

Quality Assurance Board (QAB)

Strengthening Audit Practices

ANNUAL REPORT

F.Y. 2080/81 (2023/24)



नेपाल चार्टर्ड एकाउन्टेन्ट्स संस्था

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NEPAL

Established under the Nepal Chartered Accountants Act, 1997

Fundamental Principles of Professional Accountants

INTEGRITY

OBJECTIVITY

PROFESSIONAL COMPETENCE AND DUE CARE

CONFIDENTIALITY

PROFESSIONAL BEHAVIOR

PREFACE

The purpose of this report is to provide information about the activities carried out by the Quality Assurance Board (QAB) and Quality Assurance Division (QAD) acting under QAB during the F.Y. 2080/81 (2023/24) in pursuit of strengthening and improving the quality of audit services of Practice Units (Audit Firms) in accordance with the established Audit Quality Assurance Framework.

This report constitutes mainly the overview of the framework of audit quality assurance, the synopsis of Quality Assurance Activities carried out during the year, glimpses of audit quality across the firm's system and engagement performance, and common observations noted during the review.

This report is prepared pursuant to the requirement of Clause 12 of the Audit Quality Assurance Review Procedure 2073 and for general information.

CONTENTS

Quality Assurance Board and Quality Assurance Division	6
Audit Quality Assurance	7
QUALITY ASSURANCE WORK PROCESSES	9
Planning, Execution and Completion	9
Understanding Grades, their Limitations and Resulting Action	10
QUALITY ASSURANCE REVIEW VISITS AND GRADES TILL F.Y. 2023/24	13
SYNOPSIS OF THE QUALITY ASSURANCE ACTIVITIES OF F.Y. 2023/24	16
Commentary on the Number of QA Review Visits during F.Y. 2023/24	16
Overview of Review Results in F.Y. 2023/24	17
Findings from Review	20
Weaknesses Observed at Client's End	29
Potential Root Causes	30
Training on Audit Practice/Audit Documentation Manual	32
Challenges to the QA Review Program	32
Key Message to the Audit Firms to improve audit quality	33
GOVERNANCE AND MANAGEMENT	34
Quality Assurance Board	34
Composition of Staff	35
DISCLAIMER	36

LIST OF ABBREVIATIONS

CA	Chartered Accountant
CoP	Certificate of Practice
EQCR	Engagement Quality Control Review
ICAN	Institute of Chartered Accountants of Nepal
IFAC	International Federation of Accountants
KAM	Key Audit Matters
NAS	Nepal Standards on Accounting
NFRS	Nepal Financial Reporting Standard
NSA	Nepal Standards on Auditing
NSQC	Nepal Standard on Quality Control
OAGN	Office of the Auditor General Nepal
QA	Quality Assurance
QAB	Quality Assurance Board
QAD	Quality Assurance Division
RA	Registered Auditor
SEBON	Securities Exchange Board of Nepal
SMO-1	Statement of Membership Obligation-1
UDIN	Unique Document Identification Number

MESSAGE FROM CHAIRPERSON



On behalf of the Quality Assurance Board (QAB), I am pleased to present the annual reports for the year ended 31 Ashad 2081 (2023/24) pursuant to clause 12 of Audit Quality Assurance Review Procedure 2017 which summarizes operation of the Board. Over the past eight years, QAB has been committed to promoting and ensuring audit quality through its reviews of audit firms.

This report provides the summary of progress made by the QAB in undertaking the activities during 2080/81 (2023/24) in accordance with its terms of reference as conferred by Rule 103 of Nepal Chartered Accountants Regulation 2061 (2005). The review procedure and brief findings of review conducted, potential reason behind non-

compliance of auditing standards etc. has also been reflected in this report.

In terms of performance, the Quality Assurance Division (QAD) has performed 194 quality assurance review visits till 2023/24 with a diverse business nature which consisted of the review of 168 Chartered Accountants (CA) firms and 26 Registered Auditors (RA) firms. Due to the limitation in the number of reviewer staff, the Board could not achieve the target compared to prior years.

As we know, the capacity to deliver results depends on the skilled staff and their commitment to their assigned tasks. Firm's practice environment largely reflects the auditor's attitude towards audit quality. The review outcomes also indicate poor-quality control system and leadership of the audit firm across the majority of audit firms

QAB not only reviews the audit file and operation of the audit firm but is also engaged in developing guidance material and in organizing skill development activities of the practicing members of the ICAN. In an effort to enhance meaningful communication between the QAB and practitioner's firms, QAB conducted workshops on the matters of quality control and audit practice manual.

Due to the nature of business and legislative enactments, there is a long list of standards and guides for the members of the ICAN to be referred to while engaging in audit. There are more than fifty auditing standards,

guidelines, legislation etc., to be complied with by the audit professionals while conducting the audit, irrespective of size of the audit. The role of audit profession is to uphold public interest by abiding such standards and laws. If we fail to protect the public interest, the perception about the profession will be negative.

Looking at the review findings, the trend of audit deficiencies observed is similar to the past years. We call upon audit firms to take appropriate action to minimize the weaknesses in audit deficiencies and keep abreast of evolving audit risks. So, we appeal all the practicing audit firms/members to manage the audit firms as demanded by NSQC 1 to develop a professional workplace and deliver the quality audit services by complying with relevant legislation and Nepal Standards on Auditing to protect the public interest.

We have been witnessing frequent staff turnover in the QA division over the past few years, which has hampered the achievement of review targets and impacted on the knowledge retention process at QAD. It is hoped that next year this situation will be improved as the Institute has initiated its recruitment process requesting the Public Service Commission for a fresh selection of CA.

While much has been achieved, we acknowledge that there is still a long way to go. QAB remains steadfast in its mission to ensure quality in audit practices, build public trust, and contribute to the strengthening of the accounting profession in Nepal.

