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AUDIT QUALITY MATTERS: DECODING REGULATOR'S OBSERVATION AND EXPECTATION

Building trust through consistent & high-quality audits

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AGENDA

- What is Audit Quality
- Why Audit Quality Matters
- Evolution of Regulatory Oversight in India
- What Regulators are looking for
- NFRA observations
- Audit Documentation

- Sector-wise regulator's oversight

(RBI, SEBI, STOCK EXCHANGES, IRDAI, AMFI)

- Summary of sector-wise observations
- Regulator's future expectations
- Bonus tips and insights
- Closing statement

WHAT IS AUDIT QUALITY

QUALITY
Q – Question management
U – Understand business
A – Assess risks dynamically
L – Link risks to procedures
I – Investigate anomalies
T – Think skeptically
Y – Yield evidence-based conclusions

Inputs
- Competence
- Ethics
- Independence
- Resources

Process
- Risk assessment
- Evidence gathering
- Professional skepticism
- Documentation

Outputs
- Appropriate audit opinion
- Meaningful communication

Outcomes
- Public confidence

WHY AUDIT QUALITY MATTERS

"Audit quality is not merely compliance with standards; it is the consistent execution of professional skepticism, independence, judgment, and robust audit procedures."

- Audit quality is fundamental to confidence in financial reporting.
- Investors, lenders, regulators, and other stakeholders rely on audited financial statements.
- Audit failures can lead to:
  - Loss of investor confidence
  - Financial losses
  - Regulatory sanctions
  - Reputational damage to firms and professionals

