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PEER REVIEW

21.1 Introduction

The term "peer" means a person of similar standing. The term "review" means conduct of re-examination or retrospective evaluation of the subject matter. In general, for a professional, the term "peer review" would mean review of work done by a professional, by another professional of similar standing. 'Peer Review' is defined as, a regulatory mechanism for monitoring the performances of professionals for maintaining quality of service expected of them for enhancing the reliance placed by the users of financial statements for economic decision-making.

As per the Statement of Peer Review (ICAI, 2002) "Peer Review" means an examination and review of the systems and procedures to determine whether they have been put in place by the practice unit for ensuring the quality of attestation services as envisaged and implied/mandated by the Technical Standards, Ethical Standards and Professional Standards and whether these were effective or not during the period under review".

The examination and review of a practice unit would be carried out by a "reviewer", i.e., a member, selected from a panel of reviewers maintained by the Board. The term "practice unit" means members in practice, whether practising individually or as a firm of Chartered Accountants.

21.2 Objectives of Peer Review

The main objectives of peer review are as discussed below:

(i) To ensure that members while performing attestation services comply with technical standards, Ethical Standards and Professional Standards laid down by the Institute;

(ii) To ensure that such a member has in place proper system (including documentation system) for maintaining the quality of attestation services performed by him;

(iii) To ensure adherence to various statutory and other regulatory requirements; and

(iv) To enhance the reliance placed by the users of financial statements for economic decision making.

Thus the primary objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. The Statement of Peer Review also makes it clear that the peer review, "does not seek to redefine the scope and authority of the Technical Standards specified by the Council but seeks to enforce them within the parameters prescribed by the Technical Standards". The peer review is directed towards maintenance as well as enhancement of quality of attestation services and to provide

guidance to members to improve their performance and adherence to various statutory and other regulatory requirements. Such an objective of the peer review process makes it amply clear that the reviewer is not going to sit on the judgement of the *practice unit* while rendering attestation services but to evaluate the procedure followed by the practice unit in rendering such a service. Accordingly, where a practice unit is not following technical standards, the reviewers are expected to recommend measures to improve the procedures. To elaborate further, the key objective of peer review exercise is not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature. For instance, absence of formal planning of an audit represents a serious deficiency that needs to be remedied by the practice unit. An instance of the auditor not carrying out physical verification of furniture and fixture may not attract the same comment. However, certain items of assets are best verified through the physical verification process and not adopting the same procedure may rightly be viewed as a systemic failure. The conclusion, therefore, is that the peer review seeks to identify and address patterns of non-compliance with quality control standards.

21.3 Scope of Peer Review

The Statement on Peer Review (ICAI, 2002) lays down the scope of review to be conducted as under:

The peer review process is directed at the attestation services of a practice unit:

(1) Once a practice unit is selected for review, its attestation engagement records pertaining to the immediately preceding three completed financial years shall be subjected to review.

(2) The Review shall focus on:

- (i) Compliance with Technical Standards
- (ii) Compliance with Ethical Standards.
- (iii) Compliance with Professional Standards.
- (iv) Quality of Reporting.
- (v) Office systems and procedures with regard to compliance of attestation services systems and procedures.
- (vi) Training Programs for staff (including Articled and Audit Assistants) concerned with attestation functions, including appropriate infrastructure.

As it is clear from the above, that the Statement of Peer Review aims to confine the scope of review to preceding three years since this would establish the consistency or deviations, if any, in respect of procedures followed by the practice unit. The tenure of immediately three financial years, perhaps, has been envisaged since all practice units would not be subjected to mandatory annual review.

The Statement defines the scope of peer review which revolves around compliance with technical, ethical and professional standards; quality of reporting; office systems and

procedures with regard to compliance of attestation engagements; and, training programmes for staff including articled and audit assistants involved in attestation engagements.

A *Practice Unit* means members in practice, whether practicing individually or a firm of Chartered Accountants.

The entire peer review process is directed at the attestation services which may be used interchangeably as audit services, attestation function or audit functions of a practice unit. The attestation services which shall be subjected to peer review include auditing or verification of financial transactions, books, accounts or records and verification or certification of financial accounting and related statements as defined under section 2(2)(ii) of the Chartered Accountants Act, 1949. Thus, the term attestation services include all those services such as internal audit, concurrent audit etc., which involve provisions of some kind of element of assurance to users. Specifically, the services which have been excluded from the scope of attestation services are all management consulting engagements, representing a client before the authorities, preparing tax returns and providing tax advice, compilation services, testifying as expert witness and providing expert opinions based on facts. It may be noted that while reviewing office systems and procedures and training programmes for the staff, the reviewer shall focus on such areas which may affect the quality of attestation services performed.

It is also quite important for a reviewer to understand the scope of review with reference to compliance with technical standards ethical and professional standards because the said term has been defined in an inclusive manner in the Statement on Peer Review.

As per the Statement, Technical, Ethical and Professional Standards - Mean and include:

(i) Accounting Standards issued by the Institute of Chartered Accountants of India and Central Government of India;*

(ii) Auditing and Assurance Standards (including General Clarifications thereof) issued by the Institute of Chartered Accountants of India;*

(iii) Engagement Standards issued by the Institute of Chartered Accountants of India;

(iv) Framework for the Preparation and Presentation of Financial Statements, Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services issued by the Institute of Chartered Accountants of India and Framework for Assurance Engagements;

(v) Statements issued by the Institute of Chartered Accountants of India;

(vi) Guidance Notes issued by the Institute of Chartered Accountants of India;

(vii) Notifications/Directions/Announcements issued by the Institute of Chartered Accountants of India including those of self-regulatory nature;

(viii) Provisions of the various relevant Statutes and/or Regulations which are applicable in the context of the specific engagements being reviewed including instructions/guidelines/ notifications/directions issued by the regulatory bodies;

(ix) Ethical Standards/pronouncements issued by ICAI.

Professional Standards generally expected to be adhered by Chartered Accountants in terms of regulatory, legal & societal norms.