Finally, I feel honored to have had the

opportunity to serve as Chairperson of the QAB for the last two consecutive terms and express my gratitude towards the Council for reposing trust by nominating me for the third term also. I take this opportunity to welcome new QAB members and hope that their knowledge and experience will help in performing the mandated task more effectively.

I wish to convey my deepest appreciation to our QAB members for their commitment and support from audit firms. I also thank the QAD team for their hard work and outstanding efforts.

Dev Bahadur Bohara

Chairperson, Quality Assurance Board

ABOUT US

Quality Assurance Board and Quality Assurance Division

Quality Assurance Board (QAB)

QAB is the independent board formed by the council that provides direction, oversight, and control of operations of audit Quality Assurance (QA) activities. Rule 103 of Nepal Chartered Accountants Regulation, 2061 (along with amendments) has provisioned for the structure, governance, and operation of QA activities. The Audit Quality Assurance Review Procedures 2073 provides operational guidance to the QAB function.

The QAB consists of 7 members including the chairperson. The chairperson is one from among the past presidents of the Institute of Chartered Accountants of Nepal (ICAN) or a retired special class employee of the Nepal government. The members comprise of two members from the council, 2 members from other than the council member having experience of at least 10 years and not holding Certificate of Practice (CoP), the chairperson of the Securities Exchange Board of Nepal (SEBON) or the Director nominated by him, and the representative from the Office of the Auditor General Nepal (OAGN). The QAB is formed in the first tenure of every new council and the tenure of the QAB members is generally for the period of three years.

The functions and duties of the QAB are to prepare the policies and program of QA review of the audit firms, to carry out or cause to carry out the QA review of the firms as per such policies and program, to make aware to the audit firms for corrective actions if deficiencies are observed and to inform the council as the case may be, to recommend to the council to impose restrictions on audit firms for audit of a particular entity or of the whole sector based upon the gravity of non-compliance or issues observed within the audit firm.

Quality Assurance Division QAD

QAD is the unit within ICAN consisting of staff reviewers and administrative staff for carrying out QA reviews of the audit firms as per the QA policies and program approved by the QAB. The review procedures performed by the reviewers are as per the guidance provided by Quality Assurance Review Unit Procedures Manual 2020 and the Quality Assurance decisions, supervision, and oversight of QAB from time to time.

QAD is equipped with 4 Chartered Accountants working in the position of Director to Senior Officer, and administrative staff in a team.

Audit Quality Assurance

About Audit Quality Assurance

Audit quality assurance comprises operations aimed at ensuring audit firms' adherence to the prevailing laws and regulations, professional standards and other guidelines issued by the ICAN. The operations normally constitute QA reviews and all the processes in relation thereto are connected with audit quality monitoring and assisting firms to improve their systems and audit processes.

The objective of audit QA activities is to enhance the quality of audit engagements to contribute towards credible financial reporting by entities and build up impeccable public trust in the audit profession. For achieving the objective, QA Reviews of the audit firms are carried out to make an objective assessment of:

1. Whether the practicing member and audit firms have complied with Nepal Standards on Quality Control and whether the provisions on quality control have been constantly applied.
2. Whether the practicing member and audit firms have complied with applicable Nepal Standards on Auditing and Code of Ethics in engagement performances.
3. Whether the practicing member and audit firms have complied with relevant laws and regulations applicable to the engagement performance.

Standards of Quality Assurance Review (IFAC- SMO 1)

The need for establishing and institutionalization of the QA mechanism is not just the regulatory tools applied by ICAN at its sole discretion. The Statement of Membership Obligation 1 (SMO1)– Quality Assurance requires every Professional Accountancy Organizations to have the QA mechanism within the purview of certain standards pronounced within it as a condition of continued membership of IFAC. The standard requires that the firms performing audit of financial statements should be mandatorily subject to QA Review. The international best practice of audit regulation is now a mandatory requirement for all jurisdictions and ICAN is not an exception. The regulations, policies and procedures related to QA are based on the standards set by SMO-1, and efforts are continuing to meet them.

Limitations of Quality Assurance Review

The QA Review System is one of the regulatory apparatuses of the ICAN and should not be construed as an audit or investigation. It attempts to provide a limited assurance to the ICAN for taking regulatory decisions and as inputs for policy drives and the QA report is limited to the use of the concerned firm and the ICAN. The QA Review should not be treated as a substitute for the firm's own engagement quality control or audit monitoring activities. Even after the review of the firm, the firm and the proprietor/partners bear the same level of

responsibility, legal or otherwise, as to their opinion expressed in the audit engagements. The QAD, the QAB and the ICAN do not guarantee or assure members and stakeholders that the files reviewed are immune against any material misstatements that are still not disclosed in the financial statements and acted upon by the auditors.

Information on Quality Assurance Review Visits

- The QA Review visits comprise of Routine, Follow-up, and Risk visits.
- The routine review visits of audit firms performing the audit of listed entities takes place in a cycle of 3 years.
- The review cycle for all other firms is 6 years as of now as per IFAC's SMO-1; however, a shorter time frame may be decided by QAB if felt necessary.
- The follow-up visits take place generally in the next year after the completion of the routine visit.
- Currently, Chartered Accountants (CA) firms performing the audit of listed entities and 'B' Class Registered Auditor's (RA) firms performing audit of entities whose total assets exceed NRs 500 million have been prioritized for QA review.

QUALITY ASSURANCE WORK PROCESSES

“The Quality Assurance Unit Procedure Manual 2020” guides the reviewers in conducting QA reviews of practitioner firms. It provides standardized forms and formats, while also allowing flexibility for reviewers to make necessary additions based on their judgment.

