

The Chamber of Tax Consultants
Accounting and Auditing Committee

Changing audit landscape
Learnings from regulatory inspections

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Important: The areas discussed in this presentation are for your information only and are not a complete list of all possible areas which can be subject to inspection. The content of this presentation is the sole expression and opinion of its speaker and do not represent the views and opinions of the organizations, businesses or institutions the speaker is, or has been a part of.

Overview

Managing increasing expectations

- ▶ Market has never been more complex with ever changing economic environment in India and globally, growth potential given the Indian market dynamics and constraints driven by volatility, investor confidence, talent
- ▶ Complex reporting requirements introduced – for both Corporates and Auditors
- ▶ A tougher regulatory environment for the audit profession, and a more challenging role of the auditors with inspection oversight from NFRA, ROC, SEBI, FRRB, QRB, ICAI
 - ▶ Expectation is the auditor should detect fraud, audit should include investigative procedures
 - ▶ Multiple regulators (audit and agencies such as SFIO, ED, EOW) investigate instances of fraud or corporate failures
- ▶ Board, Audit Committee, Promoter, Management expect higher involvement of senior and experienced auditor early and throughout the audit process for the audits of their companies
- ▶ Limited bandwidth and time for an audit partner and their team to perform a high quality audit

Course objectives

- ▶ To highlight key observations from external inspection reports available in public domain
- ▶ To suggest measures to prepare for meeting the increasing and evolving expectations

Objective is to demonstrate adherence to quality control and auditing standards for the execution of an audit having thorough written documentation

Overview - Auditing in current times

Understand

- ▶ Status of economy and outlook, sectors your clients operate in
- ▶ Business / operations and financial health of your clients
- ▶ Board / Audit Committee / Senior Management controls
- ▶ Operating and financial controls
- ▶ Significant / other judgements and estimates – going concern, impairments, ECL
- ▶ Regulatory matters – impacting your clients and generally

Strong team

- ▶ Sharing of experience
- ▶ On-the-job training of our teams – making them understand of accounting and auditing concepts
- ▶ Formal and informal communication
- ▶ Early identification of issues
- ▶ Focus on frauds, whistle blower complaints, short seller reports, news in the media
- ▶ Consult with peers – leverage collective experience

Expectation: Audit Partner and team understands business, risks, controls and demonstrates professional scepticism, challenges management, applies judgment and evidences involvement and leadership of an audit engagement

Changing focus of inspections (highlights)

Inspections	Earlier	Now and going forward
Orientation	Quality of an audit file Inspection of Audit Engagement File Review	<ul style="list-style-type: none"> • SQC 1 - Quality of a firms processes including governance • Inspection of adherence to firm policies, accounting and auditing standards substantiated by appropriate documentation in the audit engagement file
Information reviewed	Documents provided	<ul style="list-style-type: none"> • Review of firm policies, documents supporting adherence to policies, complete audit workpaper file
Focus	Documents available on file, whether provided by the auditee or prepared by the auditor to support audit work	<ul style="list-style-type: none"> • Beyond auditee provided documentation - Evidence of audit work performed • When were the workpapers prepared • Who prepared the workpapers • Who reviewed the workpapers • Did the partner review the workpapers • Did the EQCR review the workpapers
Meetings and interactions	With engagement team	<ul style="list-style-type: none"> • Separate meetings with firms leadership teams and engagement teams
<u>Inspection team</u>		
Size	Single reviewer	<ul style="list-style-type: none"> • Multiple reviewers
Experience and knowledge	Dependent on the reviewer	<ul style="list-style-type: none"> • Experienced reviewer, subject to inspection training and having support of senior and experienced auditors from the inspecting organisation
Inspection period	A few days to a week	<ul style="list-style-type: none"> • 3 to 8 weeks

Key theme from inspections – strict adherence to auditing standards

Sr.	Topic
1	Standard on Quality Control (SQC 1) - Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements”
2	Audit Documentation – SA 230
3	Materiality in Planning and Performing an Audit – SA 320
4	Analytical Procedures – SA 520
5	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures – SA 540
6	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment (SA 315)
7	External confirmations – SA 505
8	Going Concern – SA 570
9	Internal Controls over Financial Reporting (ICFR) – Guidance note
10	Subsequent events – SA 560
11	Written Representation – SA 580
12	Quality Control for an Audit of Financial Statements – SA 220
13	Communication with those charged with governance (TCWG) - SA 260

Compliance with SQC 1

- ▶ The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partner(s) are appropriate in the circumstances.
- ▶ The nature of the policies and procedures developed by individual firms to comply with this SQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network
- ▶ The firm's system of quality control should include policies and procedures addressing each of the following elements
 - ▶ Leadership responsibilities for quality within the firm
 - ▶ Ethical requirements
 - ▶ Acceptance and continuance of client relationships and specific engagements
 - ▶ Human resources
 - ▶ Engagement performance
 - ▶ Monitoring
- ▶ The quality control policies and procedures should be documented and communicated to the firm's personnel.

