

## Summary of Deficiencies Noticed by the Reviewers during Peer Review Exercise

Note: A broad summary of description of the reasons for issuing the Interim/Qualified Reports by Reviewers is given below. The reasons put forward by Reviewers have been classified in four broad headings in terms of Para 7.0 "Scope of the Peer Review" of the Statement on Peer Review, viz.,

The Review shall focus on:

- (i) Compliance with Technical Standards.
- (ii) Quality of Reporting.
- (iii) Office system and procedure with regard to compliance of attestation services systems and procedures.
- (iv) Training programs for staff (including Articled and Audit Clerks) concerned with attestation functions, including appropriate infrastructure."

While classifying different reasons stated by Reviewers in respect of each PU under distinct headings, all care has been taken to eliminate duplicate comments but certain repetitive comments still appear with a view to retain distinct flavour of remarks/observations of different Reviewers.

Members may note that the purpose of making available this analysis is to share information for the guidance of Practice Units at large. Further, these comments are not exhaustive and are only illustrative in nature.

### I. Compliance with Technical Standards

#### AAS 3 (Documentation)

- Separate permanent and current files for attestation services not maintained, working papers not properly organized.
- Documentation of results of evaluation and testing the internal control to decide the extent of substantive procedure not in place.
- Non-compliance with AAS 3 on Documentation.
- PU does not have any set procedures to ensure proper documentation with regard to attestation services.
- In one of the engagements reviewed, it was noticed that the working papers were not properly organized to meet the circumstances of each audit and the need in respect thereof. The standardization of working papers like audit programme, checklists, specimen letters, standard organization of working papers was also missing.
- PU does not have any system of documentation of obtaining sufficient and appropriate audit evidence through substantive tests.
- Documentation - Sufficient working papers and removal of queries raised not kept.

- Working papers not maintained in certain cases as per audit programme designed.
- No proper system of indexation and cross referencing of the working papers in audit files of client companies selected for Review.
- Working papers not kept on record. Deficiency observed in maintenance of records particularly records regarding papers to form part of permanent file.
- Record of Audit plan, the nature, timing and extent of Auditing procedures performed not maintained.
- In some cases, renewal of appointment letters not obtained. There is a need to maintain permanent as well as temporary files of Auditee.
- Out of the six cases selected for Peer review, working papers were not made available in 2 cases.
- No documentation in file in respect of the following:
  - Letter of representation from the client on various matters relating to the accounts.
  - Trial balance.
  - Groupings to arrive at the figures, which enter into the schedules attached to and forming part of the financial statements.
  - Evidence to support the figures entered in “notes on accounts”.
  - Summary of inventory sheets indicating the method of valuation and value date of opening stock, net purchases, net sales and closing stock.
  - Statement on accounting policies.
  - Confirmations from parties dealing with the auditee.
  - “Trial Balance” of “Fixed asset register”.
  - Working of various ratios so that the abnormal items are immediately brought to notice.
- Working Papers i.e. copy of Audit Programme, particulars of audit test carried out ought to be kept in each Client's Record to support audit opinion including full information on work carried out.
- The Audit plan and Audit Programme should be documented, reviewed, revised and kept on record.
- Documentation needs to be improved in following areas: -
  - The papers maintained in the file fall short of the expected compliance i.e. these are not adequate to constitute either a current file or a permanent file.
  - This inadequacy of documentation is such that is not possible by referring to the papers available as to what was the audit programme, how it was carried out and how the conclusions leading the report were arrived at.

