

## **SMP Workshop on “Sharing of Observations noted during QCR”**

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ICAP Karachi**

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### **HOW QCR STARTED**

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

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### **Continued...**

- In December 1999 the Council made the QCR process mandatory for CA firms carrying out audits of statutory financial statements.
- Owing 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.
- Firms carrying out audits of unlisted entities are being encouraged to have their audit working paper files reviewed

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## NUMBER OF QCR RATED FIRMS

- Total 97 firms are currently QCR rated.
- Around 30 QCR rated firms not doing audit of listed companies but have voluntarily offered themselves for QCR.

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

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## 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

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## **AUDIT PLANNING (AP) AND RISK ASSESSMENT**

- Overall AP was not done at all.
- 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 cycles.
- The nature of entity's operation and its governance structure not reviewed/assessed
- No assessment was done of internal control system and the effectiveness of control environment.

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## **Continued.....**

- Documentation of internal control and risk assessment procedures was not reviewed
- All important areas of risk assessment not covered
- Reliance on client's risk assessment documentation and no work was performed to determine the appropriateness of such assessment
- Significant risks were not identified.
- Risks not addressed at the assertion level for account balances and classes of transactions.

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## **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.

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### **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.
- Document Indices not prepared.

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### **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.
- AR Not done at final stage
- Corroboration of the explanations obtained on fluctuations was not documented

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### **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

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### AUDIT MATERIALITY (AM)

- Audit materiality was not determined at financial statements/ account balance/ transaction level
- Materiality determined but not considered during sampling and performing audit procedures
- Qualitative aspects were not considered while calculation of AM
- Reasons for not determining AM not documented

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### 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 net realizable values of inventory by checking subsequent market prices of specific items.
- No appropriate evidence was available of physical count of inventory

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### RELATED PARTY (RP)

- RP's list not obtained/ existence not assessed.
- No audit procedures were performed to detect any undisclosed related parties.
- No AP prepared for RP transactions.

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### **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.

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### **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

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### **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.

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### **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.

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### **GOING CONCERN (GC)**

- Audit planning for GC not done appropriately.
- Appropriateness of GC assumption used by management was not assessed.
- In the event of indications of potential going concern issues, only management representation was relied
- 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.

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### **Continued...**

- Qualification paragraph did not mention the inadequacy of disclosure in the financial statements
- 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.

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### **AUDITORS' REPORT (AUR)**

- AUR did not include qualification paragraphs but merely referred concerned notes in '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
- AUR was issued from the place where firm's office did not exist.

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### **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
- Inappropriate qualification was noted such as the company does not maintain Fixed Assets register
- The company has paid the Dividend or other transaction which is subject to zakat but the audit report says no zakat was deductible at source
- Name of EP was not identified on the AUR as required under ATR 19

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### **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.

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## FAIR VALUATION OF FIXED ASSETS / INVESTMENTS

- Closely 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.
- Pled for using the work of expert not assessed.
- Adequacy of independent valuator's work not assessed.
- Relied solely on methodology and assumptions used by the management for the determination of fair value of the investment by applying valuation technique.

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## 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. For 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.

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## 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.

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## 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

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***“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')

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***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.

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## Q & A

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## Thank You

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