Audit documentation

- ▶ Documentation should contain sufficient detailed information to understand:
 - ▶ Significant findings & issues arising during the audit
 - ▶ Actions taken to address them and our conclusions, including significant professional judgments made in reaching those conclusions
 - ▶ Detailed documentation on high risk areas and complex accounting estimates
- ▶ Basis of professional judgement exercised by the auditor being challenged.
- ▶ Only the person who has prepared and reviewed the document should sign the documents in the audit file in that role - if WP is signed-off by person other than the preparer and reviewer, that would lead to professional misconduct
- ▶ Care should be taken and self review of WP's should be done to ensure:
 - ▶ Documentation is detailed enough for an independent person to review, understand and reach to the same conclusion as the engagement team
 - ▶ WPs have correct references to file that are documented in the workpaper file
 - ▶ Different WPs are consistent with one another for the same matter
- ▶ Timely conclusion of audit strategy and timing of documentation
- ▶ Self-sufficient workpapers – no reliance later on email, data in laptop, backup hard copy file (required for 'what if')
- ▶ Assembly of final audit file should be in compliance with firms policies and procedures as per SQC 1 requirements. The firm is required to have controls over retention and maintenance of the integrity of the audit file

Planning materiality

- ▶ Appropriately identify and document the users of the financial statement and their expectations (example of users of the FS are Shareholders, Banks, Debt holders in case of debt listed securities, Rating agencies, Analysts, Regulators)
- ▶ Auditor to document materiality at both the planning stage and reassessment/conclusion stage
 - ▶ Apply qualitative factors to identify significant account with balances lower than materiality. Also determine if lower materiality is required to be used for these accounts.
- ▶ Document clearly how materiality has been used to determine the nature, timing and extent of audit procedures.
- ▶ Document basis of conclusion for qualitative factors
- ▶ No materiality thresholds have been specified by ICAI

Analytical Procedures

- ▶ Use of Analytical procedures during planning phase for identification of Risk
- ▶ Analytical procedures should be beyond flux analysis and should include trends, ratios, industry comparisons, comparisons with anticipated results, test of reasonableness etc.
- ▶ Analysis of relationship between various elements of financial information and between financial and non-financial information needs to be performed
- ▶ Ensure all material variances are investigated and documented
- ▶ Ensure proper documentation including the formulas used for variances

Auditing accounting estimates

- ▶ Document in sufficient detail:
 - ▶ how competence, capabilities and objectivity of management experts have been determined
 - ▶ procedures performed in order to determine reasonableness of the assumptions/methods used by management experts
 - ▶ procedures performed by the audit team over management assessment
 - ▶ the professional judgements made by the auditor in concluding on high estimate areas

- ▶ in case of critical estimates/balances, involve experts for determining appropriateness of the assumptions/methods used for valuation

- ▶ In case there are caveats in valuation report, legal opinions etc. documentation on how the auditor has dealt with those

Assessing Risk of Material Misstatement (ROMM)

- ▶ ROMM identified should be specific to the risk factors identified by the engagement team
- ▶ Assessment of ROMM should be done during initial stages of audit; Re-assessment, if any should be documented separately
- ▶ Enquire with internal auditors for identification of ROMM based on their observation and findings during the year. Discussions should be documented
- ▶ Perform detailed analytical procedure to identify ROMM
- ▶ Audit procedures around ROMM should include control testing, substantive procedures and should also include special considerations
- ▶ Ensure consistency with respect to documentation across all the working papers
- ▶ Enhanced focus on having detailed minutes of meetings with management and TCWG including our inquiries with them with respect to ROMM due to fraud
- ▶ Quality of Minutes / documentation of the discussion on above and other ROMM between the team in team meetings and with EQCR

External confirmations

- ▶ Confirmations should be obtained for all parties (considering significance – qualitative and quantitative) including related party balances
- ▶ Control should be maintained over external confirmation requests, these should be designed and properly addressed to the right party and contain return information for responses to be sent directly to the auditor
- ▶ Obtaining direct confirmation is a key audit procedure. If management suggests that we should not circulate a specific party, we should understand the reasons and evaluate the implications of management's refusal on the relevant risks of material misstatement. In such situations, auditor should perform alternate audit procedures designed to obtain relevant and reliable audit evidence.