EVOLUTION OF REGULATORY OVERSIGHT

Before 2018

- ICAI Peer Review
- QRB Reviews

After NFRA formation

- Enhanced oversight
- Independent inspections
- Enforcement powers

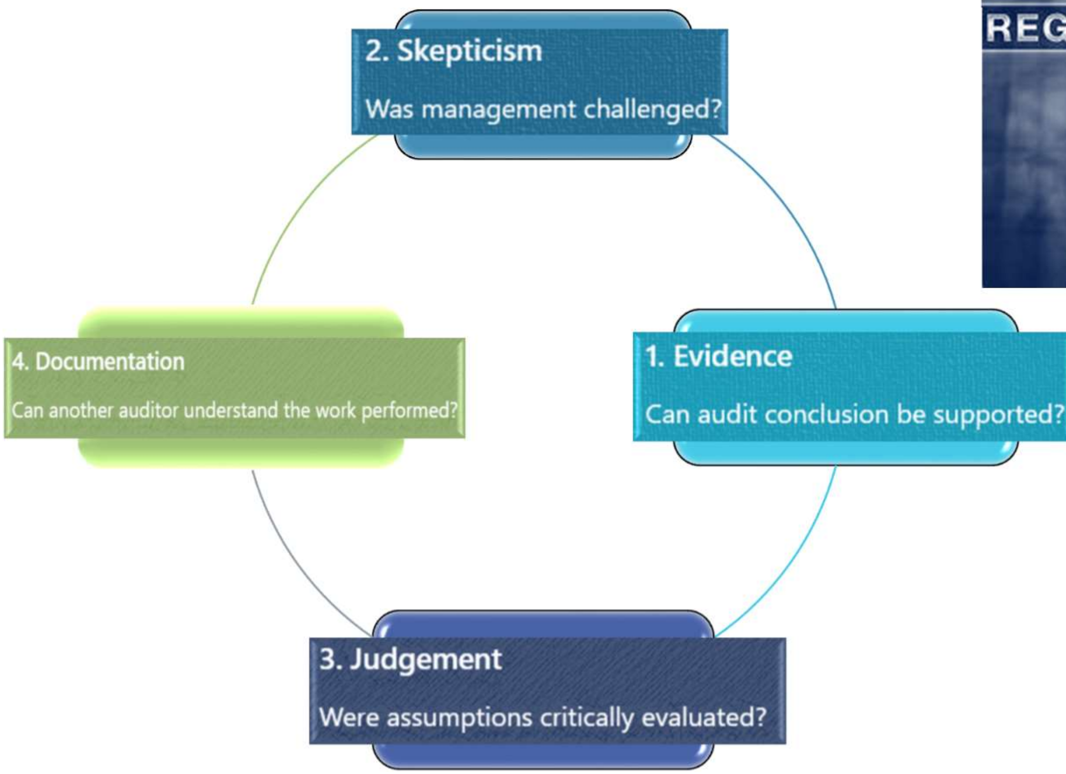
Key Stakeholders

- National Financial Reporting Authority (NFRA)
- Institute of Chartered Accountants of India (ICAI)
- Securities and Exchange Board of India (SEBI)
- Ministry of Corporate Affairs (MCA)

Regulatory Objectives

- Enhance audit quality
- Protect public interest
- Strengthen accountability
- Improve financial reporting ecosystem

WHAT REGULATORS ARE LOOKING FOR



NFRA OBSERVATIONS

About National Financial Reporting Authority

Regulatory body overseeing audit quality in India

Conducts inspections & issues orders against auditors

If NFRA questions tomorrow - can your file speak?

Inadequate Documentation

- No evidence of procedures performed
- Missing working papers for key areas (e.g., revenue, loans)

Lack of Professional Skepticism

- Blind reliance on management representations
- No independent verification

No Link Between Risk & Procedures

- Audit procedures not aligned with identified risks

Insufficient Evidence

- Conclusions without supporting documentation

Poor Review Mechanism

- No documentation of review notes
- Lack of supervision evidence

Area	Observation
Audit Documentation	Most frequent finding
Related Parties	Repeated deficiencies
Revenue Recognition	Inadequate testing
Independence	Monitoring weaknesses
Estimates	Lack of challenge
EQCR	Ineffective reviews

Standard Violations

- Non-compliance with:
  - Institute of Chartered Accountants of India auditing standards

NFRA OBSERVATIONS

Case 1 – IL&FS Audit Failures

NFRA observed:

- Failure to report material irregularities
- Lack of skepticism
- Going concern issues overlooked

