had applied auditing standards and professional judgement with due professional care.
- Same situation is progressively emerging in India.
(Peer Review > Quality Review > Disciplinary Committee > Court)
- When things go wrong, the question is: why the auditor did not warn those affected?
- The quality of an auditor's work is challenged and the methodology of each audit procedure that he carried out or failed to carry out comes under independent regulatory scrutiny or, worse, under the opposition lawyer’s scrutiny



Audit Scenario

- The onus is on the auditor to “prove” that he was not professionally negligent in the performance of his duty.
- If his work papers do not evidence his having performed a procedure, the assumption is that the audit procedure was not performed
- Scope and resource limitations faced by the auditor are no defence if he did not give a disclaimer of opinion as required per SA 700.
- Documentation is the only way an auditor can prove to outsiders that he planned and performed an effective audit, however good he might himself consider the audit to have been done



- Quality Assurance of the Audit :
- Financial Report Review – Technical Review
- Peer Review – Documentation of the Auditor



No one will believe you did something on an audit if there is nothing in your working papers file to show for it !!!



- SQC 1 – Standard on Quality Control
 - **Quality control for firms that perform audits and reviews of historical financial information and other assurance and related service engagements.**
- Need for documentation





What is the objective of SQC-1?

- Establish **standards** for Firms ; and
- To provide the firm with reasonable assurance that its personnel comply with applicable **professional standards** as well as the **regulatory and legal requirements** in addition to the firm's policies in respect of quality and ethics.



Why SQC-1?

All firms to have system of quality control that provides reasonable assurance that :

- ✓ Firm & personnel comply with professional standards, regulatory & legal requirements, and
- ✓ Reports issued by firm or partners are appropriate in the circumstances.



APPLICABILITY

This standard will be applicable to all the professional firms that performs :

- √ *Audit* of Historical Financial Information.
- √ *Review* of Historical Financial Information.
- √ *Assurance* and other Related Services Engagements.

KEY DEFINITIONS





DEFINITION

- ***Engagement documentation*** : the record of work performed, results obtained, and conclusions the practitioner reached (also referred to as “working papers” or “workpapers”).
- ***Engagement quality control review*** : a process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.



Contd./..

- ***Engagement team*** : all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
- ***Reasonable assurance*** : a high, but not absolute , level of assurance.
- ***Monitoring*** : a process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.



Contd./..

- ***Network Firm*** : an entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally.
- ***Professional standards***: engagement standards, as defined in the AASB’s “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” and relevant ethical requirements as contained in the Code.



Elements of System of quality control

The Firm's system of quality control (QC) should include policies & procedures (P&P) addressing each of the following issues:

1. Leadership responsibilities for QC
2. Ethical requirements
3. Acceptance and continuance of client relationships and specific engagements
4. Human resources
5. Engagement performance
6. Monitoring



Elements of System of quality control

Before moving forward and deliberate on each of the element of System of Quality Control, I just want to have a word of caution, about two very important and significant matters.

DOCUMENTATION

&

COMMUNICATION



Elements of System of quality control

The firm should Document and Communicate the Quality Control Policies & Procedures (QC P&P) to the firms' personnel. Firm should also

- Review QC P&P periodically
- Monitor it & get the feedback on QC P&P from it's personnel;
- update it's QC P&P, if required.
- Make sure its operations.
- Put in the place crises management system (i.e course of action ,in case of non-compliance)

I. Leadership Responsibilities for QC

- Promote internal culture w.r.t. :
 - ✓ essential of quality in engagements.
 - ✓ Compliance with professional standards, regulatory/ legal requirements.
 - ✓ Issue of reports appropriate in circumstances.

- Require CEO/ managing partner to assume ultimate responsibility for QC.

- Recognise & reward high quality work.

I. Leadership Responsibilities for QC

- Leaders to recognise quality precedes business objectives:
 - ✓ Assign management responsibilities appropriately
 - ✓ HR policies to demonstrate firm's QC commitment
 - ✓ Sufficient resources for development, documentation & support of
 - ✓ QC policies & procedures

- Person delegated the QC responsibility by CEO/ Managing partner to have sufficient appropriate experience & ability, & necessary authority to assume responsibility

I. Leadership Responsibilities for QC

Saying something is very easy but implementation of the same would be difficult. Therefore the next big Question, which cropped up in the mind is :

How to promote & take lead ?

