



Warming Up for Peer Review

Guidance for Practice Units

J B Nagar
CPE Study Circle

Khurshed Pastakia
7th December 2014



Agenda

Introduction to peer review

After intimation

Compliance review of quality controls

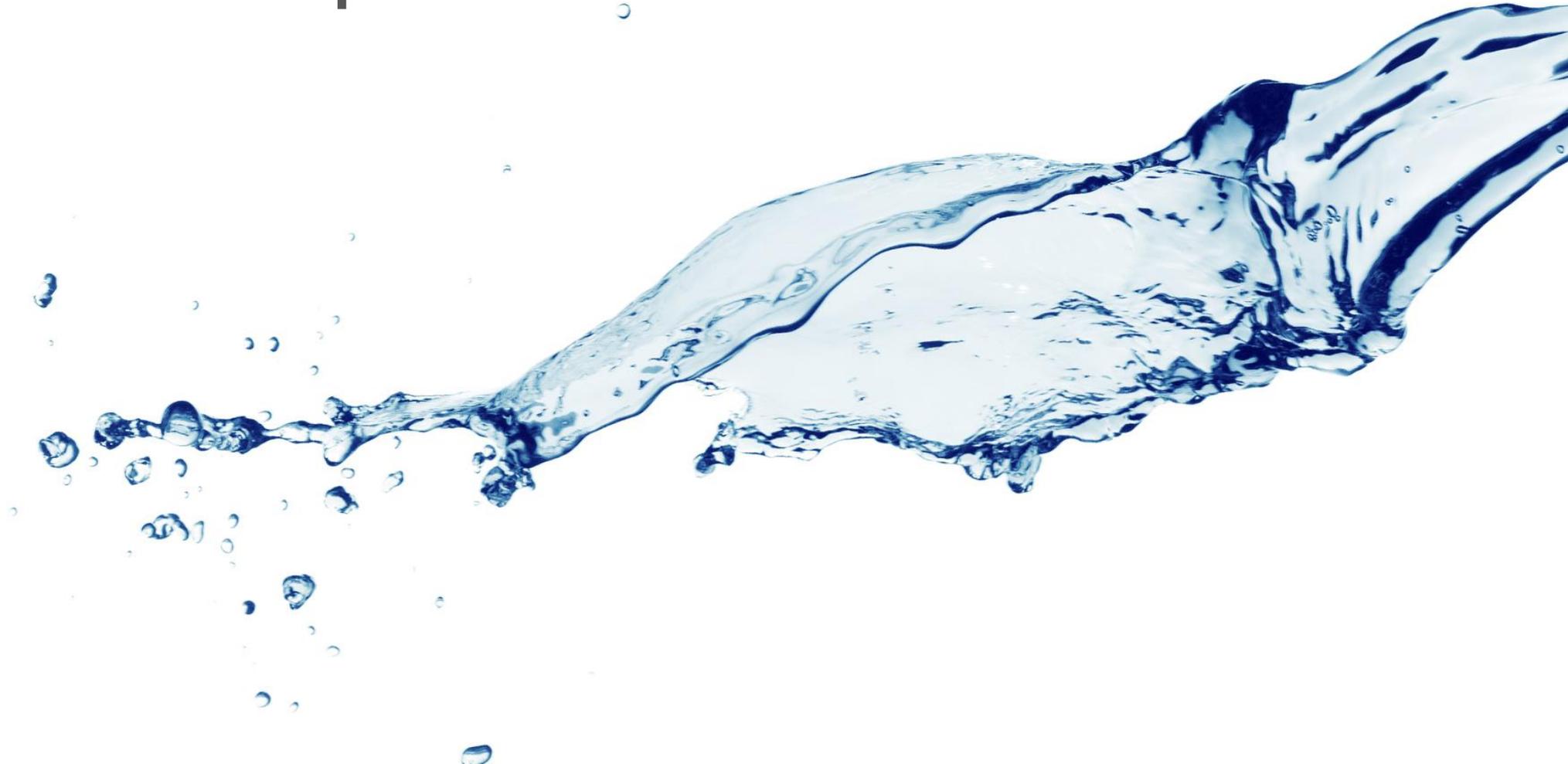
Review of records

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*

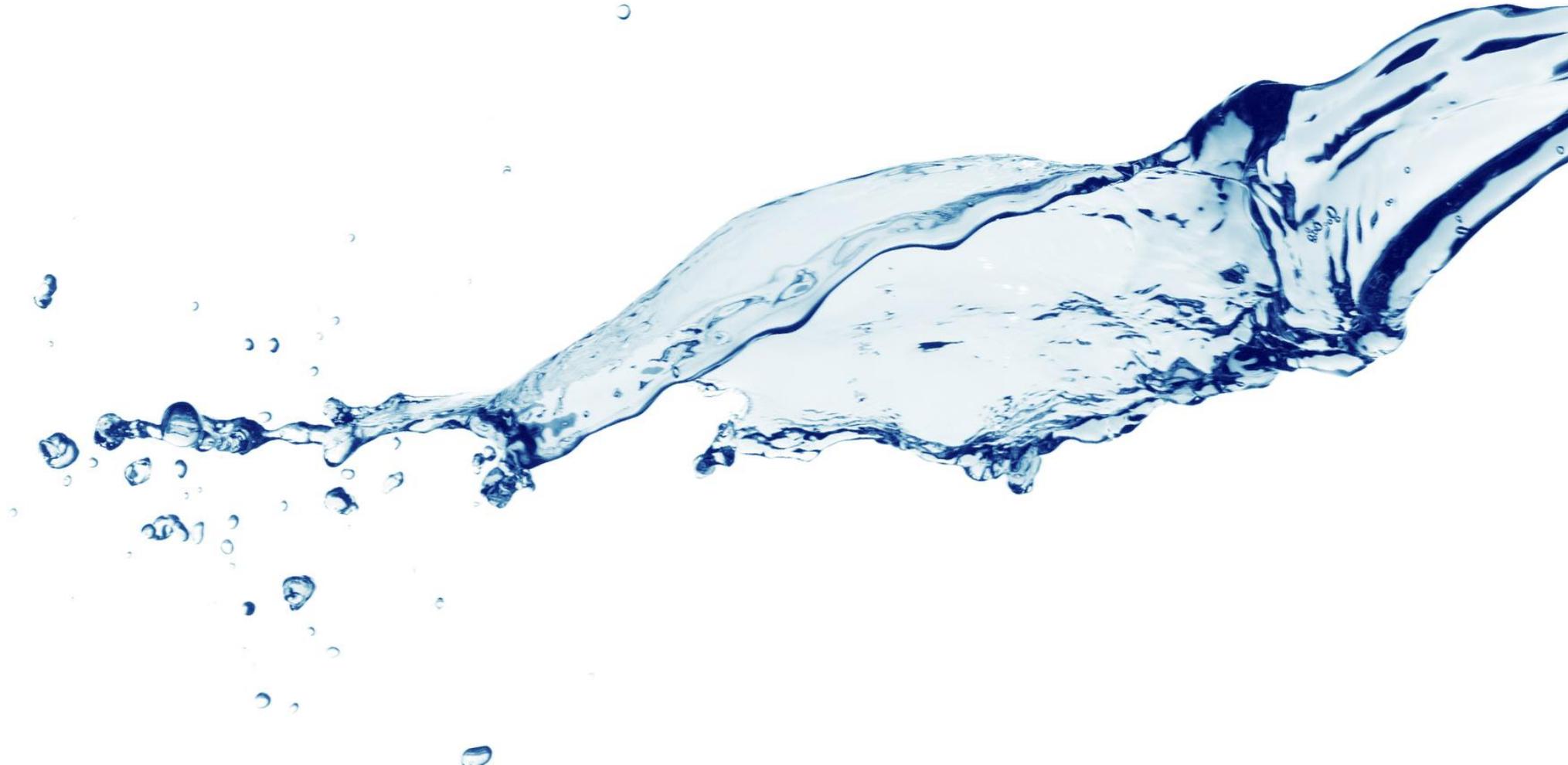
Review process

- 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

- It is very important to get the right reviewer
- Three names offered by PRB – you have to choose one of them
- You may even ask PRB for a reviewer from another location, if you pay his cost. Generally Meant for small town where everyone knows everyone and there may be concerns about confidentiality
- 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