Challenge management assumptions

Evaluate liquidity realistically

Do not rely only on management representations

Documentation gaps can override actual audit work

Audit file must demonstrate compliance

Complex financial entities require deeper risk assessment

Case 2 – DHFL

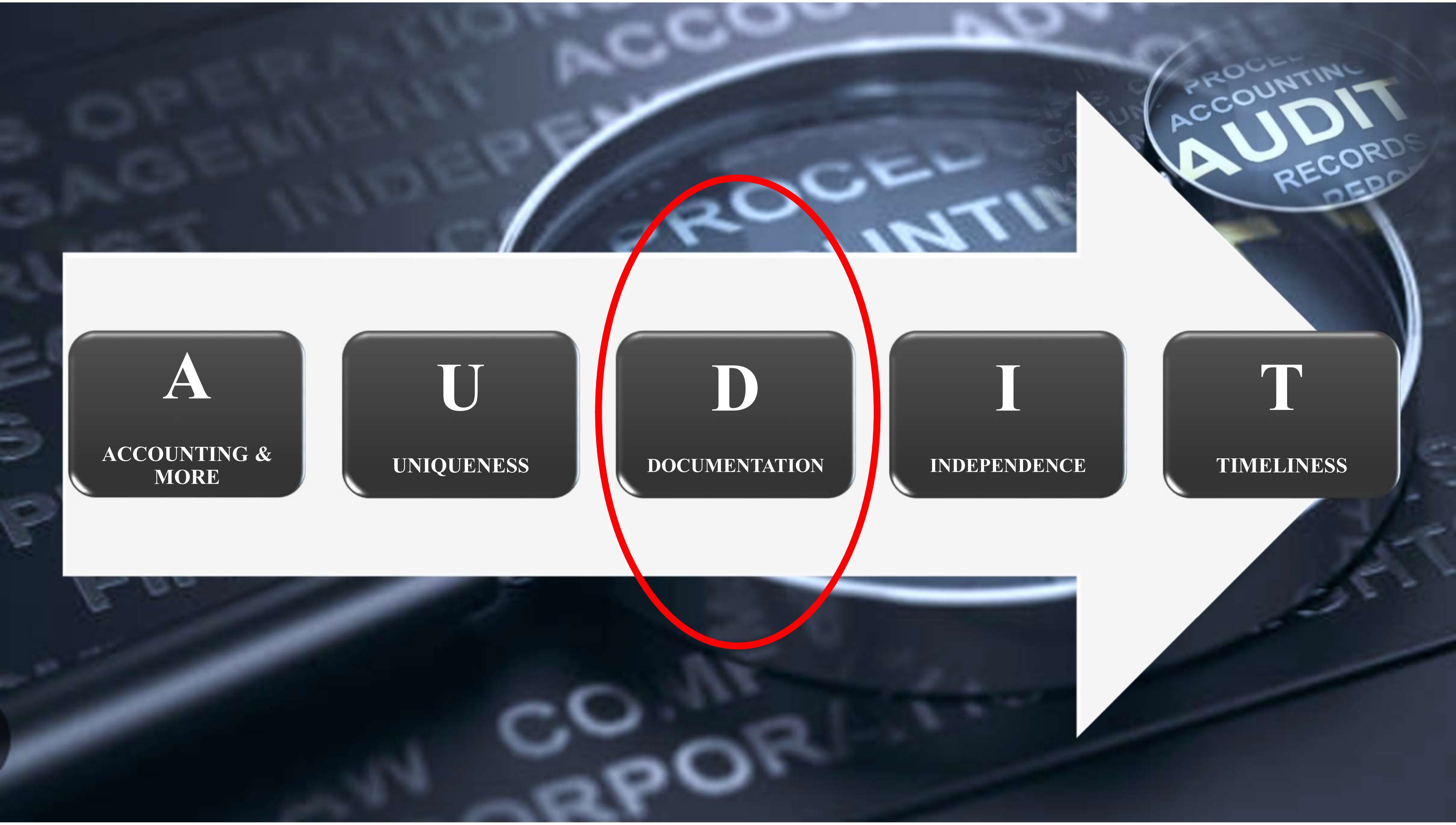
Findings:

- Large related party transactions missed
- Insufficient verification
- Failure to identify fraud indicators

Case 3 – Coffee Day Global

Issues:

- Diversion of funds
- Related party concerns
- Weak audit challenge process


A
ACCOUNTING & MORE
U
UNIQUENESS
D
DOCUMENTATION
I
INDEPENDENCE
T
TIMELINESS

FEATURES OF AUDIT DOCUMENTATION

Completeness

- Covers all material areas
- No gaps in audit trail

Clarity

- Understandable without verbal explanation
- Logical structure

Relevance

- Only relevant information included
- No unnecessary clutter

Good documentation answers:

- **What was done?**
- **Why was it done?**
- **What evidence was obtained?**
- **What was concluded?**

Poor Documentation Indicators

Generic statements ("checked and found correct")

Missing evidence

No linkage to risk

No reviewer sign-off

Audit Trail

- Shows:
  - Who performed work
  - Who reviewed it
  - When

Reliability

- Based on credible evidence
- Proper source verification

Traceability

- Cross-referenced:
  - Working papers ↔ Financial statements

Timeliness

- Prepared **contemporaneously**
- Not post-audit reconstruction

Objective → Risk → Procedure → Evidence → Observation → Conclusion

IDEAL FORMAT OF AUDIT DOCUMENTATION

1. Heading Section
- Client Name (Bank / Branch)
- Area (e.g., Advances / NPA)
- Period (FY)
- WP Reference Number

2. Objective
- Example:
  - "To verify correctness of NPA classification and provisioning"

3. Risk Identification
- High / Medium / Low risk
- Link to audit plan

4. Procedure Performed
- Step-by-step audit procedures:
  - Sample selection method
  - Tests performed
  - Tools used (CBS reports, etc.)