Planning, Execution and Completion

Audit QA Review Process can be summarized as under:

Chapter I: Preparation and Planning

- Selection of audit firms for review
- Notice to firms regarding QA Visit along with information request or status request for follow-up review
- Agreeing on visit dates, reviewer allocation and independence checks
- UDIN data verification and selection of files to be reviewed
- Receiving and reviewing the response on information request or follow-up status request
- Study of annual report of audit file to be reviewed as available
- Formulation of strategy and action plan for review and identification of risk areas, if any along with the documentation in the planning record
- Discussion on planning matters with the Head of Division

- Entry meeting with firm’s proprietor or partners – briefing on scope, review approach and listening to what they have to say
- Inquiries with the firm’s personnel about the system of quality control in the firm and review of documentation system
- Review of documentation of selected files
- Inquiries with firm personnel regarding any queries related to the files
- Exit meeting for briefing the findings and suggestions and listening to their preliminary verbal explanations

Chapter II: Field Work

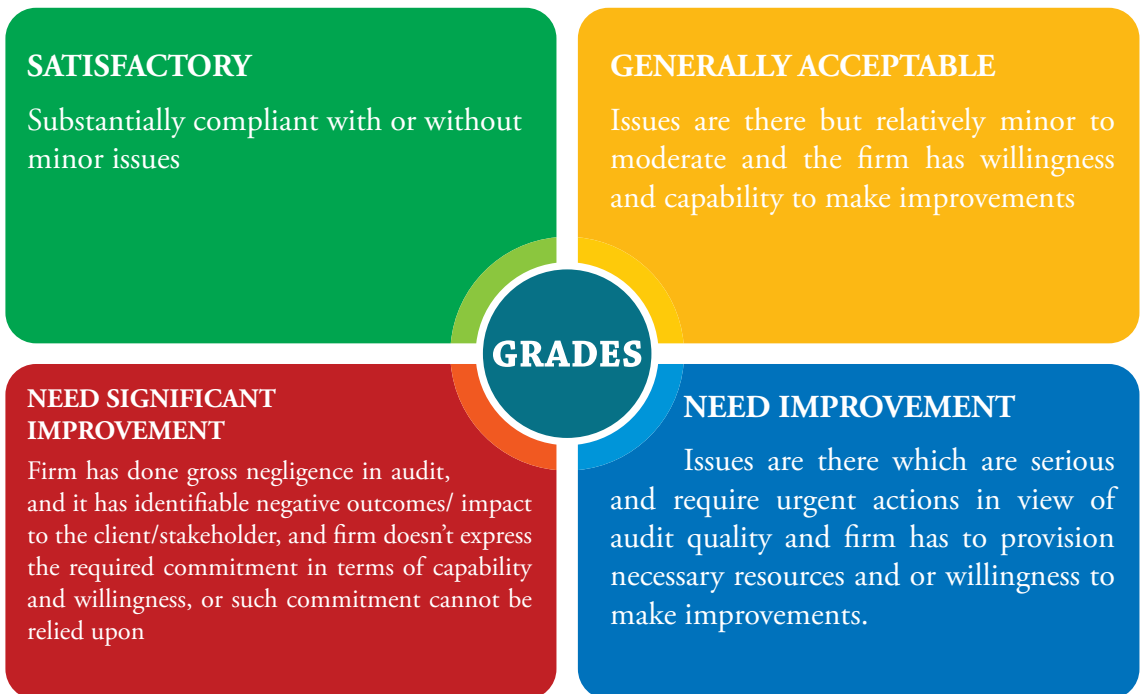
Chapter III: Reporting and Closure

- Preparation of draft QA report by the reviewer and then the draft report is reviewed by the head of the division
- Issue of the draft review report to obtain firm’s response
- Assigning marks and providing grades after evaluating the response received
- Prepare the summary report and forward it to QAB for further discussion and approval
- Communicate QAB’s decision by sending of closure letter to the firm
- Monitor the progress of the firm or plan for follow-up visits for next year, if necessary
- Referring the findings if required to the Council for further course of action

Understanding Grades, their Limitations and Resulting Action

Grading

Upon completion of the review, grades are assigned to the reviewed audit firms so that the QAD will be able to track the improvements made by the firms. Since it contains some limitations as detailed below, it is not for the purpose of disclosures to the firms on an individual basis. However, QAB discloses the number of firms falling into each grade in QAB's Annual Report as a measure of adherence to quality standards observed at the reviewed firms. QAB assigns the audit firms with four grades. The grades assigned and their connotations have been presented below:



The marking and grading tool is a 100 marks checklist to include 30 marks to firm's 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) which are further sub marked in detail under each of these categories.

The firms will generally be graded in the following manner based upon the scores assigned to them after their review visits.

- Firms obtaining Marks = or 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

After the firms are allocated with marks as above, they are further checked in terms of any critical issues if any therein. The presence of critical issues may result in bringing down the firm's grades even if the marks scored represents the higher grade as above.

The score obtained by the firms is a measure to assess to what extent the requirement of all areas of the firm's system and audit quality has been complied with and considers the responses of the firm in the issues identified. Grades are assigned to the firms such that the QAD will be able to track the improvements made by the firms as it contains some limitations, it is not for the purpose of disclosures to the firm on an individual basis.

The limitations with the grades are:

- Grades represent the status of audit firms as on the date of review.
- Grades are based on samples of completed audit files reviewed.
- Grades do not signify as Quality Approved Status and shouldn't be construed upon as such.
- Grades are a fair measure of quality but not an absolute measure.
- Prevalence of any critical issues in the audit firm can make the firm fall into lower grades despite their scores/marks obtained.

However, the Grading System carries much significance and is an indispensable measurement tool to the QAD to precisely indicate the quality status of firms and to determine any further course of remedial actions if necessary.

