



Achieving audit quality excellence

Key considerations for Audit Committees

Board Leadership Center (India)

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Introduction



In the recent years in India, there has been a noticeable increase in organisational attention and emphasis on audit quality, largely attributed to establishment of the National Financial Reporting Authority (NFRA), India’s first independent audit regulator. Within a few years of its inception, NFRA has swiftly demonstrated its potential to enhance audit quality and regulatory oversight through both enforcement actions and engagement with all stakeholders including the institution of firm level and engagement level inspections.

NFRA’s pivotal role as an independent regulator

has catalysed focus on audit quality and transparent financial reporting practices in organisations. However, despite these advancements, some instances of corporate collapses and malfeasance persist, unsettling investors and underscoring the role of organisations and auditors in improving audit quality. These incidents serve as reminders of the potentially significant consequences stemming from any lapse or negligence by organisations or auditors in fulfilling their reporting or audit responsibilities.

Role of leadership and management in promoting audit quality



Effective leadership sets the tone at the top, emphasising the importance of audit quality and ensuring that it is ingrained in the organisation’s values and operations. Further, the management supports these efforts by implementing robust internal controls, providing necessary resources

and fostering an environment where auditors can operate independently and without undue influence. Here are some ways in which the leadership and management promote audit quality within their organisations:

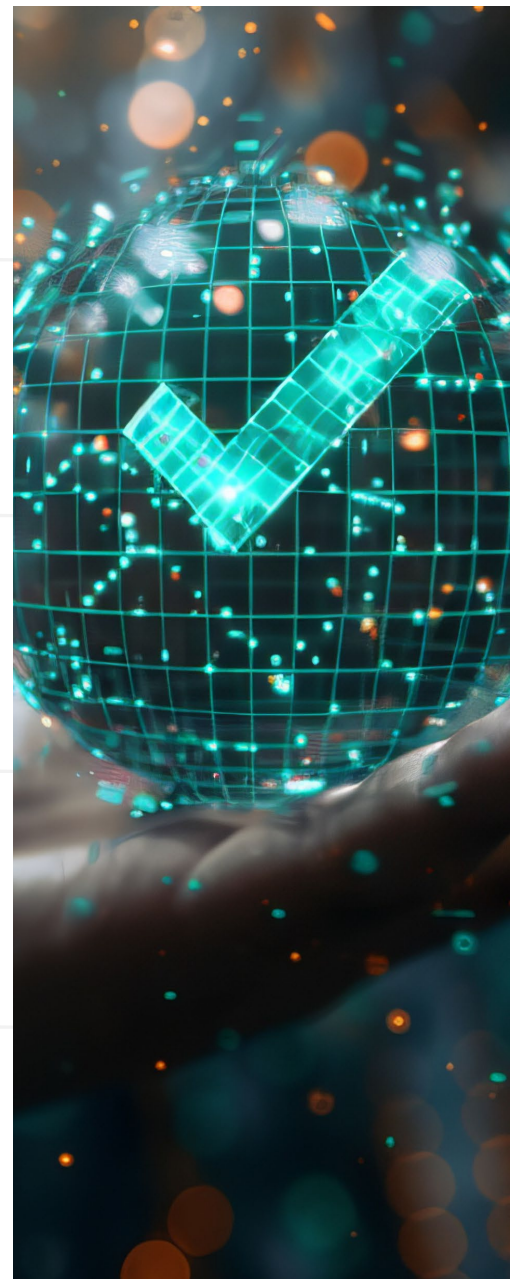


The role of auditors



Whether internal or external, auditors assume a pivotal responsibility in elevating audit quality within organisations. The current regulatory environment defined by rapid technological advancements and heightened stakeholder expectations encourages auditors to conduct holistic risk assessments that go beyond

