

QAB Annual Report 2018-19



नेपाल चार्टर्ड एकाउन्टेन्ट्स संस्था

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NEPAL

(Established under the Nepal Chartered Accountants Act, 1997)

Quality Assurance Board

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Message from the Quality Assurance Board

The Quality Assurance Board is pleased to present its Annual Report for the year 2018-19, the beginning year of its 3 years' term. This is the maiden report of QAB prepared after its establishment as per the requirement of Audit Quality Assurance Review Procedure, 2017.

A total of 34 audit firms performing the audit of listed entities were reviewed during this period by the Quality Assurance Unit (QAU) along with the steering and oversight of QAB. The number is just too small for now but the impact it has created is enormous as the audit market knows well that the Institute has stepped in as a watchdog and audit quality is highly emphasized. This has created both enthusiasm as well as pressure to firms to strive for better firm's system and standard audit performances leading to audit quality.

Audit quality has direct relationship with credibility of financial reporting by entities, public confidence in audit and trust in the accounting profession. As Quality Assurance System is recently established in the Institute, QAB has taken its term both as a challenge and an opportunity to institutionalize the system with international benchmarks.

Towards our journey so far, Institute of Chartered Accountants in England and Wales (ICAEW)'s technical assistance is worth mentioning as it was instrumental fueling the start-up of the QA review visits.

It is imperative for all of us to bear in mind that, QAB has still long way to go to fulfill its part of the role to promote audit quality, but is encouraged by the warm cooperation extended from practicing audit firms and their members who are the major stakeholders of the accounting profession and audit quality. Hence, the QAB would like to extend its sincere gratitude and appreciation to the practicing firms and their members for cooperating with our reviewers and QAB's initiation. We must appreciate the efforts and initiatives of the entire team of Quality Assurance Unit who actually carries out the review of audit firms that makes the Quality Assurance System functional.

Dev Bahadur Bohara

Chairperson, Quality Assurance Board

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1. Introduction

This report provides an overview of the activities carried out by the Quality Assurance Board (QAB) and the Quality Assurance Unit (QAU) of the Institute together for the year 2018-19. This report is prepared pursuant to the requirement of Clause 12 of Audit Quality Assurance Review Procedure 2017 and for general information.

The Quality Assurance activities normally constitute all activities necessary to fulfill the Institute's responsibility of audit quality monitoring of audits carried out by its member firms intended at ensuring and upholding public confidence in audit and trust in the accounting profession.

To achieve such goals and objectives, the Quality Assurance System has to cover the following points within its scope:

- Review of firm's system of quality control as required by NSQC-1 (ISQC-1) – whole firm
- Review of compliance to Nepal Standards on Auditing and Code of Ethics – selected audits
- Review of compliance to applicable laws and regulation – selected audits

2. Frameworks, regulations and policy guidelines on Quality Assurance

- The Statement of Membership Obligation (SMO-1) provides the conceptual framework for establishing and operating Quality Assurance Review Systems by its member Professional Accountancy Organizations (PAOs).
- Rule 103 of Nepal Chartered Accountant Rules 2061 prescribes the structure of QAB, and functions, duties and powers of the QAB including scope of quality assurance.
- Audit Quality Assurance Review Procedure 2017 as approved by the Council on 14 July 2017 provides guidelines for operation of the activities of the QAB.
- Quality Assurance Manual 2018 provides guidance to the quality assurance reviewers in carrying out reviews of firm's quality control systems and reviewing their audit quality for selected audit engagements.

3. Institutional Arrangements for Quality Assurance

The Council of the Institute has formed a 7 member Quality Assurance Board (QAB) to carry out or cause to carry out quality assurance activities with the three year term. The current QAB is the second one in the history after the term of the first one ended a year ago. The composition of the QAB for the year 2018-19 is as follows

S. No.	Names	Role	Remarks
1	Mr. Dev Bahadur Bohara	Chairman	Former Deputy AG at Office of Auditor General
2	CA. Kiran Dongol	Member	Council Member and a practicing Chartered Accountant
3	RA. Abdul Karim Khan	Member	Council Member and practicing Registered Auditor
4	CA. Badri Kumar Guragain	Member	Member of ICAN and CEO of a National Cooperative Bank Ltd
5	RA. Laxman Khanal	Member	Member of ICAN and Under Secretary in Financial Comptroller General's Office
6	Mr. Parishthanath Poudel	Member	Executive Director of SEBON
7	Mrs. Bindu Bista	Member	Assistant AG at Office of Auditor General

The Executive Director of the Institute, CA. Sanjay Kumar Sinha is the secretary of the QAB.