- The Questionnaire is very important as the PU gives written assertions about its QCs in response. The reviewer will want to see evidence supporting these assertions during QC review
- 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, both seniors and juniors
 - Compile documentary evidence to support each of your answers to Part B – General Controls and keep it ready
 - There may be some 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 put right 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 SQC 1 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 Annexures in the IG that you need to with minimum changes to meet your documentation requirements under SQC 1
 - Annexures are given for:
 - Illustrative Annual Firm Independence Confirmation
 - Illustrative Independence Policies
 - Illustrative Client/ Engagement Acceptance/ Continuance Form
 - Illustrative Engagement Planning Memorandum
 - Illustrative Engagement Summary Memorandum
 - Illustrative Firm Quality Control Inspection Checklist
- Designating a senior partner as the firm's QC Partner and giving him time and resources to set up and monitor the PU's QC System in accordance with SQC 1
- Ensuring that adequate documentation is created to substantiate and evidence that the PU (i) had the policies and procedures in place, (ii) that it had communicated them, (iii) that it had implemented them, and (iv) that it had monitored compliance by all personnel (starting with partners) with the QCs

What do you do after you get intimation?

Step # 2 – Fill up the Questionnaire

- 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. Standard checklists may be adopted.
- 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

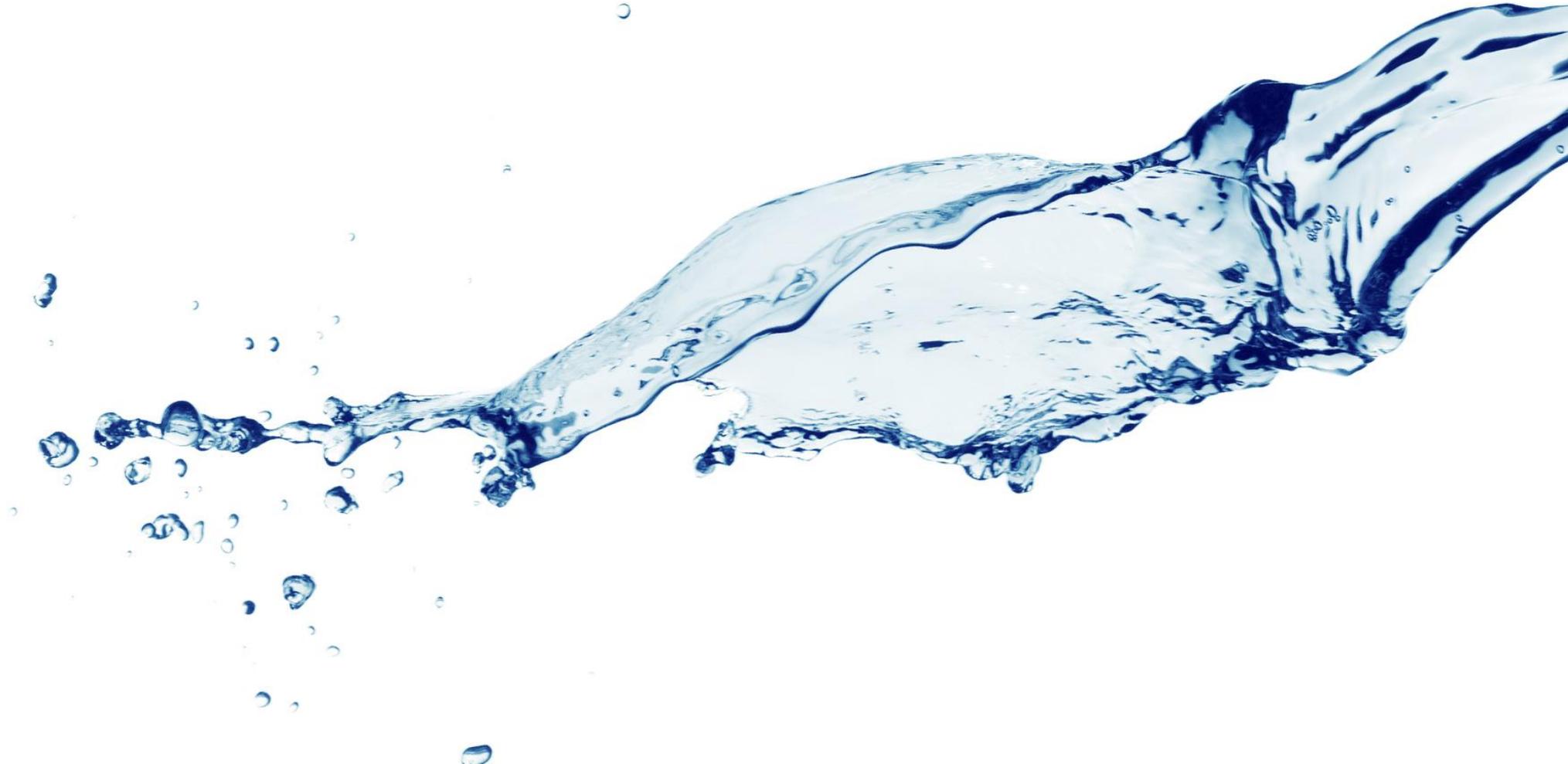
- The reviewer is allowed to select any number of files over a period of three preceding years. If the reviewer insists on examining old files it would involve more hardship to the PU – eg some of the people dealing with the audits may have left, the QCs in earlier years may be different from those existing 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, QC, etc, should corroborate with evidence from office records and 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 pre-examine their files wrt the illustrative checklist in paragraph 4.19 of the revised PR Manual before the review and they remain physically present to walk the reviewer through the workpapers when the file is taken up for review – *this is because it is important to demonstrate to the reviewer that the partner/ manager are fully “on top of” the audit*
- 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 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 could 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

