

STANDARD ON QUALITY CONTROL (SQC) 1

Quality control for firms that perform audits and reviews of historical financial information, and other assurance and related services

Presented by:

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22 November 2014



Introduction

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Issued by

The Institute of Chartered Accountants of India (ICAI)

Effective Date of Applicability

1 April 2009 and is applicable to ALL FIRMS

Objective

To provide the firm with **reasonable assurance** that its **personnel** **comply** with applicable professional standards, regulatory and legal requirements in addition to the firm's policies

This is to be read with the Chartered Accountants Act, 1949, the Code of Ethics; other pronouncements of ICAI and other regulatory requirements.

Key definitions

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Engagement partner – the partner or other person in the firm, who is a **member of ICAI and is in full time practice**. He is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Engagement quality control reviewer – a partner, other person in the firm (ICAI member), suitably qualified external person or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the **significant judgments the engagement team made and the conclusions they reached in formulating the report**. However, in case the review is done by a team of individuals, such team should be headed by a member of ICAI.

Key definitions

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Suitably qualified external person – an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner or an employee (member of ICAI) of another firm.

Engagement team – all personnel performing an engagement, **including any experts contracted by the firm** in connection with that engagement.

Partner – any individual **with authority to bind the firm** with respect to the performance of a professional services engagement.

Reasonable assurance – in the context of this SQC, a high, but not absolute, level of assurance.

Elements of a System of Quality Control

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The firm's system of quality control should include policies and procedures addressing each of the following elements:

- Leadership responsibilities for quality within the firm
- Ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

Leadership Responsibilities for Quality within the Firm

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- The policies and procedures should be in place to **promote an internal culture**.
- **Firm's CEO** (or equivalent) or **firm's managing partners** (or equivalent), to assume **ultimate responsibility**:
 - Management responsibilities assigned to appropriate personnel
 - Performance evaluation, compensation and advancement
 - Allocation of appropriate resources for quality control.
- **Persons assigned** with such operational responsibilities for quality control systems by the firm's CEO/NMP, should have **sufficient and appropriate experience and ability, and the necessary authority**, to assume that responsibility.

Ethical requirements

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- The **policies and procedures** should be in place to ensure that its personnel **comply with relevant ethical requirements of ICAI** as:
 - Integrity
 - Objectivity
 - Professional competence and due care
 - Confidentiality and
 - Professional behavior.
- The firm's policies and procedures should **emphasize the fundamental principles**, which are reinforced in particular by (a) the leadership of the firm, (b) education and training, (c) monitoring, and (d) a process for dealing with non-compliance.
- **Independence** for assurance engagements is so significant that it is addressed separately in the Code.

Independence for Assurance Engagements



- The **policies and procedures should be in place** to ensure that the firm, its personnel, experts and network firm personnel **maintain independence.**
- **Such policies and procedures should enable** the firm to:
 - **Communicate** its independence requirements to its **personnel and, where applicable, to others** subject to them; and
 - **Identify and evaluate** circumstances and relationships that create **threats to independence,** and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

Independence for Assurance Engagements(Contd)



Threats To Independence

- **Self-interest Threat** – Auditing firm, partner or associate has financial interest in an audit client.
- **Self-review Threat** – Member of audit team was previously a director or senior employee of the client.
- **Advocacy Threat** – When an auditor promotes client's opinion.
- **Familiarity Threat** – Auditor forms relationships with the client and ends up being sympathetic to the interests of the clients.
- **Intimidation Threat** – Auditor is deterred from acting objectively with an adequate degree of professional skepticism.

Independence for Assurance Engagements(Contd)



Safeguards against Independence Threats

- Obtain **written confirmation, at least annually**, that compliance with policies and procedures on independence has been ensured, either in paper or electronic form.
- For the **audit of listed entities**, the engagement partner should be **rotated after a pre-defined period**, normally not more than seven years.
- Involving an **additional partner** who is not associated with the audit engagement.