Likewise, grades are not currently assigned to the firms of RA as they are reviewed based upon simplified checklists, considering overall scenario of firms of RA in terms of number of partners, size of the firm, resources, nature and size of clients etc.

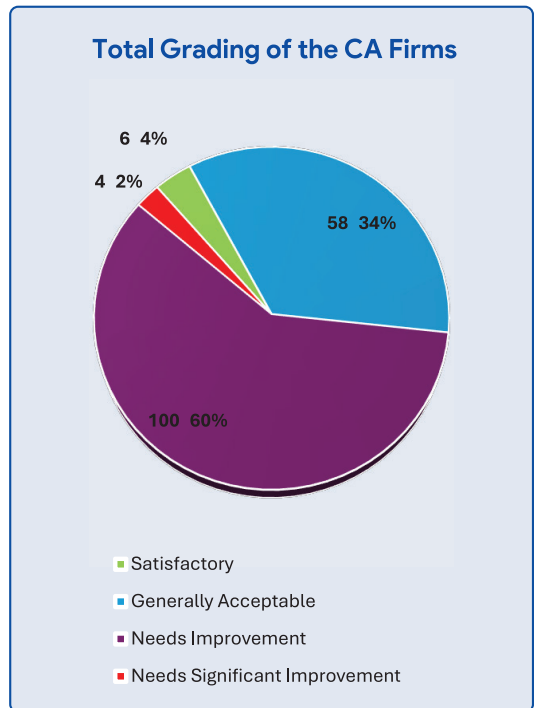
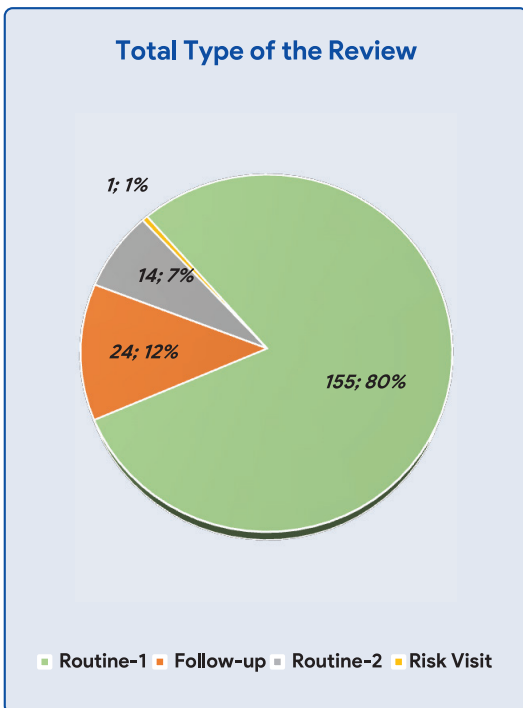
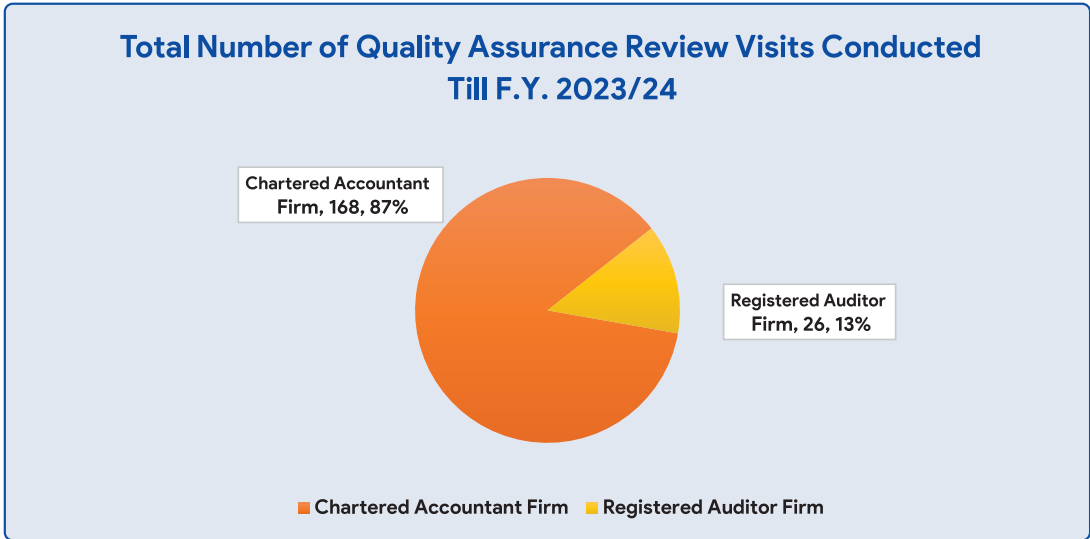
Resulting Actions on Closure of Reviews



If progress is not seen in follow-up review visits, QAB might consider notifying the compliance issues in the firm to Council and recommending other actions to the firm including audit restrictions. It's at the discretion of the Council whether to decide upon actions or to order that it be registered as a case for further disciplinary proceedings. Likewise, alternatively, the QAB may still find it necessary to carry out another follow-up visit and provide another opportunity by charging follow-up review fees, when the QAB believes that the firm is still committed to making improvements.

