

Peer Review: Enhancing Audit Quality



The Council of the Institute of Chartered Accountants of India issued the Statement on Peer Review which lays down the framework for conduct of peer reviews by setting up of the Peer Review Board (the Board). The details of composition of the Board were earlier published in May, 2002 issue of *The Chartered Accountant*.

CONCEPT OF PEER REVIEW

- ◆ The term “peer review” involves review of work done by one person by another person of similar standing (the peer).
- ◆ Peer Review is defined as “an examination and review of the systems and procedures to determine whether they have been put in place by the practice unit (means members in practice, whether practising individually or a firm of Chartered Accountants) for ensuring the quality of attestation services as mandated by the Technical Standards.

AIM AND OBJECTIVE

- ◆ Essentially, peer review process is directed towards maintenance as well as enhancement of quality of attestation services and to provide guidance to members to improve their performance and adhere to various statutory and other regulatory requirements. The Statement on Peer Review intends to achieve, *inter alia*, the following aims and objectives:
 - To identify areas where a practising unit may require guidance in improving the quality of its performance and adherence to Technical Standards.
 - To increase the basis of reliance placed by users of financial statements for economic decision making.
 - To ensure better quality and consistency in accounting and auditing services across cross-section of auditing firms.
 - To strengthen public confidence in financial reporting and effectiveness of audit process.

COMPOSITION OF PEER REVIEW BOARD

- ◆ Peer Review Board established by the Council of the

Institute to conduct peer reviews in terms of the Statement on Peer Review.

- ◆ Consists of maximum of eleven members comprising at least six members from the Council and balance from prominent individuals of high integrity and reputation nominated from C &AG, RBI, DCA, SEBI & FICCI.
- ◆ The term of the members of the Board shall be for one year or such period as may be prescribed by the Council.
- ◆ Members of the Disciplinary Committee or the Committee on Ethical Standards and Unjustified Removal of Auditors of the Institute shall not concurrently serve on the Board. Such a provision has been made to provide much needed independence to the Board.
- ◆ Special invitees representing cross-section of the public such as judiciary, banking, insurance sector etc. on the Board with a view to providing transparency in the functioning of the Board.

SCOPE OF PEER REVIEW

- ◆ The peer review process is directed at the attestation services of a practice unit with focus on:
 - Compliance with technical standards.
 - Quality of reporting.
 - Office systems and procedures
 - Training programmes for staff concerned including appropriate infrastructure.
- ◆ Attestation engagement records pertaining to the immediately preceding three completed financial years be subjected to review.
- ◆ Records pertaining to years prior to the accounting year beginning on 1.04.2002 shall not be subjected to review.

A THREE-STAGE IMPLEMENTATION SCHEDULE

Stage I – Implementation will be initiated from 1.04.2003 in respect of practice units which are:

- Central statutory auditors of Public Sector Banks,

Foreign Banks and Public Financial Institutions;

- Central Statutory Auditors of Central and State PSUs and Central Co-operative Societies;
- Central Statutory Auditors of Insurance Companies;
- 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 etc.;
- Conducting audits or rendering attestation functions for asset management companies and mutual funds schemes.

◆ **Stage II – Implementation will be initiated from 1.04.2004 to cover practice units conducting statutory audits of:**

- Branches of Public Sector, Private Sector and Foreign Banks.
- Regional Rural Banks/Co-operative Banks.
- NBFCs based on such criteria as may be decided by the Board
- Companies having paid-up capital of Rs.5 crores or less and criteria of turnover, etc.as may be decided by the Board
- Concerns which have raised funds from the Public/FIs of over Rs. one crore and those who have shown readiness to raise such funds.

◆ Finally, during **Stage-III** phase, all other practice units will be covered from April 1, 2005.

PERIODICITY AND COST OF PEER REVIEW

- ◆ Practice units covered under Stage I shall be subjected to mandatory review once in a block of three years. However, a practice unit may request for a review even at a shorter interval.
- ◆ Practice units falling under other two stages shall be selected on random sample basis.
- ◆ Practice units not selected in any of the three stages may also apply, *suo moto*, to the Board for its peer review.
- ◆ An auditee may also request the Board for peer review of its auditor (practice unit). In such case, cost of peer review would be borne by auditee.
- ◆ Cost of peer review shall be borne by the practice unit. The Board shall decide on the manner of determina-

tion of the cost of peer reviews.

QUALIFICATIONS OF THE REVIEWER

- ◆ An individual serving as a Reviewer shall be:
 - a member of the Institute of Chartered Accountants of India,
 - possessing 15 years' or more experience of audit; and
 - currently active in the practice of accounting and auditing.