- Working of estimates such as provisions for taxation and deferred tax calculation, proof evaluation of internal audit, expert opinion on labour liabilities, etc. have not been placed on record.
- In working Papers, cross reference or indexing/numbering, details of collection of audit evidence, etc. not given in few files.
- The letter of Preliminary Audit observations and comments/replies/final observations thereon, not found on record.
- No standardized form/checklist/questionnaire or guidelines in place for carrying out the engagement.
- Non availability of Organization chart of the client.
- Audit checklists are not handed over to assistants before commencement of the audit. Filled up checklists evidencing work done, the extent of auditing procedure performed and the conclusions drawn from evidences obtained are not available.
- Record for the assessment of materiality levels and significant audit areas to be made available for each attestation service.
- Records are not maintained in accordance with the norms required for attestation services.
- There was no evidence as to review of audit points with date by a senior
- No record of audit monitoring visit/meeting by audit incharge is kept.
- Queries are not being noted down in a uniform and standard manner.
- A document reflecting review and substantive tests applied through section wise checklists will surely go a long way in further strengthening the quality of attest function.
- Audit programme for conduct of audit was not documented.
- Details of conduct of audit like which partner has conducted and supervised the audit, when it was conducted, names of staff members involved, allocation of work conducted by the staff were not documented.
- Documentation to reveal the compliance of technical standards during the conduct of audit was not available.
- 'Appointment Letters' for the audit assignments for the period under review were not available on record.

#### AAS 5 (Audit Evidence)

- PU does not always follow the procedure of collection of audit evidence for performing substantive test and results obtained thereat not properly documented.
- The unit does not obtain direct evidence from parties and business associates of the clients.

- Audit plan, nature of work, timing and extent of audit procedure performed, conclusion drawn there on, not found in a large audit assignment.

#### AAS 6 (Risk Assessment and Internal Control)

- While making the review and evaluation of internal control system, the Audit Risk and its components not measured. Hence, the weaknesses noticed in the internal control system, which requires improvement.
- Assessment of audit risk and its components not done.
- No test of controls to obtain audit evidence to support any assessment of control risk.
- Review and evaluation of system of internal controls not carried out.
- PU has not been doing any risk analysis with regard to their audit function.
- PU does not conduct test of controls to obtain audit evidence to support any assessment of control risk.
- PU does not have any policy to consider and assess inherent level of control risk in determining the nature, timing and extent of substantive procedures required to reduce audit risk, to an acceptable low level.
- Written statements in questionnaire form or flow chart form not available regarding internal control system.
- Review and evaluation of system of internal control in large audits not documented.
- Review and evaluation of risk assessment of client's business in large audit not evaluated.

#### AAS 7 (Relying upon the work of an Internal Auditor)

- Review and reliance placed on work of an internal auditor few large audits not documented.

#### AAS 8 (Audit Planning)

- No audit programme is prepared for conducting audit.
- PU does not always follow requirements of written audit programme.
- Audit plans not developed.
- No documentation or audit programme in large audits.
- Scope of audit not found to be elaborate.
- Audit plan before commencing the audit is not prepared in all the cases.
- An audit plan for each audit giving time schedules is not available.

#### AAS 11 (Representation by Management)

- PU does not have any system to obtain written representation from the management on matters material to financial information.
- It was noticed in number of instances, the representation from the management was not received in spite of the fact that sufficient appropriate audit evidence did not exist.
- Representation letters from the client have not been obtained in all the cases.
- Management Representation was not being received where no audit evidence available. Even annual amounts as being reported were not found signed by partners/proprietors.
- The practice of obtaining representation letters is not noticed and confirmation regarding physical stock, valuation of stock, bank balances, etc. not obtained.

#### AAS 14 (Analytical Procedures)

- No performance of analytical review.
- PU does not have any system of performing analytical review.
- Non compliance with Analytical Procedures.
- Working of various ratios to find out the abnormal items not done.

#### AAS 15 (Audit Sampling)

- While determining the sample size, PU does not consider the sampling risk, the tolerable error, and the expected error.
- No use of either statistical or non-statistical sampling methods to design and select an audit sample.
- Non compliance with Audit Sampling.
- Audit sampling- Audit objectives have not been specified while selecting the sample and its size. It has not been indicated whether sampling risk has been minimized or not.

#### AAS 17(Quality Control of Audit Work)

- System for scheduling and staffing for carrying out the audit engagement needs to be established.
- No system to lay down qualifications deemed necessary for various levels of responsibility to ensure the technical standards and professional competence required to enable them to fulfill their responsibility with due care.
- The unit does not have a written manual for policy of review of audit work.
- Review of work done by assistants and supervisions, directions given or any observation are not found in few files particularly in large audit.
- Proper system of control not in existence.