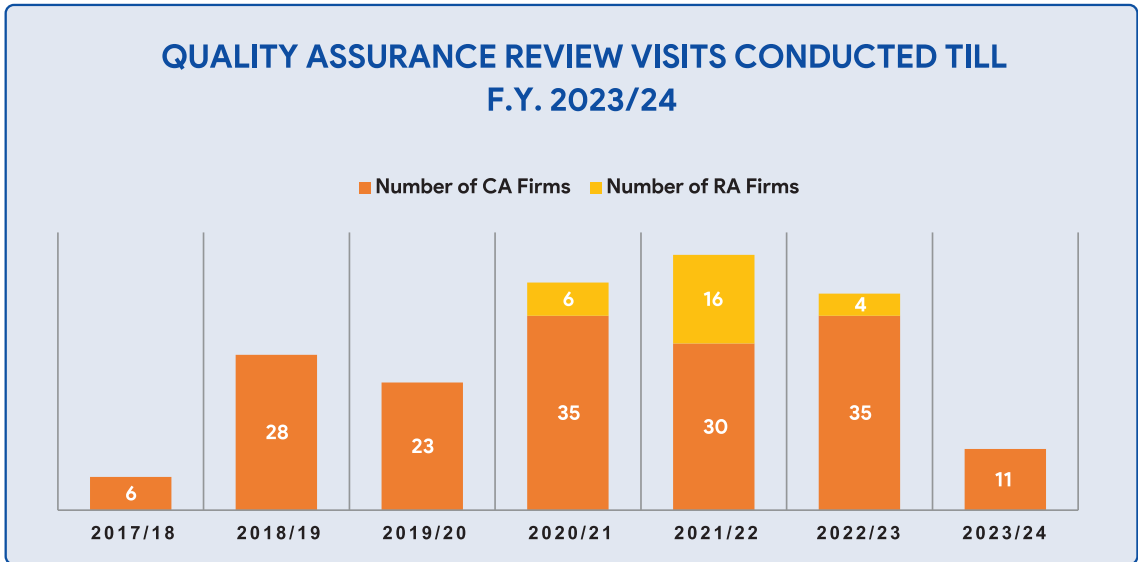
QUALITY ASSURANCE REVIEW VISITS AND GRADES TILL F.Y. 2023/24

Synopsis of review conducted over the last seven years beginning from F.Y. 2017/18 till the end of F.Y. 2023/24



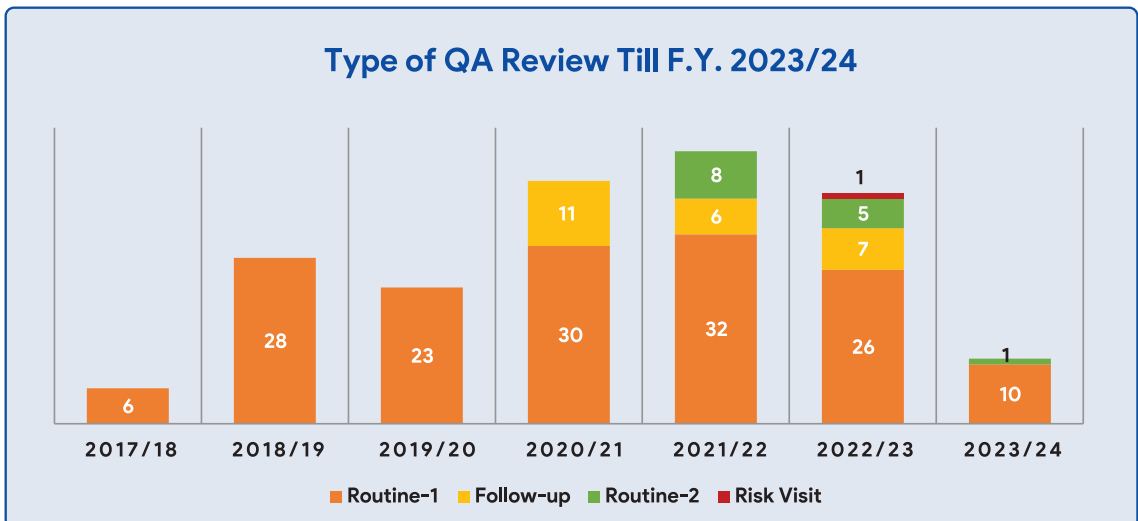
Reviews Carried Out Till F.Y. 2023/24

QA Review visits started from F.Y. 2017/18 and a total of 194 reviews have been completed till the end of F.Y. 2023/24. The practicing firms reviewed consisted of 168 CA Firms and 26 'B' Class RA firms.



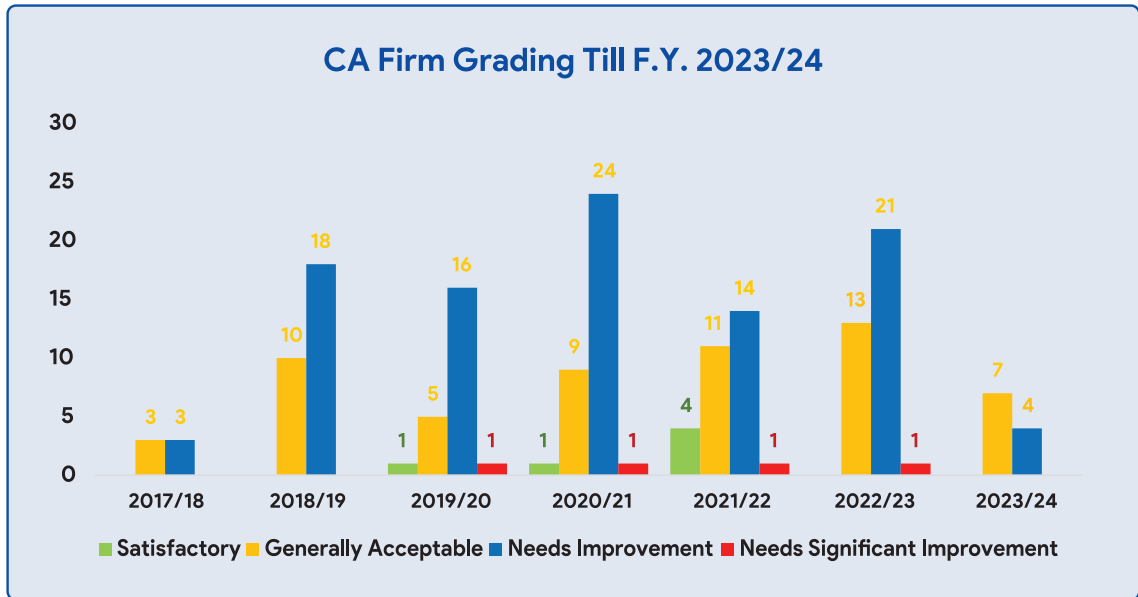
Types of Reviews Carried Out Till F.Y. 2023/24