21.4 Applicability

'Practice units' (PU) covered under Peer review during the first year i.e., April 1, 2003 are:

(i) Central Statutory Auditors of Public Sector Banks, Private Sector Banks, Foreign Banks and Public Financial Institutions;

(ii) Central Statutory Auditors of Central and State Public Sector Undertakings and Central Cooperative Societies based on criteria such as turnover or paid up capital etc. as may be decided by the Board;

(iii) Central Statutory Auditors of Insurance Companies;

(iv) Conducting audit of Companies having paid up capital of over Rs. Five crores and an annual turnover of more than Rs. Fifty crores and such other criteria as may be decided by the Board;

(v) Conducting audits or rendering attestation functions of asset management companies and mutual fund entities;

(vi) Conducting audit of enterprises whose equity or debt securities are listed in India or enterprises which are in the process of listing their equity or debt securities as evidenced by the board of directors' resolution in this regard;

(vii) Entities which have raised funds from banks/public/financial institutions of over Rs. One crore at any time during the period covered by the review and satisfy such other criteria in this regard as the Board may decide, as well as entities who have shown readiness to raise funds of the above amount or more as evidenced by their filing of prospectus.

Coverage with effect from April 1, 2004 includes:

(i) Branches of Public Sector Banks;

(ii) Branches of Private Sector and Foreign Banks;

(iii) Regional Rural Banks/Co-operative Banks;

(iv) Non-Banking Financial Companies (NBFCs) which are not covered under Level I, based on such criteria as the Board may decide;

(v) Companies having paid-up capital of Rs. Five crores or less and such other criteria such as turnover etc. as may be decided by the Board.

Coverage with effect from April 1, 2005 includes:

(i) all other practice units

Stage wise implementation shall proceed on the basis of random selection.

21.5 Peer Review Board

The Council of the institute of Chartered Accountants of India in March 2002 established the 'Peer Review Board' for maintaining Quality of Service as well as enhancing the quality of service of professional members engaged in attestation function. The Board shall consist of maximum of 12 members to be appointed by the Council, of whom at least 9 shall be from amongst the Members of the Council. The balance members of the Board shall be drawn from outside bodies and amongst prominent individuals of high integrity and reputation, including but not limited to, former public officials, regulatory authorities, bankers, senior professional chartered accountants, security industry executives, educators, economists and business executives. Such persons shall, as far as possible, be chartered accountants and shall be treated as co-opted Members of the Board in terms of Section 17(2) of the Chartered Accountants Act, 1949, in the event of their being members of the Institute; otherwise, they be treated as Special Invitees to the Board. The Chairman and Vice-Chairman of the Peer Review Board is appointed by Council from amongst the members of the Council. At least 2/3rd of Council members on the Board shall hold Certificate of Practice. The term of a member shall be for one year, or such period as may be prescribed by the Council. Casual vacancies on the Board shall be filled in by the council. The term of a member shall be for one year or such period as may be prescribed by the Council. The members of the Disciplinary Committee or the Committee on Ethical Standards of the Institute of Chartered Accountants of India shall not be members of the Peer Review Board as well.

21.5.1 *Qualifications of Reviewer* – The Peer review board would maintain a panel of reviewers. To be a panel member, an individual should be:

(a) a member of ICAI;

(b) possessing at least 10 years experience of audit; and

(c) currently active in the practice of attestation service engagements; and

(d) be free from any obligation or conflict or interest in the reviewed firm or its partners or personnel.

21.6 The Peer Review Process

The Peer Review process has three stages – planning, execution and reporting.

Stage I: Planning - Planning includes the following steps:

1. Empanelment of Reviewers - The process begins with the empanelment of an individual to act as the reviewer. A panel of reviewers is maintained by the Peer Review Board, satisfying the qualification requirement set by the Board i.e,
   (a) a member of ICAI;
   (b) possessing at least 10 years experience of audit; and
   (c) currently active in the practice of attestation service engagements; and

(d) be free from any obligation or conflict or interest in the reviewed firm or its partners or personnel.

2. Selection of the Practice Unit - PU's are selected for Peer Review on a random basis, as per applicability.

3. Intimation to the Practice Unit - Once a practice unit has been selected for Peer Review, an intimation in writing is sent by the Board to the practice unit informing of its selection for peer review. Along with the intimation, the following documents shall also be sent to the practice unit.

   (i) A copy of the statement on Peer Review.

   (ii) A panel of three reviewers suggested by the Board or Sub-Committee constituted by it for this purpose,

   (iii) A copy of the questionnaire.

4. Initial Communications by the Practice Unit - After receipt of the intimation from the Board, as mentioned in paragraph above, the practice unit is required to communicate to the Board, its choice of the reviewer from the above mentioned panel within a period of 15 days from the receipt of intimation.

   The practice unit is also required to complete and send the questionnaire to the reviewer selected by it within one month of the receipt of the intimation, alongwith a complete list of its attestation service engagement clients. It may, however, be noted that the practice unit may not provide the names of all such clients but instead provide code numbers alongwith other relevant details provided the practice unit has been maintaining register allotting the code numbers to all its clients. It is quite possible that a practice unit may have more than one office and its branch office(s) may spread over more than one State/Region. In that eventuality, the reviewer is expected to take cognizance of the same and obtain additional information from the practice unit. Ascertaining such information would be quite crucial while selecting sample of attestation services in an objective manner.

   It may be noted that apart from the information given in the questionnaire, the reviewer is entitled to seek such other information as the reviewer considers necessary to facilitate selection of sample of attestation services engagements, which appropriately represents the practice unit's client portfolio.

5. Selection of Sample Attestation Service Engagements - The reviewer, on the basis of the information given in the questionnaire or after seeking other information, selects a sample of attestation service engagements on random basis for review. It is clarified that the selection of a sample for review out of the complete list of attestation service clients is at the discretion of the reviewer. However, the reviewer is required to select a sample that is representative of the practice unit's client portfolio.

6. Communication of Sample Selection - After the selection of sample of attestation service engagements for review, the reviewer sends a written intimation to the practice unit about the sample selected by the reviewer, two weeks in advance, from the date the reviewer intends to begin the review. The intimation also contains a request for ready

availability of that relevant records relating to the attestation service engagements selected for review.