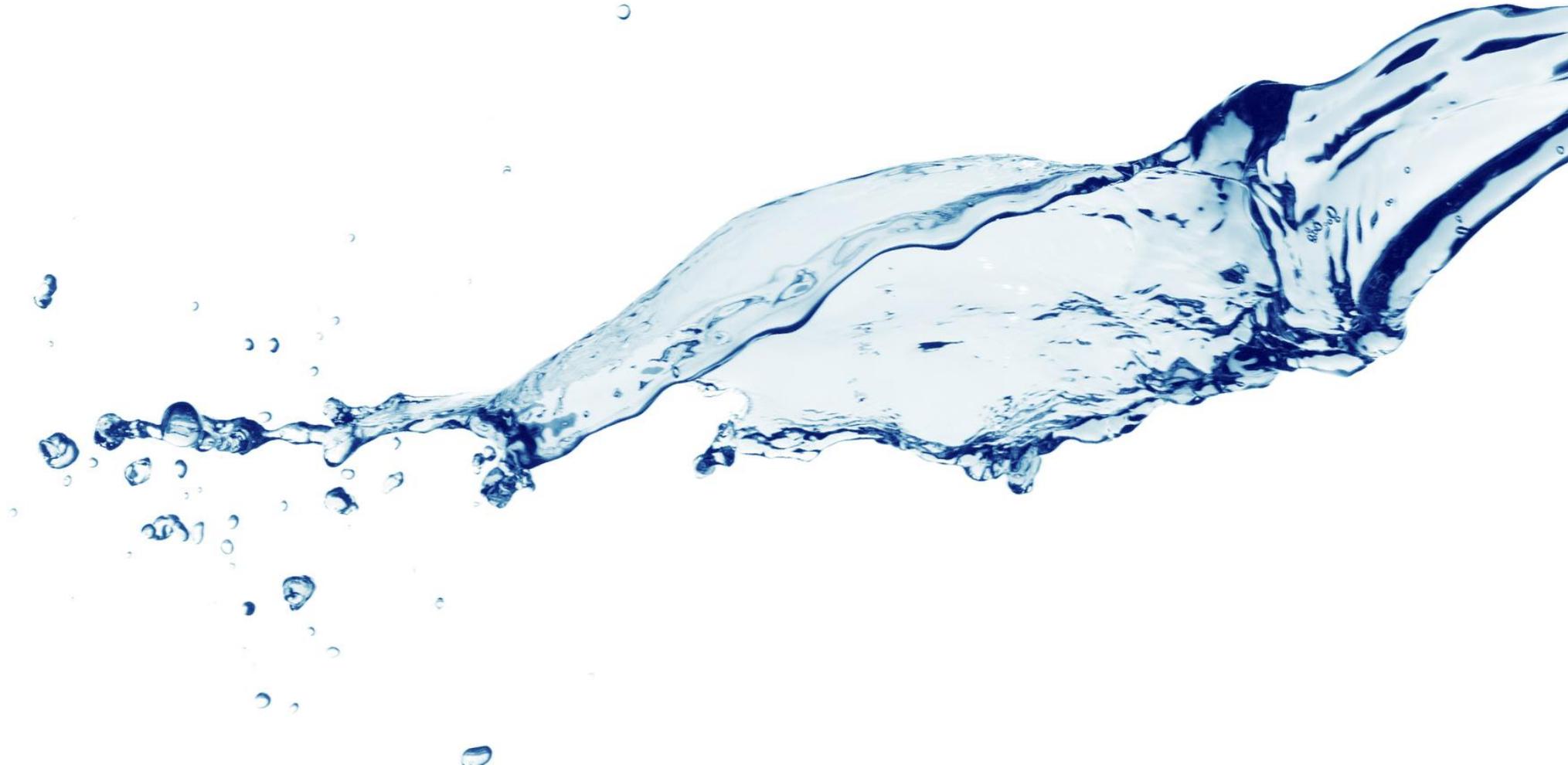
Compliance review of QCs – suggested approach

- 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 client's controls systems
 - Details for understanding the client's 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 MCOTABD (material classes of transactions, account balances and disclosures)
 - 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)
- Determining materiality for the audit as a whole
- Design of audit plan to address/mitigate the assessed risks
- Plan for tests of internal controls
- Plan for account balances to be tested and sampling methodology
- Selection of representative samples
- Perform tests of controls, and conclusion on controls reliability
- Communication of control weaknesses to management
- Performing substantive analytical testing, where planned

Review of records – what is the reviewer looking for?

- Performing substantive tests of detail
- Obtaining and documenting 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 limitations, 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

