Role of QRB in Improving Audit Quality

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'Quality Review Board' – a term often heard in financial reporting and auditing world but only half understood. Quality Review Board ('QRB') is a body set up under Chartered Accountants Act, 1949 that comprises a chairperson and ten other members. Central Government nominates the Chairperson and 5 members. Remaining are nominated by the Council of the ICAI. QRB is responsible (a) to make recommendations to the Council of ICAI; (b) to review the quality of audit services provided by the members; and (c) to guide the members to improve the quality of services and adhere to the various statutory and other regulatory requirements.

QRB conducts quality review with an objective to evaluate quality of an audit engagement including adherence to applicable financial reporting framework, compliance with various statutory and regulatory requirements, adherence to standards of auditing and other professional and ethical standards, examining no material misstatement exists in the financial statements and examining audit opinion.

QRB selection for quality review is predominantly a risk-based selection including factors like reported fraud or likelihood of fraud, serious accounting irregularities in the financial statements highlighted by the media and other reports, major non-compliances under relevant statutes highlighted in past reviews, or on a reference made to it by any regulatory body like RBI, SEBI, IRDAI, NFRA, MCA, etc.

Section 132 of the Companies Act, 2013 read with Rule 3(1) of National Financial Reporting Authority (NFRA) Rules, 2018 restricts the power of QRB to select the companies for quality review for certain classes of companies. These includes listed companies, banking and insurance companies and unlisted companies with certain thresholds on net worth, turnover, borrowings, etc. QRB can only carry out review of such companies if reference to conduct such review is made by NFRA to QRB.

QRB selects Audit Firm and the no. of audit file (engagement) for review based on their internal protocols. QRB identifies Technical Reviewer (TR) empaneled with the Board to conduct Quality Review and intimates to Audit Firm Under Review (AFUR). TR & his team carry out the Quality Review and submits to QRB summary of his findings and his final comments after taking into consideration responses of AFUR and Quality Review Group. Basis severity of findings, weaknesses and gaps identified, QRB decides further course of action that includes:

(a) recommendation to the Council of the ICAI for referring to the Disciplinary Directorate of the Institute for consideration and appropriate action.
(b) issue advisory and guidance to the AFUR for improvement in the quality of services and adherence to various statutory and other regulatory requirements.
c) inform the details of the non-compliance to the regulatory bodies relevant to the entity
(d) in case of review arising out of a reference received from a regulatory body, inform the results of review and the details of action taken to the concerned regulatory body.
(e) consider the matter complete and inform the AFUR accordingly.

TR qualifies the report due to one or more of the following: (a) non-compliance with technical standards and other relevant guidance; (b) non-compliance with relevant laws and regulations as required under applicable auditing standard; (c) quality control system design deficiency; or (d) non-compliance with quality control policies and procedures.

Periodic reports as published by QRB are available on its website. These reports include key findings, deficiencies, etc. in an aggregate manner. Some key issues highlighted in QRB report are reiterated below to provide some insights on nature of gaps identified by QRB:

- Violation of the norms on the auditor's independence, engagement acceptance.
- Not documenting/keeping sufficient audit document for recording audit procedures performed and audit evidence obtained for areas like existence and valuation of inventories, physical verification reports of inventory, bank confirmations, depreciation schedule, terms of loan given and compliance with sec 185 & 186 of Companies Act, 2013, impairment testing of investments, financial assets, etc.
- Lack in defining materiality & performance materiality.
- Failure in testing of the Internal Financial Controls.
- Failure to evaluate the use of the going concern basis of accounting appropriately and sufficiently by the Management and failure to note the implications thereof in the Auditor's Report.
- Not obtaining written representations from the management as per SA 550 & SA 580.
- Errors in preparation of cash flow statements.
- Failure to perform enough tests of details to verify the occurrence, completeness, and accuracy of the revenue transactions.
- Incomplete and inappropriate accounting policies.
- Not rounding off figures as per schedule III even if turnover criteria for rounding off is met.
- Non-disclosure of purpose of loan to group entities under section 186.
- Lapses in the Audit of transactions with related parties & violation of section 177 of the Companies Act, 2013.
- Failure to maintain audit documentation as per SA 230.

QRB creates awareness amongst AFUR on areas of improvement and deficiencies that exists to take remedial actions enabling their clients provide high quality financial information to their stakeholders. QRB reports also acts as a ready reckoner for all auditing firms to understand errors and non-compliances to avoid thereby improvising quality of audit procedures and strengthening audit documentation.

As per 'Report on Audit Quality Review 2020-21' published in October 2021, during financial year 2020-21, QRB completed 34 reviews of audit quality pertaining to the financial statements for the years ending from March' 2016 to March' 2018. Out of these 34 completed reviews, QRB issued advisories in 25 cases for further improvement, 2 cases were recommended to council of ICAI for referring them to the Disciplinary Directorate of ICAI for further necessary actions and 7 cases were closed. Further, between period from 2012 till 2020-21, QRB has completed 580 reviews, out of which 61% cases required improvements and 6% cases required significant improvements.

Besides QRB performing its role, audit firms are responsible to follow auditing standards, make use of such reports, spread awareness amongst its engagement team members and work towards improving their audit quality on consistent basis. It may not be feasible for QRB to be able to cover all auditing firms under its review therefore audit firms are expected to refer to key findings published annually and take measures to prevent such issues occurring in engagements handled by them.

It may not be considered wise to wait for being selected for review by QRB which in turn may have serious consequences in case of material non compliances. It is no harm to learn from mistakes of others and rectify well in advance. Since QRB is now able to Suo-moto initiate reviews only in respect of entities other than those covered under Rule 3(1) of NFRA Rules, 2018, it exposes a large range of auditing firms involved in audit of private companies (which would mean mostly all) that may be selected for quality review purposes. The auditing firms providing audit services to private companies from various industries susceptible to risks needs to be mindful and should have well designed audit controls and well-maintained mechanism in order to face such unprecedented challenges.

Improved visibility of such reports through training sessions, CPE learnings, seminars at CA forums, media coverage etc. can enhance impact of such reports and a large no. ICAI members and auditing firms can avail benefits. Additionally, implementation of quality review cycle that mandatorily would cover almost all audit firms in a phase wise manner will act as deterrent for auditing firms to compromise on audit quality or audit documentation.

It is also worthy to mention here that improving audit quality and improving quality of financial information are interdependent. Auditors are responsible for a quality audit and management is responsible for quality and law compliant financial statements. Accounting standards notified and Schedule III that prescribes format of financial statements is a GAAP and not an act therefore do not have assessment mechanisms or direct penal consequences on account of non-compliances. Because of this, audit and financial statements may sometimes not get the senior management's attention and involvement that it deserves.

QRB is certainly performing the role that it has been bestowed upon and is making attempts to introduce new measures and assist members in improving audit quality. However, greater contributions from corporates in ensuring that their financial statements are law compliant and auditing firms making diligent and continuous efforts in improvising their audit quality will act as a catalyst in improvising the quality of audit as well as the financial statements. This will uplift the faith of the stakeholders, various regulatory bodies and public at large in the audit and in the audited financial statements.