Out of a total of 194 reviews conducted till fiscal year 2023/24, 155 were routine-1 reviews, 24 were follow-up reviews conducted generally in one year's time, 14 were routine-2 reviews whose reviews had been completed three years ago, whereas 1 review was conducted as risk visit (Special Review Visit) based on the risk information obtained.

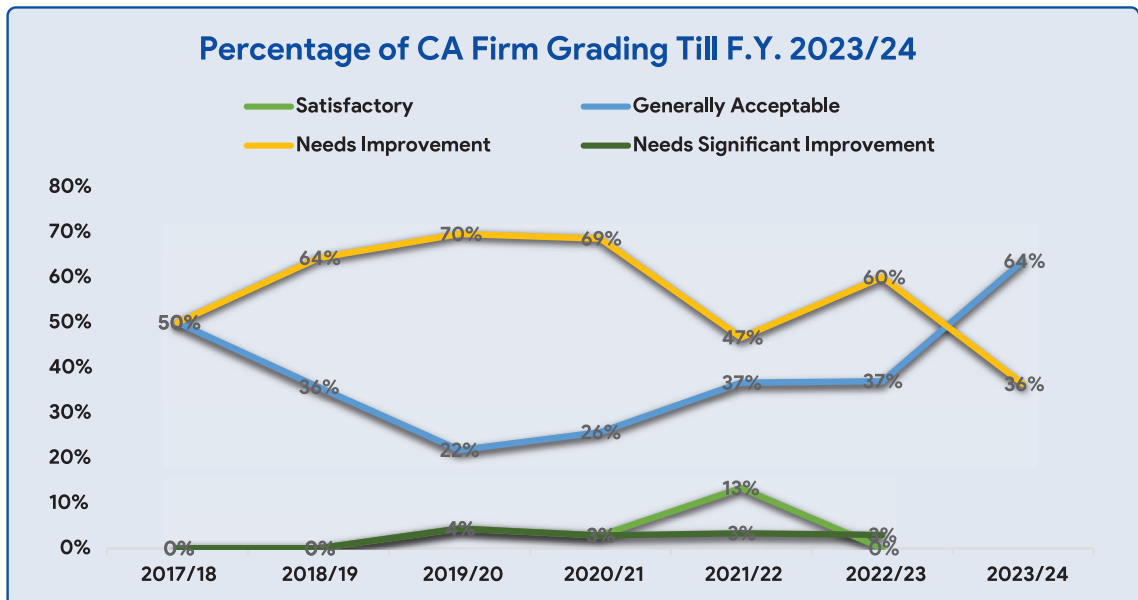


Grading Provided till F.Y. 2023/24

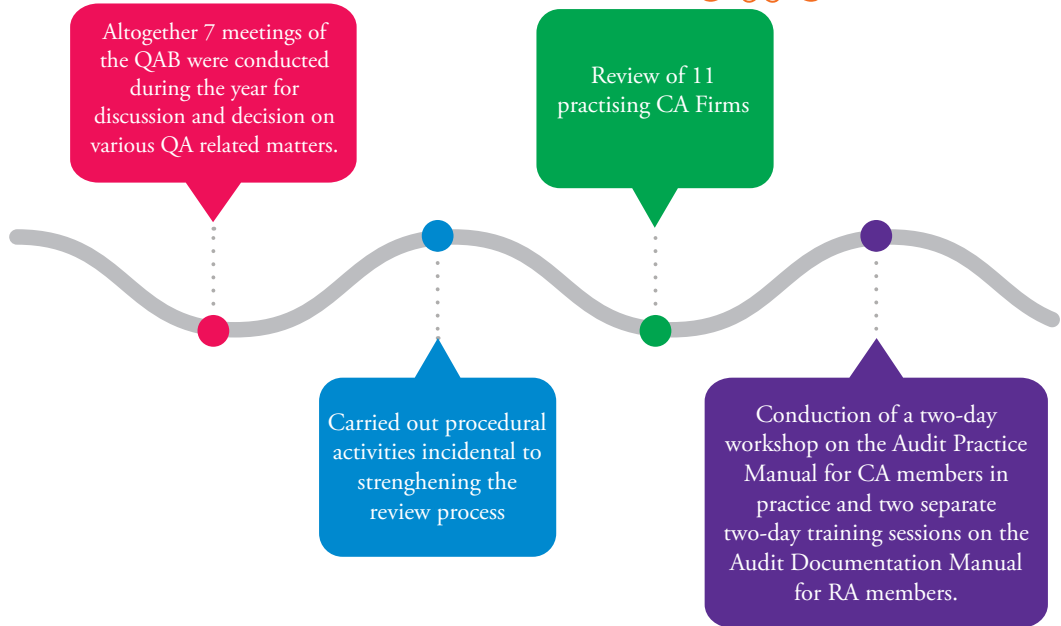
The total of 168 CA firms reviewed till the end of F.Y. 2023/24 rated in different grade categories as per the decision of QAB is as under.