- Work assigned to staff is regardless of the qualification required.
- Has not documented the monitoring of progress of engagements.
- Review of audit work performed by each assistant not done by the personnel of at least equal competence.
- Complete record of work assignment and instructions to Audit Assistants found lacking.
- There is no built up network of accountants, solicitors and advocates and technical consultants in industries in which its client operate.
- A system of second partner review is not prevalent in the firm.
- The practice unit has not established system for second person review.
- There was no checklist or standardized format or questionnaire on record to show the review of work by senior partner for compliance with technical standards.
- Whether the skill and competence of assistants are considered before assignment of work.
- No proper policies & procedures for quality control of the attestation services.
- No panel for outside consultation & the record of such consultation is maintained.
- PU is not maintaining any record of outside consultation or consultation within the firm.

#### AAS 23 (Related Parties)

- Sufficient audit evidence was not received regarding the identification and disclosure of related parties and related parties' transactions that are material to financial information.
- In few cases, related parties list and organizational structure are not available.

#### AAS 26 (Terms of Audit Engagement)

- Acceptance letters are not sent to clients.
- On a few of the occasions engagements letters not issued.
- PU does not have any practice of issuing engagement letter.
- Engagement letters of Tax audits not obtained.

#### AAS 28 (The Auditor's Report on Financial Statement)

- In one of the engagements reviewed, it was noticed that the qualifications in the Auditors reports to the members of the company were not in accordance with the requirement of this AAS.
- The basis of confirmation from outside parties viz., Debtors, Creditors, etc. not on record.
- Audit reports are invariably in report formats as prescribed under relevant statute & without incorporating reporting standard as prescribed (AAS 28).

- The auditor's report was not in accordance with AAS 28.

#### AAS 29 (Auditing in a Computer Information System Environment)

- In case of auditing in computerized environment, scope and nature of the terms of assignment and extent of responsibility not specified.

#### Accounting Standards

- In case of a company where Cash Credit facility is availed against hypothecation of stock and debts and other movables, classification of the loan as secured is required to be supported with the documents creating charge with the Registrar of Companies. No such documents were made available.
- As required vide AS- 1, if any enterprise does not disclose Accounting Policies at one place, the auditor should disclose the fact in his audit report without necessarily making it subject matter of audit qualification.
- Disclosure regarding non-compliance of AS 1 "Disclosure of Accounting Policies" not done in the Auditors' Report in all the cases of non-corporate clients, which is mandatory for all the enterprises.
- Audit report did not clearly report that the company is not an on going concern.
- Non-Compliance of AS 2 i.e. valuation of inventories not mentioned in the audit report, though the accounting policy in this respect clearly shows its deviation.
- AS 22 regarding Deferred Tax not followed in few cases.
- There is lapse in the system of preparation of Bank Reconciliation Statement.
- Tax liability of firm is not provided by debit to profit & loss account of firm. Also advance Tax payment is not shown as part of assets of firm. Instead these are channelised by entry to debit/credit of partners in respective profit sharing ratio.

#### Independence

- The PU should formulate an independence policy and apprise the staff of the importance of independence. Even take an undertaking from the staff members at the time of appointment to the effect that, "they will disclose their relations in the organizations of which attestation work is assigned to them".
- No written policies for independence of staff members maintained.
- Policies regarding Independence not in writing provided to the staff at the time of joining or subsequently on periodical basis.
- No policies & procedures found in place to ensure independence.
- Audit Planning needs to be done by studying business environment & volume of checking of Auditee. The representation from management should be obtained and evidence of management representations needs to be documented.
- PU does not have any system to monitor compliance with policies and procedures relating to

independence by way of sending the Memorandum of inquiry or receiving written representation or by any other method from personnel on regular basis.

- Records relating to independence by way of sending memorandum of inquiry has not been maintained.
- The unit does not have a documented policy for independence of staff members.
- No laid down policies and procedures relating to independence framed out & communicated to all personnel.
- No individual has been designated to be responsible for providing guidance and to resolve issues on independence policies.
- At the time of joining the firm, PU has no procedure for taking the undertaking from employee, regarding independence policy.