Reply :

- ❖ Leaders must set example by their own conduct.
- ❖ Communicate System of QC to the firm's personnel by way of organizing Training, workshops, formal newsletters etc.

II. Ethical Requirements

Establish policies & procedures to reasonable assure that Firm & personnel comply with relevant ethical requirements of :

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality ; and
- Professional behavior

* Ethical requirements en shrine **INDEPENDENCE**

II. Ethical Requirements

Independence: The firm must establish P&P, which should enable the firm to:

- Communicate its independence requirements to its personnel and, where applicable to others;
- Evaluate the circumstances and relationships that create threats to independence;
- Take appropriate action to eliminate those threats or reduce them to an acceptable level.
- For all these Independence matters, this SQC-1 has put lot of responsibilities on the shoulders of “Engagement Partner”

Independence

- Establish policies & procedures → reasonable assurance that
 - ✓ Maintenance of independence by relevant personnel
 - ✓ Firm notified of breaches of independence requirements

- Policies & Procedure should enable:
 - ✓ Communication of independence requirement to personnel & others
 - ✓ Identification & evaluation of circumstances/ relationships threatening independence
 - ✓ Take appropriate action for elimination/ reduction of threats/ withdrawal from engagement
 - ✓ Resolution of breaches of independence

Independence (contd.,)

Policies / procedure should require:

Maintenance of independence of personnel	Breach of independence
<ul style="list-style-type: none">➤ Engagement partners to provide firm with relevant information about client➤ Prompt notification of threats to independence➤ Accumulation & communication of relevant to appropriate personnel	<ul style="list-style-type: none">➤ All subjected to independence to promptly notify breach of independence➤ Prompt communication of identified breaches

Independence (Contd.)

- Firm should obtain Annual written confirmation as to compliance with independence requirements.

- Create Policies & procedure :
 - ✓ Firm has to update its records (preferably annually) relating to independence; and also design policies to make sure that it would get notified of breaches of independence.

 - ✓ Audit of FS of listed entities – rotation of engagement partner – at least every 7 years

III. Acceptance and Continuance of Client Relationships and Specific Engagements

Establish policies/ procedures to reasonable assure that clients are accepted/ continued only where :

- ✓ Client integrity has been considered.
- ✓ Firm is competent to perform engagement with respect to capability, time & resources.
- ✓ firm can comply with ethical requirements.



III. Acceptance and Continuance of Client Relationships and Specific Engagements (*Contd.*)

- ✓ If any issue raised, document how it resolved.
- ✓ Establish Policies w.r.t. withdrawal from engagement and communication requirements, if circumstances warrant.

III. Acceptance and Continuance of Client Relationships and Specific Engagements (*Contd.*)

Withdrawal from Engagement:

Policies to address following issues:

- Discussion with appropriate level of management & those charged with governance
- If withdrawal necessary, discuss with management & those charged with governance
- Professional/ regulatory requirement to:
 - Not to withdraw, or
 - Report withdrawal from engagement and / or client relationship
- Documentation of significant issues, consultations , conclusions ,basis fir conclusion.



IV. Human Resources

The firm should establish P&P to provide reasonable assurance that:

- It has sufficient personnel with the
 - Capabilities
 - Competence
 - Commitment to ethical principal
- Issues to be addressed by HR policies:
 - ✓ Recruitment
 - ✓ Performance evaluation
 - ✓ Capabilities
 - ✓ Competence
 - ✓ Career development
 - ✓ Promotion
 - ✓ Compensation
 - ✓ Estimation of personnel needs

IV. Human Resources (*Contd.*)

The Capabilities & Competence are developed through:

- Professional education
- Continuing professional development, including training
- Work experience
- Coaching by senior partners of the firm.

SQC-1 has also emphasis on the matter that:

“Where internal technical & training resources are unavailable, the firm may use a suitably qualified external person for that purpose.”