Over the last seven years, most of the firms have received grade category of Need Improvement however, few firms have fallen under grade category of Need Significant Improvement. The percentage of the grade category of firms reviewed over the last seven years has been presented below:



SYNOPSIS OF THE QUALITY ASSURANCE ACTIVITIES OF F.Y. 2023/24



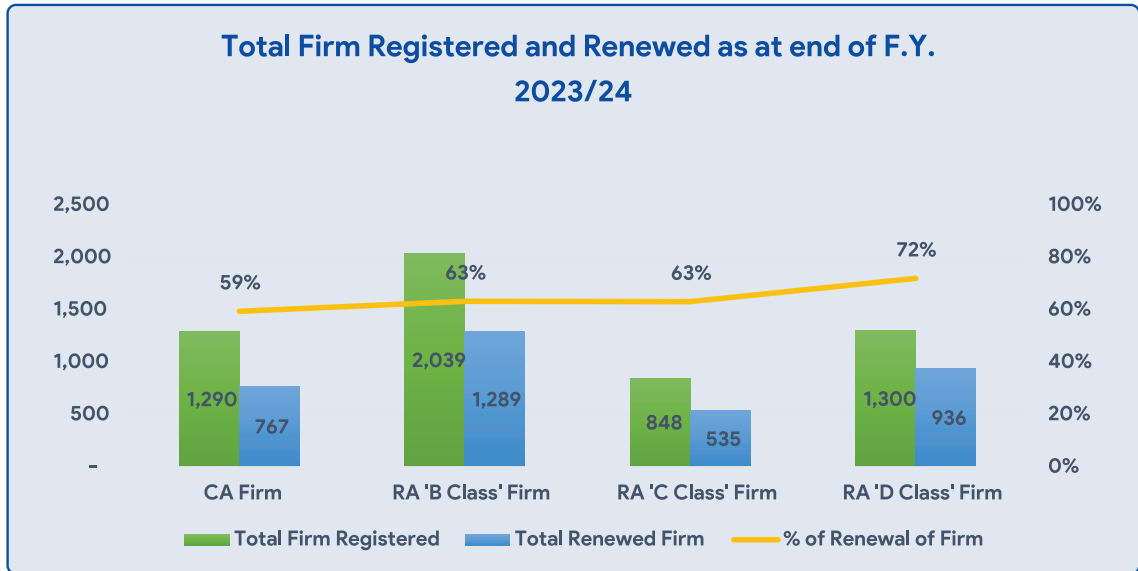
Commentary on the Number of QA Review Visits during F.Y. 2023/24

The QAD could complete the QA review visits of only 11 firms as compared to 39 firms completed during the immediately preceding year, amounting to a reduction of 71.79%. Likewise, the QA review visits conducted covered only the CA Firms and QA review visits of the RA Firms were not made in the fiscal year. This was due to the lack of adequate reviewers in the QAD. The division has a total requirement of 5 CAs including 1 Joint Director, 1 Assistant Director and 3 Senior Officers. However, the division was not manned with any reviewers until the end of the 8th month of the fiscal year due to the resignation of the incumbent reviewers. The 3 vacant positions were filled up only in the 9th month of the financial year. The newly joined staff, after having their induction on QA review visit program of the ICAN, then started to carry out the review visits for the year thus accomplishing 11 visits for the year.

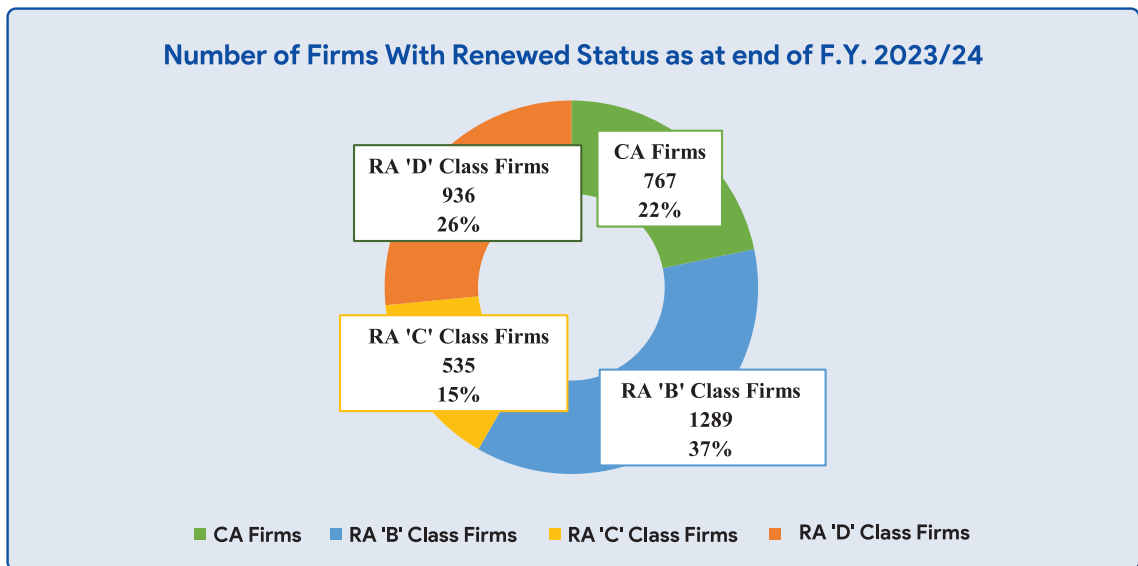
Overview of Review Results in F.Y. 2023/24

