



Warming Up for Peer Review

Guidance for Practice Units

J B Nagar
CPE Study Circle

Khurshed Pastakia



Agenda

Introduction to peer review

After intimation

Compliance review of quality controls

Review of records

Reporting by reviewer

Sundry matters



Introduction to peer review



What and why?

- Review of work done by one professional by another of similar standing (peer)
- Emphasis on ensuring high quality in assurance services rendered
- PR is a universal process in the profession across the world
- Importance of PR is gaining urgency due to increasingly higher levels of regulatory scrutiny over auditors in India
- Twin objectives (per Statement on PR)
 - To ensure that in carrying out the assurance service assignments, the members of the Institute comply with the technical, professional and ethical standards including regulatory requirements
 - To ensure that such a member has in place proper system (including documentation system) to amply demonstrate the quality of assurance services

The PR Board

- Set up by the Council of the Institute under the Statement on PR
- Maximum 12 members to be appointed by the Council of whom at least 50% are from the Council and rest nominated by the Council from outside
- Members of Disciplinary and Ethics Committees and FRRB cannot be members of the PRB

Objectives of PR process

- PR does not seek to redefine the scope and authority of the technical, professional and ethical standards but only seeks to ensure that they are implemented in both letter and spirit
- A reviewer *cannot sit in judgement* of the practice unit (PU) while rendering assurance services. His job is to evaluate the procedure followed by the PU in rendering such a service
- The objective is to maintain and enhance the quality of assurance services by *providing appropriate guidance* rather than simply pointing out deficiencies of the PU
- The key objective of PR is *not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature*

Review process

- Selection of Practice Units (PU) by PRB
- Intimation to PU and questionnaire
- Initial communications by PU
- Initial selection of engagements
- Communication of selection
- Confirmation of visit
- Initial meeting
- Compliance review

Review process

- Refinement of selection
- Review of records:
 - Compliance approach
 - Substantive approach
- Preliminary report of reviewer
- Reply to preliminary report
- Final report of reviewer

After intimation



What do you do after you get intimation?

Step # 1 Select your reviewer

- Three names offered by PRB
- Select
 - One who has maturity
 - One who has a dominant audit practice
 - One whose practice matches your own
 - One who is likely to understand the spirit of PR, rather than one with other motivation

What do you do after you get intimation?

Step # 2 – Fill up the Questionnaire

■ Part A – Profile of PU

- Including client list

- PU not obligated to reveal names, may provide unique code number
- List is broken up into 12 categories – by type of entity

■ Part B – General Controls (Based on SQC 1)

- Leadership responsibilities for quality within a firm
- Ethical requirements (including independence)
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

What do you do after you get intimation?

Step # 2 – Fill up the Questionnaire

- Be honest, don't lie and don't exaggerate
- Do your groundwork before replying
 - Prepare **draft answers** – consult your people
 - Compile **documentary evidence** to support each of your answers to Part B – General Controls
 - There may be several things you were required to do as per SQC 1 that you may **not have done**. Realise that these may be picked up as **deficiencies** by the reviewer. You cannot rectify quality controls (QCs) retrospectively.
 - The best thing is to immediately put in place the missing QCs and if the reviewer questions you, admit that you did not have those controls during the period of testing, but say that you have **since installed** them for future implementation

What do you do after you get intimation?

Step # 2 – Fill up the Questionnaire

- If you already had QCs but those were not documented, put in place the **documentation** before PR starts, and inform the reviewer that while you did not have such documentation during the period of testing, you have since put it in place for the future use
- While this advice is for those who are caught unprepared for PR, **this audience** should do well to immediately start preparing to pass the PR test by –
 - Studying the requirements of SQC 1 as given in the Standard as well as by referring to the Institute’s “**Implementation Guide to SQC 1**” which is a very handy, practical guide for all PUs – and has been specifically designed for the smaller PUs

What do you do after you get intimation?