IV. Human Resources (*Contd.*)

Assignment of Engagement Teams

- The firm should assign responsibility for each engagement to an “**ENGAGEMENT PARTNER (EP)**” .
- The firm should establish the Policies & procedure requiring that:
 - Identity & role of engagement partner communicated to key personnel of client management & those charged with governance.
 - Engagement partner is capable & competent & has time & authority for engagement.
 - Responsibility of engagement partner clearly defined & communicated to him/ her.
- Assign appropriate staff
- Assessment of staff capability & competence



V. Engagement Performance

Establish policies/ procedures to reasonable assure w.r.t.:

- ✓ Compliance with professional standards.
- ✓ Compliance with laws/ regulations.
- ✓ Engagement partner issues reports appropriate in the circumstances.



V. Engagement Performance (contd.)

Important aspects of engagement performance :

- ✓ Supervision
- ✓ Review
- ✓ Consultation
- ✓ Differences of opinion
- ✓ Engagement Q. C. review
- ✓ Engagement documentation



V. Engagement Performance (contd.)

This section of the SQC-1 emphasis on establishment of P&P by the firm which should address the following matters:

- How the assignment is to be performed?
- How engagement team would be briefed about the objectives of the assignment to be achieved?
- How engagement team would be briefed about the objectives of the assignment to be achieved?
- When & how to take Consultation, in case it requires to resolve the complicated issues?
- How to resolve the difference of opinion?

V. Engagement Performance (contd.)

Difference of opinion could exist between:

- Engagement partner & Reviewer;
- Engagement partner & Quality Control Reviewer
- Engagement partner & Audit staff
- Engagement partner & Independent consultants.

In that case it is **mandatory** as per SQC-1 to document those matters, where the difference of opinion exist and **firm should not issue report until matter is resolved.**

V. Engagement Performance (contd.)

Other matters to be taken care of includes:

Engagement of Quality Control Reviewer (QCR): The P&P in this regard should address the issues like:

- How to appoint QCR ?
- What precautions to be taken while appointing QCR?
- Who should be QCR? I.e. Internal or External
- Decide about the nature, extent and timing of his Review.
- What should be the contents of QCR's Report?

V. Engagement Performance (contd.)

Other matters to be taken care of includes:

- **Assembly of Final Engagement Files:** The P&P of the firm ensure the assembly of engagement files after the issue of engagement reports. Ordinarily **within 60 days** after the date of the auditor's report this work should be completed.
- **Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation:** The P&P of the firm should ensure that the confidentiality of information as contained in the "Engagement Letter" must be maintained unless client or law of the land permits otherwise.

V. Engagement Performance (contd.)

Other matters to be taken care of includes:

Retention of Engagement Documents : The P&P of the firm should ensure that engagement documents should retain for a period sufficient to meet the needs of the firm or as required by law or regulation.

SQC-1, in this regard says that “The retention period ordinarily is **no shorter than 10 years** from the date of the auditor’s report, in case of Audit engagement.”

Unless otherwise specified by law or regulation, engagement documentation is the property of the firm



VI. Monitoring

The firm should establish P&P to ensure that the System of QC are :

- Relevant
- Adequate
- Operating Effectively and
- Complied with in practice by firm & its personnel.

VI. Monitoring (Contd.)

Ongoing consideration and evaluation of the system of QC includes matters such as:

- Analysis of new developments in professional standards
- Determination of corrective actions to be taken and improvements to be made.
- Communication to appropriate firm personnel of weaknesses identified in the system.
- Follow-up by appropriate personnel of the firm to make sure the modifications are made in the QC.



Documentation

The firm should establish the P&P requiring appropriate documentation to provide evidence of the operation of each element of its system of Quality Control, i.e.

- Leadership responsibilities for quality within the firm;
- Ethical Requirements
- Acceptance and continuance of client relationships
- Human Resources.
- Engagement Performance.
- Monitoring.



Process of Peer Review

- Selection of Practice Unit (PU). A PU can also suo –moto apply.
- Intimation to PU
- Choice of Peer Reviewer
- Intimation and selection of peer reviewer
- Questionnaire and list of clientele
- Selection of sample
- Site visit
- Accuracy of Questionnaire



Process of Peer Review (Contd.)

