Seminar on QCR Findings

March 30, 2012
Multan

Shahid Hussain
Director Quality Assurance
ICAP

Haroon Adeel
Senior Manager Quality Assurance
ICAP

HOW QCR STARTED

- In the 25th ICAP AGM held on December 30, 1986 a concern was raised on the quality of auditing services rendered by CA firms.
- The Council in its 82nd meeting held on February 19, 1987 seriously deliberated the matter and decided to constitute a Committee of four members for conducting the QCR of practicing firms on voluntary basis.
- The program was run on a peer review basis until 1998.

Continued…

- In December 1999 the Council made the QCR process mandatory for CA firms carrying out audits of statutory financial statements.
- Due to some legal issues and the provisions of the CA Ordinance the program was made mandatory for only those firms carrying out audits of listed entities.
- SECP vide SRO 268(I)/2012 dated March 16, 2012 has extended the scope of QCR to ESCs.
- Firms carrying out audits of unlisted entities are encouraged to have their audit working paper files reviewed.

NUMBER OF QCR RATED FIRMS

- Total 98 firms are currently QCR rated.

- 35 firms on the list are not doing audit of listed entities and have voluntarily offered themselves for QCR

NOW WE TAKE A LOOK AT FREQUENT OBSERVATIONS NOTED DURING QUALITY CONTROL REVIEWS

ENGAGEMENT LETTER (EL)

- No evidence of review of the terms of the engagement and consideration whether the client needed to be reminded of the terms
- EL not signed by engagement partner
- EL not acknowledged by management
- EL did not mention about QCR of audit documents files

AUDIT PLANNING (AP) AND RISK ASSESSMENT

- Overall AP was not done at all.
- AP done but work was not carried out in accordance with AP
- AP documentation was not appropriately tailored to the client/ nature of business
- The audit plan only included a brief description of the client’s business and did not identify key features of the client’s business.
- The nature of entity’s operation and its governance structure not reviewed/assessed

Continued…

- No assessment was done / documented of internal control system and the effectiveness of control environment. Accordingly the auditor failed to identify associated significant risks.

- All important areas of risk assessment not covered

- Risks not addressed at the assertion level for account balances and classes of transactions.

AUDIT PROGRAMS

- Audit programs not tailored to the specific circumstances of an engagement

- Did not match with the detail of work done and working paper reference was not given.

- Audit programs were used as substitute for substantive audit procedures/test of details.

AUDIT DOCUMENTATION

- Audit procedures performed on significant audit areas were not documented.

- Audit working papers did not state sample selection basis, how tests were performed and conclusion drawn

- Working papers were not appropriately referenced.

ANALYTICAL REVIEW (AR)

- AR not done at planning stage to assist auditor in planning the nature, timing and extent of other auditing procedures
- AR was done but there was no analysis of variance. In some cases the reasons for material variances were not explained.
- Corroboration of the explanations obtained on fluctuations was not documented AR Not done at final stage
- AR not done at final stage

AUDIT SAMPLING (AS)

- AS was either not done or done but method adopted was not documented

- Reason for adopting AS method not documented

- Conclusions drawn from AS method not documented

AUDIT MATERIALITY (AM)

- Audit materiality was not determined/ documented by the auditor.

- Materiality determined but not considered during sampling and performing audit procedures

- Qualitative aspects not considered while calculating Audit Materiality

AUDIT EVIDENCE (AE)

- Instead of appropriately documenting audit procedures for verification of various account balances only ticks were marked on ledger sheets/ copies of invoices.
- Adequate audit procedures were not performed to test NRV's of inventory. i.e. checking of subsequent prices.
- Appropriate evidence of attendance during physical count of inventory not available.
- Not performing appropriate audit procedures in case of balances brought forward on the pretext that the same verified last year

RELATED PARTY (RP)

- RP's list not obtained

- No audit procedures were performed to detect any undisclosed related parties or transactions with RP's

- No AP prepared for RP transactions.

SUBSEQUENT EVENTS REVIEW (SER)

- SER not done at all.
- SER procedures were not updated to the audit report date.
- Subsequent balance checking of debtors/ creditors was considered as SER.

EXTERNAL CONFIRMATIONS

- Control sheet not prepared
- Reminders not sent where external confirmations were not received
- Alternative audit procedures not applied where confirmations not received
- Representation from management not obtained when responses were not received of confirmation request letter
- Confirmations were arranged by client personnel.
- Confirmation was not directly sent/addressed to the auditors

MANAGEMENT REPRESENTATION LETTER (MRL)

- No MRL available in the file
- MRL signed after the date of the auditor's report.
- MRL did not cover all important matters e.g. going concern, related party transaction, fraud and error etc.
- MRL not dated and not signed by appropriate authority
- Figures in MRL did not agree with the FSs.