Step # 2 – Fill up the Questionnaire

- Adopting any of the **Appendices in the IG** that you need to with minimum changes to meet your documentation requirements under SQC 1
- Ensuring that adequate **documentation** is created to substantiate and evidence that the PU **had** the policies and procedures in place, that it had **communicated** them, that it had **implemented** them, and that it had **monitored** compliance by all personnel (starting with partners) with the QCs
- With regard to **engagement performance** (audits), as a PU you need to examine the audit processes as per auditing standards that your ETs do not generally follow and ensure that going forward the PU is in **compliance** with all **auditing standards, laws and regulations**.

What do you do after you get intimation?

Step # 2 – Fill up the Questionnaire

- In case of smaller practices, that are not dominant audit practices, it may be a good idea to put partners and professionals through **intensive training** on auditing standards and then prepare a documented PU audit approach that guides everyone on the decisions taken by the PU on how various aspects of audit should be planned and performed
- Ensure and monitor that ETs on all audits prepare **adequate documentation** during/ after audit and before file archival, to evidence compliance with auditing standards in accordance with **SA 230 and the various documentation paragraphs in individual SAs**

What do you do after you get intimation?

Step # 3 – Study the PR Manual

- **Study** the Statement on PR, the PR Manual and FAQs issued by the PRB
- Understand the 3-stage PR process **flowchart** and illustrative **time schedule**
- Ensure that **key persons** in your PU also do this
- Appoint one partner as the **coordinator** for the PR
- This coordinator should know the **PR Manual** well and have a couple of managers to **assist** him when the PR is in progress

What do you do after you get intimation?

Step # 4 – File selection

- The reviewer will **respond** to the Questionnaire by sending the PU a **selection** of client files that he wants to examine
- He is expected to make his selection of files based on the following criteria
 - Size and nature of engagement
 - Results of reviewer's QC testing
 - Methodology adopted by PU
 - Number of partners/ members
 - Number of locations/ branches
 - Fees charged
- The reviewer may make an initial selection of files but will generally **reduce/ increase** it after he examines the PU's QC

What do you do after you get intimation?

Step # 4 – File selection

- The reviewer is allowed to select any number of files over a period of **three preceding years**. If the reviewer insists on examining old files it would involve more hardship to the PU – eg some of the people dealing with the audit may have left, the QCs in earlier years may be different from those existing now, etc
- Perform **in-house reviews** of your selected audit files to ensure that you will be in a position to demonstrate **compliance** with all or most of the sub-questions of **Q.21** of the Questionnaire as well as with the larger body of **auditing standards**
- Ensure that whatever you tell the reviewer during the compliance review about PU level audit approach should **corroborate** with what is actually in the audit workpapers – otherwise it would prove non-compliance with your own QCs

What do you do after you get intimation?

Step # 4 – File selection

- Ensure that **partners/ managers of engagements** selected by the reviewer have examined their files wrt the illustrative checklist in paragraph 4.19 of the revised PR Manual
- Remember – you are **not permitted** to make any **alterations** to the audit files as per paragraphs 15, 16, and A23-25 of SA 230
- If there are non-compliances with the auditing standards in the way audits were performed, at least you will be **aware** of what those are and not be taken by surprise if the reviewer points them out

Compliance review of QCs



Compliance review of QCs – suggested approach

- Historically many of the reviewers are **less focused** on review of QCs than they are on the file reviews
- A reviewer has a maximum of **7 days** to do the review. This is a lot of time if he concentrates only on file reviews. So, if the reviewer shows an inclination to do so, the coordinator should suggest that he spend one or two days looking at PU-level QCs as he would have to report on those as well
- For this the PU should line up one or more **PowerPoint presentations** where various people in the PU, as per their area of expertise, may take the reviewer through each of the **six control elements** given in SQC 1: namely – (i) leadership responsibility, (ii) ethical requirements, (iii) acceptance/ continuance of clients/ engagements, ((iv) HR, (v) engagement performance and (vi) monitoring