5. Evidence Obtained
- List of:
  - Documents verified
  - Reports extracted
- Attach:
  - Screenshots / extracts (key portions only)

6. Observations / Findings
- Clearly mention:
  - Deviations
  - Errors
  - Exceptions

7. Conclusion
- Whether:
  - Area is fairly stated / requires adjustment

8. Cross-Referencing
- Link to:
  - Financial statements
  - Other working papers

9. Sign-offs
- Prepared by
- Reviewed by
- Date

CORE PRINCIPLES - DISCIPLINES

Core Principles

- Ensure documentation is:
  - **Complete** (covers all assertions)
  - **Clear** (understandable to a reviewer)
  - **Concise** (avoid unnecessary clutter)
  - **Self-explanatory** (no dependency on verbal explanation)

Review & Supervision

- Ensure **multi-level review**
- Document **review notes & their closure**
- Highlight **key risk areas clearly**

Good:

- "Verified 25 loan accounts > ₹5 Cr; 3 accounts incorrectly classified as standard instead of NPA due to overdue >90 days."

Bad:

- "Loans checked and found OK."

Documentation Discipline

- Document:
  - **Audit objective**
  - **Procedure performed**
  - **Evidence obtained**
  - **Conclusion reached**
- Maintain **proper cross-referencing** (lead schedules ↔ supporting docs)
- Use **standardized formats/templates**
- Include:
  - Date of preparation
  - Prepared by / Reviewed by
- Maintain **audit trail of changes**

KEY POINTS TO NOTE

Common Mistakes by Auditors

- ❌ Reliance only on verbal explanations
- ❌ Copy-paste of previous year without validation
- ❌ Leaving blank or incomplete working papers
- ❌ Generic conclusions
- ❌ Ignoring contradictory evidence
- ❌ Over-documentation (irrelevant data dump)
- ❌ Skipping documentation due to time pressure

Best Practices for Auditors

- ✅ Document simultaneously with audit work
- ✅ Avoid post-facto documentation
- ✅ पर्याप्त (sufficient) audit evidence & appropriateness
- ✅ Maintain documentation for peer review
- ✅ No changes without proper audit trail (maintain indexing and version control system)
- ✅ Usage of Digital audit tools / folders

Working Papers are your insurance policy

If it is NOT DOCUMENTED, it is NOT DONE…

If it is NOT JUSTIFIED, it is NOT DEFENSIBLE…

And if it is NOT DEFENSIBLE, it is a PROFESSIONAL RISK…

Key Learnings from NFRA Orders

"**Documentation is the backbone of audit quality**"

If not documented → treated as **not performed**

Emphasis on:

- Professional skepticism
- Evidence-based conclusions
- Proper review & supervision

Top 5 Golden Rules

1. Document **as you audit, not after**
2. Ensure **clear linkage: Risk → Work → Conclusion**
3. Maintain **evidence for every conclusion**
4. Avoid **generic documentation**
5. Follow **SA 230 rigorously**

INDEPENDENCE – NON NEGOTIABLE FACTOR

Regulators increasingly view independence failures as audit quality failures.

Threats

- Self-review
- Familiarity
- Advocacy
- Intimidation
- Self-interest

Professional skepticism is not suspicion; it is disciplined curiosity

PROFESSIONAL SKEPTICISM

– The Most Misunderstood Concept

Skepticism means

- Trust but verify
- Challenge assumptions
- Seek contradictory evidence

Red Flags

- Management override
- Unusual journal entries
- One-off transactions
- End-of-year adjustments

Regulatory concern:

Auditors accepted management explanations without adequate corroboration.

REVENUE RECOGNITION

– Where Fraud Begins

Revenue remains one of the highest-risk audit areas.

Regulatory observations:

- Inadequate substantive testing
- Weak risk assessment
- Poor cut-off testing

Learning:

Never substitute inquiry for evidence.

RELATED PARTY TRANSACTIONS (RPT)

– Regulatory Hotspot

Why regulators focus here:

- Frequent fraud vehicle
- Hidden diversion of funds

Common deficiencies:

- Incomplete identification
- Reliance on management declaration
- Inadequate testing

AUDITING ESTIMATES AND FAIR VALUES

Did we audit the model or merely review management's output?

