

Procedure for Quality Review of Audit Services of Audit Firms

Introduction

1. In exercise of the powers conferred by Section 28A of the Chartered Accountants Act, 1949, consequent to the Chartered Accountants (Amendment) Act, 2006, the Central Government, by notification, constituted a Quality Review Board consisting of a Chairperson and ten other members. Quality Review aims to assess the quality of audit of the financial statements of a company as well as the work done by the auditors in carrying out their statutory function.

Definitions

2. In these procedures, unless the context otherwise requires, :-
- (a) "Board" means the Quality Review Board constituted under Section 28A of the Chartered Accountants Act, 1949.
 - (b) "Council" means the Council of the Institute of Chartered Accountants of India.
 - (c) "Institute" means the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949).
 - (d) "Member" means a member of the Institute of Chartered Accountants of India.
 - (e) "Notification" means a notification published in the Gazette of India.
 - (f) "Stakeholders" in respect of a company may include shareholders, investors, creditors, suppliers, customers, Government, employees, trade unions and society.
 - (g) "Technical Standards" include:-
 - i. Accounting Standards issued by the Institute of Chartered Accountants of India;
 - ii. Statement on Standard Auditing Practices and Engagement Standards issued by the Institute of Chartered Accountants of India;
 - iii. Framework for the Preparation and Presentation of Financial Statements and Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services issued by the Institute of Chartered Accountants of India;
 - iv. Statements issued by the Institute of Chartered Accountants of India;

- v. Compliance of the Guidance Notes issued by the Institute of Chartered Accountants of India;
 - vi. Notifications/Directions issued by the Institute of Chartered Accountants of India including those of a self-regulatory nature; and
 - vii. Compliance of the provisions of the various relevant Statutes and/or Regulations which are applicable in the context of the specific engagements being reviewed.
3. Words and expressions used and not defined in these procedures but defined in the Companies Act, 1956 (1 of 1956) or Chartered Accountants Act, 1949 (38 of 1949), shall have the same meanings respectively assigned to them in those Acts.

Scope and functions of the Board

4. Section 28B of the Chartered Accountants Act, 1949 provides that:
- “The Board shall perform the following functions, namely:-
- (a) to make recommendations to the Council with regard to the quality of services provided by the members of Institute;
 - (b) to review the quality of services provided by the members of the Institute including audit services; and
 - (c) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.”
5. In exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949, the Central Government has made ‘Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006’. Rule 6 specifies that the Board may, in discharge of its functions: –

(a) on its own or through any specialized arrangement set up under the Institute, evaluate and review the quality of work and services provided by the members of the Institute in such manner as it may decide;

(b) lay down the procedure of evaluation criteria to evaluate various services being provided by the members of the Institute and to select, in such manner and form as it may decide, the individuals and firms rendering such services for review;

(c) call for information from the Institute, the Council or its Committees, Members, Clients of members or other persons or organizations, in such form and manner as it may decide, and may also give a hearing to them;

(d) invite experts to provide expert/technical advice or opinion or analysis on any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work and services offered by the members of the Institute;

(e) make recommendations to the Council to guide the members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements and other matters related thereto.

6. The Quality Review Board has decided that the *modus operandi* for accomplishment of the quality inspection and assessment of the work of Auditors while carrying out audit function needed to be worked out so that the Board could not only assess the quality of audit but also the work done by Auditors in carrying out their statutory function. Further, the broad contours and requirements of review and the manner in which such review would be carried out, should not only be made known to users, stakeholders and service providers, in advance, but should also be transparent.

Manner of Review

7. Quality Review under the Chartered Accountants Act, 1949 is directed towards inspection/evaluation of audit quality and adherence to various statutory and other regulatory requirements. The Quality Review would involve inspection and assessment of the work of auditors while carrying out the audit function so that the Board is able to assess:

- a) the quality of audit and reporting by the auditors; and

- b) the quality control framework adopted by the auditors/ audit firms in conducting audit.

However, these procedures for review of quality of audit services of audit firms would not extend to internal audit services provided by the members of the Institute which shall be covered by the Board at a later stage. Further, these procedures would also not extend to services provided by the members of the Institute, in employment.