7. Confirmation of Visit - The reviewer, in consultation with the practice unit, is required to fix the date(s) for on-site review. While fixing the date for on-site review, both the practice unit and the reviewer should bear in mind that date(s) are to be fixed in a manner so that the peer review process is completed within four months of the receipt of intimation by the practice unit.

Stage II: Execution - At the execution stage, it is important for the reviewer to note that such visits will be conducted at the practice unit's head office. Therefore, it is suggested that the reviewer at the planning stage should identify the sample clearly. However, it may also be possible that if a practice unit happens to be quite a big outfit and has several branches, the reviewer may have to visit more than once. The Board decided to clarify that the reviewer may not visit a branch (outside the city/ town limits from head office) of practice unit unless the turnover of attestation functions of that branch is more than one million rupees. In such a case, he may instruct the practice unit to get documents and relevant records in respect of attestation engagement performed by such branch office to the head office. Where the Reviewer decides to visit a branch/ office whose turnover from attestation engagements is more than one million rupees, the rate of TA/DA of the reviewer for both the stages shall be as per RBI guidelines (Refer Notification No. PRB/Notn./004/04-05, dated 23rd July, 2004) Execution includes the following steps:

1. Initial Meeting - Before the commencement of the review, an initial meeting should be held between the reviewer and the partner (designated by the practice unit for the purpose) or the sole proprietor of the practice unit. The primary purpose of the meeting is to confirm the accuracy of responses to the questionnaire. The description of the system in the Questionnaire may not fully explain all the relevant procedures and policies adopted by the practice unit and this initial meeting can provide additional information. The reviewer should have a full understanding of the systems and procedures and be able to form a preliminary evaluation of its adequacy at the conclusion of the meeting.

   Large practice units which have extensive documentation regarding their practice and procedures (i.e. formal office procedure manuals and audit manuals) will find it unnecessary to document all the controls and will be expected to cross reference the Questionnaire to the relevant sections of their manuals. For practices like these, an additional planning visit will be arranged before the on-site review to review the relevant manuals. Practice units should have procedures and documentation sufficient to cover each of the key control areas. Members in smaller practices may find some of the documentation too elaborate for most of their clients and so should tailor their attestation services documentation to suit their particular circumstances with justification for doing so provided to the reviewer.

2. Compliance Review - The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration and

evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed.

The reviewer should review these general controls to gain an understanding of the working of the practice unit and specific control procedures existing at the practice unit. This helps the reviewer in making an identification and evaluation of those control procedures on which it might be effective and efficient to rely in conducting the review. The review of these general controls would consist mainly of inquiries from the partner (designated by the practice unit for the review) or the sole proprietor of the practice unit with reference to the responses by the practice unit to the questions given in the questionnaire.

Apart from making inquiries with the personnel concerned, the reviewer may adopt other procedures to establish the fairness of the responses by the practice unit to the questions. Selection of other procedures or techniques is a matter of the reviewer's judgement.

3. Selection of Attestation Service Engagements - The number of attestation service engagements to be reviewed depends upon, inter alia, the number of practising members involved, degree of reliance to be placed on general controls and the total number of engagements undertaken by the practice unit during the period under review. The reviewer may modify the initial sample selected for review in consultation with the practice unit at the execution stage. The further refinement of initial sample is done by the reviewer on the basis of information and knowledge that he gains during the course of initial meeting and by performance of compliance review of the key controls within the practice unit. It may, however be noted that, the reviewer should neither review those attestation services engagements of the practice unit which have been the subject matter of disciplinary proceedings nor should the practice unit, in any way, influence the reviewer to select such engagements for review.

4. Review of Records- Compliance and substantive Approach - The reviewer may adopt the compliance approach that helps in determining the nature, timing and extent of the substantive review procedures to be applied in review. The reviewer should conduct adequate compliance procedures to gain an evidence that those general controls on which the reviewer intends to rely operate generally as identified by the reviewer and they have been functioning effectively throughout the period of reliance. Based on the results of compliance procedures, the reviewer concludes either to rely or not to rely on the general controls. In case the reviewer decides to rely on the general controls, he would also need to determine the extent of reliance to be placed on such controls. In such a situation, the nature, timing and extent of substantial procedures would be, normally, less extensive and vice-versa. The compliance approach may not be warranted if the size of the firm is small or medium or the kind of attestation services rendered by the practice unit does not warrant elaborate controls within the firm. In such a case, the reviewer may adopt only substantive approach for conduct of review.

   The substantive approach involves application of such review procedures that provide the reviewer evidence as to the appropriateness of the factors on which the review is

required to be focussed on. The reviewer establishes the appropriateness of factors by reviewing the documentation available within the practice unit. For example, review of working papers related to an attestation engagement would provide the reviewer an evidence that the attestation services have been undertaken in accordance with the prescribed technical standards. The details of the execution of the peer review are given in the Statement on Peer Review. Reviewers are also advised to refer to the Statement for a detailed description of the execution stage of the peer review.

5. Obligations of the Practice Unit - In order to carry out the compliance and substantive procedures, the reviewer is required to access the records or documents related to attestation services of the practice unit. The Statement as per paragraph 12.1 requires the practice unit to produce to the reviewer or afford him access to, any record or document which contains or is likely to contain information relevant to the peer review. The practice unit is also expected to provide all assistance by way of providing explanations and further particulars as may be required with reference to documentation. If the information or matter recorded is not in a legible form, the practice unit shall provide and present to the reviewer a reproduction of such information or matter, or of the relevant part of it in a legible form, with a suitable translation in English if the matter is in any other language. The reviewer may inspect all the documents relevant to his review in one or more offices of the practice unit but under no circumstances he shall communicate with or visit the client of the practice unit. The Board decided to clarify that the reviewer may have access to, or take the abstracts of the records and documents maintained by the practice unit in order to carry out the review work at practice unit's office, but in order to ensure the confidentiality of client's file with the practice unit, the reviewer shall not carry extracts of the client's files or records acquired by him while conducting peer review, as part of his working papers.