Independence for Assurance Engagements(Contd)



- **Discussing independence** issues with the auditee's **audit committee**
- **Carrying out procedures** for confirming the **independence of another Firm** that performs part of the engagement
- **Withdrawing an individual** from an audit, when that individual's economic or financial interests create a **threat to independence.**
- **Withdrawal from an engagement** if safeguards to reduce threats to independence to an acceptable level **cannot be applied**

Acceptance and Continuance of Client

Relationships and Specific Engagements

- The **policies and procedures** should be in place to ensure that the firm-
 - has considered the integrity of the client;
 - is competent to perform the engagement and has the capabilities, time and resources to do so; and
 - can comply with the ethical requirements.
- The Firm should **obtain such information** as it considers necessary:
 - before accepting an engagement with a new client;
 - when deciding whether to continue an existing client relationship and/or engagement; and
 - when considering acceptance of a new engagement with an existing client.

Acceptance and Continuance of Client

Relationships and Specific Engagements (Contd.)

Policies & Procedures

- Evaluate management's integrity and consider the risk.
- Evaluate whether the engagement can be completed with professional competence
- Obtain an understanding regarding the services to be performed.
- Document how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.
- Evaluate at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.
- Establish procedures on withdrawal from an engagement.

Human Resources

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- The Firm's policies and procedures should be designed to provide it with reasonable assurance:
 - that it has sufficient personnel with capabilities, competence and commitment to ethical principles to perform its engagements
 - such personnel will carry out professional work in accordance with professional standards and regulatory and legal requirements
 - the Firm or engagement partners will issue reports which are appropriate in the circumstances.

Human Resources (Contd)

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- Policies and procedures related to human resources normally address the following personnel issues:
 - Recruitment;
 - Performance evaluation;
 - Capabilities;
 - Competence;
 - Career development;
 - Promotion;
 - Compensation; and
 - Estimation of personnel needs

Human Resources (Contd)

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- Capabilities and competence are developed through a variety of methods, including the following:
 - Professional education.
 - Continuing professional development/ training.
 - Work experience.
 - Coaching by more experienced staff
- The firm's performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles.

Assignment of Engagement Teams

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- The firm should assign responsibility for each engagement to an **engagement partner**.
- The firm should establish policies and procedures to ensure:
 - **Identification of the engagement partner** and **his/her role communicated** to key members of the client's management and those charged with governance;
 - engagement partner has the **appropriate capabilities, competence, authority and time** to perform the role; and
 - **responsibilities** of the engagement partner are **clearly defined and communicated** to that partner.

Assignment of Engagement Teams (Contd)

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- The firm should also **assign appropriate staff** with the necessary capabilities, competence and time to perform engagements:
 - in accordance with professional standards and regulatory and legal requirements, and
 - to enable the firm or engagement partners to issue reports that are appropriate in the circumstances

Engagement Performance

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Policies and procedures to be in place to ensure that engagement performance is in accordance with professional standards and regulatory and legal requirements.

Consultation

Policies and procedures in place to ensure :

- appropriate consultation takes place on difficult or contentious matters;
- sufficient resources are available to enable appropriate consultation;
- the nature and scope of such consultations are documented; and
- conclusions resulting from consultations are documented and implemented.

Engagement Performance (Contd)

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Differences of Opinion

Policies and procedures to be in place for dealing and resolving differences of opinion within the engagement team, with those consulted and between the engagement partner and the engagement quality control reviewer. Conclusions reached should be documented and implemented.

Engagement Quality Control Review

Policies and procedures in place for an engagement quality control review should:

- require quality control review for all audits of listed entities;
- set out evaluation criteria requiring quality control review; and
- require an engagement quality control review for all engagements meeting the criteria established in compliance with sub paragraph (b).

Engagement Performance (Contd)

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Criteria for the Eligibility of Engagement Quality Control Reviewers

The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:

- The technical qualifications required to perform the role, including the necessary experience and authority; and
- The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.

Engagement Performance (Contd)



Criteria for the Eligibility of Engagement Quality Control Reviewers (Contd..)

The engagement quality control reviewer:

- is not selected by the engagement partner;
- does not otherwise participate in the engagement during the period of review;
- does not make decisions for the engagement team; and
- is not subject to other considerations that would threaten the reviewer's objectivity.

Engagement Performance (Contd)

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Engagement Documentation

Completion of the Assembly of Final Engagement Files

Policies and procedures to be in place to complete the assembly of final engagement files on a timely basis after issue of reports.

Confidentiality, Safe Custody, Integrity, Accessibility and ability to Retrieve and Retain Engagement Documentation

Policies and procedures in place for the retention of engagement documentation as required by law or regulation. In the specific cases, the retention period ordinarily is no shorter than seven years from the date of the auditor's report/ the group auditor's report.