#### Statutory Requirements

- For acceptance of audit in company cases acknowledged copy of Form no. 23-B (intimation to the ROC) not on file.
- Disclosure requirement as per Schedule VI of Companies Act, 1956 not complied with.

#### Code of Ethics

- In one case it was observed that the practice unit did not ascertain whether its appointment was valid as per the rules and regulations of the auditee.

## II. Quality of Reporting

- The Audit programme and Audit contents not documented properly.
- The basis for arriving at audit conclusions not documented.
- In Tax audit report issued u/s 44AB of the I.T. Act, prescribed particulars were certified to be true and correct, even though the statutory audit of the accounts of the Society was not done, with the observations which read as under:-

"I report that the statutory audit of [name and address of the assessee with permanent account number] was conducted by (Accounts are yet to be audited) in pursuance of the provisions of the \_\_\_\_\_ Act,"

- The work allocation, number of man days required are not documented. The management comment on Draft Audit Report should also be documented.
- There were errors in reporting which were corrected.
- The company had used short-term funds for acquisition of Fixed Assets, same has remained to be highlighted in CARO Report.

- Where positive opinion was expressed in audit reports the same was not supported by observations/findings contained in working papers.
- Closing Stock is not being verified by the firm as a rule, instead it is invariably "As valued & certified by partners/proprietor".
- The PU has not obtained in all cases cash & stock certificate duly signed by the proprietor or partner of the concern.
- In all audit report PU has not annexed Notes on Accounts – accounting policies, method of accounting, fixed assets, depreciation & amortization, inventories, investments, retirement benefits & gratuity, events after the balance sheet, prior period adjustment, change in accounting policies, extra ordinary items.
- All the engagements of non corporate clients reviewed by us, the audit report u/s 44AB of the Income Tax Act, 1961 complies with applicable form as prescribed under this statute but does not contain the disclaimer clause as announced by the ICAI and published in Journal April, 2002 issue at page no. 1229.

### III. Office Systems and Procedures with regard to Compliance of Attestation Services Systems and Procedures.

- Personnel policies to be laid down.
- Appointment letters for staff and files not maintained.
- The PU firm has not maintained any register for availability of expertise and/or experienced individuals for consultation with the consent of the auditee.
- The PU is carrying out most of the activities from branch office. The PU does not have its own office premises as well as not made any seating arrangements for staff, keeping records, etc.
- The PU does not have their own library at branch office from where major activities are carried out.
- Regular meetings are held at regular intervals for discussing various issues but no records are there in support of it.
- Not maintained any staff file.
- Checklists found in the files are not filled in some cases and in other cases filled in part only.
- Staff files having necessary information about date of appointment, experience, information of training programme undergone during employment and periodic evaluation of performance, etc. not found.
- Register containing the List of Clients which may provide information about the kind of services being rendered to the client among other things not found.
- Checklist for Auditing & Assurance Standards, guidance notes, etc. not prepared to ensure compliance with all the standards while performing a particular attestation engagement.
- No written guidelines on the responsibility at each level on the expected performance and

qualifications necessary for advancement to the next level.

- No system to evaluate staff performance and communicate to staff on periodical basis.
- The firm does not have system of maintaining separate audit file. For each client, audit papers and income tax papers are maintained in the same file.
- Working papers of all attestation work have been kept separately which should be kept in audit file of respective clients and such working papers should have formal presentation so that the same can be suitably presented as evidence, if and when required.
- Manual for policies and procedures not documented and maintained.
- The latest available materials from the Institute on technical standards may be kept in the library.
- For the period under review, no appointment letter from the client is seen.
- No practice of having discussions with staff and no minutes or register showing the details of the meetings being maintained.
- No list or index available showing the classification and comprehensiveness of reference books.
- There are no standardised forms and checklists to assist staff in the conduct of audit.