Stage III : Reporting - Reporting includes the following steps:

1. Preliminary Report of Reviewer - At the end of the on-site review, the reviewer is required to send a preliminary report to the practice unit before making any report to the Board on the areas in case systems and procedures of the practice unit reviewed have been found to be deficient or where non-compliance with reference to any other matter has been noticed by the reviewer during the course of review. The reviewer has to take care that the report does not contain name of any individual of the practice unit. However, no preliminary report is required in case no deficiencies or non- compliance are noticed by the reviewer.

   The reviewer while preparing the preliminary report should review and assess the conclusions drawn from the review that indicates the deficiencies to be reported upon. The preliminary report is addressed to the practice unit. The report, apart from mentioning the areas where systems and procedures of the practice unit have been found to be deficient, should also contain a paragraph that discusses the scope of the review performed by the reviewer. If the reviewer draws a conclusion that there existed a limitation on scope of review, the fact, along with such limitation on the scope of the review, should also be communicated to the practice unit through the preliminary report.

The reviewer should prepare the report on his letterhead. The report should be dated and also contain the reviewer's signature and membership number and reviewer's code number allotted by the Board.

2. Reply to Preliminary Report - The practice unit has to send its submissions or representations, in writing, to the reviewer, on the areas mentioned in the preliminary report. The reply to the preliminary report should be sent by the practice unit within a period of 21 days from the receipt of the preliminary report from the reviewer.

3. Qualified Report of the Reviewer - If the reviewer is not satisfied with the reply of the practice unit, the reviewer has to submit a qualified report to the Board. The report so submitted should clearly indicate that it is a "qualified report". The Board may then order after twelve months for follow up review by appointing a new reviewer. The new reviewer is then required to submit the follow up report to the Board for consideration.

4. Final Report of the Reviewer - If the reviewer is satisfied with the reply of the practice unit, the reviewer shall submit his final report to the Board. The final report should incorporate the findings as discussed with the practice unit.

21.6.1 *Qualified Assistant* - The reviewer may take the help of a qualified assistant while carrying out peer review. In this context, the Board decided to clarify that a reviewer is permitted to take the assistance of only one assistant who shall be a chartered accountant and a person who does not attract any of the dis-qualifications prescribed under Section 8 or Section 21 of the Chartered Accountants Act, 1949. The name of the qualified assistant which the reviewer would like to assist him shall be identified and intimated to the Board as well as the practice unit before the commencement of the peer review. Such a qualified assistant shall also have to sign the declaration of confidentiality as annexed to the Statement. He shall have no direct interface either with the practice unit or the Board. Further the person chosen for assisting the reviewer shall be from the firm of the reviewer and should have been working with him for at least one year as a member in practice.

21.6.2 *Confidentiality* - Strict confidentiality provisions shall apply to all those involved in the peer review process, namely, reviewers, members of the Board, the Council, or any person who assists any of these parties.

Those persons subject to the secrecy provision:

(1) Shall at all times after his/ their appointment preserve and aid in preserving secrecy with regard to any matter coming to his/ their knowledge in the performance or in assisting in the performance of any function, directly or indirectly related to the process and conduct of peer reviews;

(2) Shall not at any time communicate any such matter to any other person; and

(3) Shall not at any time permit any other person to have any access to any record, document or any other material in any form which is in his/their possession or under his/their control by virtue of his/their being or having been so appointed or his/their having performed or having assisted any other person in the performance of such a function.

Non-compliance with the secrecy provisions in the above clause shall amount to professional misconduct as defined under Section 22 of the Chartered Accountants Act, 1949.

A statement of confidentiality shall be filled in by the persons who are responsible for the conduct of peer review i.e., reviewers, the members of the Board and others who assist them.

21.6.3 *Approach of the Reviewer* - Briefly, the stepwise approach which may be adopted by the reviewer is discussed in the following paragraphs:

(a) The reviewer should gain an understanding of the engagement letter since an attestation engagement or for that matter any other kind of engagement should begin with an engagement letter. Engagement letter is an important document as it defines the nature and scope of the attestation engagement, practice unit's responsibilities with regard to the engagement. This understanding would help him in planning the review of documentation. The reviewer should focus the review primarily on the key engagement matters. The reviewer should also consider the materiality of the matter while planning the review.

(b) The number of attestation engagements to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the questionnaire and the size of the practice unit. The objective is to obtain a reasonable cross-section of the practice unit's clients although greater weight may be given to large clients.

(c) The practice unit may have policies and procedures for accepting a particular engagement. These policies and procedures may not exist in the form of records in each practice unit. In such a case the reviewer should consider enquiring from the concerned persons about such policies and procedures. The reviewer should, wherever possible, examine that the policies and procedures for acceptance of audit have been complied with and necessary documentation with regard to the same exists.

(d) The reviewer may follow a combination of compliance procedures and substantive procedures throughout the peer review process. The mix of compliance and substantive procedures depends upon the professional judgement of the reviewer. The reviewer may consider the following:

- In carrying out the compliance tests, the reviewer may evaluate whether the policies and procedures of the practice unit are sufficient to ensure compliance of technical standards and whether these policies and procedures are adequately communicated to all staff who are involved in carrying out the attestation work.
- In performing substantive tests, the reviewer should evaluate whether the practice unit's working papers relating to the client adequately document the findings and conclusions and whether the report of practice unit is in consonance with the findings and conclusions drawn.

(e) Finally, the reviewer while evaluating records may consider the following:

- determine that any significant issues, matters, problems that arose during the course of the engagement have been appropriately considered, resolved and documented;

- determine that adequate audit evidence or other relevant evidence in relation to the engagement is obtained to support the reasonableness of the conclusions drawn; and
- determine that significant decisions relating to the engagement, use of professional judgement, resolution of significant matters have been properly documented.

21.6.4 *Inherent Limitations of Review* - The reviewer conducts the review in accordance with the Statement on Peer Review. The review would not necessarily disclose all weaknesses in compliance of technical standards and maintenance of quality of attestation services since it would be based on selective tests. As there are inherent limitations in the effectiveness of any system of quality control which happens to be subject-matter of review, departure from the system may occur and may not be detected.

