

RISK, GOVERNANCE AND AUDIT

CORPORATE LEVEL

TUTE 09

QUALITY CONTROL **(S.L.Au.S – 220)**



by

Jeewantha Perera

(FCA, ACCA, MBA, B.Sc Accountancy (sp))

QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS.

A) Introduction

The objectives of the Audit Firm is to establish and maintain a system of Quality Control to provide with a reasonable assurance that;

- a) The firm and its personnel comply with Professional Standards and applicable legal and regulatory requirements.
- b) The reports issues by the Firm or Engagement Partners are appropriate in the circumstances.

The ultimate objective of an audit engagement is to provide an appropriate audit opinion supported by the necessary evidence and judgements. Quality Control Procedures can be established in two stages.

a) At the individual Audit Level.

Consider the individual audits separately and prepare the procedures to enhance the quality of the professional service provided to the clients.

b) At the Overall Audit Level.

Consider the Audit Firm as one unit and prepare the procedures to enhance the quality of the professional services provided to the clients.

B) What are Quality Control Procedures

"The policies and procedures implemented both at the Individual Audit Level and Overall Audit Level, with the view of enhancing the Quality of the Professional Services provided to the Clients" can be defined as Quality Control Procedures.

C) Important Points to Consider

Engagement Partner

"The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body"

Engagement Quality Control Review

"A process designed to provide an objective evaluation, on or before the date of the auditor's report, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report". The engagement quality control review process is for audits of financial statements of listed entities and those other audit engagements, if any, for which the firm has determined an engagement quality control review is required.

Engagement Quality Control Reviewer

“A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report”.

D) Requirement of Quality Control/ Steps of Quality Control

D.1) From the perspective of the Overall Audit Firm Level

Requirement 01 : The Firm and the leadership responsibility for Quality Control

The standard requires that the firm implements policies such that the internal culture of the firm is one where quality is considered to be essential. Such a culture must be inspired by the leaders of the firm, who must promote this culture by the example of their actions and messages.

The Audit Firm should establish policies and procedures designed to promote an internal culture recognizing that the quality is an essential factor in performing engagements. In order to do that, someone from the audit firm, (either the Managing Partner or Senior Partner/s) should take the ultimate responsibility for the Firm's system of Quality Control.

The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures.

Requirement 02 : Human Resources

Firm should have policies and procedures on ensuring excellence in its staff, to provide the firm with 'reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagement in accordance with Professional Standards and regulatory and legal requirements and enable the Engagement Partner to issue report that are appropriate in the circumstances.

These will cover the following issues.

- Recruitment
- Performance evaluation
- Capabilities
- Competence
- Career development
- Promotion
- Compensation
- The estimation of personnel need

Requirement 03 : Engagement Performance

The firm should take the steps to ensure that the Engagements are performed correctly, in accordance with Standards and Guidance. Ensuring good engagement performance involves number of factors such as;

- a) Direction b) Supervision c) Review d) Consultation
- e) Resolution of Dispute

The firm should have policies and procedures to determine when a quality control reviewer will be necessary for an engagement. This will include all audits of financial statements for listed companies. When required, such a review must be completed before the report is signed

The firm shall establish policies and procedures designed to provide it with reasonable assurance that,

- a) Appropriate consultation takes place on difficult or contentious matters
- b) Sufficient resources are available to enable appropriate consultation to take place
- c) The nature and the scope of and conclusions resulting from such consultation are documented and are agreed by both the individuals seeking the consultation and individual consulted
- d) Conclusion reached from the consultations are implemented.

Requirement 04: Monitoring

The standard states that firms must have policies in place to ensure that their quality control procedures are:

- Relevant • Operating effectively • Adequate • Complied with

There are two types of monitoring activity;

- a) An ongoing evaluation of the system of quality control, and
- b) periodic inspection of a selection of completed engagements.

The people monitoring the system are required to evaluate the effect of any deficiencies found. These deficiencies might be one-offs. Monitors will be more concerned with systematic or repetitive deficiencies that require corrective action. When evidence is gathered that an inappropriate report might have been issued, the audit firm may want to take legal advice.

D.2) From the perspective of the Individual Audit Level

Requirement 01 : The Firm and the leadership responsibility for Quality Control

The Engagement Partner is required to set an example with regard to quality control. The actions of the Engagement Partner and the appropriate messages to the other members of the Engagement Team, in taking responsibility for the overall quality on each Audit Engagement. The Engagement Partner should emphasise the importance of

- a) Performing work that complies with the professional standards and applicable regulatory requirements
- b) Comply with the firm's Quality Control Procedures as applicable
- c) Issuing the Audit Reports that are appropriate in the circumstances

Requirement 02: Relevant Ethical Requirements

The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. The fundamental principles of professional ethics, which include:

- a) **Independence** - The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements, maintain independence where required by relevant ethical requirements. 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.
- b) **Integrity** - to be straightforward and honest in all professional and business relationships.
- c) **Objectivity** - to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.
- d) **Competence and Due Care** - to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
- e) **Confidentiality** - to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.