The Institute has Quality Assurance Unit (QAU) to work for and under the QAB. The unit consisted of the following staffs of the Institute to carry out quality assurance activities, however, the discussions are undergoing for recruitment of additional human resources to increase the volume of quality assurance activities and the number of reviewed firms in particular.

S. No	Particulars	Position
1	CA. Kiran Kumar Khatri	Joint Director
2	CA. Ghanashyam Kafle	Deputy Director
3	CA. Bharat Nepal	Deputy Director

A QAB Task Force, a sub-committee under the QAB, was also formed to evaluate the Quality Assurance Review Report of audit firms submitted by the Unit.

The QAB meets as required with the Council, President, Vice-President, Executive Director and other regulators through Chairman of the QAB and Unit Head to facilitate the smooth operation and usefulness of quality assurance activities.

4. Functions, Duties and Powers of the QAB

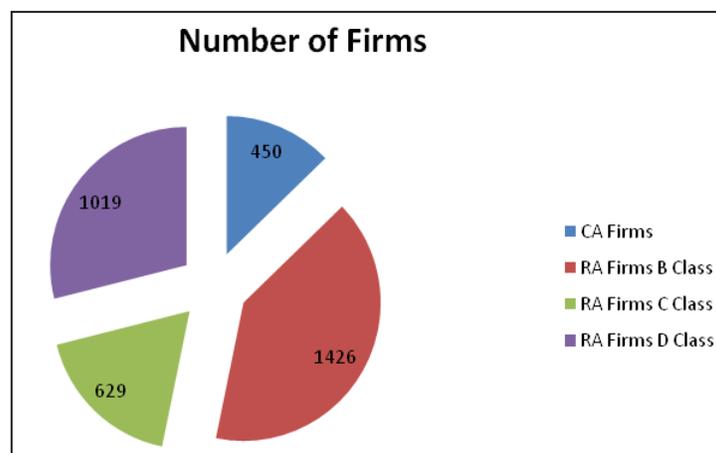
As per Rule 103(6) of the Institute of Chartered Accountants Rules, 2061, QAB is entrusted with number of functions, duties and powers, as follows:

- Prepare policy and program for Quality Assurance Review,
- Enforce and conduct reviews of Practice Unit(PU) in accordance with the approved policy and program ; and conduct its effective monitoring,
- Make aware to the PUs if improvement required to be made in any area are noted during the Quality Assurance Review and inform the Council to that effect.
- Recommend to the Council to prohibit the PU to carry out audit of any related entity or of particular sector on the basis of issues observed during QAR of PU, and
- Other functions as prescribed by Council.

The audit quality assurance review procedure 2017 builds on above broad functions and powers of QAB and provides detailed guidance for its work.

5. Current volume of Practicing Audit Firms

The numbers of audit firms based on class of firms duly renewed for the year 2018-19 are presented in chart below.