21.7 Review Procedures

A reviewer, based on the information and explanation obtained during the course of review, has to assess the evidence obtained and formulate his opinion on the compliance with technical standards and the internal controls within the practice unit that contribute towards maintenance of the quality of reporting. This chapter outlines the procedures that may be adopted by the reviewer in achieving the very object of the review. The word "should" used in this Chapter could be read as "would" also, wherever the context so requires.

21.7.1 *Off-Site Procedures* - The reviewer would start his review procedures as soon as response of the practice unit to the questionnaire is received. The reviewer should examine the response given by the practice unit. This examination is done with a view, among other things:

- to determine initial sample of the clients to whom attestation services have been rendered; and
- to obtain basic understanding of the broad framework of quality control policies and procedures under which the practice unit operates.

The above examination would provide the reviewer with the knowledge about the practice unit, which would ultimately help the reviewer in developing an appropriate plan for the review. Accordingly, the reviewer would be able to conduct the review in an effective, efficient and timely manner.

The reviewer may also, based on his evaluation of the responses given in the questionnaire, frame further questions to seek replies from the practice unit or determine the additional information that may be required for the review. The reviewer would also determine the relevant records/ documentation that may be required to be examined during the course of the review.

While conducting off-site reviews, the reviewer would select an initial sample from the complete list of attestation services. This initial assessment of selection of sample may either be further reduced or increased at the execution stage in consultation with the practice unit.

21.7.2 *On-Site Procedures* - The on-site procedures would begin with the initial meeting with the practice unit. The Statement makes it abundantly clear that a reviewer must fix the date(s) for on-site review in consultation with the practice unit. While flexibility is built-in in this process, the reviewer must fix-up the date by mutual consent so that he can conduct the review within specified time.

The primary purpose of the initial meeting with the practice unit is to determine the accuracy of the responses given in the questionnaire and seek additional information in respect of those questions which fail to explain all relevant procedures. For example, the reviewer, in order to verify the accuracy of particulars filled in Part A of the questionnaire (Profile of the Practice Unit) examines the file containing the particulars. Similarly, the practice unit may have written policies and procedures which may corroborate the responses given in the questionnaire. It may, however, be noted that absence of such written policies and procedures does not necessarily mean that the policies and procedures followed by the practice unit are not adequate for maintaining the quality of service being rendered. The reviewer should obtain sufficient appropriate evidence to ensure that the responses to the questions are accurate. The manner of obtaining the evidence is discussed later in this chapter.

Based on the above procedures, i.e., initial examination of the responses given in the questionnaire, additional information sought by the reviewer on inspection of internal manuals, if any, in case of large practice units, responses to further questions posed by him and after establishing the accuracy of the responses, the reviewer should be able to have a thorough understanding of the policies and procedures followed by the practice unit.

Once the reviewer identifies the policies and procedures followed by the practice unit, the reviewer's next task is to perform compliance testing or compliance review. The primary purpose of the compliance review is to make an evaluation and identification of those control procedures on which it might be efficient to rely upon. Then the reviewer applies substantive procedures.

The reviewer should obtain sufficient appropriate review evidence through the performance of compliance and substantive review procedures to enable him to draw reasonable conclusion that the policies and procedures adopted by the practice unit under review have been designed to carry out professional attestation service engagements in a manner that ensure compliance with the technical standards as defined in paragraph 3.7 of the Statement on Peer Review.

The reviewer obtains sufficient appropriate review evidence by applying one or more of the following methods:

- Inspection;
- Observation; and
- Inquiry;

Inspection mainly consists of examination of documentation (working papers) and other records maintained by the practice unit.

Observation consists of witnessing a procedure or process being performed by others. For example, while conducting on-site review, the reviewer may review the performance of internal control.

Inquiry consists of seeking appropriate information from the partner (designated by the practice unit for the purpose)/sole proprietor or other knowledgeable persons within the practice unit. The

inquiries may originate from the responses to the questions given in the questionnaire. The inquiries may also arise from the inspection of documentation maintained by the practice unit.

While observation and inquiry may be considered as external independent sources of review evidence, inspection remains the most significant method for confirming the effective observance of control procedures in the practice unit. Observation and inquiry may also corroborate the evidence provided by inspection. The reviewer, in order to carry out the review effectively, should have an understanding of the documentation maintained by the practice unit.

21.7.3 *Compliance Review Procedures* - It is the first stage of applying review procedures to ascertain whether the practice unit has been observing the systems as contemplated by it in the questionnaire. The Statement requires the reviewer to consider the 'general controls' which comprise of five controls, viz., Independence, Maintenance of Professional Skills and Standards, Outside Consultation, Staff Supervision and Development and Office Administration. The Statement makes it imperative that all practice units are expected to address each of the five key control areas. However, the reviewer shall have regard to the size of the practice unit while evaluating such controls. It also envisages that the reviewer may have certain supplementary questions to consider and evaluate whether such controls are installed and are operational within the practice unit. A checklist which is illustrative in nature for the guidance of reviewers in respect of each five general controls is given hereunder:

A. *Independence* -

- Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy?
- Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff?
- Does the practice unit monitor compliance with policies and procedures relating to independence?
- Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?

B. *Professional Skills and Standards*-

- Does the practice unit have an established plan for personnel needs at all levels, based on current and anticipated clientele, business growth, impending retirements, etc.?
- Does the practice unit have an established recruitment policy?
- Are applicants and new personnel informed of the personnel policies and procedures relevant to them?
- Does the practice unit have continuing education programmes for partners and staff?
- How easily are current and relevant professional literature, including accounting and auditing standards and pronouncements by professional bodies, available to partners and staff?

- Does the practice unit conduct programmes for developing expertise in specialised areas and industries?

C. *Outside Consultation* -

- Is there any policy for consulting experts (both internal and external)?
- Has the practice unit built up a network of other accountants, solicitors and advocates, and technical consultants in industries in which its clients operate?

