

The Peer Review: An Implementation Guide For SMPs

The Rationale: Why all Practice Units (PUs)?

Peer Review, as a self-regulatory mechanism, allows the accountancy profession to reassure society and all stakeholders at large that the profession is conscious of its responsibilities and is striving to do its best in ensuring that all practising members observe the highest standards. Therefore, it is imperative that all PUs, irrespective of their form or size, be subjected to a peer review on a periodic basis for the simple reason that an association with the name of a professional accountant lends credibility to financial infor-

Public Company Audit Firms Peer Review Programme (Center PRP) and AICPA Peer Review Programme (AICPA PRP). The Center PRP, which was established on January 1, 2004 as successor to the SEC Practice Section Peer Review Programme, is a peer review programme designed to review and evaluate those portions of a firm's accounting and auditing practice that are not inspected by the Public Company Accounting Oversight Board (i.e., the non-SEC issuer practice) to ensure that such firms can meet their state licensing, federal regulatory and/or AICPA

scheme and shall be reviewed on an average of at least once in every six years, and will be selected on a combination of random, cyclical and risk-based factors.

On November 20, 2000, the Council of the Institute of Certified Public Accountants of Singapore approved the introduction of the Practice Monitoring Programme (PMP) to ensure that all practising members maintain, observe and apply an appropriate level of professional standard to their work. The PMP runs on a five year cycle which requires that practising members be monitored every five years. Similarly, the Hong Kong Institute of Certified Public Accountants has also prescribed the framework for a Practice Review Programme since 1992 to ensure that all members in public practice maintain, observe and apply the required professional standards.

The Statement on Peer Review (the Statement) issued by the ICAI, in consonance with the best global practices, also contemplates review of all PUs performing attestation services.

In recognition of the issue of acute variations amongst PUs, the ICAI's Statement classified PUs in to three different categories and prescribed the implementation of a peer review process over a staggered time period and in different proportions. Under Stage I, the peer review process has been implemented from April 1, 2003 in respect of PUs which are central stat-

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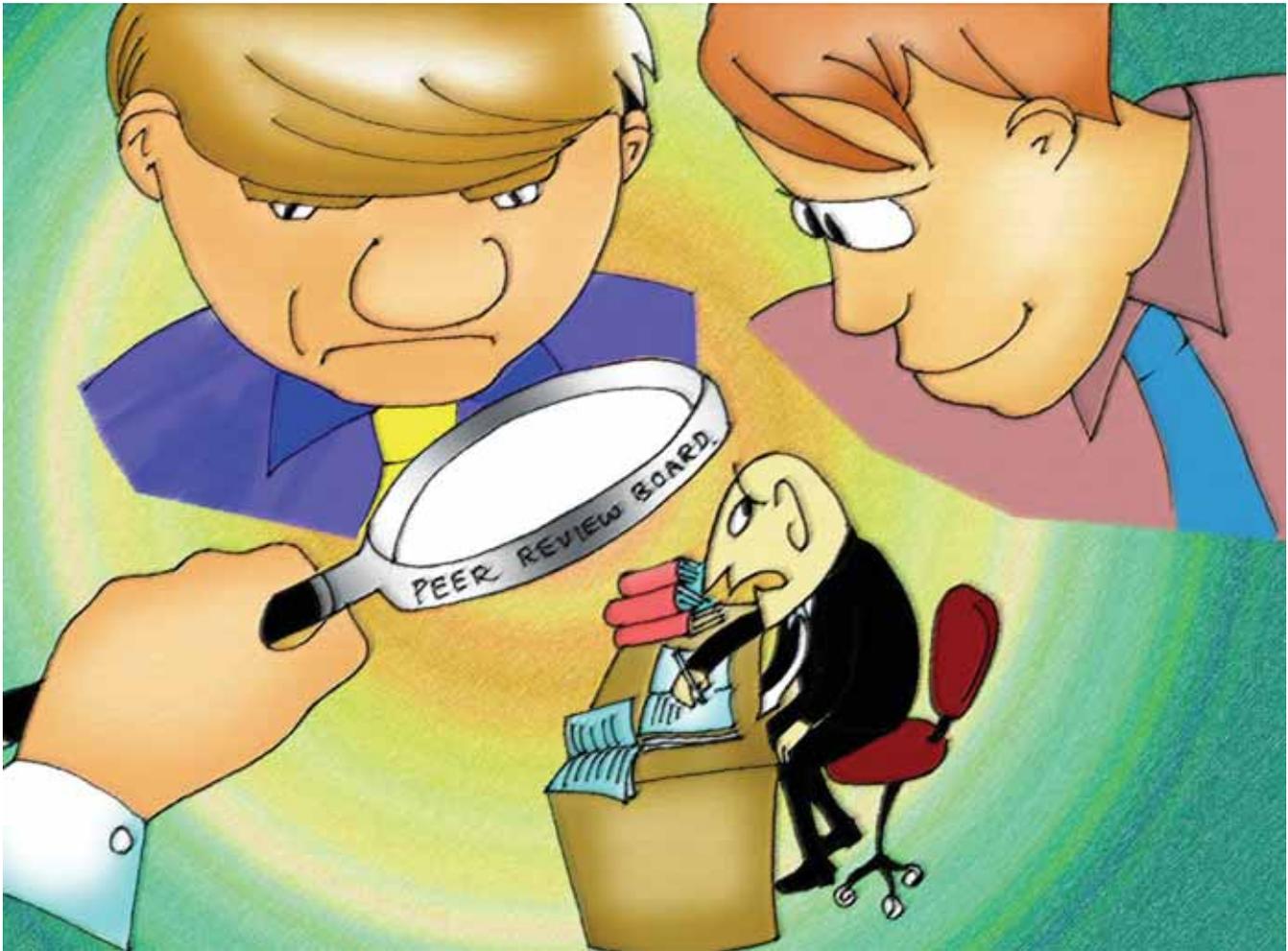
The accountancy profession in India took a giant leap forward with the establishment of the Peer Review Board in April 2002. This endeavour of the Council of the Institute of Chartered Accountants of India (ICAI) has the following aims: Maintain and enhance the quality of attestation services; guide members towards improving their performance; and ensure adherence to various technical standards issued by the Board from time to time.