NFRA has frequently highlighted inadequate testing of impairment assessments and management assumptions.

Focus areas:

- ECL provisions
- Impairment
- Fair valuation
- Going concern

SECTOR WISE REGULATORY OVERSIGHT – RBI (BANKS AND NBFC)

"The first loss in banking is often the smallest loss."

Key areas:

Asset Classification

- NPA recognition
- Evergreening
- Restructured advances

Provisioning

Divergence Reporting

Fraud Reporting

IT Controls

ECL Models

Governance

RBI-Type Findings

1. Delayed STR filing.
2. Incomplete KYC records.
3. Credit monitoring deficiencies.
4. NPA classification errors.
5. Unreconciled suspense accounts.
6. Weak cyber monitoring.
7. Delayed regulatory reporting.
8. Account review lapses.
9. Documentation deficiencies in loans.
10. Exception approvals not evidenced.

RBI's supervisory focus increasingly centres on:

- Early stress identification
- Asset quality integrity
- Governance failures
- Related-party exposures

YES Bank

Key lessons:

- Governance concerns
- Asset quality questions
- Divergence issues

PMC Bank

Lessons:

- Hidden exposures
- Related-party lending
- Confirmation failures

SECTOR WISE REGULATORY OVERSIGHT – SEBI AND STOCK EXCHANGES

"Investors lose money long before the market discovers the truth."

"A delayed disclosure is a denied disclosure."

SEBI's Expectations from Auditors

Focus areas:

- Corporate governance
- Financial reporting quality
- Related-party transactions
- Disclosure adequacy
- Qualified opinions
- Resignation of auditors

SEBI Type Findings

1. Inadequate client risk profiling.
2. Mis-selling evidence.
3. Improper distributor supervision.
4. Delayed investor grievance closure.
5. Trade surveillance gaps.
6. Insider trading monitoring deficiencies.
7. Incomplete disclosure records.
8. Client consent documentation missing.
9. Suitability assessment failures.
10. Deficient advisory documentation.

Zee–Invesco Governance Dispute

Discussion points:

- Related-party governance
- Disclosure expectations
- Audit committee interactions

Karvy Stock Broking

- Client securities misuse

Satyam

- Revenue inflation
- Cash balance manipulation

Brightcom Group

Issues:

- Revenue recognition
- Disclosures
- Corporate governance

SECTOR WISE REGULATORY OVERSIGHT – IRDAI (INSURANCE COMPANIES)

"In insurance, today's estimate becomes tomorrow's liability."

Recent regulatory concerns have included pressure on actuarial assumptions used in solvency calculations, with warnings issued regarding practices that could present an artificially stronger capital position.

IRDAI Expectations

Focus areas:

- Solvency
- Actuarial assumptions
- Product governance
- Claims provisioning
- Policyholder protection

IRDAI-Type Findings

1. Policy issuance control gaps.
2. Claims processing delays.
3. Agent training deficiencies.
4. Customer communication lapses.
5. Product governance issues.
6. Underwriting exceptions.
7. Claims documentation gaps.
8. Mis-selling indicators.
9. Grievance handling weaknesses.
10. Outsourcing oversight deficiencies.

SECTOR WISE REGULATORY OVERSIGHT – AMFI (MUTUAL FUNDS AND AMCs)

"Investor money demands institutional discipline."

Expectations Around Mutual Fund Audits

Focus areas:

- Valuation
- Side-pocketing
- Expense allocation
- Related parties
- Stress events

Franklin Templeton Debt Fund Crisis

Discussion:

- Valuation uncertainty
- Liquidity assumptions
- Subsequent events

AMFI-Type Findings

1. Inadequate client risk profiling.
2. Mis-selling evidence.
3. Improper distributor supervision.
4. Delayed investor grievance closure.
5. Trade surveillance gaps.
6. Insider trading monitoring deficiencies.
7. Incomplete disclosure records.
8. Client consent documentation missing.
9. Suitability assessment failures.
10. Deficient advisory documentation.