Going Concern

- ▶ Analyse key ratios over past years to identify trends, if any
- ▶ Enquire with management whether there are any indicators for GC and perform own assessment of the same.
- ▶ Obtain management assessment of GC with future cash flow projections for at least 12 months approved by Board. Managements refusal to provide assessment should be highlighted to TCWG and reporting implications should be assessed
- ▶ Discuss / challenge managements assumptions of going concern and the minutes of such discussion should contain, management view and auditor's assessment and conclusion
- ▶ Assumptions that cannot be audited should be benchmarked to industry trends or past trends of the Company
- ▶ In case support letter is received for the company/group, test the ability and intention of provider of the support letter
- ▶ Management representation should be conclusive and preferably detailed to cover all significant assumptions and judgements
- ▶ Enquire with Management subsequent to audit report date but before the Financial Statement Issue date any changes in circumstances / GC indicators
- ▶ While assessing going concern, review the cash flow statement for the period under audit to understand the cash flow pattern and identify any anomalies
- ▶ Do not be over reliant on TCWG, our communication with TCWG should clearly bring out the key assumptions and judgements applied in the GC assessment, management representations, our evaluation and conclusion
- ▶ Document conclusion about entity's ability to continue as a going concern, including all workpapers that support our conclusion

Internal Controls over financial reporting (ICFR)

- ▶ Adequate documentation and procedures for controls around management override (remain cautious that deviation to the process might be a red flag for management override even if its inbuilt in Company's Risk Control Matrix)
- ▶ Perform inquiries with Internal audit team and document the same by way of minutes
- ▶ Evaluation of findings in Internal audit report/management testing and its impact on ICFR conclusion to be documented; management testing of ICFR to be obtained by teams
- ▶ Ensure that the observations during substantive testing (e.g. recorded and unrecorded audit difference or outcome of Analytical procedures) are evaluated from control perspective as well
- ▶ Equal focus should to placed on lower risk areas while testing controls

Subsequent events

- ▶ Be alert to events after audit report date but before the financial statements are issued; Date the financial statements are issued is the date that the auditor's report and audited financial statements are made available to third parties
- ▶ Any information after the issuance of the audit report that comes to the attention of auditor, which if known at the time of issuance of audit report, may have caused the auditor to amend the auditors report (SA 560 para 10-13) should be critically evaluated and discussed with the management

Written representation - Management Representation Letter (MRL)

- ▶ MRL does not affect the nature or extent of procedures to be performed; MRL is not a substitute to audit work
- ▶ In case there are inconsistencies in the representation and evidence obtained, attempt to resolve the matter
- ▶ Be mindful of evidence available contrary to managements representations
- ▶ Should be issued on the same date as the audit report

Quality control for an audit of financial statements

- ▶ Compliance with Ethical requirements
- ▶ Acceptance and Continuance of Client Relationships and Audit Engagements
- ▶ Assignment of Engagement Teams
- ▶ Engagement Performance
 - ▶ Direction, Supervision and Performance
 - ▶ Reviews
 - ▶ Consultation (ensure compliance with Ethical requirements)
 - ▶ within the firm
 - ▶ with other professionals
(ensure client confidentiality and compliance with Code of Ethics)
 - ▶ Engagement Quality Control Review
 - ▶ Differences of Opinion
- ▶ Monitoring
- ▶ Documentation

Engagement Partner

- ▶ Build discipline for timely planning, supervision and review, evidenced by sign-off work
- ▶ Plan the engagement and budget adequate time
- ▶ Evidence of time spent on the audit

Engagement Quality Control Review

- ▶ Document evidence of review of key workpapers by EQCR, mere sign off is not sufficient
- ▶ Examples - Minutes of meeting, Audit conclusion memo
- ▶ Establish clear communication and documentation protocols
- ▶ Evidence of time spent on the audit

Communication with Those Charged With Governance (TCWG)

- ▶ Identify appropriate TCWG, if sub-group is identified document why communication with the Board is not necessary
- ▶ Agree on the communication protocol and timing of communication with TCWG
- ▶ Hold meeting(s) with TCWG to communicate audit plan including ROMM
- ▶ Document minutes of meeting with TCWG (including audit committee)
- ▶ Presentations to TCWG should also include key procedures performed / judgments made by the audit team and the conclusion reached
- ▶ For critical matters (including regulatory / third party reports provided) document (i) management's assessment (ii) what sufficient appropriate audit evidence has been obtained (iii) the conclusion reached by the Engagement Team
- ▶ Minimum communication with TCWG – ensure compliance with SA 260
 - ▶ Auditor Independence
 - ▶ The Auditor's Responsibilities in Relation to the Financial Statement Audit
 - ▶ Planned Scope and Timing of the Audit
 - ▶ Significant Findings from the Audit including auditor's assessment
- ▶ Inquiries with TCWG and response thereto

Key takeaways – have adequate documentation to substantiate the following

Compliance with all components of SQC 1

Compliance with mandatory Standards on Auditing, Accounting and Code of Ethics and ICAI guidance

Communication with company management and those charged with governance on a timely basis

Talent competency and training

Challenge management; demonstrate professional scepticism

Adequate Engagement Partner and EQCR involvement

Perform work; then obtain Management Representation: MR should not be the only response for significant matters

Consultation – use collective professional experience and knowledge

Independence - in substance and in form

Communication within the firm and with engagement teams

ICAI resources:

- Committee for Capacity Building Members in Practice (CCBMP), ICAI: E-Booklet on Sample Checklist on SAs- Ready Reference for the Practitioner & CA Firms
- ICAI – AASB: Practitioner's Guide to Audit of Small Entities (Revised 2020)

Questions