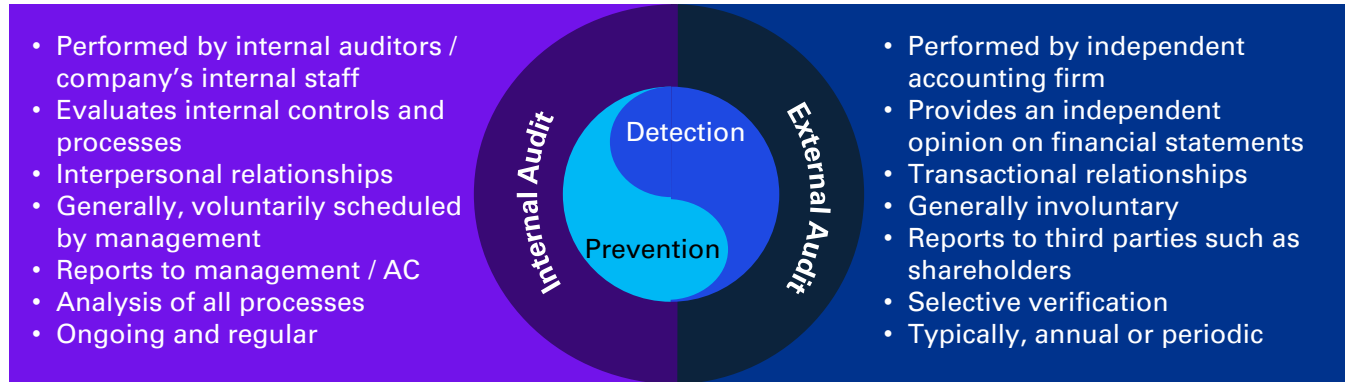
regulatory mandates, tailoring audit approaches to the organisation's unique needs and risks while diligently identifying and highlighting areas impacted by fraudulent activities. Here are a few ways in which auditors can effectively play their role or enhance it from current practices:



Collaboration between internal and external audit for governance excellence



Achieving audit quality excellence is a critical goal for any organisation, and it necessitates the effective collaboration between internal and external audit functions. Despite their fundamental differences, their synergy can significantly enhance governance standards.

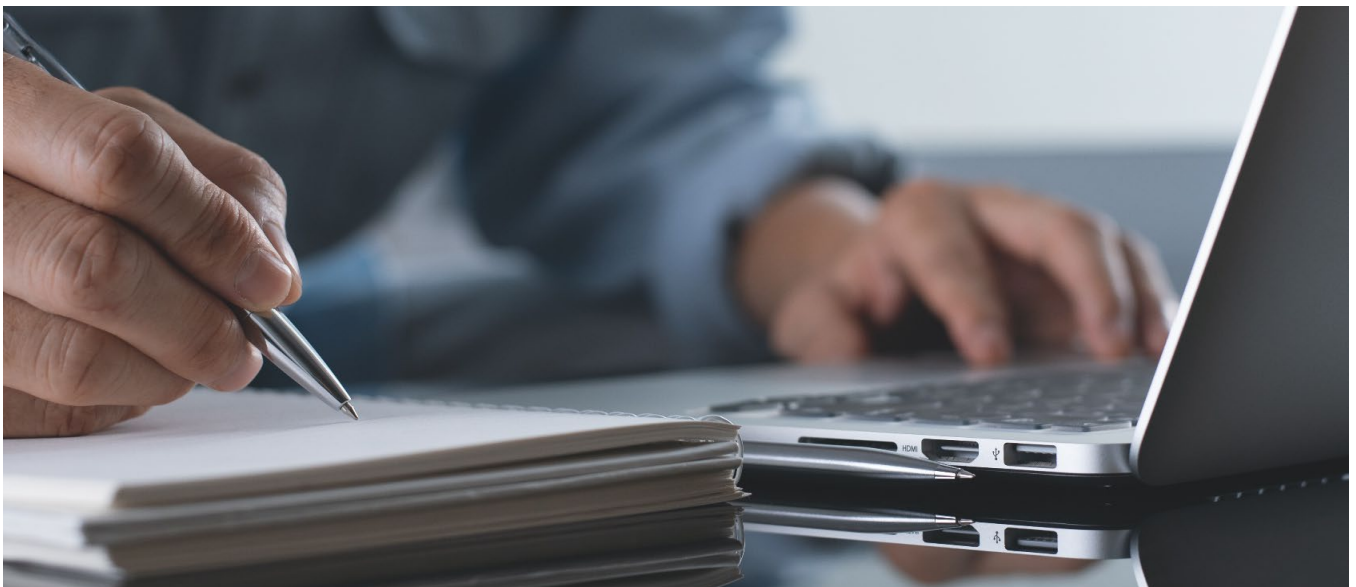


Internal Audit: Internal auditors focus on evaluating and improving the effectiveness of risk management, control, and governance processes. Their work is preventive, aiming to identify and mitigate risks before they manifest into significant issues. By continuously monitoring and assessing the internal controls, internal auditors ensure that the organisation is operating efficiently and in compliance with relevant policies and regulations.

External Audit: On the other hand, external auditors are responsible for providing an independent opinion on financial statements of an organisation. Their primary role is to detect and report material misstatements, whether due to fraud or error. External auditors provide assurance to stakeholders that the financial statements

present a true and fair view of the organisation's financial performance and position.

While their core objectives differ, the collaboration between internal and external auditors can produce substantial synergies. Findings and insights from internal auditors can serve as valuable inputs for external auditors, offering a deeper understanding of the organisation's control environment and potential risk areas. For enhancing the audit quality of organisations, both internal and external auditors shall work in collaboration through knowledge sharing and clear communication and leverage their respective expertise and resources while promoting transparency and contributing to effective risk management.