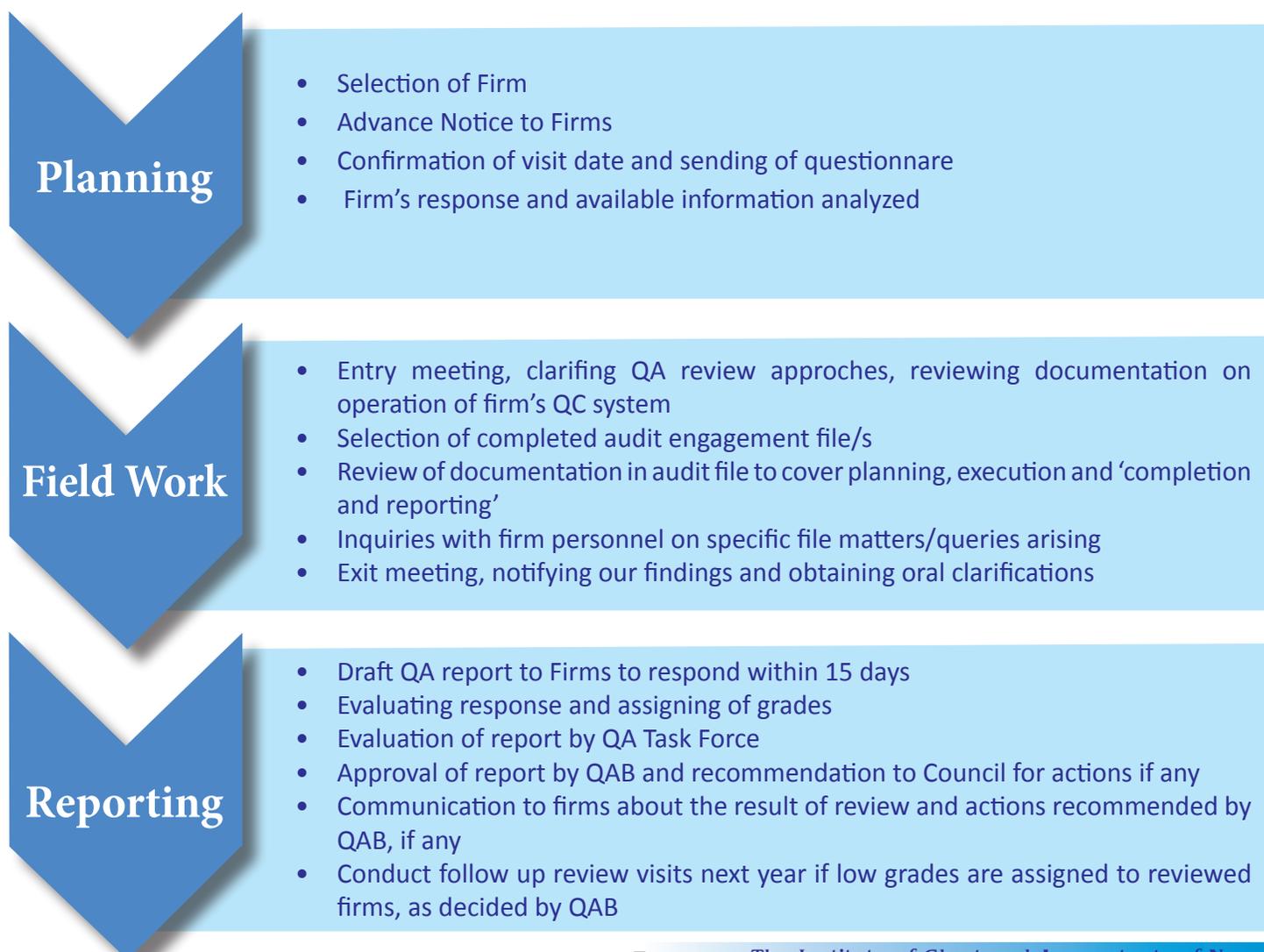


The limit of entities to be audited by an auditor of any class is set at 100 entities per auditor including maximum number of public limited companies to be 10. While the Chartered Accountant Firms of auditors can carry out audit of an entity with any volume of turnover or total assets, restrictions applies to registered auditor firms with maximum limit to volume of business of an entity being NPR 1000 million, NPR 250 million and NPR 100 million for B, C and D class of firms of Registered Auditors (RAs) respectively. Around 70 CA firms are engaged in the audit of listed and PIE clients whereas all other firms carry out audit of private sector or other than listed entities. All of the RA firms are sole practitioners and they are usually engaged to provide statutory audit and tax services to small and medium private entities and community based entities like cooperatives.