mation, which in turn raises the confidence of third parties. Therefore, it is not surprising to learn that a peer review process for all PUs is a global phenomenon because world over it is felt that the work performed by a practicing chartered accountant enjoys distinct credibility amongst a cross-section of society.

In the United States, the AICPA has two approved practice monitoring programmes, viz., Centre for

membership requirements. All other firms are required to undergo a peer review under the AICPA PRP.

In the United Kingdom, members of the Institute of Chartered Accountants of England and Wales (ICAEW) voted in favour of the introduction of a compulsory practice review known as Practice Assurance (PA) on June 8, 2004. As per the scheme, all members who hold a practice certificate come within the PA



utory auditors of public sector banks, foreign banks and public financial institutions, insurance companies, etc. In view of the fact that PUs falling under Stage I are expected to have a fairly good turnover from attestation services, these are required to undergo a mandatory review once in every three years.

In respect of PUs covered under Stage II, the Statement specified that the time frame would begin from April 1, 2004. As a matter of record, about 987 PUs fall under Stage I while 16,809 PUs fall under Stage II. It may be noted that the bulk of PUs under Stage II (16,707) are branch auditors of banks. The Peer Review Board picked up 1550 PUs in Phase I of Stage II.

In selecting these PUs, the Board has been following a combination of a random, cyclical and risk-based approach. In respect of residual category of PUs falling under Stage III (around 29,000), the implementation of the peer review process would be effective from April 1, 2005. The exact number of PUs to be covered in Phase II of Stage II and Phase I of Stage III will be determined by the Board in due course.

With the progress of the peer review covering all PUs, many small and medium sized practitioners have expressed a lot of uncertainty as to the compliance and eventual benefits, if any, which would flow from this exercise. While it is almost impossible to lay down

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a standard and comprehensive approach given the issue of acute variations in size and operations, an attempt has nevertheless been made in this article to put forth in simple terms an approach that would enable SMPs to undergo this exercise successfully.