Key Audit Quality Indicators (AQIs) for enhancing audit quality



Paramount to enhancing audit quality is identification of key AQIs for efficient measurement and reporting within an organisation. There are different approaches adopted in formulating AQIs ranging from qualitative and quantitative methods. Below is an indicative compiled list of qualitative and quantitative indicators for organisations to assess and enhance the quality of their audits.

Element	AQIs
People	<ul style="list-style-type: none"> • Competence and years of experience of audit professionals • Quality and expertise of lead audit partner • Attrition rate and firm's ability to retain skilled and experienced staff • Methods/tools used by the firm for resource allocation on engagements • Maintenance of minimum staff to partner ratio
Service quality	<ul style="list-style-type: none"> • Breadth and depth of service offerings • Potential to cover the entire governance, risk, and compliance landscape • Availability of proprietary and holistic risk, audit, and controls frameworks • Experience and years of service in the local jurisdiction
Training and development	<ul style="list-style-type: none"> • Hours spent on professional development of management and employees • Staff preparedness with technological skill sets such as AI, blockchain, audit and data analytical tools • Performance management culture that rewards high performing employees
Technology Adoption	<ul style="list-style-type: none"> • Number of audits conducted using technology and data analytics tools to improve audit quality • Automated internal processes for saving time and cost • Digital storage of records • Centralized server/ cloud • Data security and cyber security mechanisms
Workflow	<ul style="list-style-type: none"> • Completion of audits within planned timeframe and examining the cause for delays if any • Presence of audit manuals containing the firm's methodology • Availability of standard formats relevant for audit quality like Letter of Engagement (LOE), representation letter, reports, and implementation
Service Delivery	<ul style="list-style-type: none"> • Capacity planning process for each engagement • Budget vs actual analysis of time and effort spent to identify the costing and pricing • Deployment of technology for monitoring efforts spent • Quality review of all engagements and documentation
Independence	<ul style="list-style-type: none"> • Auditor independence monitoring • Independence of internal and external audit teams
Coaching and consultation	<ul style="list-style-type: none"> • Technical accounting and auditing resources • Number of consultations undertaken and by type • Experts and specialists' hours on engagements

Leveraging technology for audit quality excellence



In today's competitive landscape, emerging technologies and accelerated digitalisation are radically changing the future of audit. Machine learning algorithms can swiftly analyse vast datasets, identifying anomalies and patterns that might escape human scrutiny. While human judgement and oversight remains irreplaceable, a hybrid approach of leveraging technology in the pre-audit phase and flagging potential areas for human scrutiny can be effective for organisations.

Some trending ways in which organisations can leverage technology for enhanced audit quality:

- **Analysing entire data sets and spotting anomalies sooner:** By using bots trained to execute rules-based business processes, auditors can identify deviations across an entire population of transactions – not just a representative sample
- **Big data for driving efficient and accurate audit:** Advanced data analysis technologies such as Natural Language Processing (NLP), Optical Character Recognition (OCR) and Artificial Intelligence (AI) are greatly improving audit accuracy and efficiency
- **Technology assurance for increased security:** Technology controls today are more important than ever. New digital opportunities can help deliver more efficient, accurate audits – but only if there is a technology governance framework in place
- **Machine Learning in Risk Assessment:** Applying machine learning algorithms to analyse historical audit data and identifying emerging risks and trends.

Key considerations for Audit Committees



- How do we ensure the independence and competency of our internal and external audit teams, especially the internal and external audit heads?
- How strong is the selection criteria for auditors and what criteria do we use to evaluate the qualifications and experience of our audit personnel?
- Are there mechanisms in place to ensure that the audit processes are performed in strict compliance to the applicable regulatory requirements, accounting standards, and auditing guidelines issued by regulatory bodies such as SEBI and ICAI?
- Does the Audit Committee and its members regularly review and approve the audit plan including the scope of work, materiality thresholds and key audit areas based on risk assessment?
- Does the organisation have effective whistleblower mechanisms and processes for reporting suspected financial misconduct, fraud, or irregularities related to audit processes?
- Do the auditors track material changes to materiality assessments, scope, physical inventory counts and the overall planned audit approach?
- How does the committee members approach any "close calls" or areas pertaining to the audit quality that were particularly challenging because of the current complex business environment?
- What additional procedures does the external auditor conduct to gain comfort regarding key assumptions, estimates and prospective financial information?
- How satisfied are the clients (internal stakeholders or external clients) with the audit process? Are there feedback mechanisms in place to gather client feedback on audit services?

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