#### **IV. Training Programmes for Staff (including Article and Audit Clerks) concerned with Attestation Functions, including Appropriate Infrastructure.**

- Even though we were informed that there are guidelines for continuing professional education however no mechanism/record was found in place for monitoring continuing professional education.
- Non-existence of adequate staff Training.
- Inadequate Training Programme for staff including audit staff concerned with attestation functions and non-maintenance of records thereof.
- Non-compliance of CPE hours by partner as well as other CA employees.
- Staff files having necessary information regarding the training programmes undergone during employment and periodical developments required to be maintained.
- No introductory procedures established for new employees like discussion regarding requirements of the ICAI, Continuing Professional Education and Independence.
- No orientation programme for new employees.
- Procedure for documenting orientation of new appointees missing.
- Firm needs to have adequate mechanism for training of staff & maintaining records thereof.
- PU does not have any system of monitoring the continuing professional education by way of maintaining records thereof.

- Unit does not monitor the continuing Professional Education.
- No information as to training programme for staff made available.
- The unit does not maintain formal records for the continuous professional education imparted to its staff members; the unit does not have a written for policy of review of audit.
- There is need to develop library for continuing education of staff containing developments in Auditing and Assurance Standards, Guidance Notes and monitoring continuing professional education of staff.
- The unit does not maintain formal records for the continuous professional education imparted to its staff members.
- Though the Audit in charge are well versed about Accounting Standards, there is need to apprise the junior staff about Accounting Standards which may be done even in house.
- The PU is not maintaining any register for in house training or mechanism for CPE hours.
- PU firm does not have procedure for CPE hours for other staff (Other than Qualified staff and articulated clerks).
- The PU is not maintaining any Register for lectures, seminars, workshop, etc. attended by qualified as well as other staff members.
- For in house training given, no record for attendance register or signature thereon is maintained.
- As informed by PU there is no in house or out side CPE programme attended by other staff, the question of monitoring the same does not arise.
- No separate training programme has been conducted.
- No evidence to show training programme undergone by staff.

## Reviewers' Experience and Views on Peer Review Exercise

Note: As a matter of policy, the Peer Review Board decided to obtain feedback from Reviewers, immediately after the completion of peer review assignment. Such a feedback was of immense value to the Board, particularly during the initial stage of commencement of peer review to understand difficulties and problems, if any, faced by the PUs and Reviewers.

We are reproducing below in brief, the experiences of Peer Reviewers as shared with us.

- The system of Peer Review will achieve the following:
  - Enhance the quality of attestation services discharged by members.
  - The society can expect certain uniform standards from all members in practice.
  - Directing members to pay attention to office system and procedures.
  - To create awareness about need for empowering their staff in technical and soft skills by strengthening in house training programmes which will enable them to conduct the audit more efficiently and effectively.
  - The size of the practice unit matters most, when delivering quality attestation services for large audits. There is need to work on strengthening of the firm by deliberating management issues in viability of the firm such as:
    - ✓ Strategy & Profitability of the firm
    - ✓ Clients Management
    - ✓ Building Human Capital in the firm – Partner Performance Counselling, Partners Compensation & Partnership Governance.
- In the Indian context, where the size of audit firm is small and considering the level of audit fees, it becomes really uneconomical, and time consuming exercise but this labour is necessary to deliver quality professional services and safeguard auditor's own interest.
- As a practicing chartered accountant, we had always done the job of reviewing of records of other persons.
- It was indeed a different type of experience compared to the normal experience of facing a commercial concern. Moreover I had to apply different angle and attitude while performing this task.
- Peer Review Unit allotted to me had deputed one of their partners for this purpose. He was completely with me for full three days. The Peer Review Unit co-operated me nicely and appreciated some of my suggestions. The Unit satisfied all my queries in totality.
- I feel that the time allotted is too small in comparison to volume of work. Therefore I suggest that it should be increased to 7-8 days.
- Though the maintenance of proper documentation and other systems along with required technical expertise is in the best interest of our members only, the amount of time and cost involved in such documentation seems to be worrying factor.

Especially, looking at some of the issues like lack of competent staff, more and more compliance responsibilities shouldered under various statutes by the members, low level of remuneration from the clients as compared to the work performed etc. Among other minor queries, such members are expecting that a Board may come out with some sort of minimum level of requirements or base line for different levels of the firms.