- Review of General Controls
- Final selection of sample
- Review of records
- Preliminary report to PU
- PU's response thereof to the Reviewer
- Interim/Final Report
- Issue of Certificate



Obligations of the PU

- Selection of Independent peer reviewer(PR)
- Maintain a list of all attestation services
- Provide a list to PR for sample selection
- Fill the Questionnaire with factual details
- Provide Documents/files for selected samples and provide information and explanations
- Allow abstracts of records maintained by PU
- Reply to the Preliminary Report of PR
- Issue Compliance Letter
- Adhere Time Frame [__days]
- Pay the cost of Peer Review to the PR as prescribed by the Institute



Documents before Review –

- Profile of the PU
- Registration papers – Partnership Deed, Firm Registration with Registrar of Firms and with ICAI and all documents regarding changes therein
- Details of Employees – Qualified, Semi-skilled and unskilled, including articulated assistants
- Details of branches, if any.
- List of Attestation Clients



Documents before Review –

- Policies
- Independence Policy and procedures – for partners as well as employees
- Continuing Professional Education Programme Policy for Partners, Employees and Articles Trainees.
- Employment Policy
- Training Policy

Documents before Review –

- Procedures
- Procedure for audit delegation
- Procedure for scheduling and staffing of audits
- Procedures for review of audit process
- Procedures for supervision of audit process
- Procedure for Engagement letters
- Procedure for documentation



Documents before Review –

- Other Documents
- Audit Plans
- Use of Audit programmes
- Procedure for review
- Maintenance and retrievability of Audit records
- Compilation of Clients' business
- Procedure for compliance and substantive tests
- Staff files and records

Documents before Review –

- Checklists for Accounting Standards
- Checklists for Auditing Standards
- Procedure for arriving at an opinion
- Review of opinion
- Drafting of Report
- Fully filled up questionnaire
- Records of sample clients selected by PR



During Peer review

- Ensure that all the documents and papers as required by the TR are kept ready for verification.
- Offer explanation for the queries raised by the TR.
- Where TR has issued a Preliminary Report, reply to the same in a very clearly and to the point.
- Where the TR has issued Final Report, offer explanations, where necessary to the appropriate authority.
- Ensure that the PR certificate is obtained

Broad checklist for Quality Review

- Whether the auditor has appropriately dealt with in his report the deviations from accounting standards.
- Whether the audit report is qualified
- The qualifications are clear and unambiguous.
- The qualifications are quantified. If not, whether adequate justification is provided therefor.
- The overall effect of the qualifications on the true and fair view presented by the financial statements, have been considered
- The auditor has complied with the applicable standards of Auditing.
- Does the auditor/audit firm have a policy to ensure independence, objectivity and integrity, on the part of the partners/staff and the person responsible for this policy. Are the policies and procedures complied with?
- Does the auditor/audit firm have an established recruitment policy? Are programmes for developing expertise in specialised areas/industries conducted.
- Does the auditor/audit firm have established procedures for record retention and security aspects thereof.
- Does the auditor/audit firm evaluate the accounting and internal control system of the auditee
- Whether the procedures followed ensure that audit report is in accordance with the relevant authoritative requirements or technical standards including accounting standards



Documentaton - Form & Content

- *The factors that determine the form and content of documentations for a particular engagement are:*
 - ✓ *The nature of the engagement*
 - ✓ *The nature of the business activity of the client*
 - ✓ *The status of the client*
 - ✓ *Reporting format*



Documentation - Form & Content (Contd.)

- *The factors that determine the form and content of documentations for a particular engagement are:*
 - ✓ *Relevant legislations applicable to the client*
 - ✓ *Records maintained by the client*
 - ✓ *Internal controls in operation*
 - ✓ *Quality of audit assistants engaged in the particular assignment and the need to direct and supervise their work*



The Principle

- The auditor should prepare audit documentation such that it
- Is sufficient and appropriate
- Provides a record of the basis for the auditor's report, and
- Demonstrates that the audit was performed in accordance with SAs and applicable legal and regulatory requirements

Nature

- Documentation may be on electronic media and Includes
 - Audit programs
 - Analyses
 - Issues memoranda
 - Letters of confirmation and representations
 - Checklists
 - Extracts of important documents
 - Correspondence (including e-mails) concerning significant matters
 - Schedules of work the auditor performed