Selection of Audit Firms

8. Quality Review may be introduced in stages, with firms selected from different classes or types of audit firms being subjected to review at each stage. The Board may decide the audit firms to be included in the selection during each stage. Such selection of audit firms for review may be on the basis of following criteria:

(a) Criteria based on companies whose accounts have been audited:

- i. In the initial stage, the audited accounts of companies having wider public interest, such as listed companies, may be selected on the basis of one or more of the following:-
 - random selection;
 - on account of being a part of a sector otherwise identified as being susceptible to risk on the basis of market intelligence reports;
 - regulatory concerns pointing towards stakeholder risks;
 - reported fraud or likelihood of fraud;
 - major non-compliances with provisions relating to disclosures under relevant statutes.
- ii. The Board may review the general purpose financial statements of the enterprises and the auditor's report thereon with a view to assessing the quality of audit and reporting by the auditors either *suo moto* or on a reference made to it by any regulatory body like Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs etc. The Board may also review general purpose financial statements of the enterprises and the auditor's report thereon relating to which serious accounting irregularities in the general purpose financial

statements may have been highlighted by the media and other reports. The criteria for selection of general purpose financial statements of the Public Sector Undertakings may be separately determined by the Board.

- iii. The Board may select any enterprise for *suo moto* review of its general purpose financial statements with a view to assessing the quality of audit and the auditor's report thereon. The selection for *suo moto* reviews may, however, be done using methods such as random sampling, selection of particular class or classes of enterprises/audit firms.
- iv. The Secretariat should place the details of the enterprises, selected for review before the Board for its consideration. The Board, at this stage, may consider whether the case warrants a review by a Quality Review Group constituted for this purpose and may refer the cases selected for review to the relevant Quality Review Group. The Board may obtain the Annual Report of the company concerned in terms of the 'Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006'.

(b) Criteria based on Audit Firms auditing the accounts:

Selection of audit firms should also be made for review of their work on random basis, the volume of work handled by them represented by the number and nature of clients, their involvement in sectors that may be identified as facing high risk, as well as on account of their reported involvement in fraud or likelihood of fraud. Audit firms auditing large as well as mid-cap/small cap companies may be selected for the purpose.

Constitution of Quality Review Groups

9. The Board may constitute one or more Quality Review Groups (hereinafter referred to as Review Groups) to conduct preliminary reviews of the general purpose financial statements, with a view to assessing the quality of audit and reporting by the auditors, in consultation with the Board. There could be two categories of the Review Groups:

- (a) Industry Specific; and
- (b) Generic.

10. Industry Specific Review Groups may be constituted for reviewing general purpose financial statements of enterprises associated with a particular industry, for example, banking, insurance, electricity, mutual funds, merchant bankers, etc.

11. Each of the Review Group would be assisted by Technical Reviewer(s), who may be an outsourced service provider. The job of the Technical Reviewer(s) would be to prepare a report on the review of general purpose financial statements, with a view to assessing the quality of audit and reporting by the auditors, and the review of quality control framework adopted by the auditors/ auditing firms in conducting audit.

Functioning of the Review Groups

12. The report, so prepared by the Technical Reviewer, may be considered at the meetings of the Review Group. The Review Group may also consult the Board on any issue, on which the Group feels that the guidance of the Board is necessary.

13. The Review Group may complete the review of cases referred to it and submit its report on the same to the Board within the specified period of time. The Board may, however, extend this time limit for submission of reports by the Review Group.

14. The report of the Review Group shall expressly state the following:

- (a) Particulars of the enterprise;
- (b) A detailed description of the non-compliance with the matters stated in the Terms of Reference of the Board, if any;
- (c) A detailed description of the evidences that support the non-compliance; and
- (d) Review Group's recommendations about the actions that are required to be taken in a particular case.

15. The members of the Review Groups and the Technical Reviewer/s may be entitled for reimbursement of travelling expenditure incurred in connection with the meetings of the Review Groups equivalent to that is reimbursable to a member of the Council of the Institute. Members of the Review Groups (other than the ICAI's Central Council Members, Regional Council Members and the Members of the Branch level Management Committee) and Technical

Reviewer/s would be eligible for such an amount of honorarium that would be decided by the Board from time to time.

Reporting

16. The reviewer, after completion of his review, is required to submit a preliminary report to the audit firm on the review of the quality of audit and reporting by the auditors in the general purpose financial statements within the specified period of time before submitting the final report to the Board. The Board may, however, extend the time limit for submission of preliminary review report. The reviewer, based upon his satisfaction from the representation by the audit firm, may decide to issue either an interim report or a final report to the Board. The purpose is to establish the guidelines on the form and contents of the reviewer's report issued pursuant to review of the quality of audit services of an audit firm.