Currently, the Quality Assurance Unit is carrying on the review visit to CA firms that are involved in the audit of entities listed in Nepal Stock Exchange Limited (NEPSE) on a priority basis. Preparations are ongoing to schedule the visits to other smaller CA firms and to registered auditor firms of B class with reduced and simplified work program suitable to the nature and size of the firm and their clients. Also, the stated cycle of review visits is three years for audit firms performing the audit of listed entities whereas the 6 years cycle is proposed to be applied for the review visits to smaller CA firms and RA firms of B class. The QA unit, with permission of QAB, is empowered to carry out review visits to firms of any class at any time based upon risk information available to the QA Unit. However, the QAB is of the opinion that review visits to C and D class RA firms will only be carried out on need basis for now considering the resources and priority of review to other class of audit firms.

6. Quality Assurance Review Process

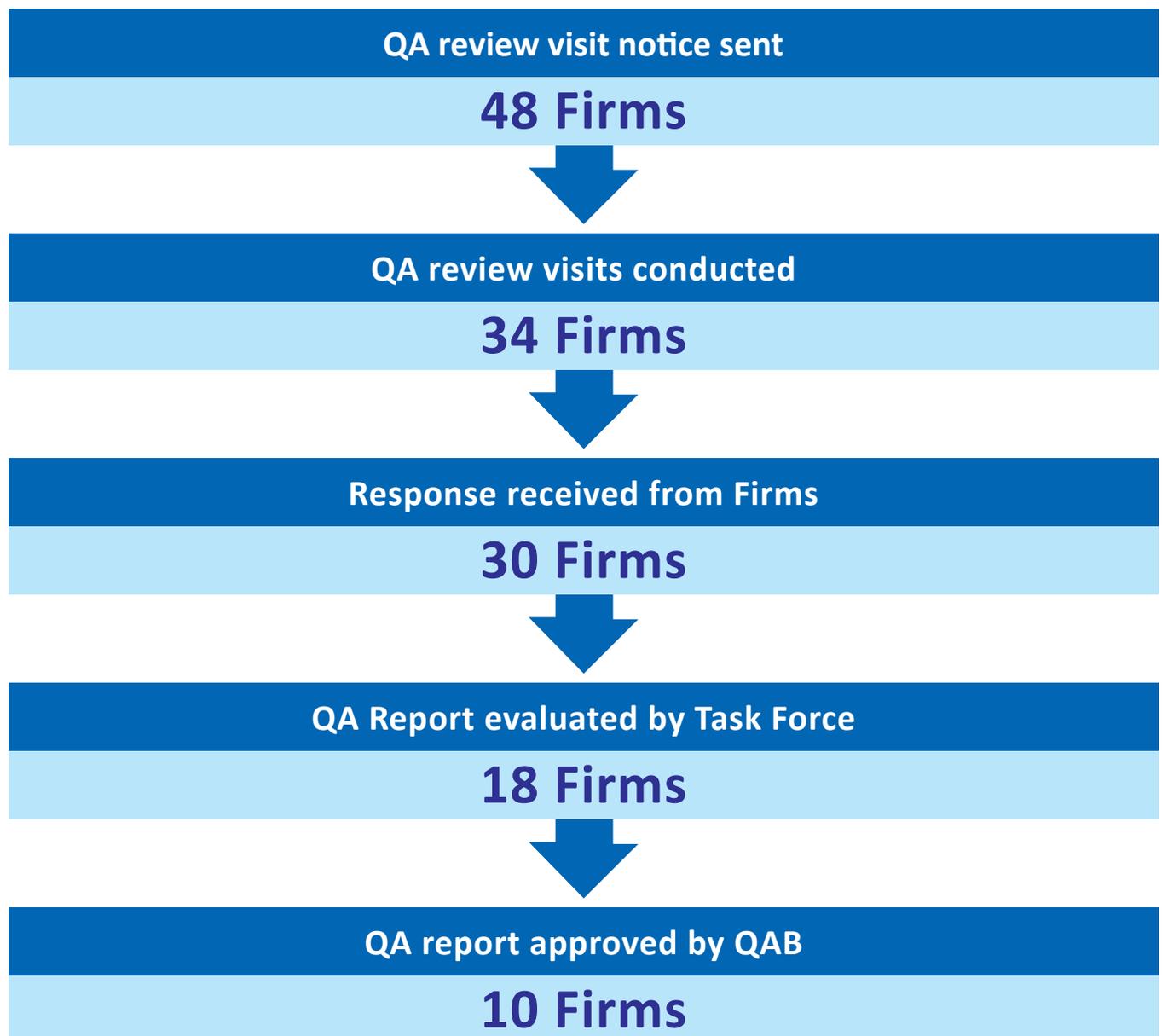
The review process is summarized in few bullet points below:



7. Progress on Quality Assurance Activities in 2018-19

7.1 Review of Audit Firms

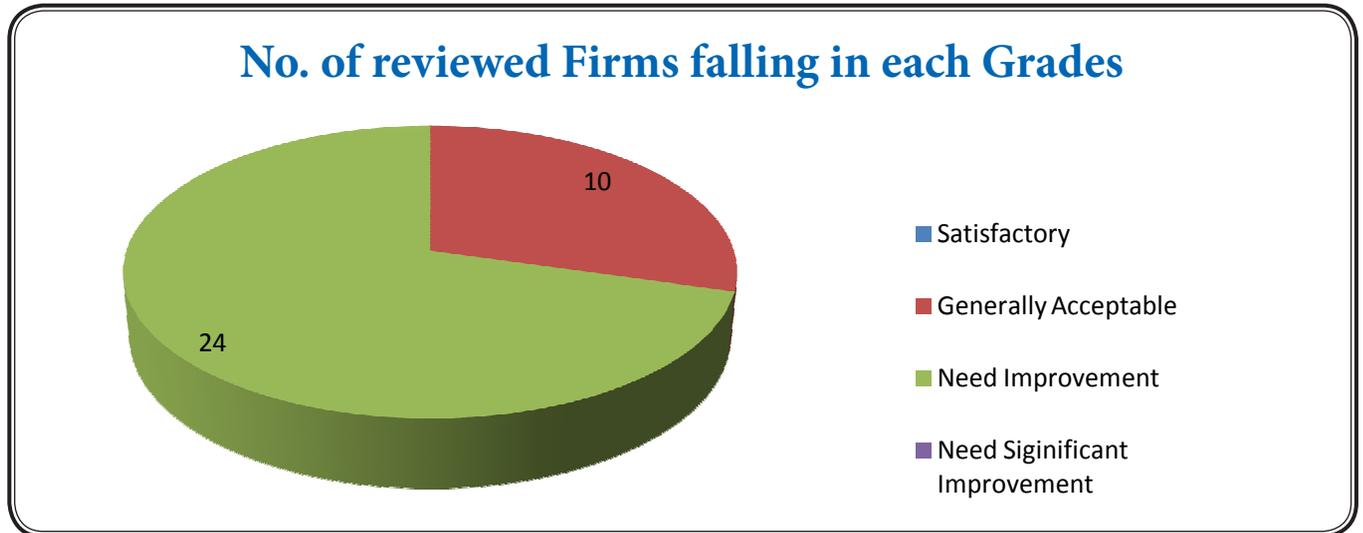
The Quality Assurance Unit has accomplished the review of 34 firms out of targeted of 65 in the year 2018-19. All the firms that were reviewed were the firms of Chartered Accountants performing the audit of listed entities for the financial year 2017-18. One or two engagement files were reviewed in each firm on sample basis depending upon the total portfolio of listed audits with the firms. The selected audit engagement comprised of audit of companies with diverse business nature such as banks and financial institution (all categories), insurance companies, manufacturing industries, hydropower companies, service sector companies, etc. The statistical progresses of reviews including finalization and closure of reviews are presented in process chart below.



The above progress is up to the year-end date of year 2018-19.

7.2 Results of Quality Assurance Reviews

All the 34 audit firms that were reviewed were assigned grades of audit quality based upon the Marking and Grading Tool approved for use by the QAB that complies with the broad categories of audit quality as prescribed in the QA manual. Though this assignment of grades by the QAU is subject to further evaluation and ratification by the QAB, a preliminary result of grading of reviewed firms is presented in pie chart below.