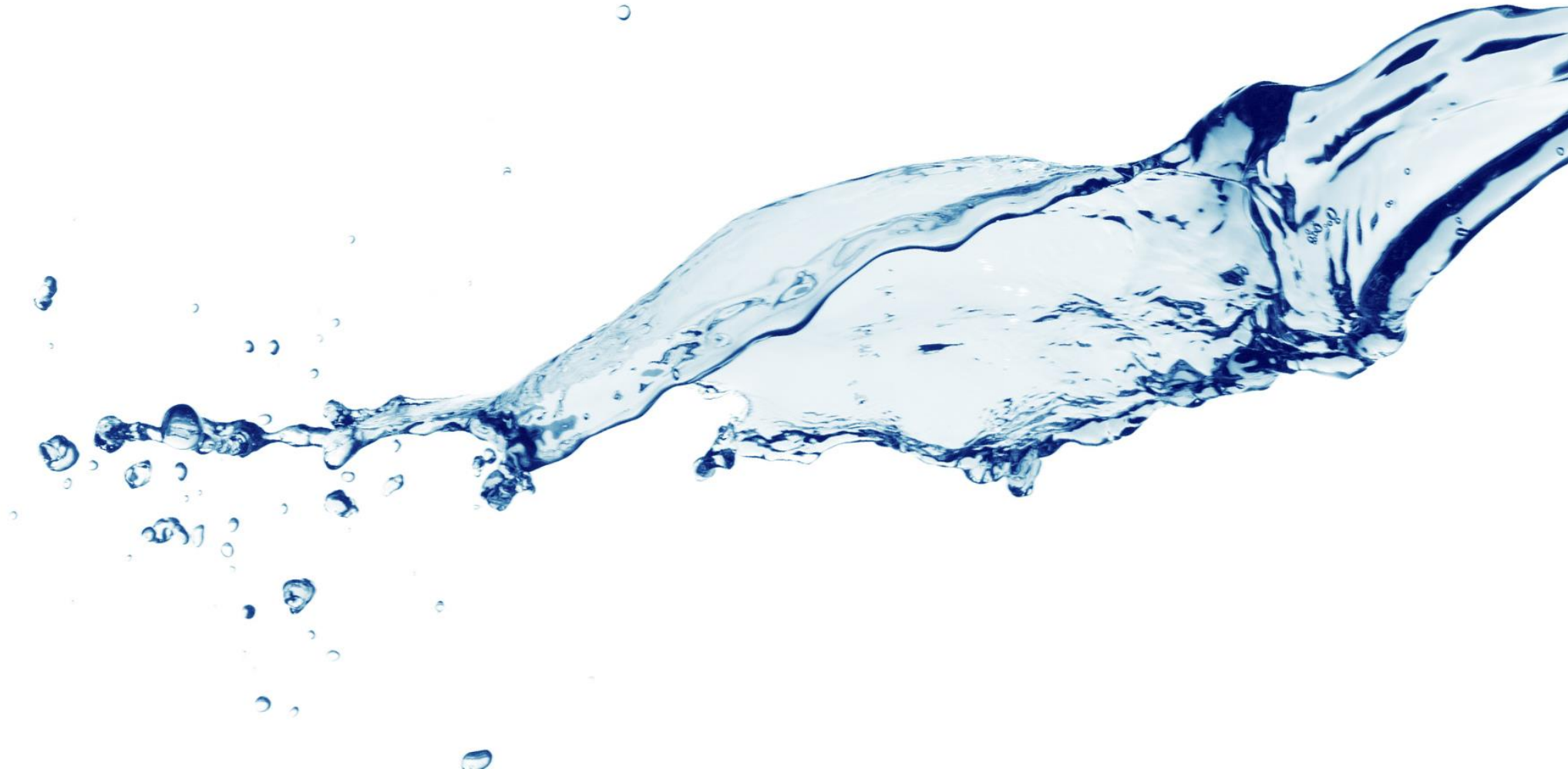
Compliance review of QCs – suggested approach