SECTOR WISE REGULATORY OVERSIGHT – MCA (CORPORATE AND AUDIT REPORTING)

"Substance over form is not optional."

"Compliance is evidence. Governance is behavior."

1. CARO Reporting Deficiencies

- Generic reporting
- Unsupported conclusions
- Incomplete coverage
- Non-reporting of exceptions
- Boilerplate disclosures

2. Related Party Transactions

- Section 188 non-compliance
- Disclosure failures
- Approval deficiencies
- Arm's length assessment gaps
- Documentation weaknesses

3. Going Concern Assessment

- Cash flow assumptions
- Funding dependencies
- Debt servicing concerns
- Stress testing absent
- Management bias

4. Internal Financial Controls

- IFC testing inadequate
- Design assessment absent
- Operating effectiveness weak
- IT controls omitted
- Documentation gaps

5. Fraud Reporting

- Section 143(12)
- Whistleblower matters
- Management override
- Investigation coordination
- Reporting delays

MINISTRY OF CORPORATE AFFAIRS

SECTOR WISE REGULATORY OVERSIGHT – SUMMARY OF AREA OF OBSERVATIONS

Fraud / Issue Type	BFSI	Non-BFSI	Regulator Focus
Revenue inflation	Medium	Very High	SEBI, NFRA
Related parties	High	Very High	SEBI, NFRA, RBI
Evergreening	Very High	NA	RBI
Diversion of funds	High	High	RBI, SEBI
Governance failures	Very High	Very High	All
KYC failures	Very High	Medium	RBI, IRDAI
Mis-selling	High	Medium	IRDAI, SEBI
Disclosure deficiencies	High	Very High	SEBI
Weak controls	Very High	High	All
Auditor skepticism failures	High	High	NFRA

REGULATOR'S FUTURE EXPECTATIONS

Across RBI, SEBI, NFRA, MCA, IRDAI and stock exchanges, the dominant themes were:

1. Revenue inflation and fictitious transactions
2. Related-party and connected-party arrangements
3. Evergreening of loans and asset quality masking
4. Governance failures
5. Mis-selling and investor protection failures
6. Weak KYC/AML controls
7. Inadequate disclosures
8. Auditor failures in skepticism and documentation
9. Technology, cyber and digital-payment control failures
10. Solvency, provisioning and valuation concerns

What Regulators Will Focus on Next

- AI and Analytics
- ESG Assurance
- Fraud Detection
- Related Parties
- Going Concern
- Independence
- Quality Management Systems

BONUS TIPS

- ✓ Compilation of NFRA orders/ observations
- ✓ Regulators annual reports from official websites
- ✓ Entity specific inspection reports issued by the Regulators
- ✓ Audit Planning is the KEY (N-T-E)
- ✓ Quality throughout Audit Life-cycle
- ✓ Sustenance testing

The Future Auditor Mindset

- ✓ Think like a regulator
- ✓ Challenge like an investigator
- ✓ Document like a reviewer
- ✓ Conclude like a professional

Regulators Expect Auditors To:

- ✓ Think independently
- ✓ Challenge management
- ✓ Follow risk-based auditing
- ✓ Gather persuasive evidence
- ✓ Document conclusions
- ✓ Report transparently
- ✓ Demonstrate professional skepticism

Audit quality is no longer judged by compliance with standards alone. It is judged by whether the auditor can demonstrate independence, skepticism, challenge, evidence, and professional judgment under regulatory scrutiny. The question is no longer "Was the audit completed?" but "Can the audit withstand inspection?"

What Regulators Are Really Saying

RBI
"Recognize stress early."
Challenge management.

SEBI
"Disclose completely and transparently."
Protect investors.

MCA
"Comply in substance, not merely form."

IRDAI
"Protect policyholders before profits."

Stock Exchanges
"Inform investors on time."

NFRA:
Show me the evidence.

Audit Committee:
Tell me what keeps you awake.

THANK YOU

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