While few firms obtained the score to nearly make their standing to satisfactory grade, no any firm succeeded to be in the satisfactory grade. Likewise, no any reviewed firms were seriously degraded in terms of audit quality that needed immediate severe actions. 'Generally Acceptable' category of reviewed firms had some systems of quality control and procedures for audit performances with very few principal findings and some other 'further improvements required' type of findings. More of these issues were related to documentation or advanced compliance to NSAs. The 'Need Improvement' category of audit firms had lapses in the design and implementation of the quality control system along with lapses in the application of principal audit procedures or compliance to apparent requirement of NSAs along with documentation issues.

The Marking and Grading Tool is a 100 marks checklist to include 30 marks to firms system of quality control and 70 marks to engagement level performance quality (20, 30 and 20 marks respectively for planning, execution and completion of audit engagement). The firms will be graded in the following manner based upon the scores assigned to them after their review visits.

Firms obtaining Marks above 80 = Satisfactory

Firms obtaining Marks ≥ 60 and < 80 = Generally Acceptable

Firms obtaining Marks ≥ 40 and < 60 = Need Improvement

Firms obtaining Marks < 40 = Need Significant Improvement

Note: The score obtained by the firms is a measure of to what extent the requirement of all areas of firms system and audit quality has been complied with and hence the grades assigned is not an absolute measure of audit quality. Some issues capable of impacting the audit quality severely are considered additionally, whatever the grades assigned may be, to determine actions if any.

Grades are assigned to the firms such that the QA unit will be able to track the improvements made by the firms and because it contains some limitations, it is not for purpose of disclosures to the firm on an individual basis.

7.3 Other Developments and Initiatives

Apart from review visits and finalization of reports, several other activities were conducted directly related to or supportive to strengthening quality assurance review system.

Those activities are mentioned below:

- QA review system established (firm selection, file selection, working papers, QAB and Task Force meetings, report finalizations and issuance etc.) and made functional.
- Policy, Procedures and Manual on Quality Assurance operationalized.
- Structure of report evaluation and oversight of QA functions arranged.
- Simplified manual and checklists prepared for the review of small practices/RA Firms. It is under process of review and approval from QAB for implementation.
- Interaction program on QA was conducted with other regulatory authorities to include NRB, SEBON, FCGO, OAG, and IRD just before the start of this year. This program was successful to disseminate/communicate a message to the other regulators that auditors were subject to quality monitoring from ICAN and their concern over audit quality and feedback to the recently established QA system was obtained.
- Interaction program was conducted with partners of firms performing audit of listed entities just before the start of the year. This event was conducted at the starting period of review visits to firms where QA review system of the Institute was explained and their feedback and suggestions were received for further considerations.
- To further increase the level of awareness and communicate the findings of QA in general, a session was included in 3 days continued professional education (CPE) program. Many auditors participating in the CPE program benefited from the learning and updates on firm's system of quality control, audit processes and audit documentation that are the factors of audit quality.
- The Institute has signed MOU with PEFA Secretariat, MOF on 15 July 2018 for capacity building program of the Institute which also includes supports for conducting programs for strengthening QA system of the Institute.

7.4 Deliveries under a RETA 1 project for strengthening Quality Assurance

A RETA 1 project for strengthening quality assurance system of the Institute had many things to deliver in 2018-19 before its closure. The project is technically facilitated by ICAEW under a funding support of ADB. A phase 2 of this project is approved for implementation by building on the achievements of RETA 1 project. The major achievements of this project during this year were:

- A TOT on Model Audit Practice Manual was provided by Consultant to 9 local trainers who were professional accountants currently involved in practice, training and QA. A pilot training to partners of 20 audit firms was conducted in the same occasion by the local trainers in mentoring of the Consultant.
- 3 events of training with two days duration on Audit Practice Manual were arranged to CA firms where partners and representatives from over 90 audit firms participated.
- An exposure visit to ICAEW, UK was made by the QA unit Head and other senior executives of the Institute to gain an understanding on the QA system of ICAEW. Accompanying to live review visits with reviewer of ICAEW was most useful to understand the review process and firm's system and procedures in the UK.
- Model Audit Practice Manual was made available to audit firms encouraging its use in the performance of audit engagements.