Ownership of Engagement Documentation

Unless otherwise specified by law or regulation, engagement documentation is the property of the firm.

Monitoring



Policies and procedures in place to ensure system of quality control is relevant, adequate, operating effectively and complied with in practice.

Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

- Purpose of Monitoring Control is to evaluate:
 - Adherence to professional standards and regulatory / legal requirements
 - Whether QC system has been properly designed and implemented
 - Whether QC policies and procedures have been appropriately applied to ensure that reports are appropriately issued

Complaints & Allegations

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The firm should establish policies and procedures to deal with complaint and allegations that:

- the work performed fails to comply with professional standards and regulatory and legal requirements.
- non-compliance with firm's quality control system.

Investigation of complaints and allegations should be done by:

- A partner having sufficient experience and authority in the firm and who was not involved in the engagement.
- A suitably qualified external person
- Another firm.

ISQC 1 Vs. SQC 1 ---- Additions to SQC-1



- In the definition of “engagement quality control reviewer” the “other person in the firm” with sufficient and appropriate experience and authority who can also act as quality control reviewer **has to be a member of ICAI.**
- The definition of “engagement quality control reviewer” provides that the review can be done by a team of individuals, comprising the partner, other person in the firm and/or the suitably qualified external person. Such team should be **headed by a member of ICAI.**
- In the definition of “firm” as “a sole practitioner, partnership, corporation or other entity of professional accountants” the term ‘Proprietor’ has been added to the definition of the firm.
- The minimum period of engagement documentation as five years has been extended to seven years.

ISQC 1 Vs. SQC 1- Deletions to SQC-1

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- In the definition of “firm” as “a sole practitioner, partnership, corporation or other entity of professional accountants”, the word ‘Corporation’ has been deleted.
- In the definition “suitably qualified external person” as a partner of another firm, or an employee of either a professional accountancy body, these words has been deleted.

ISQC 1 Vs. SQC 1

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- The lines, “an organisation that provides relevant quality control services can also act as a suitably qualified person” are deleted.
- The requirement that in all engagements of audit of listed companies, the engagement partner of the firm should be rotated within a period of seven years in order to avoid the familiarity threat. SQC-1 does not mandate such a provision in the audit engagements of the listed entities that are audited by the sole practitioners/proprietors. However, SQC 1 provides for peer review in such cases.
- ISQC 1 also deals with the **public sector perspective**. However all the guidance issued by the ICAI are equally applicable in all the cases so this is not specifically mentioned.

Thank you



Peer Review

Presented by:

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22 November 2014
ICAI, Bombay



Definitions



Peer review

- The term “Peer” means a person of similar standing. The term “review” means a general survey or assessment of a subject or thing. The term “Peer Review” would mean “review of work done by a professional, by another professional of similar standing”.
- Definition as per Statement on Peer Review by ICAI (Para 3.5)
 - Peer Review means an examination and review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the Technical, Professional and Ethical Standards and whether the same were consistently applied in the period under review

Definitions

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Assurance Services

Assurance Services means assurance engagements' services as specified in the “Framework For Assurance Engagements” issued by ICAI, **but does not include:**

- Management Consultancy Engagements
- Representation before various Authorities
- Engagements to prepare tax returns or advising clients in taxation matters
- Engagements for the compilation of financial statements
- Engagements solely to assist the client in preparing, compiling or collating information other than financial statements
- Testifying as an expert witness
- Providing expert opinion on points of principle, such as Accounting Standards or the applicability of certain laws, on the basis of facts provided by the client and
- Engagement for Due diligence

Definitions



Practice Unit

Practice Unit (PU)

- means a **firm of CAs** or a **member in Practice**, practicing whether in an individual name or a trade name or such other entity as recognised by the ICAI from time to time.

Need for Peer review

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- Reassuring the stake holders and the society at large that the profession is conscious of its responsibilities and strives its best to ensure that the highest standards are observed by all practicing members rendering audit and attestation services to the society.
- Peer review process is an endeavor to enhance the quality of services rendered by members of ICAI in public practice.

Objective

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To ensure that in carrying out their professional attestation services assignments, the Institute's members in practice:

- comply with the Technical Standards laid down by the Institute and
- have in place proper systems (including documentation systems) for maintaining the quality of the attestation services work they perform for their clients

Significant objective of peer review is not to find out deficiencies but to improve the quality of services rendered by the members.