D. *Staff Supervision and Development* -

- Does the practice unit have written guidelines on the responsibility at each level, and on the expected performance and qualifications necessary for advancement to the next level?
- Does the practice unit have a system for gathering and evaluating information on the performance of personnel?
- Does the practice unit have a system of periodically counselling personnel on performance and career opportunities?
- Does the practice unit have a system of assigning an audit to the most appropriate personnel? Are requirements of specialised expertise and personnel skills given due consideration?
- Does the practice unit have written guidelines for maintaining working papers (form and content)?
- Does the practice unit have standardised forms, checklists, and questionnaires to assist in the conduct of audit?

E. *Office Administration* -

- Does the practice unit have established procedures for record retention, including security aspects?
- Does the practice unit maintain a record containing particulars such as client name, nature of engagement, particulars regarding date of commencement of audit, date of audit report, billing, etc?
- Does the practice unit maintain staffs register?
- Does the office have a proper library containing relevant books and all publications of Institute of Chartered Accountants of India?

Evaluation of general controls by the reviewer would help him in determining the appropriate selection of sample. It is expected that the reviewer shall aim to draw a sample comprising of clients of varying size representing cross-section of the industry so that it reflects the overall performance of a practice unit.

21.7.4 *Review of Records - Compliance/Substantive Review Procedures* - After evaluating general controls by performing compliance procedures, the Statement envisages that a reviewer should actually review the records of the practice unit. Such review may either be

conducted by compliance approach or substantive approach or a combination of both. At the first stage, the records in respect of following key controls are to be reviewed to ensure compliance with technical standards:

- Audit Record Administration
- Financial Statements Presentation
- Review and Evaluation of System of Internal controls
- Substantive Tests
- Audit Conclusion
- Audit Report

The above key controls required to be evaluated by the reviewer actually represent the logical sequence in which an audit ought to have been conducted by the reviewer. At this stage, as far as reviewer is concerned, the documentation aspect shall be of critical importance. Accordingly, the Statement makes it amply clear that "members in smaller practices may find some of the documentation too elaborate for most of their clients and so should tailor their attestation services documentation to suit their particular circumstances with justification for doing so provided to the reviewer". Reviewers are expected to take note of this while reviewing records of smaller-sized practice units.

21.7.5 *Illustrative Checklist of Audit Programme of a Reviewee* - A checklist which illustrates the contents of the audit programme of a reviewee for the guidance of the reviewer for the peer review process is given hereunder:

- Appointment and the relevant resolution about the appointment.
- Terms of the engagement including reports required and manner of determining audit fees.
- System of book-keeping and the list of the books of accounts maintained by the entity.
- Particulars of the promoters, directors and their powers.
- Names of persons who write the books of accounts and other authorised officers.
- Memorandum and Articles of Association, Partnership Deed as applicable.

  Details of business of client and its accounting systems by reviewing and assessing information on:

- nature of business of the entity; and
- the internal control system including owner/manager controls.
- Profit and loss account, balance sheet, auditor's and directors' reports of the previous year and the reports of internal auditor.

  Analytical review procedures in order to:

- identify areas of accounts which are important because of their size;
- highlight unusual or unexpected figures or relationships in the accounts;
- design audit test which concentrates on important and unusual items; and

- obtain sufficient audit assurance to allow the reduction or even elimination of detailed testing in some areas.
- Assessment of audit risk by using the professional judgement and audit procedures to ensure that it is reduced to an acceptably low level.
- Preliminary estimates of materiality for the audit as a whole.
- Class of accounting transactions which are relevant and to decide the type of testing and samples.
- Selection of representative samples.
- Compliance tests to evaluate the reliability of key controls.
- Material weaknesses in the operation of key controls to management.
- Performance of analytical review procedures, substantive tests of detail to obtain sufficient, relevant and reliable audit evidence for each audit objective.
- Fundamental accounting assumptions i.e., consistency, going concern and accrual basis of accounting are followed by the client in the preparation and presentation of financial statements.
- Any change in an accounting policy which has a material effect have been disclosed.
- Audit report is received from all the Branch Auditors and any reservation made by the branch auditor is appropriately dealt with in the finalisation of Head Office accounts by the Firm.
- Working papers contain all audit evidence, and are cross-referenced.
- Summary of work done, problems, important judgements and audit conclusions.
- Review by senior incharge of work of all assistants, audit programme followed and work performed as per time schedule.
- Permanent file updated throughout the audit.
- Review of unadjusted errors to determine whether individual and aggregate effect is material.
- Compliance with Companies Act, 1956 and other relevant statutory requirements.
- Compliance of all mandatory Accounting Standards issued by the Institute.
- Post balance sheet events.
- Formulation of draft audit opinion.
- Comparison of budgeted time to actual and reasons for major variations.
- Complete staff evaluation forms.
- Planning of next year's audit and including it in the permanent audit file.

Submission of the Final Report along with the Annexure in the prescribed format by the reviewer to the Peer Review Board.

Finally, the reviewer may decide to employ substantive procedure only in case he is unable to place reliance in specific control procedures. The application of substantive review procedures

would involve inspection of working papers of the attestation engagement and necessary compliance of the Technical Standards issued by the ICAI.

21.7.6 *Compliance with Technical Standards* - The Statement identifies the following components to be part of technical standards:

- Accounting Standards issued by the Institute of Chartered Accountants of India;
- Auditing and Assurance Standards issued by the Institute of Chartered Accountants of India;
- Framework for the Preparation and Presentation of Financial Statement and Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services issued by the Institute of Chartered Accountants of India;
- Statements issued by the Institute of Chartered Accountants of India;
- Guidance Notes issued by the Institute of Chartered Accountants of India;
- Notification/Directions issued by the Institute of Chartered Accountants of India; and
- Compliance of the provisions of the various relevant Statutes and/or Regulations which are applicable in the context of the specific engagement being reviewed.

A complete list of Statements, Guidance Notes, notifications/ directions issued by the Institute of Chartered Accountant of India is given as Annexure to this chapter.

21.7.7 *Quality of Reporting* - The reviewer should verify whether the practice unit has policies and procedures to provide reasonable assurance that the reports issued are supported by conclusions reached at each stage of audit and are adequately referenced. The quality of report encompasses, apart from what is stated in the preceding sentence, the form and contents of the report also. This section aims at providing some procedures that should be followed by the reviewer to verify that the reporting done by the practice unit is of desired quality.