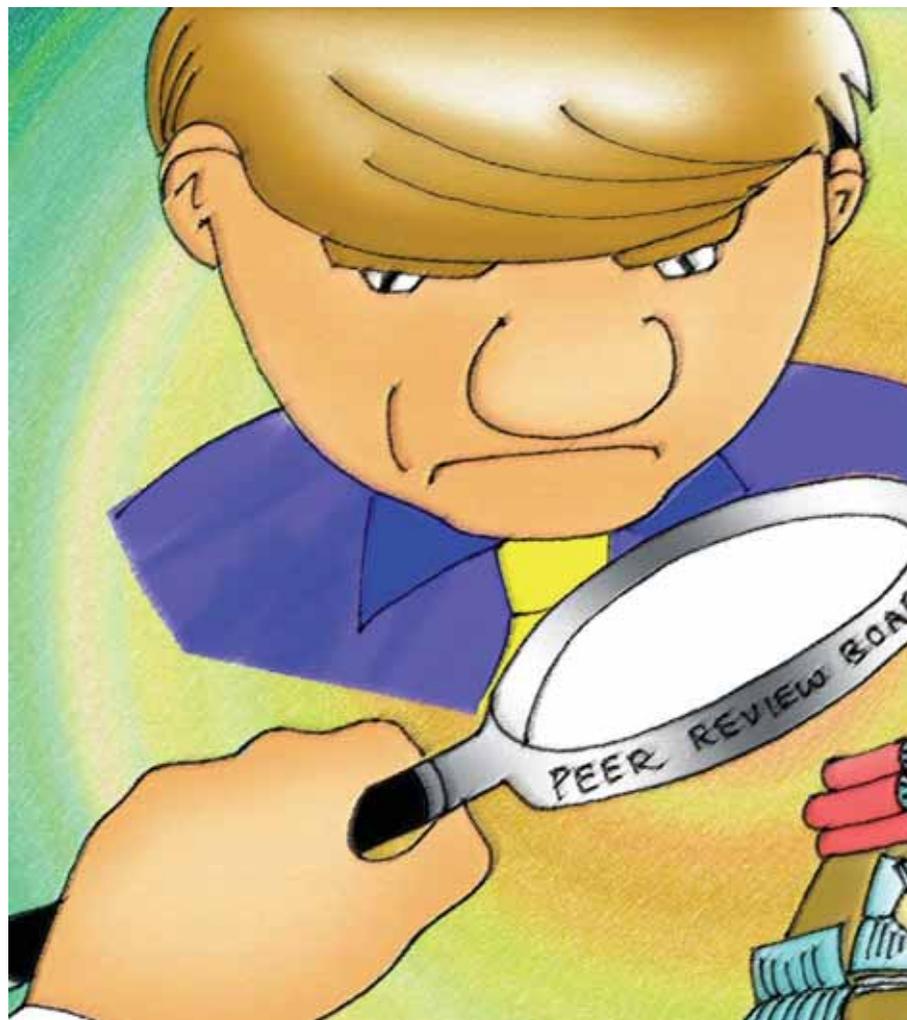
Establishing a system of Quality Control

At the outset, it must be understood clearly that the peer review process involves examination and review of the system and procedures obtaining in the practice unit to perform attestation services.

The Statement lays down two broad aspects of a quality control system, viz., “general controls” and “specific key controls”. The five general

controls are – independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration. The Statement further prescribes six specific key controls in the areas of audit record administration, financial statements presentation, review and evaluation of systems of internal control, substantive tests, audit conclusion, and audit report. The linkage between “general controls” and “specific key controls” can be visualised with reference to the fact that the “general controls” define the environment in which the PU operates while the “specific key controls” lay down the specific manner of performing an attestation engagement. It is quite interesting to note that the Statement itself clearly recognises the fact that smaller PUs may face difficulty in complying with the peer review requirements. For instance, Clause (2)(iii)(c) of Para 16.2 dealing with the five general controls states, “all questions in the questionnaire may not necessarily be relevant to particular types of PUs because of their size and culture, etc. However, PUs should still assess their internal control systems to ascertain whether they address the objectives that are laid down under the five key control areas”.

Further, Clause (2)(v)(a) of Paragraph 16.2 dealing with the six specific key controls specifies that, “PUs 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”.