The objective of peer review is not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature

Scope

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- Applicable to all the assurance services provided by a PU.
- Once a PU is selected, all assurance engagement records of the PU carried out within the peer review period shall be subjected to review.
- **The Review shall cover:**
 - Compliance with Technical, Professional and Ethical Standards
 - Quality of reporting
 - Systems and procedures for carrying assurance services
 - Training programmes for assurance staff
 - Availability of appropriate infrastructure
 - Compliance with guidelines issued by ICAI for members, eg. fees to be charged, number of audits undertaken, register for engagements
 - Compliance with guidelines issued by ICAI for article and audit assistants; e.g. attendance register, work diaries, stipend payments etc.

Peer review board

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- The board shall be constituted by the Council.
- The board consists of a maximum of twelve members to be appointed by the Council, of whom not less than 50% shall be from **amongst the members of the Council** as defined in Section 9 of the Chartered Accountants Act, 1949.
- The Council may nominate members to the Board from outside bodies and from amongst prominent individuals of high integrity and reputation, including but not limited to, regulatory authorities, bankers, academicians, economists, legal professionals and business executives.
- The term of a member shall be for one year, or such other period as may be prescribed by the Council from time to time.

Reviewer



- A Reviewer shall,
 - be a member of the Institute,
 - possess at least 10 years' audit experience; and
 - be currently active in the practice of accounting and auditing, be free from any obligation or conflict of interest in the reviewed firm or its partners or personnel.
- 10 years' audit experience need not be continuous but cumulative; but any block of less than 2 years' experience in determining cumulative experience shall not be counted.
- Reviewers must be empanelled with the Board and should have undergone the requisite training. Reviewer should have signed the Statement of Confidentiality and no disciplinary action should be pending against him.

Reviewer (Contd.)

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- The Reviewer may take help of only qualified assistants. The assistant should:
 - be a **member** of the Institute.
 - **not be disqualified** under the Chartered Accountants Act, 1949.
 - have been a **partner or employee** of the Reviewer for **at least one year** and
 - sign the **Statement of Confidentiality**.
- Finally, the Reviewer must send intimation to the Board before the commencement of the peer review. It has to be noted that such qualified assistant shall not have direct interface either with the PU or the Board.

Peer review process

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The process will include:

- Selection of Practice Unit
- Appointment of the Reviewer
- Planning
- Execution
- Reporting

Peer review process (Contd.)

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The peer review process in India has been introduced in three stages, namely, Stage I, Stage II and Stage III. Different types of PUs are included at each stage.

Periodicity of Peer Review

The Periodicity of Peer Review will be

- Stage I Practice Units – Once in 3 years.
- Stage II Practice Units – Once in 4 years
- Stage III Practice Units – Once in 5 Years

However, if the Board so decides or otherwise at the request of the Practice Unit, the Peer Review for a Practice Unit can be conducted at shorter intervals.

Practice Units

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Stage I covers those PUs which are conducting the following:

- **Central Statutory Audit** of Public Sector Banks, Private Sector Banks, Foreign Banks and Public Financial Institutions
- **Central Statutory Audit** of Central and State Public Sector Undertakings and Central Cooperative Societies having paid up capital of over Rs. 5 crore and an annual turnover of more than Rs. 50 crore.
- **Central Statutory Audit** of Insurance Companies.
- **Audit of Companies** having paid up capital of over Rs. 5 crore and an annual turnover of more than Rs. 50 crore.
- Audits or rendering attestation functions for **Asset Management Companies and Mutual Funds Schemes**.

Practice Units (Contd.)

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- Entities which have **raised funds from banks/public/financial institutions of over Rs.1 crore** at any time during the period covered by the review and satisfy such other criteria in these regards as the Board may decide, as well as concerns who have shown readiness to raise funds of the above amount or more as evidenced by their filing of prospectus.

The implementation of this stage has been commenced from **1st April, 2003.**

Practice Units (Contd.)

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Stage II covers PUs conducting statutory audit of the following:

- **Branches** of Public Sector Banks
- **Branches** of Private Sector and Foreign Banks
- **Regional** Rural Banks/Co-operative Banks
- **All NBFCs listed on the Stock Exchanges** which are not covered under stage-I
- **Companies** having paid up capital of over Rs. 2 crore and upto Rs.5 crore and having turnover above Rs. 20 crore

The implementation of this stage has commenced from **1st April, 2004.**

Practice Units (Contd.)