17. The reviewer should adhere to the principle requirements mentioned while preparing his report. It may be noted that the requirements mentioned apply to the interim as well as the final reports of the reviewer.

18. Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a reviewer may qualify the report due to one or more of the following:-

- ◆ non-compliance with technical standards;
- ◆ non-compliance with relevant laws and regulations;
- ◆ quality control system design deficiency;
- ◆ non-compliance with quality control policies and procedures; or
- ◆ non-existence of adequate training programmes for staff.

Basic elements of the Reviewer's Report

19. The report should contain:

(a) Elements relating to audit quality of companies:-

- i. A reference to the description of the scope of the review and the period of review

- of audit firm conducted alongwith existence of limitation(s), if any, on the review conducted with reference to the scope as envisaged.
- ii. A statement indicating the instances of lack of compliance with technical standards and other professional and ethical standards.
 - iii. A statement indicating the instances of lack of compliance with relevant laws and regulations.
- (b) Elements relating to quality control framework adopted by the audit firm in conducting audit:-
- i. An indication of whether the firm has implemented a system of quality control with reference to the quality control standards.
 - ii. A statement indicating that the system of quality control is the responsibility of the reviewed firm.
 - iii. An opinion on whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards for attestation services and whether it was complied with during the period reviewed to provide the reviewer with reasonable assurance of complying with technical standards in all material respects.
 - iv. Where the reviewer concludes that a modification in the report is necessary, a description of the reasons for modification. The report of the reviewer should also contain the suggestions.
 - v. A reference to the preliminary report.
 - vi. An attachment which describes the quality review conducted including an overview and information on planning and performing the review.
20. The Quality Review Report should be issued on the reviewer's (individual) letterhead and signed by the reviewer. The report should be addressed to the Board and should be dated as of the date of the conclusion of the review.

Guidelines for qualifying Review Report

21. In deciding on the type of report to be issued, a reviewer should consider the evidence obtained and should document the overall conclusions with respect to the year being reviewed in respect of following matters:

- (a) whether the policies and procedures that constitute the reviewed firm's system of quality control for its attestation services have been designed to ensure quality control to provide the firm with reasonable assurance of complying with technical standards.
- (b) whether personnel of the reviewed firm complied with such policies and procedures in order to provide the firm with reasonable assurance of complying with technical standards.
- (c) whether independence of audit firm/ auditors is maintained in conducting audit.
- (d) whether the firm has instituted adequate mechanism for training of staff.
- (e) whether the audit firm ensures the availability of expertise and/or experienced individuals for consultation with the consent of the auditee.
- (f) whether the skill and competence of assistants are considered before assignment of attestation engagement.
- (g) whether the progress of attestation service is monitored and work performed by each assistant is reviewed by the service incharge and necessary guidance is provided to assistants.
- (h) whether the audit firm has established procedure to record the audit plan, the nature, timing and extent of auditing procedures performed and the conclusions drawn from the evidences obtained.
- (i) whether the audit firm maintains the permanent file and the current file as per the standards laid down by the ICAI.
- (j) whether the audit firm verifies compliance with laws and regulations to the extent it has material effect on financial statement.
- (k) whether the internal controls within the audit firm contribute towards maintenance of quality of reporting.

Consideration of the Reports of the Review Groups

22. The Review Group's Report on the quality of audit by the auditor of a Public Sector Undertaking (PSU) should be furnished to the Office of Comptroller and Auditor General of India (C&AG), on case to case basis, and the C&AG's views, if any, shall be put-up before the Board along with the Report (on the particular PSU) of the Review Group. In all other cases, the Review Group's Report alongwith the decision of the Board on the quality of audit by the auditor of a PSU should be furnished to the Office of the C&AG for information.

23. The reports of the Review Groups on the quality of audits by the auditors of enterprises (other than those covered under Para 22) shall be placed before the Board for its consideration directly.

24. The Board may, after due consideration of the report and comments of Office of C&AG, wherever applicable, decide whether the recommendation made by the Review Group should be accepted or otherwise. The Board may, *suo moto*, take such further action, as it may deem appropriate. If the Board decides against the recommendations made by the Review Group in its report, the Board shall record the reasons for doing so.