- If the **QC** is in line with that suggested in the **IG on SQC 1** of the Institute, the PU will be on stronger footing for defending its robustness before the reviewer
- For each of the QCs, or at least for the major ones, the PU should keep ready **evidence** of (i) the fact that the policy/ procedure **exists** in the PU, (ii) illustrations of how that policy/ procedure **operated effectively**, and (iii) how the firm has been **monitoring** it
- Always remember that, from a reviewee perspective, when the PU shows the QCs and evidence of their working **upfront** to the reviewer, it is better than the reviewer getting it after asking for it
- As stated earlier, **if a QC does not exist**, be ready to demonstrate how the PU has realised this, and **remediated** it for the future

Compliance review of QCs – suggested approach

- Is it necessary to have **documentary evidence for all QCs**? – The PR Manual does not mention anywhere that evidence for QCs to be produced to the reviewer has to be documentary, but if it is not, then the PU must have the ability to **convince the reviewer** that the QC was indeed in place, operating effectively and monitored

Review of Records



Review of records- approach to review

- A reviewer is expected to follow a **compliance-cum-substantive** approach to file reviews
- Generally it is found that reviewers get greater comfort by doing **substantive** testing alone, so be prepared for a full-scope file review
- Most likely, a reviewer may take the **checklist** given in paragraph 4.19 of the **revised PR Manual** and use that in conducting the review
- There are some reviewers who may bring their **own checklists** or **questionnaires**, either developed by themselves or based on discussion with other experienced auditors, or they might compile them based on the reported findings of weaknesses put out by **FRRB** and look top-down to find if such weaknesses exist in your workpapers, some others get **accounting/ auditing standards checklists**

Review of records- cardinal principle in file building

**What is not
documented
is not done**

Review of records – what is the reviewer looking for?

- Documentation of:
 - Appointment of auditor
 - Terms of engagement: engagement letter
 - Accounting records available: system, reports
 - Composition of management; organisation chart
 - Book-keepers and authorised signatories
 - Memorandum/Articles, Prospectus, Partnership Deed
 - Details for understanding the client's business
 - Details for understanding the controls systems
 - Details for understanding the accounting system
 - Past financial statements and reports of directors / internal / statutory auditors

Review of records – what is the reviewer looking for?

- Preliminary analytical review procedures followed to:
 - Identify key account balances
 - Highlight unusual/unexpected amounts and relationships
 - Design appropriate testing procedures
 - Obtain sufficient audit assurance for reducing/eliminating detail testing
- Assessment of audit risks (inherent, control, detection)
- Design of audit plan to address/mitigate risks
- Determining materiality estimate for the audit as a whole
- Plan for account balances to be tested and sampling methodology
- Selection of representative samples
- Performing tests of controls, and conclusion on controls reliability
- Communication of control weaknesses to management
- Performing substantive analytical testing

Review of records – what is the reviewer looking for?

- Performing substantive tests of detail
- Obtaining sufficient, appropriate audit evidence
- Ensuring prevalence of fundamental accounting assumptions – consistency, going concern, accrual accounting
- Examination and reporting changes in accounting policies and their impact
- Branch audit reports – qualifications, scope limit reservations
- Adequate audit evidence for assertions made in financial statements – especially those regarding accounting estimates and judgements
- Workpapers agreeing with books of account, financials and completely cross-referenced
- Performing financial statements review
- Completing lead schedules
- Preparing audit summary memorandum
- Reviewing assistants' work

Review of records – what is the reviewer looking for?