The reviewer should determine the level of supervision of the engagement under review. In determining the level(s) of supervision required for a particular engagement, the reviewer should examine the following:

- Complexity of the subject matter;
- Qualifications of persons performing the work;
- Extent of consultation available and used;
- Degree of authority delegated to assistants on an engagement;
- Performance of personnel assigned to an engagement; and
- Risk inherent in the engagement.

The working papers of the practice unit must contain adequate evidence to support the audit opinion including full information on work carried out by other auditors. This will normally include copies of the audit programme, particulars of audit tests carried out, copies of the principle working papers and a letter of representation or copy, if addressed to the other auditors. The reviewer should examine the working papers from this angle also.

When preparing the auditor's report, the practice unit should comply with the reporting standards prescribed under the Companies Act, 1956 or other applicable laws, Auditing and Assurance Standards, Statement on Qualifications in Auditor's Report and other relevant reporting guidance issued by the Institute.

The auditor's report should contain a clear written expression of opinion on the financial information and if the form or content of the report is laid down or prescribed under any agreement or statute or regulation, the audit report should comply with such requirement.

The following specific circumstances should be referred to in the report issued by a practice unit:

- The scope of the auditor's examination is affected by conditions that preclude the application of one or more auditing procedures considered necessary in the circumstances.
- The financial statements are affected by a departure from acceptable accounting principle.
- Inadequate disclosure in the financial statements of a material nature.
- The financial statements are affected by material uncertainties concerning future events, the outcome of which is not reasonably determinable at the date of the auditor's report.
- The auditor wishes to emphasize a matter regarding the financial statements.

The auditor's report includes the following basic elements, ordinarily in the following layout:

(a) Title: The auditor's report should have an appropriate title.

(b) Addressee: The auditor's report should be appropriately addressed as required by the engagement and regulations, if any.

(c) Opening or Introductory Paragraph:

  (i) The auditor's report should identify the financial statements of the entity that have been audited, including the date of and period covered by the financial statements.

  (ii) The report should include a statement that the financial statements are the responsibility of the entity's management and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.

(d) Scope paragraph:

  (i) The auditor's report should describe the scope of the audit by stating that the audit was conducted in accordance with SAs issued by the Institute.

  (ii) The report should include a statement that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

  (iii) The auditor's report should describe the audit as to include the examination of evidence on test basis, assessing the accounting principles used, assessing the significant estimates made by the management and evaluating the overall financial statement presentation.

(iv) The report should also include a statement by the auditor that the audit provides a reasonable basis for the opinion.

(e) Opinion Paragraph: The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements and state the auditor's opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework and, where appropriate, whether the financial statements comply with statutory requirements.

(f) Date of Report: The auditor should date the report on which the auditor signs the report expressing an opinion on financial statement.

An unqualified opinion indicates the auditor's satisfaction in all material respects with the following matters or as may be laid down or prescribed under the relevant agreement or statute or regulation, as the case may be:

- The financial information has been prepared using acceptable accounting policies, which have been consistently applied;
- The financial information complies with relevant regulations and statutory requirements; and
- There is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

When a qualified opinion, adverse opinion or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons there for. The reviewer should, particularly, ascertain that principles relating to manner of qualifying the audit report as laid down in the Statement on Qualifications in Auditor's Report and other relevant pronouncements of the Institute have been complied.

21.7.8 *Office Systems and Procedures* - The reviewer should focus on it that an assistant is wasting time on non-essentials. Again, a senior may lose control by failing to compare the schedule with the complete item of work. In the olden days, such lapses would be covered up by night work but nowadays client's staffs are generally not too happy to keep the office open at nights to accommodate the auditors.

Staffing: The requirement of proper staff is a critical component of the practice unit. In this context, the following may be noted:

- The practice unit should have laid down qualifications deemed necessary for various levels of responsibility. This is to ensure that the firm is staffed by personnel who have attained and maintain the Technical Standards and professional competence required, to enable them to fulfil their responsibilities with due care.
- There should be introductory procedures for the new employees like orientation programme, discussion of office procedures, etc.
- The performance of each staff should be evaluated and communicated to the staff on periodical basis and should be filed in the staff file.

Professional development of staff: All big or medium size practice units or progressive small practice units should have the system of continuous professional development of its staff:

- Laid down policies and procedures of the practice unit relating to independence and the system to communicate them to the staff at the time of joining and subsequently on periodic basis.
- In-house mechanism for continuous professional development education.
- Provide access to libraries and other authoritative sources to its staff; provide copies of Technical material issued by the Institute, from time to time, thereby ensuring that they are aware of changes taking place in Accounting and Auditing and Assurance Standards.
- Designating the expert/experienced individuals as available for consultation and their area of expertise.

21.7.9 *Training and Office Administration* - The training programme of the articled/audit clerk is a significant component to ensure the availability of a proper manpower. The objectives of such training programme implementation of these systems and procedures during the course of review. The reviewer may, however, note that applicability of these may vary with the size and level of practice unit.

Practice Unit's policies may include -

- The implementation of quality control policies and procedures by the practice unit, designed to ensure that all audits are conducted in accordance with Auditing and Assurance Standards.
- The practice unit's general quality control policies and procedures communicated to its personnel in a manner that provides reasonable assurance that the policies and procedures are understood and implemented.
- The implementation of those quality control procedures which are, in the context of the policies and procedures of the firm, appropriate to the individual audit.

Office procedures include -

- The organisation of the field work of audit and delegation of the work to assistants in a manner that provides reasonable assurance that the work would be performed with due care by the person having the degree of professional competence required in the circumstances.
- The auditor while performing supervisory responsibilities should consider the professional competence of assistants performing work delegated to them when deciding the extent of direction, supervision and review, appropriate for each assistant.
- Assistants to whom work is delegated should be given appropriate directions. Direction involves informing assistants of their responsibilities and the objectives of the procedures they are to perform.
- The audit programme is an important tool for communication of audit directions.