FRAMEWORK FOR CONDUCTING PEER REVIEW

The methodology for conducting peer reviews can be divided in three distinct stages, viz. Planning, Execution and Reporting.

- ◆ Planning would involve the following steps:
 - Notification in writing to practice unit by the Board alongwith a questionnaire for completion together with a panel of three suggested names of Reviewers.
 - Time period of 15 days' allowed to practice unit for selecting the Reviewer.
 - Return the completed questionnaire to Reviewer within one month of its receipt alongwith a complete list of attestation service.
 - Selection of initial sample by the Reviewer out of complete attestation services client list and informing the practice unit about two weeks in advance to keep relevant records ready.
 - Confirmation of on-site visit in consultation with practice unit in a manner so that review is conducted within four months of notification.
- ◆ Execution Stage involves different steps as under:
 - On-site review will be conducted at the practice unit's head office or other officially noted/recorded place of office within four months of notification.
 - Initial meeting between the Reviewer and a designated partner to conduct a preliminary evaluation and to confirm responses given in the questionnaire.
 - Compliance review of the general controls to select the attestation services engagements to be reviewed. Five key controls are: independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration.

(It is clear from the above that practice units are expected to address each of the five key control areas. The Statement on Peer Review also contemplates that larger practice units which have extensive documentation regarding their practice and procedures will not find it necessary to document all the controls. Thus, it is normally expected that all large practice units (at least those covered in Stage I) shall be having formal office procedure manuals and audit manuals and they shall be in a comfortable position to comply with the peer reviews' requirements. However, the Board is contemplating to provide guidance to the members in this regard by bringing out a publication which would enable the members to comply with peer review requirements.)

- Determination of number of attestation services engagements to be reviewed would depend upon factors such as number of practising members; the degree of reliance placed, if any, on general quality controls; and the total number of attestation services engagements undertaken by the practice units for the period under review.
- Following compliance approach or substantive approach or a combination of both in the review of attestation services engagement records. Compliance approach would involve assessment of control procedures in accordance with six key controls, viz, Audit Record Administration, Review and Evaluation of System of Internal controls, Financial Statements Presentation, Substantive Tests, Audit conclusion, Audit Report. Substantive approach would require a review of the attestation working papers in order to establish whether the attestation work has been carried out as per norms of Technical Standard.
- On-site review may take at least a day but in any case would not exceed seven working days.
- ◆ Reporting involves following distinct stages:
 - Communicate a *preliminary report* at the end of on-site review. Name of any individual shall not be mentioned in the report. 21 days' time allowed to practice unit to make any representation on the report.
 - Submission of final report by Reviewer to the Board in case the Reviewer is satisfied with the replies received from the practice unit. Alternatively, Reviewer may submit an *interim report* to the Board.
 - In the case of *interim report*, the Board may ask for a review after six months to verify that systems and procedures have been streamlined. In case the Reviewer is not satisfied even at a subsequent review,

he may submit report accordingly to the Board incorporating reasons. If even a follow-up review does not satisfy the Reviewer, he may submit a *final report* to the Board incorporating the reasons for dissatisfaction.

- *Final report* to be examined by the Board in terms of compliance with Technical Standards in the light of submissions of the practice unit.
- Recommendations and follow up actions, if any, by the Board
- Issuance of the Peer Review Certificate by the Board - A hallmark of excellence.

IMMUNITY AND CONFIDENTIALITY

- ◆ Practice unit shall not incur any liability under the Code of Ethics under the Chartered Accountants Act, 1949.
- ◆ Immunity clause intends to ensure that such reviews are for the purpose of enhancing quality of professional work and they have no relationship whatsoever with any disciplinary or any other regulatory mechanism. The reviews begin with the assumption that professionals work professionally and end with an enhancement of those attributes of professionalism that serve to keep the profession of chartered accountancy in India in the forefront of the accounting and auditing profession in the world.
- ◆ 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.

In sum and substance, the peer review process is an excellent tool of self-regulation with the basic objective of enhancing the audit quality.

DO YOU WISH TO KNOW MORE

This write-up is aimed at creating a general awareness amongst members of the profession and the general public at large. Members and others are requested to visit our web-site www.icaai.org for further details.

We at the Peer Review Board would love to clarify any doubts in the minds of the readers. You are welcome to send queries, clarifications, etc. on e-mail to The Chairman, Peer Review Board. We sincerely hope that such a process would enable to lay down crystal clear guidelines to make the whole peer review process an enviable. ■