7.5 Outcomes of Quality Assurance

The ultimate objective of quality assurance activities of any PAO is to ensure that audit conducted by its members meet designated standards of quality to contribute to credible financial reporting by entities and enhanced public confidence in audit. This demands an appropriate environment of regulation, facilitation and contributions by all stakeholders. Towards achieving these objectives, the QA system of the Institute has started to create the following impacts.

- Message is disseminated that Audit Quality has been started to be monitored by the regulator, and has taken its pace. All firms are becoming aware that their system, audit processes and documentation are subject to review by regulator. As a result they are forced to improve on their systems, procedures, and documentation. Firms are developing their quality control policies and organizing trainings to staffs on various topics.
- Audit Firms are positive, cooperating and committed to the review. They acknowledged that this initiative from the regulator (the Institute) will be able to create favorable environment for quality audits.
- Weaknesses in the reviewed firm's system and audit quality have been identified for the first time in the history of many firms. Peer review by firms or monitoring of the quality control system by the firms themselves was almost non-existent.
- Other interaction and awareness programs have drawn the attention of the firms not reviewed till date to improve on their system and prepare for the quality assurance review visits well in advance.
- The feedback received from the audit firms and other stakeholders including those in governance role of Institute is contributing to the process of institutionalization of QA system within the Institute.

7.6 Quality Assurance Board Meetings

The QAB has met for 4 times during the year 2018-19 to discuss and decide on several matters relating to quality assurance and allied activities. The attendance of each of the members of the QAB is presented as follows:

S. No.	Names	Designation	Meetings attended
1	Mr. Dev Bahadur Bohara	Chairperson	4
2	CA. Kiran Dongol	Member	3
3	RA. Abdul Karim Khan	Member	3
4	CA. Badri Kumar Guragain	Member	2
5	RA. Laxman Khanal	Member	2
6	Mr. Parishthanath Poudel	Member	2
7	Mrs. Bindu Bista	Member	3
8	CA. Sanjay Kumar Sinha	Secretary	4

8. Key findings noted by quality assurance reviews

All of the findings reported to firms are either related to weaknesses in firm's system of quality control or deficient level of compliance with professional standards and specific legal or regulatory requirements. When reporting to firms, these findings are further classified into principal findings and further improvement required type of findings. Presented below is the list of common findings reported, but they may be present in various degree of seriousness in any firms or may not be present in any firm. In very few firms, many of the weakness pointed out below may also be non-existent:

8.1 Key Findings at Firm Level

These are findings that represent weaknesses in the firm's system of quality control as per the requirement of NSQC-1 that include the elements like leadership responsibilities, compliance with the relevant ethical requirements, acceptance and continuance of the client relationships and specific engagements, engagement performance, human resources and monitoring.

The most common types of findings at firm level are related to:

- Development of Quality Control Policy suitable to nature and size of firm
- Informal reward system for qualitative performances
- Confirmation of compliance to independence requirements
- Documentation of a client's acceptance decision
- Provision of training to staffs in-house or through external sources
- Provision of an audit system and defined process of facilitating the audit engagement
- Monitoring by a firm of its own system and deciding on improvements to be made

8.2 Key Findings at Engagement Level

Most of the key findings identified in the engagement level are pointed out below categorizing them into planning, execution and 'completion and reporting' phases:

8.2.1. Key Findings at Planning Phase

The findings at planning phase are related to:

- Documentation of understanding of an entity including its system of control/sufficiency of information for an understanding of entity (NSA 315)
- Assessment of risk of material misstatements - significant risks, fraud risk, risk relating to revenue and planned response (NSA 315 and NSA 330)
- Determination of materiality level and its further consideration (NSA 320, NSA 530 and NSA 450)
- Preliminary Analytical reviews (NSA 315)
- Formalization of engagement team planning meeting and entry meeting with the client and its documentation (NSA 300)

8.2.2 Key Findings at Execution Phase

The findings at execution phase are related to:

- Documentation of evidence for all material financial statement items (NSA 500)
- Documentation of findings, conclusions for all area of audit/material financial statement items (NSA 230)
- Standard Audit Program and tailoring to meet specific clients
- Deficient procedures for specific NSAs like Using the work of an expert (NSA 620), Related Parties (NSA 550), Accounting estimates (NSA 550) Litigation and Claims (NSA 450), External confirmations (NSA505)
- Use of checklists for verification of requirements of laws and regulation or incorporation into audit program