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Stage III covers residuary firms which are not covered in Stage I and Stage II.

The implementation of this stage has commenced from **1st April, 2005**

Selection of PU for review

- At each stage of peer review, certain PUs, satisfying the criteria laid down in the Statement, would be selected for peer review on a **random sample basis**. The Board is empowered to decide the proportion of PUs to be included in the selection during each phase of implementation.
- A PU may also, suo moto; apply to the Board for the conduct of its peer review. Further, an auditee concern may request the Board for the conduct of peer review of its auditor (PU). In such a case, cost of the peer review would be borne by the auditee concern.

Obligations of the Practice Unit

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Any PU, in addition to the prescribed information to be furnished including the questionnaire, statements and other particulars, shall

- produce to the Reviewer or allow access to, any record, document or prescribed register maintained by the PU or any other record or document which is of a class or description so specified, and which is in the possession or under the control of the PU
- provide to the Reviewer such explanation or further particulars in respect of anything produced in compliance with the requirement under sub clause (i) above, as the Reviewer shall specify
- provide to the Reviewer all assistance in connection with Peer Review;

Where any information or matter relevant to a PU is recorded otherwise than in a legible form, the PU shall provide and present to the Reviewer a reproduction of any such information or matter, or of the relevant part of it in a legible form, with a translation in English or Hindi if the matter is in any other language, and if such translation is requested for by the Reviewer.

Reporting

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Discussion / Communication of findings to PU:

- After completing the on-site review, the reviewer, before reporting to the Board, shall communicate his findings to the PU, if in his opinion, there are some deficiencies or if there are other matters where he wants to seek clarification.
- The PU shall within 15 days after that, make submissions in writing to the reviewer.

Reporting (Contd.)

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Peer Review Report of Reviewer

- If the reviewer is satisfied with the reply received from the PU, he shall submit a Peer Review Report to the Board with his initial findings, response by the PU and the manner of dealing with responses, **with a copy of the same to the PU.**
- In case the reviewer is not satisfied with PU's responses, he shall submit a modified Report to the Board, with his reasons for the same, along with his initial findings, response by the PU and the manner of dealing with responses, with a copy of the same to the PU.
- In case of a **modified report**, the Board shall order for a “Follow On” Review after a period of one year from the date of issue of report as mentioned above.
- The period of one year may be reduced (but not less than six months) at the discretion of the Board.

Reporting (Contd.)

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Peer Review Certificate

- On receipt of the Peer Review Report, the Board shall **within three months**:
 - **Issue a Peer Review Certificate to the PU**, mentioning the next due date for review or
 - Inform the PU that a Peer Review Certificate cannot be issued (along with the reasons), mentioning the next due date for conducting a follow on review.

Working Papers



- The reviewer shall document all his working papers and submit a copy of the same to the Board (if called for by the Board) within 12 months of completion of review / submission of Review Report.

Confidentiality

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- **Strict confidentiality** shall be maintained by all those involved in the Peer Review process, e.g. reviewers, members of the Board, qualified assistants or PU.
- Non-compliance with the secrecy provisions shall amount to **professional misconduct** under Section 22 of the Chartered Accountants Act, 1949.
- A **declaration of confidentiality** shall be signed by the persons who are responsible for the conduct of Peer Review and be filed with the Board.
- **All members of the Board** shall also sign a declaration in the prescribed manner.

Cost of Peer Review

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- The cost of Peer Review including the limit of out of pocket expenses shall be decided by the Board and shall be paid by the PU.
- In case of "Follow-On Review", the same rate of the original review would apply.
- The amount shall be paid by the PU within 30 days of receipt of the bills from the reviewer.

Global scenario in Peer Review

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- In the US, public accountancy firms are required to enroll professionals in an approved **Practice Monitoring Programme** in order to be **admitted to or retain membership in the AICPA** (the professional body in the US).
- Furthermore, under Sec 104 of the Sarbanes-Oxley Act, 2002 they are **additionally liable to be inspected by the PCAOB** (Public Companies Accounting Oversight Board), to **assess the degree to which each firm and its associated persons comply** with the Act, the PCAOB and SEC rules, the professional and reporting standards, etc.
- In some countries, **the findings of the peer review can lead to disciplinary proceedings** but not in India.

Thank you

