

Quality Audit: Need of the Hour

Posted May 03, 2021



Rajat Mohan

Senior Partner, AMRG & Associates

With inputs from Navika

Introduction

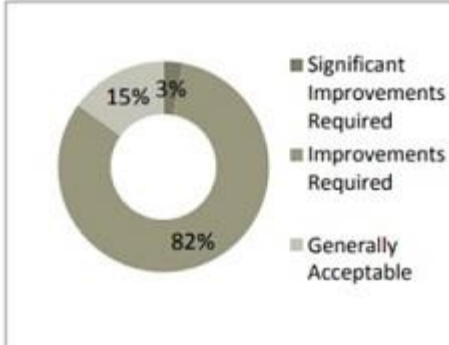
An Audit is presumed to be a quality audit if the Auditor is able to perceive and expose any questionable accounting practices and infringement of applicable accounting regulation in the financial statements. Audit firms should continue their efforts to improve audit quality on a consistent basis. However, there are instances where they fail to do so.

Hence, the Central Government constituted a Quality Review Board (QRB) in 2007 under Section 28A of Chartered Accountants Act, 1949 to review quality of services provided by the members of the ICAI and to steer them in improving quality of service and to suggest Council of the ICAI to take necessary action. Quality Review Board has adopted risk based approach for selection of audit engagements for initiating audit quality reviews.



Key Highlights – FY 2019-20

The key findings are in respect of the audit quality reviews completed by the Quality Review Board during the FY 2019-20 pertaining to the financial statements for the years ended on 31 March 2014, 31 March, 2015 and 31 March, 2016. These key findings have been categorised under various sections such as Standards on Auditing, Accounting Standards and Other Relevant Laws and Regulations.

<p>Audit Quality Reviews covered in the Report</p>  <ul style="list-style-type: none"> ■ Significant Improvements Required ■ Improvements Required ■ Generally Acceptable 	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">Audit Firms Reviewed</td> <td style="width: 50%;">Entities Covered</td> </tr> <tr> <td>72</td> <td>69</td> </tr> <tr> <td colspan="2">Audit Files Reviewed</td> </tr> <tr> <td colspan="2">87</td> </tr> <tr> <td colspan="2">Advisory issued by QRB to Audit Firms</td> </tr> <tr> <td colspan="2">71</td> </tr> <tr> <td colspan="2">Referred by QRB to ICAI Council</td> </tr> <tr> <td colspan="2">3</td> </tr> <tr> <td colspan="2">Closed</td> </tr> <tr> <td colspan="2">13</td> </tr> </table>	Audit Firms Reviewed	Entities Covered	72	69	Audit Files Reviewed		87		Advisory issued by QRB to Audit Firms		71		Referred by QRB to ICAI Council		3		Closed		13	
Audit Firms Reviewed	Entities Covered																				
72	69																				
Audit Files Reviewed																					
87																					
Advisory issued by QRB to Audit Firms																					
71																					
Referred by QRB to ICAI Council																					
3																					
Closed																					
13																					

During the FY 2019-20, the board reviewed 72 audit firms pertaining to the financial statements for the years ended 31st March 2014, 31st March 2015 and 31st March 2016. 87 audit files were reviewed where about 3% significant improvements were required. 82% of the files needed some other requirements whereas 15% was generally accepted and approved. [Key observations mentioned by the board](#) are highlighted below: -

a) Standards of Auditing (SAs)

- SQC 1

It was often seen that the policies and procedures of the firms, including the documentation and communication of the same, lacked adequacy in accordance with the nature and complexities involved in the audits. These policies includes policies for independence, compliance with ethical requirements, acceptance and continuance of client relationships, dealing with difference of opinion, assembly of final audit papers on timely basis, monitoring processes and dealing with complaints and allegations.

Also, it was noticed that firms are not obtaining a written confirmation of compliance with its policies and procedures on independence from all firm personnel even on annual basis. Details of internal training provided to firm's personnel is also required to be maintained.

- General Principles and Responsibilities

Audit documentations stand as the evidence of the work done to support the opinion formed. However, some auditors fail to maintain sufficient and appropriate documentations including check lists as required by the standards and various other statute requirements. Many a times, auditors fail to plan, perform and document procedures with respect to misstatements caused by fraud or error.



- Risk Assessment and Response to Assessed Risks and Audit Evidence

Planning and documenting risk assessment procedures including materiality are the prerequisites of an audit. It is often seen failure to comply with the above requirement including responses to address assessed risks and test of controls.

Similarly, adequate sample size is an important factor for reducing the sampling risk to an acceptable level. Failing to do so leads to higher audit risks.

Sufficient and Appropriate audit evidence was missing regarding various matters including compliance with law, indication of fraud, work of internal auditors, etc.

- Audit Reporting

SA specifies form and content of the audit report to be used to express audit opinion. Also, it requires certain quantification of the qualifications to be made. Sometimes, auditors change the format as per their convenience leading to misreporting.

b) Accounting Standards

Auditor has the responsibility to ensure that information presented in the financial statements are true and fair. Accounting Standards ensure that standard practices are followed by all the entities to ensure uniformity.

- Disclosure of Accounting Policies

Time and again entities fail to disclose significant accounting policies as required by the standard on matters like Taxation, Impairment of Assets, MAT credit, etc.

- Cash flow Statements

Cash and Cash equivalent as per the standard should be held for meeting short term cash requirements and should be highly liquid usually 3 months. However, in some cases, other investments were also included in the same.

Bifurcation of Operating, Investing and Financing is specifically given in the standard but not always followed while drafting the statement. Some non-cash adjustments like provision for doubtful debts are also missed to be adjusted.