COVERING LETTER (CL)

- CL not issued

- CL did not require copy of BOD resolution for approval of Financial Statements.

- Receipt of CL was not acknowledged by management.

GOING CONCERN (GC)

- Appropriateness of the use of the GC assumption not assessed at the planning stage.
- Specific representation for GC issue was not obtained from management.
- Only financial indicators were evaluated to assess GC issue and operational and other indicators were neither evaluated nor their assessment was documented.
- In the event of indications of potential going concern issues, only management representation was relied upon

Continued…

- Management's assessment (with proper supporting documents) on the appropriateness of use of GC assumption not obtained.
- Auditor failed to document his review of the management's assessment of the GC assmptn.
- No document to evidence review of the adequacy of disclosure in the financial statements by the auditor.
- Auditor failed to document his conclusion; or in some cases documented work did not support the conclusion drawn
- Report qualified despite adequate disclosures in the financial statements.

Continued…

- Qualification paragraph did not mention the exact deficiency in the disclosures
- Emphasis of matter paragraph given despite inadequate disclosure in the Financial Statements
- GC qualification /emphasis of matter paragraph was not appropriately worded as per ISA.

AUDITORS’ REPORT (AUR)

- Qualification paragraphs were not appropriately drawn/worded as per the requirements of relevant ISA’s. e.g. merely reference to the concerned note was given in the ‘opinion paragraph’.
- Description of the matter giving rise to the modification was not appropriately worded and also financial impact was not quantified.
- Qualification paragraph neither appeared to be a disagreement nor a limitation of scope but mere statement of facts.
- Placement of qualification paragraph was not correct

Continued…

- Despite multiple uncertainties involved that were significant to the financial statements, no reason was documented as to how the auditor dispelled the issuance of disclaimer of opinion.
- Incoming auditors did not state that the prior period financial statements were audited by another auditor and also did not indicate the type of report issued
- The company paid Dividend or other transaction which was subject to zakat but the audit report said “no zakat was deductible at source”
- Name of EP was not identified on the AUR as required under ATR 19

ENGAGEMENT QUALITY CONTROL REVIEW (EQCR)

- EQC Reviewer not appointed or EQCR not conducted (listed entities).
- EQCR conclusions not documented.
- EQCR document did not disclose the name of reviewer.
- How EQC Reviewer findings were resolved before the issuance of audit report not documented.

FAIR VALUATION OF FIXED ASSETS / INVESTMENTS

- Solely relied on valuations provided by the client and no work performed to evaluate the reasonableness of the assumptions used for the determination of fair value of assets
- Need for using the work of expert not assessed.
- Adequacy of independent valuer’s work not assessed.

FINANCIAL STATEMENTS REVIEW FINDINGS

- There was no statement of compliance identifying the financial reporting framework
- Auditors have signed the financial statements.
- Financial statements were printed on firms' letterhead
- Accounting policies of those items were disclosed which did not exist in the FS. e.g. the accounting policy for lease transaction was given whereas no leased asset was found.
- Pvt. Ltd Subsidiaries of listed companies followed accounting framework of Medium Size entity.

Continued…

- Many MSEs and SSEs did not account for retirement benefits in the financial statements
- No deferred taxation was accounted for in the Financial Statements.
- The deferred tax liability arose on revaluation of fixed assets was charged to P&L instead of taking it to statement of changes in equity which in fact distorts profit after taxation and EPS of that particular year.
- Incremental depreciation on revalued assets was not taken to retained earning through statement of changes in equity.

MISCELLANEOUS

- Audit fee was not agreed with the clients as per Council Directive ATR 14.
- Permanent audit file not maintained.
- Adequate information not available in permanent file.
- No appropriate documentation was available for division of audit areas between the joint auditors.
- No evidence of review of work done by joint auditors.
- Working papers not dated. No evidence of review by senior and/or partner

“The skill of an accountant can always be ascertained by an inspection of his working papers.”

Colonel Robert H. Montgomery
(Montgomery’s Auditing, 1912)

A founding partner of the accounting firm, Lybrand, Ross Bros. & Montgomery—
(known today as ‘PricewaterhouseCoopers’)

Traditional jokes about Auditors:

Q: How many auditors does it take to change a light bulb?

A: How many did it take last year?

Q: Why did the auditors cross the road?

A: Because they looked in the file and that's what they did last year.

Q & A

Thank You