8.2.3 Key Findings at Completion and Reporting Phase

The findings at completion and reporting phase are related to:

- Documentation of all likely misstatements, resolution of misstatements, and evaluation of all uncorrected misstatements for an impact in an audit opinion
- Review of adjustments, appropriation and disclosures including critical review of financial statements
- Deficient Procedures relating to specific NSAs, Subsequent Events (NSA560), Other information in documents containing audited financial statements (NSA 720), going concern (NSA 570)
- Auditor's report format and regulatory reporting requirements (NSA 700 and laws and regulation)
- Adequacy of communication with the management and documentation

9 Potential Causes behind the weakness noted in audit firms

In the light of the review findings there are many causes behind the revelation of finding that are related to firm's internal reasons and some are external factors created by the client. QAB is of the view that symptoms of individual review findings give message for improvement but the key underlying causes of review findings need to be considered by the audit firms in future audit engagements. It is worth to mention here that most of practicing firms reviewed have accepted the review findings and expressed their commitment to resolve the issues in their written response over the review report and at the time of exit meetings held with them.

The QA Unit is not in a position to determine the exact causes or reasons behind the weaknesses; it has laid down some of the common circumstances/practices which may be responsible to impact audit quality across firms. The potential causes listed below are not in itself an exhaustive list and in many cases, there may be interplay of various causes.

- In many cases, partners of the audit firms believe that most things are under their control. As a result, they are not pressured to set formal firm systems.
- Firm personnel may not be aware of 'how strict the regulator is' in respect of audit quality monitoring
- Risk Based system of auditing is not focused on by the audit firms. There is no proper guidance to staff/engagement teams to carry out audit effectively.
- Priority is on digging out findings and working on coverage of reports rather than proper sampling, audit risk mitigation, communication to management and those charged with governance, evaluation of misstatements and forming the basis of opinion.

- The auditors are lacking guidance as to be able to determine fees in line with the volume of audit work to be done. Quoting very low fees and being able to obtain audit may put pressure towards doing very little amount of work, and limited ability towards mobilization competent team.
- Poor investment in the audit system by the audit firms.
- Many firms believe many requirement of NSAs/code of ethics may not suit the circumstances or state of economy audit and audit market. They may not be able to exercise professional judgment in what few important procedures of NSAs would make even the smaller or complex audit compliant to NSA requirements.
- In many cases, audit clients and the people in governance of those clients may not be in a position to understand audit and auditor's responsibilities properly. Auditors may need to ensure proper communication is established with them eliminating all misconception related to audit.
- Many firms complain that compelling situations to agree with limited fees for the audit engagement are barrier for establishing resourceful engagement teams and invest in firm's system.
- Many firms say that they also face an unreasonable client-imposed deadline to complete the audit,

Above list is for reference only and audit firms are encouraged to apply own professional judgment to carry out root cause analysis of the weakness persisting in their firms and identify their core causes, for being able to devise the course of actions for improvement suitable to the size and nature of the audit firms. It is expected that the management of reviewed firms will honestly initiate the corrective actions to resolve the issues that will not only help complying with the professional technical standards but also prevent recurrence negative issues and to improve the quality of audit which eventually better served their clientele.

10. Photographs of QA Programs and Events





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Head Office :

ICAN Marg, Satdobato, Lalitpur, Nepal
Phone: 00977-1-5530832, 5530730,
Fax: 977-1-5550774
Email: ican@ntc.net.np
Website: www.ican.org.np

Branch Office :

Biratnagar : Tel: 021-471395, Email: icanbrt@ican.org.np
Butwal : Tel: 071-543629, Email: icanbtl@ican.org.np
Birgunj : Tel: 051-522660, E-mail: icanbrj@ican.org.np
Pokhara : Tel: 061-537679, E-mail: icanpkr@ican.org.np
Nepalgunj : Tel: 081-525916, E-mail: icannpj@ican.org.np
Dhanghadi : Tel: 091-527493, E-mail: icandhg@ican.org.np