- Updated permanent file
- Reviewing individual and aggregate effect of unadjusted errors
- Checking compliance with legal and regulatory requirements
- Checking compliance with ICAI accounting standards
- Subsequent events review
- Final discussion points
- Draft audit opinion
- Preparing management letter
- Comparing budgeted hours to actuals and an analysis of variances
- Debriefing meetings with client / staff
- Completing staff evaluations
- Starting next year's planning

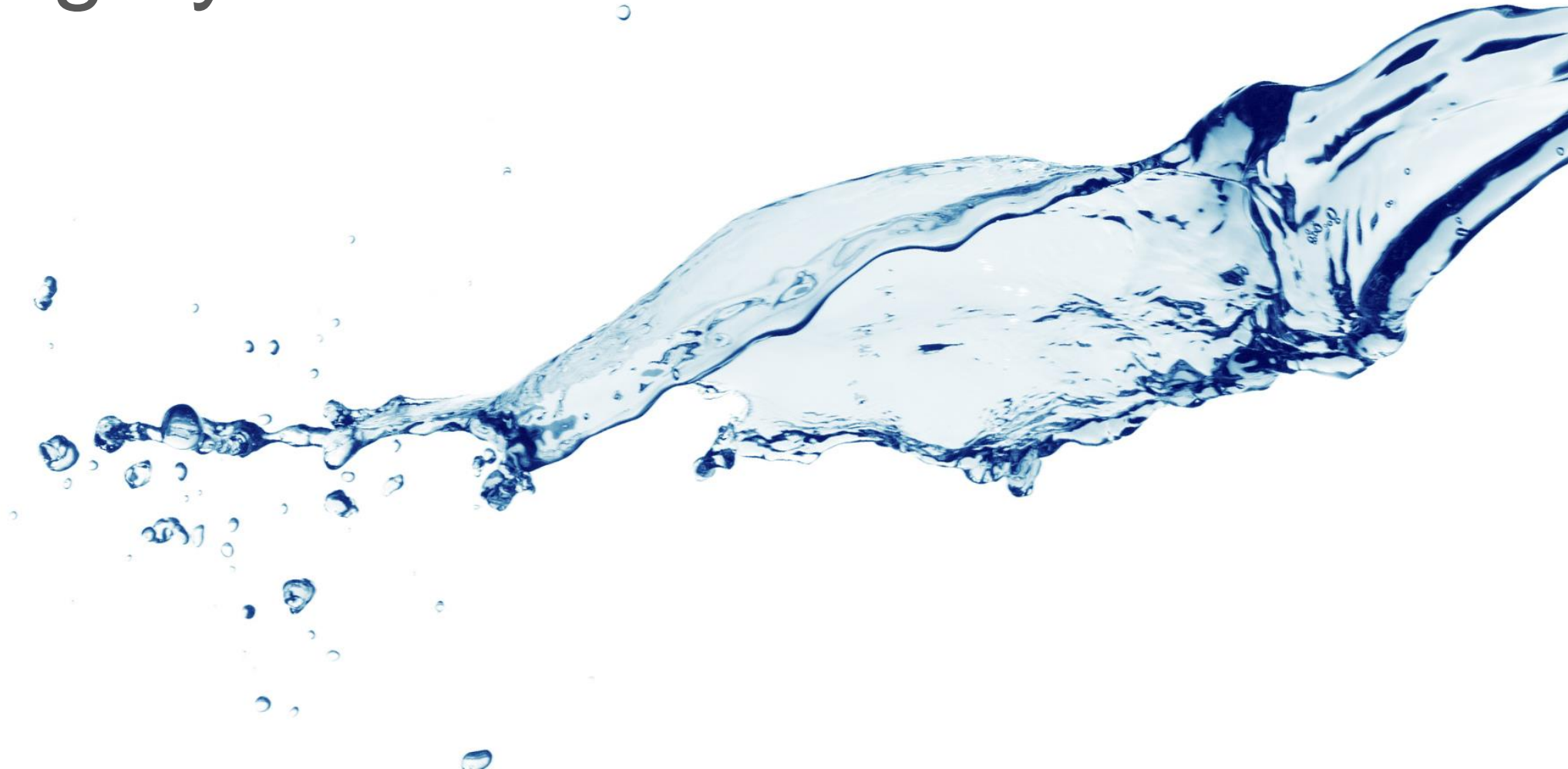
Review of records – what is the reviewer looking for?