Purpose

- To assist audit team to plan and perform the audit
- To enable supervision and quality control of work
- To demonstrate accountability of the audit team for its work
- To retain a record of matters of continuing significance to future audits
- To withstand the test of an independent experienced auditor review (including peer review) to comply with SQC 1.
- To enable an experienced auditor to conduct external reviews in accordance with applicable legal, regulatory or other requirements



Extent

- Documentation should enable an experienced auditor, having no previous connection with the audit, to understand:
- Audit evidence obtained
- Conclusions reached on significant matters
- In relation to audit procedures designed to address identified risks of material misstatement, conclusions that are not otherwise readily determinable from the documentation of the procedures performed or audit evidence obtained



Significant matters

- Matters that give rise to significant risks
- Results of audit procedures indicating
 - Possibility of material misstatement
 - Need to revise the auditor's risk assessment and responses thereto
- Circumstances that cause the auditor significant in applying necessary audit procedures that could result in a modification to the report



Accountability

- The auditor should record
 - Who performed the audit work and the date of such work
 - Who reviewed specific audit documentation and the date of such review
-



Working Papers

The working papers are classified as follows :

- ✓ *Permanent Audit Files*
- ✓ *Current Audit Files*



Permanent Audit File

- A permanent audit file normally includes:
 - Copy of initial appointment letter if the engagement is of recurring nature
 - Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor
 - NOC from previous auditor
 - Information concerning the legal and organisational structure of the entity.

Permanent Audit File

- A permanent audit file normally includes (Contd.):
 - In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions
 - Analysis of significant ratios and trends
 - Copies of management letters issued by the auditor, if any.
 - Notes regarding significant accounting policies.
 - Significant audit observations of earlier years.



Permanent Audit File

- A permanent audit file normally includes (Contd.):
 - Business Continuity Plans
 - Assessment of risks and risk management
 - Major policies related to Purchases and Sales
 - Details of sister concerns
 - Details of Bankers, Registrars, Lawyers etc
 - Systems and Data Security policies

Current Audit File

A Current audit file normally includes:

Correspondence relating to acceptance of annual reappointment.

Extracts of important matters in the minutes of Board Meetings and General Meetings, as are relevant to the audit.

Evidence of the planning process of the audit and audit programme.

Analysis of transactions and balances.

A record of the nature, timing and extent of auditing procedures performed, and the results of such procedures

Evidence that the work performed by assistants was supervised and reviewed.

Copies of communications with other auditors, experts and other third parties.

Letters of representation or confirmation received from the client.

Current Audit File

- *A Current audit file normally includes (Contd.):*
 - Copies of letters or notes concerning audit matters communicated to or discussed with the client, including the terms of the engagement and material weaknesses in relevant internal controls.
 - Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated.
 - Copies of the financial information being reported on and the related audit reports.
 - Audit review points and highlight.
 - Major weakness in Internal control



The Need for Working papers

- They aid in the planning and performance of the audit;
- They aid in the supervision and review of the audit work and to review the quality of work performed, in accordance with AAS 17 “Quality Control for Audit Work”;
- They provide evidence of the audit work performed to support the auditor’s opinion
- They document clearly and logically the schedule, results of test, etc.
- The working papers should evidence compliance with technical standards
- They document that Internal control has been appropriately studied and evaluated; and
- They document that the evidence obtained and procedures performed afford a reasonable basis for an opinion.



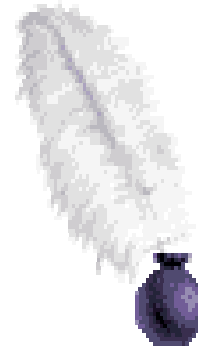
The need (contd.)

- ✓ *They retain a record of matters of continuing significance to future audits of the entity;*
- ✓ *They enable an experienced auditor to conduct quality control reviews in accordance with Statement on Peer Review issued by the Institute of Chartered Accountants of India;*
- ✓ *The process of preparing sufficient audit documentation contributes to the quality of an audit*
- ✓ *They fulfil the need to document oral discussions of significant matters and communicate to those charged with governance, as discussed in SA 260.*



Tips

- ✓ *Clarity and Understanding*
- ✓ *Completeness and Accuracy*
- ✓ *Logical Arrangement*
- ✓ *Legibility and Neatness*
- ✓ *Safety*
- ✓ *Initial and date*
- ✓ *Summary of conclusions*



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