- f) **Professional Behaviour** - to comply with relevant laws and regulations and avoid any action that discredits the profession.

Requirement 03: Acceptance and Continuance of Client Relationships and Specific Engagements

The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm is complying with below requirements. The Engagement Partner is responsible to ensure that appropriate procedures in respect of accepting and continuing with the audits are followed

- a) Competencies, Capabilities, and Resources of the Firm to accept the new engagements and to continue the existing engagements.
- b) Integrity of the client - Factors to be considered are as follows.
 - 1) The identity and business reputation of the client's principal owners, key management, and those charged with its governance.
 - 2) The nature of the client's operations, including its business practices.
 - 3) Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

Requirement 04: Human Resources & Work Allocation

The firm shall establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to:

- a) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and
- b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances.
- c) Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently.

Requirement 05: Engagement Performance

The firm shall establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and

applicable legal and regulatory requirements, and that the firm or the engagement partner issue reports that are appropriate in the circumstances.

- a) The Engagement Partner needs to take the responsibility for ***Direction, Supervision*** and ***Review*** of the Engagement with Professional Standards and applicable legal and regulatory requirement.

Direction - Engagement Partner needs to explain the following to the Audit Team.

- ✚ Their responsibilities (including objectivity of mind and professional skepticism)
- ✚ Responsibilities of respective partners where more than one partner is involved
- ✚ The objectives of the work to be performed
- ✚ The nature of the entity's business
- ✚ Risk-related issues
- ✚ Problems that may arise
- ✚ The detailed approach to the performance of the engagement

Supervision - Engagement Partner needs to obtain an understanding on the areas where the team is having issues and already identified issues.

Engagement supervision includes the following:

- ✚ Tracking the progress of the engagement.
- ✚ Whether the Audit Team understand the instructions and whether the work is being carried out in accordance with the planned approach to the engagement.
- ✚ Addressing significant matters arising during the engagement, considering their significance, and modifying the planned approach appropriately.

Review - A review consists of checking whether,

- ✚ The consideration of whether legal and regulatory requirements were met,
- ✚ The work has been performed in accordance with professional standards and applicable regulatory framework,
- ✚ There is a need to revise the nature, timing and the extent of the work performed
- ✚ whether the audit team obtained sufficient and appropriate audit evidence,
- ✚ whether all these are properly documented,
- ✚ whether the procedures performed are in line with the evidence obtained and the conclusions reached are in line with the audit evidence obtained.

b) Consultation

The Engagement Partner shall take the responsibility for the engagement team, undertaking the appropriate consultation on difficult matters. Be satisfied that the members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and outside the engagement team.

c) Perform Engagement Quality Control Review

The Audit Engagement Partner is responsible for appointing a reviewer, if one is required. They are then responsible for discussing significant matter that arise with the reviewer and for not issuing the Audit Report until the engagement quality control review has been completed.

Engagement Quality Control Reviewer needs to perform an Objective Evaluation of the significant judgements made by the engagement team and the conclusion reached when formulating the Audit Report.

The Engagement Quality Control Reviewer shall document the followings for the Audit Engagement Reviewed.

- a) The procedures required by the firm's policies on engagement quality control review have been performed.
- b) The Engagement Quality Control Review has been completed on or before the date of the Audit Report
- c) The Reviewer is not aware of any unresolved matters that would caused the reviewer to believe that the significant judgements the engagement team made and the conclusions reached were not appropriate

A quality control review for a listed entity will include a review of

- ✚ The engagement team's evaluation of the firm's independence towards the audit.
- ✚ Discussion of the significant matters with the Engagement Partner
- ✚ Review of Financial Statements and proposed Audit Report
- ✚ Review of selected Audit Documentation relating to significant audit judgment made by the audit team and conclusions reached.
- ✚ The significant risks identified during the engagement and the responses to those risks (including assessment of, and response to, fraud)
- ✚ Matters to be communicated with management/those charged with governance
- ✚ Significance of corrected and uncorrected misstatements identified during the audit
- ✚ Judgements made, particularly with respect to materiality and significant risks

Requirement 06: Review and Monitoring

An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that the policies and the procedures relating to the system of quality control are relevant, adequate, and operated effectively. Therefore, the Engagement Partner needs to consider the results of the monitoring process as an evidence to make sure that the proper procedures are implemented in order to enhance the quality of the professional services rendering the clients.

E) Advantages of Quality Control

- 1) Ability to reduce the Audit Risk to a acceptable level.
- 2) Facilitate the audit firm to have a effective utilization of the limited resources such as time, manpower.
- 3) Facilitate to provide a professional standard at the highest level.
- 4) To provide it with reasonable assurance that the firm & its personal comply with professional starboard & applicable legal & regulatory requirements.
- 5) To ensure that the reports issued by the firm or engagement partners are appropriate in circumstances