- The partner should monitor the progress of audit to consider whether the assistants have necessary skill and competence, they understand the audit directions and the work is carried out in accordance with the overall audit plan and audit programme.
- The work performed by each assistant should be reviewed by personnel of at least equal competence.

21.7.10 *Time Budget* - Time is of vital importance in all audit work. The partner must control it firmly, as assistants are generally liable to take up more time than originally scheduled. Many precious man-hours are lost if a busily occupied senior staff member fails to note that include:

- Acquisition of adequate theoretical knowledge.
- Developing skills in applying theoretical knowledge to practical situations.
- Inculcating a disciplined attitude.
- Imbibing due professional orientation.
- Developing ethical values.

While designing the training programme of articled/audit clerks, the practice unit should consider the following elements:

- Assigning progressive work experience commensurate with the expanding abilities of the trainees.
- Designing a study plan to ensure that trainees are fully prepared to take examinations at the earliest opportunity for which they are eligible.
- Ensuring that work experience is preceded and backed by practical instructions, including briefing before each assignment to ensure that the application of practical techniques to the circumstances of individual clients is properly understood.
- Ensuring in-house theoretical training is integrated with practical work experience.
- Assigning higher levels of technical and supervisory responsibility and client contact designed to ensure that personal and managerial skills are developed.
- Ensuring that professional attitude and an understanding of professional ethics are developed.

21.7.11 *Audit working papers* - The working papers are the property of the auditor and the auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirement of record retention.

21.7.12 *Filing of working papers* - The working papers should be properly filed in order to ensure that they are easily retrievable. In case of recurring audits, some working paper files may be classified as permanent audit files and the current file. To the extent possible the records related to permanent files should be kept in bound manner, duly numbered. Attention is invited to SA-230 on "Audit Documentation" in this context.

21.8 Developments in the Field of Peer Review

Recently the American Institute of certified Public Accountants (AICPA) has constituted a task Force which has recommended the following to enhance transparency and effectiveness of the Peer Review:

1. Peer review reports should be as concise as possible and written in "plain English." The "grading" terminology should be simplified and the report should be a stand-alone document that discloses the significant matters affecting the type of report issued.
2. The current peer review administrative oversight processes should be made more transparent by communicating the objectives, procedures, and results of oversight to the public through annual, and in certain cases biannual, reports issued by the AICPA and the state CPA societies that administer the program.
3. To ensure a level playing field for all practitioners, all state boards of accountancy should require peer review as a condition of licensure.
4. The AICPA should conduct a comprehensive peer reviewer recruitment campaign to attract new, quality peer reviewers and to educate firms on the benefits of having its owners and staff members involved in performing peer reviews.
5. The AICPA's Peer Review Board should continue to ensure the high quality of peer reviewers, establishing additional minimum requirements to be a peer reviewer, and consider requiring additional minimum criteria such as the number of accounting and auditing hours spent by a reviewer in his or her own firm.
6. The AICPA should provide a mechanism for members to comply with state board licensing requirements by allowing any AICPA firm to post voluntarily its peer review results in the AICPA's current public file regardless of membership in a specific AICPA section or audit quality center.

The task force recommendations resulted from a great deal of deliberation and recognition that the ultimate beneficiary of the peer review process has broadened over time, from benefiting the firm exclusively to now including the broader regulatory community and the public. The recommendations are being submitted to the Peer Review Board for consideration, analysis and possible execution. The Board decided that if the recommendations are successfully implemented, a broad based campaign to educate members and users about the significant changes would be warranted.

Forty-one state CPA societies now administer the AICPA Peer Review Program and the AICPA Peer Review Board oversees the forty-one administering bodies. Thirty-nine states require peer review as a condition of licensure; about half of which require some form of disclosure of the results. Thousands of AICPA firms currently place the results of their peer reviews in a public file as an enrollment requirement in the Center for Public Company Audit Firms peer review program or as a membership requirement of AICPA audit quality centers and the Private Companies Practice Section. In addition, thousands of firms provide their peer review results to clients to comply with governmental or regulatory requirements. Many firms take pride in the results of their peer review and use them as a marketing tool. This all contributes to the high public expectations of peer review.

[Source: AICPA Board of Directors Peer Review Task Force Report: Recommendations for Enhancing the AICPA Peer Review Programs in a Transparent Environment February 9, 2006. Also refer to Peer Review: An Era of Transparency at www. aicpa.org

AICPA Peer Review Standards & Guidance:

Standards for Performing & Reporting on Peer Reviews (effective 1/1/2005) incl. Interpretations

Additional Guidance Re: Standards effective 1/1/2005]

Self-Examination Questions

1. Explain the meaning of the term Peer Review. Do you think that the process of Peer Review will enhance the quality of audit work? Explain with a detailed reference to the objectives and scope of the Peer Review?
2. The peer review does not seek to redefine the scope and authority of the Technical Standards specified by the Council but seeks to reinforce them within the parameters prescribed by the Technical Standards – explain the statement.
3. Explain the composition of role of the Peer Review Board?
4. Explain different stages of Peer Review Process?
5. What should be the Peer Review Procedures?
6. Briefly explain the reporting requirement of the Reviewer under the "Peer Review"?
7. What is a Practice unit for the purpose of Peer Review? How is a Practice Unit selected?
8. What documents should be sent to the Practice Unit along with the intimation of selection and what should be the duty of the Practice Unit in response to initial communication?
9. Explain the process to be followed by the reviewer after initiation communications is made by the Practice Unit of the Peer Review Board?
10. How should the reviewer execute the Peer Review function?
11. Briefly explain approach to be adopted by the reviewer for the purpose of peer review?
12. Write short notes on :
    (i) Offsite Procedures of Peer Review
    (ii) On site Procedures of Peer Review
    (iii) Compliance Review Procedures.
13. Develop an illustrative check list of audit programme of a reviewee for the guidance of the reviewer under the Peer Review Process?

References

1. Statement on Peer Review, ICAI
2. Peer Review Manual, ICAI, March, 2003
3. Training Modules for Peer Reviewers, ICAI, August, 2005