

## SQC 1 &amp; SA 220

Leadership responsibilities for quality within firm

## Question 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. Promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited is in 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 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?

(ICAI Module TYU)

## Answer

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, 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.

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

Ethical requirements**Question 2**

SS Ltd. is a company listed in India. The Company has appointed M/s Z & Co. as auditors. Mr. Q, a CA has recently joined the firm and has been appointed as the engagement partner for the first time. He understands that it is necessary to ensure the compliance of independence for the audit team as per standard audit practices. But he could not find, as such, any policies and procedures available with the firm in documented form. Why do you think that the firm should have policies and procedures to ensure the independence of the firm in every assignment? How does an engagement partner ensure the compliance of independence? Discuss with reference to relevant SAs. (PYQ Nov'23, MTP May'25)

**Answer**

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.

Acceptance & Continuance of Client Relationships & Specific Engagements**Question 3**

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 managers, 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 automotive sector.

Elaborate the matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships considering the above issues. (PYQ May'24, MTP May'25, ICAI Module TYK, Model Test Paper)

### Answer

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 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, 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.

## Question 4

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 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. Lamenting 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? (ICAI Module TYU)

## Answer

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 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**.

## EQCR

## Question 5

Pine & Associates is the statutory auditor of BB Ltd., a listed company and started its operations 6 years ago. The fieldwork during the audit of the financial statements of the company for the year ended 31st March, 2023 was completed on 1st May, 2023. The **auditor's report was dated 15th May, 2023**. During the documentation review of the engagement, it was observed that the **engagement quality control review was completed on 18th May, 2023**. The **engagement partner had completed his reviews in entirety by 12th May, 2023**. Comment (MTP Apr'24, Oct'18, Mar'19, ICAI Module TYK, Model Test Paper)

## Answer

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:

- 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 BB Ltd. for the year ending on 31st March 2023 was conducted by Pine & Associates and was completed on 1st May, 2023. Subsequently, the engagement partner reviewed the audit by 12th May, 2023. The audit report issued by Pine and Associates was dated 15th May, 2023. However, **the engagement quality control review was finalized on 18th May, 2023, 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**.

Engagement documentation

## Question 6

TPX & Co., Chartered Accountants is a large audit firm. It maintains audit documentation both electronically and in physical form (hard files). The physical files are neither scanned and incorporated into electronic files nor cross-referenced to the electronic files. Further, there are many instances where audit working papers do not contain details as to whether information was obtained from client or prepared by engagement team. How do you view above situation from point of view of quality control system in audit firm? Analyse. (MTP Mar'24, ICAI Module TYK, Model Test Paper)

## Answer

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:

- Generate scanned copies** that reflect the entire content of the original paper documentation, including manual signatures, cross references and annotations;
- Integrate the scanned copies into the engagement files**, including indexing and signing off on the scanned copies as necessary; and
- 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.

Comprehensive

## Question 7

Rishikumar & Co. has been appointed as an auditor of PK Ltd. for the financial year 2016 -17. CA. Kumar, one of the partners of M/s Rishikumar & Co., **completed entire routine audit work** by 29th May, 2017. Unfortunately, on the very next morning, while roving towards office of PK Ltd. to sign final audit report, he **met with a road accident** and died. CA. Rishi, another partner of M/s Rishikumar & Co., therefore, **signed the accounts of PK Ltd.**, without reviewing the work performed by CA. Kumar. Advise, **whether CA. Rishi is right** in expressing an opinion on financial statements the audit of which is performed by another auditor. (MTP Apr'18, RTP May'25)

## Answer

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, one of the **basic principles**, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the **auditor delegates work** to assistants or uses work performed by other auditor 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. This is the fundamental principle which is ethically required as per Code of Ethics.

However, the **auditor should carefully direct, supervise and review 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. Kumar. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Rishi signed the report relying on the work performed by CA. Kumar. Here, CA. Rishi is allowed to sign the audit report, though, will be responsible for expressing the opinion. **He may rely on the work performed by CA. Kumar provided he further exercises adequate skill and due care and review** the work performed by him as required in compliance with SA 220.

### Question 8

BNE & Co. are in midst of audit process of a listed company. During the course of 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 otherwise after review. **The engagement partner is not willing to accept recommendations of reviewer. How can the stalemate be ended?** (ICAI Module TYK)

#### Answer

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 matter.

### Question 9

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 engagement quality control reviewer on this matter during the course of audit process itself. Can he consult** with engagement quality control reviewer? Discuss. (ICAI Module TYK)

#### Answer

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.

## Question 10

GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issue 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? (ICAI Module TYU)

### Answer

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

## Question 11

During the audit of Mahaveer 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. (RTP May'22, May'19, MTP Oct'19, ICAI Module TYK)

### Answer

As per **SA 220**, 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;
- **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, the **Engagement Partner is not right**. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

## Question 12

MNP & Co., a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deposes 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 quality control system of firm? (ICAI Module TYU)

**Answer**

Approach of Sudhanshu is **not proper**. Such practices blatantly **violate code of ethics** and its spirit. It reflects poorly upon 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**.

**Question 13**

RST & Co., a firm of Chartered accountants, are auditors of a listed company engaged in manufacturing of heavy machinery components. The audit report for year 2021-22 also included report 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 above reporting qualitative and in line with requirements of SA 220? (ICAI Module TYU)**

**Answer**

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.

**SA 210****Preconditions for audit****Question 14**

Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The **company** has mentioned in the audit terms that they **will not be able to provide internal audit reports** to Mr. Ram during the course of audit. Further, company **also imposed some limitation on scope** of Mr. Ram.

**What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement? (RTP Nov'19)**

**Answer**

As per **SA 210** "Agreeing the Terms of Audit Engagements", in order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the **financial reporting framework** to be applied in the preparation of the financial statements is acceptable; and
- (b) Obtain the **agreement of management** that it acknowledges and understands its responsibility
  - (i) For the **preparation of the financial statements** in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
  - (ii) For such **internal control as management determines is necessary** to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (iii) To **provide the auditor** with:
  - a) **Access to all information** of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - b) **Additional information** that the auditor may request from management for the purpose of the audit; and
  - c) **Unrestricted access** to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.