



AUDIT QUALITY INSPECTION GUIDELINES

**National Financial Reporting
Authority
(NFRA)**

भारत सरकार
7th – 8th फ्लोर, हिन्दुस्तान टाइम्स हाउस
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<https://nfra.gov.in>

National Financial Reporting Authority

Audit Quality Inspection Guidelines

Audit quality inspections, world-wide¹, are integral to the functioning of independent audit regulators. An inspection generally consists of firm-wide quality reviews and/or test-check of individual audit assignments to evaluate the level of compliance with applicable auditing standards and quality control policy and processes.

Mandate and Overall Objective

1. In keeping with the functions entrusted to NFRA under section 132 of the Companies Act 2013, audit quality inspections are a key tool with the Regulator to fulfill its statutory obligations. The mandate for inspections is derived under section 132 (2) of the Companies Act 2013 (Act, hereinafter) and relevant provisions in NFRA Rules 2018 (Rules, hereinafter).
2. The overall objective of inspections is to evaluate compliance of the audit firm/auditor with auditing standards and other regulatory and professional requirements, and the sufficiency and effectiveness of the quality control system of the audit firm/auditor including
 - (a) adequacy of governance framework and its functioning
 - (b) effectiveness of firm's internal control over audit quality
 - (c) system of assessment and identification of audit risks and mitigating measures

Criteria and Scope

3. Criteria are benchmarks used to check compliance, evaluate, or measure subject matter consistently and reasonably. Criteria is identified based on the Laws, rules, regulations, policies, standards etc governing the subject matter.
4. Accordingly, the criteria for inspections would be
 - Provisions in the Act, Rules and amendments thereof
 - SQC1 including Code of Ethics
 - Standards of Auditing
 - Policies, guidelines, manuals etc of the firm
 - Ind AS as may be applicable to selected individual audit engagements
 - Relevant circulars/directions of other regulators, as applicable
 - Directions issued by internal quality boards/committees and QRB, ICAI, as may be applicable
5. Inspections will involve a review of the quality control policy, review of certain focus areas, test check of the quality control processes, and test check of audit engagements performed by the audit firm/auditor during the year, as may be identified by the inspection teams. The inspected auditor/audit firm would have no role, whatsoever, in any selection by NFRA of the audit firm/auditor or test-check of individual audit engagements undertaken by the audit firm/auditor, the selection of which will only be made by the inspection team.

¹ Reference: Core principles of independent audit regulators by the International Forum for Independent Audit regulators (IFIAR) requires that audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other rules, laws and regulations. IFIAR comprises independent audit regulators from 54 jurisdictions.

6. The audit engagements selected may be reviewed for application of all or select auditing standards, as may be decided by the inspection team.

7. The scope of inspection will be informed by NFRA to the audit firm/auditor at the commencement of inspection. The scope of any inspection will generally not vary during its execution unless specific circumstances or findings warrant an expansion of scope or coverage. A change in scope or coverage would be intimated to the audit firm/auditor, with due authorisation.

8. Inspections are intended to identify areas and opportunities for improvement in the audit firm's system of quality control. Inspections, by nature, are distinct from investigations undertaken under section 132 (4) of the Act. However, in certain cases, test-check by the inspection teams may provide basis for or require reference of such cases/matters for enforcement or investigation under applicable provisions of the Act and Rules.

9. Inspections may not lead to a detection or identification of ***all*** the weaknesses in governance framework or system of internal control or audit risk assessment framework and are not designed to provide absolute assurance about the audit firm's/auditor's quality of audit work. In respect of selected audit assignments, inspections may not identify ***all*** the weaknesses in the audit work performed by the auditors in respect of the audit of the financial statements of the companies. Inspections are also not intended nor designed to replace the role and responsibilities of the independent statutory auditor of the companies.

10. Inspections may, in certain cases, also lead to financial reporting quality reviews of financial statements of the companies whose audits are selected for inspection. They may also result in issue of advisories or directions to the audit firms/auditors.

Methodology

11. Selection of audit firms- Selection of audit firms/auditors and determination of periodicity of their inspections by NFRA will be based on assessment of risks in the audit environment and parameters such as the size of the firm, composition and nature of the firm, number of audit engagements completed in the year under review, complexity and diversity of preparer financial statements audited by the firm and other such risk indicators as NFRA may determine from time to time. In addition, any specific concerns highlighted by Government, other regulators, issues in public domain may also influence selection of audit firms/auditors for inspection.

12. Selection of individual audit assignments- Selection of audit engagements will be on both risk-based and random selection and based on financial and non-financial indicators² identified by NFRA. Details of audit engagements conducted by the audit firm/auditor will be required to be provided by the audit firms/auditors to the inspection team in advance for purposes of selection.

13. Inspections may involve questionnaires, entry and exit meetings, discussions, site visits, interviews, observations, walkthroughs, review of documents, review of audit documentation system including ERPs in place etc.

14. The inspection cycle will usually commence with a presentation by the audit firm/auditor. The presentation would comprise specific areas as communicated by NFRA and any areas that the

² May include audit areas that are complex, areas where new accounting standards have been introduced, audit areas significant to prevailing economic trends or conditions etc

audit firm/auditor may like to present. NFRA would also outline its approach to inspections to the audit firm/auditor.

15. NFRA may issue questionnaire/s requesting audit firm/auditor to keep records ready for on-site inspection. At the start of on-site inspection, entry meetings with senior management of audit firm or heads of various verticals may be held to better appreciate the structure and working of the audit firm/auditor. Enquiry meeting with audit engagement teams of selected audit engagements may also be held at the start of the inspections. The execution cycle will comprise site-visits, interviews, review of controls, substantive testing, issue of queries and observations and follow-up of previously issued observations (to be relevant in case of recurring inspections). The inspected audit firm/auditor will be required to provide written responses to the queries and observations, and written confirmations as required by the inspection team.

16. Inspections would close with a meeting with the senior management of audit firm or the auditor. NFRA would subsequently issue a draft inspection report for obtaining responses of the audit firm/auditor before finalisation and issue of final inspection report.

Inspection Report

17. The inspection report would comprise NFRA's inspection approach in brief, findings or non-compliances, audit firm/auditor responses, NFRA's conclusions and recommendations and any other matter deemed significant by the inspection team.

18. NFRA would publish the results of the findings in accordance with Rule 8 (5) of NFRA Rules 2018, which states that 'NFRA shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.' NFRA would also ensure, in keeping with Rule 8 (6) of NFRA Rules 2018, that "The Authority shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing". The inspected firm will have to demonstrate with evidence in support which information, in its view, falls in the category of 'confidential' and 'proprietary', for the purpose.

19. The inspected audit firm/auditor will be required to provide their response to the draft inspection report within 30 days of its issue.

20. The inspected audit firm/auditor will be required to submit compliance to inspection findings contained in the final inspection report issued by NFRA, within the timelines prescribed therein.

Revision of these guidelines

21. The inspection procedures and processes outlined above will be subject to periodic review at NFRA and revised from time to time, as per requirements.