- Evidence of complying with technical standards –
 - Laws
 - Accounting standards (AS)
 - Auditing and assurance Standards (AASs)
 - Framework of Accounting and Auditing
 - Statements
 - Guidance Notes
 - Notifications
 - Recommended self-regulatory measures

Review of records – quality of reporting

- Whether the auditor's **report** has been prepared in strict **compliance** with SAs 700, 705, 706 or other standards that may be relevant for special audits or reviews
- Whether **workpapers** at the assertion level **support** the overall audit **opinion** and are adequately **referenced**
- Whether there was appropriate and adequate **supervision and review** of subordinates' work

Reporting by reviewer



Reporting by reviewer - Process

- During the review the reviewer will raise **queries, seek information, explanations**, etc
- In general, it is a good practice for the **PR coordinator** (or his designee) of the PU to sit through the whole review process with the reviewer
- It is also a good practice to take all queries raised by the reviewer with anybody and pass them on to the PR coordinator. As far as possible, major queries or queries that may have an impact on other engagements or areas of review should **not be spontaneously answered** by junior-level staff
- The PR coordinator should **consult** with the managing partner/ other senior partners in the PU before replying to the reviewer

Reporting by reviewer - Process

- Once the review is concluded, the reviewer may either be **fully satisfied** or may have some **issues to be reported**
- If he is fully satisfied and wants to issue a **clean** report, he may be allowed to make his clean **final** report with copy to the PU
- If he has issues for which he wants to **modify** his opinion, then the PU should request him to issue a **preliminary report**
- The PU should then carefully examine the matters and **prepare** its responses. Such responses have to be sent by the PU to the reviewer within 15 days
- If the reviewer is **satisfied with the responses** to the preliminary report, he issues his **clean final report** attaching the PU's responses to his preliminary report

Reporting by reviewer - Process

- If the reviewer is **not satisfied** with the PU's responses, he issues a **modified final report** attaching the **PU's responses** to his preliminary report **topped up** by the **reasons for his dissatisfaction** therewith
- The final report is addressed by the reviewer to the PRB with copy to the PU
- The PRB then examines the report and issues a **Peer Review Certificate** to the PU
- In case of a modified final report, the PU may be ordered by the PRB to face a **follow-on review after one year or less**. No Peer Review Certificate is issued to the PU until the follow-up review is completed

Sundry matters



Sundry matters

- Where a PU has more than one **branch**, and the file selection is made for audits conducted at a branch, the PU may bring the relevant files and people associated with it to the head office for the review to be done
- If the branch turnover from assurance services is more than **Rs 25 lakh**, the reviewer may choose to **visit** such branch
- Reviewers are allowed **one assistant** who must be a **member** of the Institute and either a **partner or paid assistant** of the reviewer
- A reviewer and his assistant have to submit a declaration of **confidentiality** to be submitted to the PRB. An open question is what happens if the PU requires the reviewer to sign a declaration of confidentiality

Sundry matters

- Cost of review to be paid by PU

Total annual revenue from assurance services of the PU	Cost of review (Rs)
Less than Rs 10 L	15,000
Rs 10 L – Rs 50 L	25,000
Rs 50 L – Rs 1 cr	40,000
Rs 1 cr – Rs 3 cr	60,000
Rs 3 cr – Rs 5 cr	75,000
Above Rs 5 cr	1,00,000

- A reviewer cannot raise a bill on the PU from his firm. He is appointed in his individual capacity and the PU must draw the cheque in his **personal name** only

Other matters

- **No disciplinary action** based on PR findings, except under para 8.4 of Statement
- **PU certificate does not free PU from disciplinary action**, even for reviewed audits
- **3-years' records** may be examined
- **Value** of PR certificate – for audits of **listed entities**, as well as for PU's **reputation**
- **Dispute** with reviewer may be referred to PRB
- Reviewer incurs **no liability**
- Reviewer **cannot visit client or carry extracts** of clients' records
- PR to be **once in 3-years**
- Where PU requires to get reviewed for SEBI reasons, it should **volunteer** to get PR done after 3-years of the earlier review



End
Good!