Actions to be recommended by the Board

25. The actions that the Board may recommend include:

- (a) Referring the case to the Director (Discipline) of the Institute for necessary action under the Chartered Accountants Act, 1949;
- (b) Informing the details of the non-compliance to the regulatory bod(y)/ies relevant to the enterprise;
- (c) Intimating the Auditor as to the findings of the Report as well as action initiated under Para 25 (a) and/or (b);
- (d) Consider the matter complete and inform the audit firm/auditor accordingly.

Review Team composition and cost

26. The composition of the review team should depend on the size of the companies audited by the audit firm selected for the purpose of review. The composition of the team, being multi-disciplinary in nature and mandatorily headed by an individual Chartered Accountant, having not less than 15 years experience in practice, may also include one or more of the following: –

- (a) Experts or persons with industry specific experience;
- (b) Academician possessing knowledge of the industry or accountancy;
- (c) Other experts depending on the nature of analytical work emerging from the review.

However, no firm of Chartered Accountants may be included as a member of the review team.

27. The Board should be able to obtain the services of experts including from ICAI. Funding of such cost may be sought from Government of India through contribution from the Investors Education and Protection Fund (established by the Central Government) since the primary objective is sustenance and enhancement of quality of audit and related services, and the function was exercised to ensure that the public duties of an auditor were properly discharged in the interest of investors. In addition, if a review is needed to be carried out on a request by a Regulator or Government Agency, that Regulator or Government Agency may fund the cost of such review.

Confidentiality

28. The Board shall be bound to keep all the matters referred to it as well as any other information, papers, documents, etc. received during the course of the review confidential. Similar confidentiality conditions shall also apply to the members of the Review Groups and the Technical Reviewers associated with the Board.

Declaration(s) to be obtained from audit firms

29. The following declarations have been identified as particularly relevant:-
- a) the term “conflict of interest” would be defined/spelt out clearly without any ambiguity;
 - b) appropriate declaration be obtained from the audit firm including its partners and companies with reference to its / their “interest”, if any, respectively on the company and audit firm.

Publication of the findings observed by the Board

30. With a view to apprising the stakeholders and others concerned about the findings observed during the review, the Board may publish the same in the manner considered appropriate by it.

Power to amend or modify operating Procedures

31. These operating procedures have been prepared by the Board to provide a broad framework for its functioning. It is recognised that the procedures to be followed by the Board might require modification/amendment for the efficient and effective functioning of the Board. Wherever the Board is of the view that these operating procedures require modification in the light of the experience gained, it may amend or modify the operating procedures as it may deem appropriate.

Broad Checklist for Quality Reviews

In addition to compliance with the statutory provisions and technical standards, the following broad checklist may be considered for Quality Reviews:-

1. Whether the company has prepared and presented the financial statements in the format relevant to it?
2. Examine the accounting policies of the enterprise.
 - Are all the accounting policies in accordance with the requirements of the applicable accounting standards and Guidance Notes, issued by the ICAI.
 - Whether all significant accounting policies that should have been disclosed are disclosed.
 - Whether the auditor has appropriately dealt with in his report the deviations from accounting standards.
3. Verify whether the disclosures required by the law/regulations, requirements prescribed by the regulations and those required by the accounting standards have been made.
4. Where the audit report is qualified:
 - Whether the qualifications have been made in a clear and unambiguous manner;
 - Whether the qualifications made have been quantified? If not, whether adequate justification is provided for the same;
 - Whether the auditor has considered the overall effect of the qualifications on the true and fair view presented by the financial statements.
5. Whether the auditor has complied with the requirements of the Auditing Standard SA-700, The Auditor's Report on Financial Statements, and the Statement on Qualifications in Auditor's Report, in the preparation of audit report.
6. Examine the financial statements with a view to ascertain whether there is any unusual accounting treatment/accounting entry? If yes, comment on how it has been dealt with in the financial statements.
7. Does the auditor/audit firm has a policy to ensure independence, objectivity and integrity,

on the part of partners and staff? Who is responsible for this policy?

8. Does auditor monitor compliance with policies and procedures relating to independence?
9. Does the auditor/audit firm has an established recruitment policy? Does the auditor conduct programmes for developing expertise in specialised areas and industries?
10. Does auditor/audit firm has established procedures for record retention, including security aspects?
11. Does the auditor/audit firm evaluate the accounting and internal control systems of the auditee?
12. Whether the procedures followed ensure that audit report is in accordance with the relevant authoritative requirements or technical standards including accounting standards?