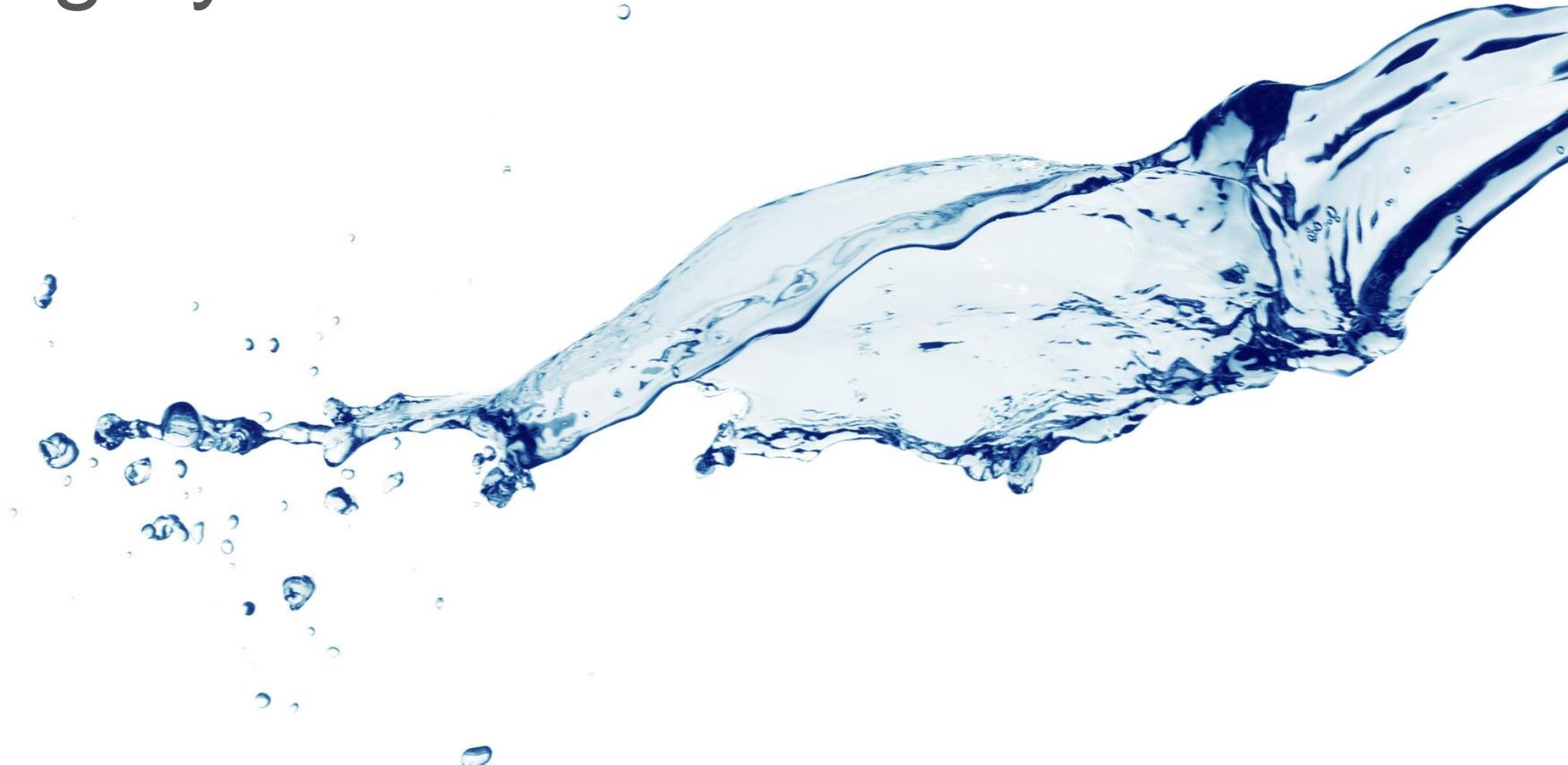
Review of records – what is the reviewer looking for?

- Evidence of complying with technical standards –
 - Applicable Laws and Regulations
 - Applicable Accounting Standards (AS)
 - Auditing Pronouncements – Standards on Quality Control, Audits and Reviews of Historical Financial Information, & Other Assurance Engagements
 - Frameworks 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 (SAs 710, 720) and standards that may be relevant for special audits or reviews (SAs 800, 805, 810, 2400, 2410, 3400, 3402)
- 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, even if different teams are assisting with the QC review or individual file reviews
- 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