Therefore, the Statement makes it clear that all PSUs, irrespective of their size and form, should establish a system for performing attestation engagements. Some of the small PUs such as, say, a sole proprietor may feel that the establishment of such a system is not required because one is able to personally supervise the actual performance of an attestation engagement. This may also be true in the case of individual/sole proprietors who operate without the services of articulated clerks or

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paid assistants. But, even such persons need to lay down some kind of policy, which ensures that they keep themselves updated with developments in accounting standards or that they maintain desired standards of independence. The following paragraphs deal with distinct elements of policy statements and procedures thereof to enable SMPs for implementing a system of quality control, as laid down by the Statement.

Implementing General Controls

The five general controls envisaged in the Statement are fundamental facts, which

should serve as the foundation for PUs performing attestation services. In the following paragraphs, an attempt has been made to lay down the action points, which may be considered by a PU while implementing general controls.

Independence

- ❖ Document the independence requirements as laid down in the Companies Act, 1956, Code of Ethics and other pronouncements of the Institute, etc. In addition, one may consider laying down requirements, which in one's opinion may affect the requirement of absolute, impartial independence. These requirements could be actions such as the non-acceptance of festival gifts and other engagements, allocating staff who are closely related to the audit client, etc.
- ❖ Ensuring that all persons in the firm are aware of the requirement of independence and what it entails.
- ❖ Designate a partner (preferably the senior most partner) for resolving any issues relating to independence.

PUs may also lay down procedures to ensure proper implementation of the Independence Policy such as periodic declarations from partners about loans taken and the details thereof; names of firms and companies in which partners have substantial interest, etc.

Professional Skills and Standards

- ❖ Document the competency profile of all partners including staff and match it with the profile of existing as well as potential clients.
- ❖ Lay down the policy to be followed in updating as well as enhancing knowledge including nature and duration thereof for partners and staff. CPE hours prescribed by ICAI may be considered as the minimum requirement.
- ❖ Provide access to libraries and other authoritative sources.

Procedures to be followed by a PU may include organising weekly in-house meetings (in case of very small sized PUs, some firms may join together to conduct such meetings), attending study-circle meetings and seminars, serv-

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ing on professional committees, etc.

In addition, to ensure that all areas of professional importance are covered, each person may be entrusted to deal with specific topics in line with their expertise. This is, particularly, important in view of the fact that in today's times, it is almost impossible for an individual to understand and acquire knowledge in a host of emerging areas. Attendance at all such programmes should also be recorded appropriately.

Outside Consultation

- ❖ Identify the names of experts in different areas who could be consulted on a regular basis.
- ❖ Maintain a list of all such persons including all contact details at one place.
- ❖ Maintain a Library Index of all books and periodicals available to the staff at a central place, apart from the chamber library of a partner.

As a matter of practice, whenever any critical issue pertaining to an attestation engagement arises, a PU must document the manner in which the same was resolved. Such documentation may include reference to ICAI pub-



lications, any other relevant literature, consultation in writing or orally with internal or external subject experts etc.

Staff Supervision and Development

- ❖ Existence of a system describing the responsibility of each person, which should be commensurate to individual qualifications.
- ❖ System of written guidelines regarding career opportunities, performance appraisals, etc.
- ❖ Policy regarding orientation of new employees, discussion of office procedures, etc.
- ❖ Availability of technical literature to staff to ensure that they are aware of changes taking place in Accounting and Auditing and Assurance Standards and other related areas.
- ❖ Designing a training and study plan for articles.

A PU should conduct periodical meetings of partners and staff to assess their potential areas of strength. Details regarding expertise, attendance of different programmes, etc. should be recorded in personal files. While allocating staff for a particular attestation engagement, due regard should be given to their competence.

Office Administration

- ❖ Maintain a register containing the list of clients, along with information about the kind of services being rendered to each client, inter alia contact details and a brief profile of the client for ready reference.
- ❖ Maintain files containing particulars of each employee, e.g., appointment letter, details of training

programmes undergone during employment, periodic evaluation of performance, etc.

- ❖ Maintenance of a proper library.
- ❖ Communicating general quality control policies and procedures to personnel in a manner that provides reasonable assurance that the policies and procedures are understood and implemented.

It may be noted that office administration in a PU is an area of crucial importance for carrying out attestation engagements. It is in the PU's own interest to maintain all records, whether relating to clients, staff or about other matters such as a library, etc., so that there are no missing links and work is carried out in a smooth manner. Office procedures so documented should also include organisation of fieldwork, supervision and monitoring the work of assistants.