- Fixed Assets

Disclosures of depreciation method used, changes due to revaluation of assets, etc. needs to be made and were left out. Also, recent changes in the standard are not considered by some entities.

- Accounting for Taxes on Income

Deferred Tax Assets should only be recognized in case of virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. However, same was not ensured and documented by the auditors. Also, breakup of Deferred Tax Assets and Liability into major components are not disclosed.



c) Companies Act, 2013

It has been seen that [Schedule II](#), which provides the useful life of depreciable assets, is not being complied. CSR spending needs to be made as per [Section 135](#) read with [Schedule VII](#) of the Act which has been missing in some cases.

d) Schedule III of the Companies Act, 2013 and Guidance Note :

[Schedule III](#) of the Act specifies the format and disclosure requirements of the financial statements. Auditors frequently fail to recheck the requirements with the Schedule and the required words and disclosures gets omitted. Some major mistakes are as follows: -

- Bifurcation of Current maturity of Long term liabilities is not disclosed in Short term liabilities
- Classification of items in wrong heads
- The terms used in financial statements are different from ones given in Schedule III. For instance, 'Sundry Creditors' are used instead of 'Trade Payables'.
- Sometimes, notes to accounts and CARO needs quantification of amounts referred in Balance Sheet. It is found to be missing or mismatching.

e) CARO' 2016 and Guidance Note:

- There are some clauses in [CARO, 2016](#) which requires auditor's opinion. However, auditor's end up reporting using the words "as informed" which is not acceptable
- Auditors end up not reporting non-compliance of various clauses.
- Some clauses are selectively applicable to some companies as per Companies Act. Auditors need to report not applicable in those cases.

AMRG Take

Audit plays an important role in generating confidence of stakeholders on the financial statements. Many investors depend on the audited financial statements to make an informed decision. Also, banks and financial institutions provide loans based on the facts stated in the annual report. Thus, professionals are expected to maintain the highest standard of quality in audit.

QRB is making constant efforts to improve the quality of audits done by firms. The observations given by the Board set a standard for all the auditors. It need to be examined and taken care of to avoid any discrepancies in the future assignments. Also, firms should provide proper training to the team in regards to Standards, Companies Act and other requirements.

The All new TaxSutra Greentick is live now!

Upon subscribing to TaxSutra Greentick, you shall be eligible to get access to the following features:

1. Well Curated Editorial Insights – Comprising [190+ Expert Articles](#), [Regular News Updates from Indian & Global Regulators](#), Weekly Newsletter
2. Opinions – Covering Key Audit Matters from over 80+ Companies (prepared in a proprietary color coded system for ease of search), 500 + Opinions from [Expert Advisory Committee](#) & [ITFG Bulletins](#)
3. [Annual Report Referencer](#) – 3500+ Disclosure Items from the Annual Report linked to the source of mandate from the Companies Act/Rules/Ind-AS
4. Bulls Eye Search – With search options ranging from Author, Subject Index, Industry & Accounting Standards
5. Industry Corner: All the articles/exclusive stories reported on the portal are tagged industry/sector wise so that you get the info dump about a particular industry, at one place and one click !



Resource Centre :

6. [Hyperlinked E-Books – 3000+ Pages of E-Books consisting of :](#)
 - a. 7 Thematically divided E-Books on Concepts of “Ind-AS” by CA Parag Kulkarni
 - b. “Accounting & Auditing – A Checklist Approach” (3E) by CA Santosh Maller
 - c. Key Audit Matters – A Practice Manual (3E) by CA Mohan Lavi (will be released by April 2021)
7. [200+ Hours of E-Learning Content –](#)
 - a. 7 Thematically divided Online Learning Modules covering all “Concepts of Ind-AS” by CA Parag Kulkarni
 - b. 30 Hours Master-Class Series covering “Advanced Issues for Professionals on IFRS & US-GAAP” by CA Mohan Lavi
8. Daily [Greentick Matinee Shots](#) – Covering exclusive Case Studies on Ind-AS by TaxSutra's Editorial Team
9. Exclusive Access to [TaxSutra Library](#) -
10. A repository of Annual Reports published by Nifty 200 Companies for the year ended March 2020 and March 2019.

[Click here](#) to read & download our Virtual Demo Guide.

And finally, the commercial offering is nothing less than mind-boggling! All of the above at an annual subscription price of just Rs.7,500 per login!

If you are excited to take a glimpse at the newest offering from the House of TaxSutra, visit <https://www.greentick.taxsutra.com>

To make online payment, [click here](#).

To subscribe, kindly write to sales@taxsutra.com or contact us on [+91 9595218026](tel:+919595218026)

Disclaimer: The information contained herein is intended solely for the use of the subscriber, user or other entity who is named in this document, and others authorised to generate/ receive/ use it. If you are using our Services on behalf of a business, that business accepts these terms. It will hold harmless and indemnify Taxsutra and its affiliates, officers, agents, and employees from any claim, suit or action arising from or related to the use of the Services or violation of these terms, including any liability or expense arising from claims, losses, damages, suits, judgments, litigation costs and attorneys' fees. If you are an unintended recipient of this document, please notify us immediately by email and then delete it from your system. Any action based on content in this document shall be at the sole risk, responsibility and liability of the individual or other entity taking such action. The contents of this document shall not, under any circumstance, be construed as any kind of professional advice or opinion and we expressly disclaim any and all liability for any harm, loss or damage, including without limitation, indirect, consequential, special, incidental or punitive damages resulting from or caused due to your reliance and actions/ inactions on the basis of this content. Contents of Disclaimer document available here is an integral part of this disclosure.