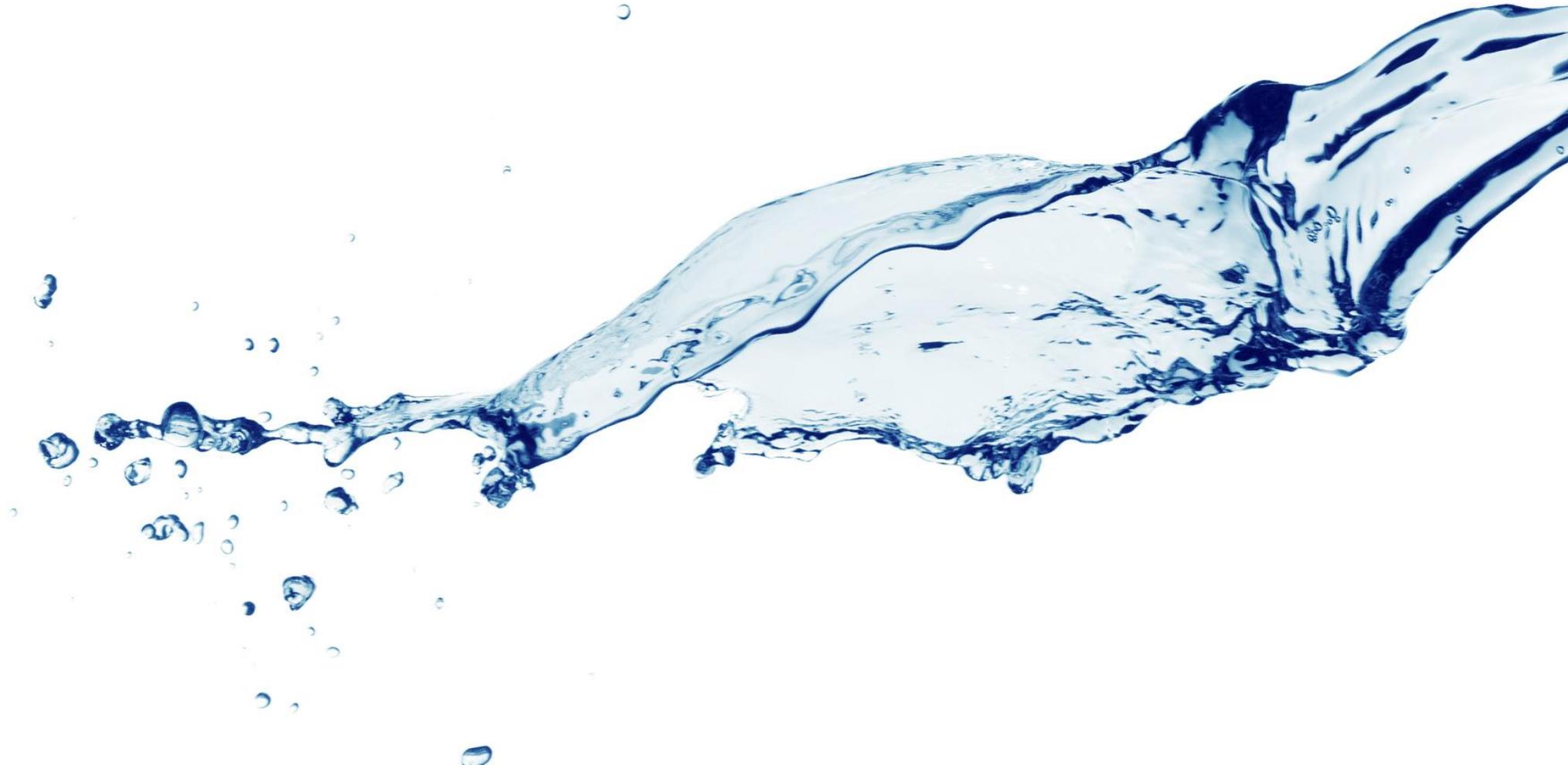
Reporting by reviewer - Process

- 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 which he may want mention in his report and/ or to modify his review 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 reasons for his dissatisfaction
- 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 if the report is clean
- 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
- If there are relatively minor matters, the PRB may instead issue recommendations to the PU

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 issue a report or raise a bill on the PU on his firm's stationery. He is appointed in his individual capacity and the PU must draw the cheque in his personal name only

Other matters

- No disciplinary action is taken 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 luck!