The five general controls described above can be described as the pillars that support the quality of work done by a PU. Therefore, the stronger the pillar, the better the quality of attestation engagements performed by a PU.

Implementing Specific Key Controls

The Statement envisages the following six specific key controls while performing any attestation engagement:

- ❖ Audit Record Administration
- ❖ Financial Statements Presentation
- ❖ Review and Evaluation of Systems of Internal Controls
- ❖ Substantive Tests
- ❖ Audit Conclusion
- ❖ Audit Report

Procedure to be followed by a PU may include organising weekly in-house meetings (in case of very small sized PUs, some firms may join together to conduct such meetings), attending study-circle meetings and seminars, and serving on professional committees, etc.

The aforesaid key controls are nothing but the logical sequence in which an audit needs to be carried out by a PU. An illustrative checklist is given below for the guidance of PUs:

- ❖ Appointment letter and the relevant resolution of the appointment.
- ❖ Issuance of letter of terms of engagement.
- ❖ Brief description of the client.
 - Particulars of the promoters, directors and their powers
 - Memorandum and Articles of Association/Partnership Deed as applicable.
 - System of book keeping and the list of the books of accounts maintained by the entity.
 - Nature of business of the entity.
 - Internal control systems including owner/manager controls.
- ❖ Results of analytical review procedures.
- ❖ Assessment of internal control systems and determining the audit risk by using professional judgement.
- ❖ Determination of the audit approach and per-



forming relevant substantive audit procedures.

- ❖ Compliance with the Companies Act, 1956 and other relevant statutory requirements.
- ❖ Compliance of all mandatory Accounting Standards issued by the Institute.
- ❖ Formulation of draft audit opinion.
- ❖ Issuing Audit Report.

As a matter of practice, a complete list of statements, guidance notes, notifications, directions may be attached to every file and reviewed constantly to ensure compliance with relevant technical standards (Readers may refer to Annexure of Chapter 4 of the Peer Review Manual). While reviewing compliance, small-sized PUs may prefer to keep a checklist of important requirements of all Accounting and Auditing and Assurance Standards. In fact, PUs need to ensure compliance with technical standards, particularly auditing and assurance standards. Finally, it is important for each SMP to understand that time is of vital importance in all audit work. Therefore, comparison of time budget to actuals must be done after completion of each assignment. This would also assist the SMP in impressing upon the client the need for an increase in fees.

Benefits Galore

A question may arise as to the value addition of a peer review exercise. First of all, it must be recognised that there are very few firms with no room for improvement. The peer review exercise provides an incentive to put into place various practice procedures, which a PU ought to have in place, but has never found the time for. Therefore, a peer

review assessment prepares a PU for continuous self-improvement, quality control, besides serving as an inbuilt guard against complacency.

In this process, a PU builds up strong documentation, which acts as a proof that the auditor has not been professionally negligent in the performance of his duties. Documentation is the only way an auditor can prove to outsiders that an effective audit was planned and performed.

So there are many benefits to making proper and adequate documentation a routine part of practice. Even if the chances of a firm becoming engaged in legal action seem slim, the chances of surviving such action are even slimmer if there is no backup. Aside from protecting a practitioner's livelihood, documentation can also enhance a practice by serving as a client development tool or as a valued billable client service.

It is beyond doubt that while establishing systems and procedures, a PU, particularly a SMP, is likely to see the compliance cost increasing in the short-term. However, the increased cost will be an investment in assisting the PU in adhering to technical standards and

improving the overall quality of audit. In addition, a PU will also benefit through gains in its overall reputation and image. Finally, in the long-term, a peer review system will be self-rewarding since clients will realise the benefits and will, therefore, be more than willing to pay additional remuneration for the services rendered.

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Concluding Observations

Audit quality proceeds primarily from a PU's enlightened self-interest and from the concept of integrity. While each PU's specific approach regarding documentation, outside consultation, professional development, etc. depends largely on its size and organisational structure, it is envisaged that each of those elements must be present in one way or the other to ensure implementation of technical standards and that the staff and partners must understand the complexities of issues involved therein. Audit quality, in any case, is a significant factor in a PU's ability to attract and retain clients.

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