- Visiting fellow member's office for the review of their work is a strange experience, that too office of a leading accounting firm. Sharing professional knowledge with big audit firm is a great opportunity.
- I wish that all the members who are eligible to empanel should be compelled to empanel so that they may get the opportunity of reviewing the attest function of fellow members and of sharing their knowledge.
- We were extended full co-operation and unrestricted access to the records maintained in respect of their auditee clients. It is note worthy that the firm had taken in writing the permission of their concerned clients for giving us access to the records pertaining to their Companies.
- I must admit that this has motivated me to do self review of my own office.
- The PU was quite happy about the discussions and agreed with us that this type of exercise by the Institute is helpful for increasing the quality of our professional services and also helpful to carry out future assurance assignments in more meaningful and scientific manner. This is a good exercise both for the reviewers and the PUs to keep them alert of various standards and procedures pronounced by ICAI.
- This being a post-mortem work, the Institute should also give another two years say upto 31.3.2006 for all the PUs to strictly adhere the documentation. For example, most of the attestation functions done are on oral basis as the clients are existing clients and they are not tuned to give engagement/appointment letter detailing the scope and coverage of work.
- The Peer Review should not be taken up during the month of April (Bank audits), July (Due date of filing IT Returns) Sept. & Oct. (Company audit & tax audit finalisation).
- Now that Articled Clerks are not available in most of the CA firms, the Institute should start conducting seminars/discussions for the staff who are not students. Just like CPE, this can be made mandatory for staff who are conducting audits.
- Firms (PU) are rather reluctant and slow in their Firm being peer reviewed by their own professional brothers. They have a feeling that just because the Institute of Chartered Accountants of India (PRB) have selected them for peer review and due to compulsion they undergo such peer review of their Firm.
- The reviewer after having been selected by the Practice Unit (PU) must have from the ICAI (PRB), a Xerox copy of letter written by ICAI(PR) to PU to undergo peer review of their Firm, with particular reference to the Financial Year involved in peer review work.
- The questionnaire sent to PU by ICAI(PR) comes in the hand of PR (peer reviewer) after quite long time, i.e. not within 30 days.
- The questionnaire must be signed by PU on each page and at the last page it should be dated

& fully signed by the Partner of PU, responsible to give answers to the questionnaire.

- Questionnaire must include the following further particulars of the P.U.
- Income Tax Permanent Account Number.
- Service Tax Registration Number.
- Xerox of relevant yearly certificate of the Firm as issued by the ICAI.
- Partnership Registration number with Registrar of Firms (if registered).
- Organization set up chart of the PU must be part & parcel of the Questionnaire.
- Xerox copy of relevant acknowledgement copy of having filed their (PU) I.T. Return for the year under review.
- Xerox copy of relevant acknowledgement copy of having filed their (PU) service tax return – half yearly & yearly.
- The Peer Review Board also must have on their record the copy of Questionnaire & reply given by the PU to the PR (Peer Reviewer).
- Disclosure of name of clients instead of serial number of the clients must be avoided so that the PR can make proper selection of important files of clients of P.U.
- Xerox copy of Audited/Tax Audit (if applicable) of Annual A/c of the Firm relevant to period of review must be a part of Questionnaire.
- Irrelevant reply to the question of the Questionnaire should be avoided by the P.U. instead of saying No or N.A.
- Registration number of the P.U. with PF Authority, ESIC Authority, Shop & Establishment Act etc. etc. also should mentioned & covered by the Questionnaire.

Tax Audit Report of the Firm for the year under review (if applicable) must be a part of Questionnaire.

- Generally time given of two days to conduct peer review work is too short because half day or full day is always consumed while understanding modus operandi of the P.U. It should be at least minimum of 3 working days in case small/medium size Firm and of 6 working days in case large size Firm.
- Copy of preliminary report given by PR (peer reviewer) relating to PU & reply to the same by PU to PR, should also be part & parcel of final report of PR on P.U. This will enable peer review Board to come to know about several observation/points covered by several PR as well nature of reply given by PU to PR.
- I personally feel that multiple partnership along with Sole Proprietary Firm existing simultaneously has been overlooked while selecting a PU for peer review which has resulted in some reservations stated above.