Audit Firms Subject to Quality Assurance Review

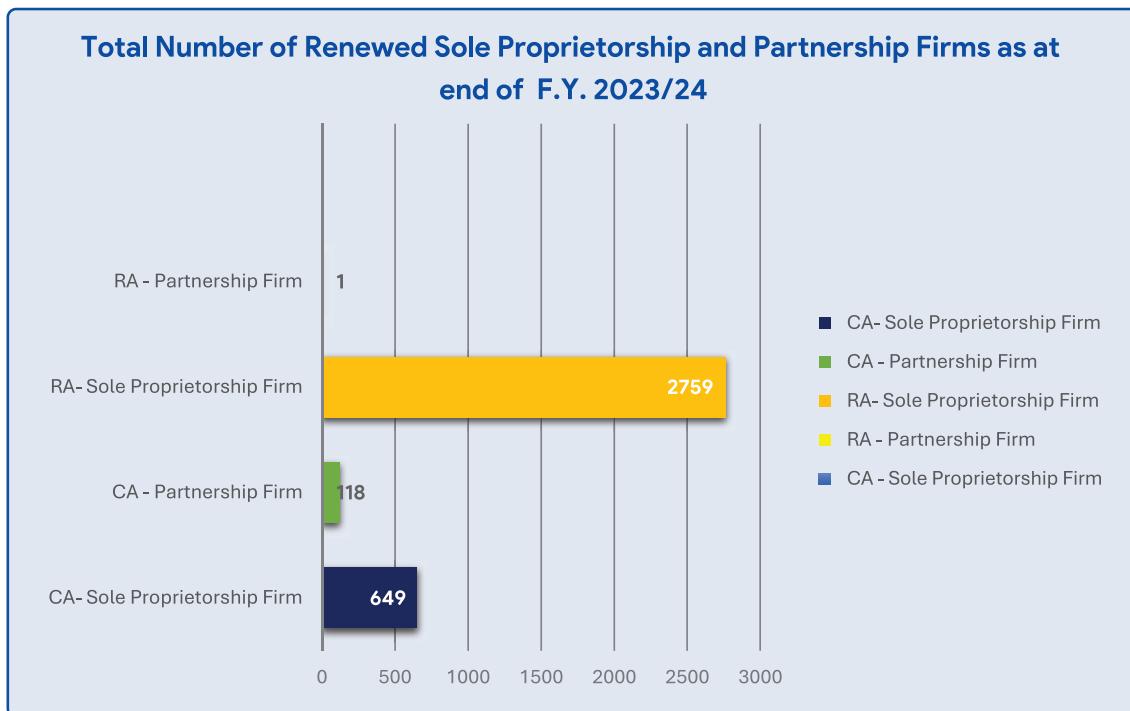
Till the end of F.Y. 2023/24 altogether 5,477 audit firms were registered at the ICAN out of which 3,527 audit firms were renewed. The total number of audit firms along with the renewed status at end of F.Y. 2023/24 has been presented below:



The number of audit firms under the purview of QA reviews as of year ended 2023/24 was as follows:



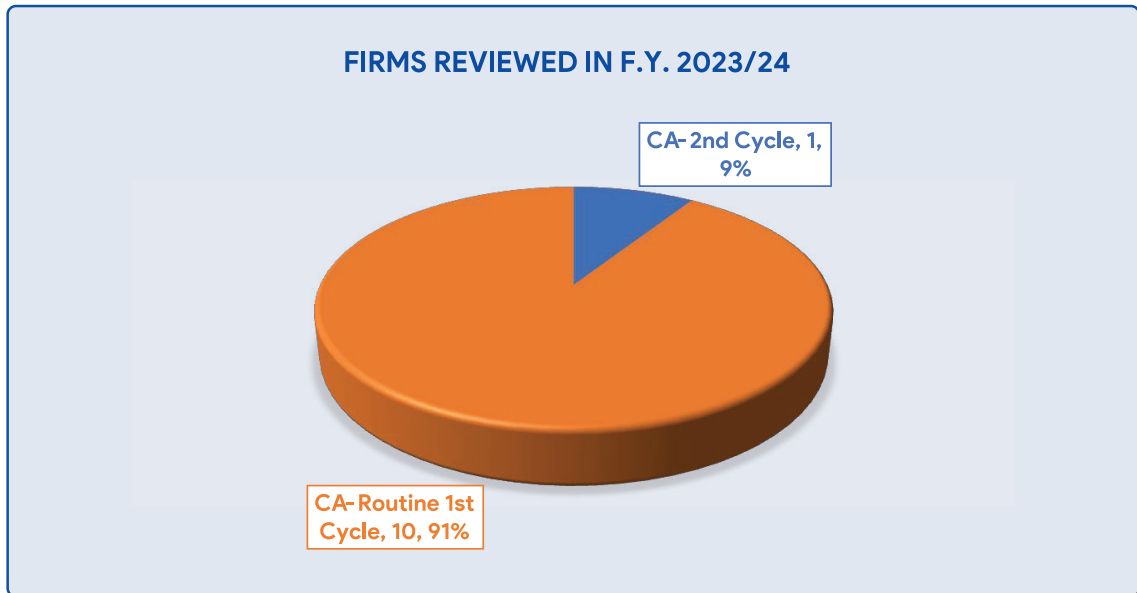
There were 3,527 renewed audit firms as at the end of F.Y. 2023/24 out of which only 21.75% were CA firms. Likewise, 85% of total CA firms in Nepal are operating on proprietorship basis whereas, only 15% of those firms are operating as partnership firms. and the maximum number of partners in the partnership firm is 6. Only 1 firm out of total Registered Auditor Firms is a Partnership Firm with the rest of them being proprietorship firms.



Similarly, there were 120 CA Firms performing the statutory audit of public listed entity and 422 CA firms and 231 “B” class RA firms performing the statutory audit of the entities with turnover of more than NPR. 50 crores based on UDIN data for F.Y. 2022/23. These firms are currently prioritized for QA Review.

QA Reviews in F.Y. 2023/24

A total of 11 CA firms were reviewed in F.Y. 2023/24. All of the reviews conducted were regular in nature; 10 being routine-1 review and 1 being routine-2 review.



Grades Provided for QA Visits in F.Y. 2023/24

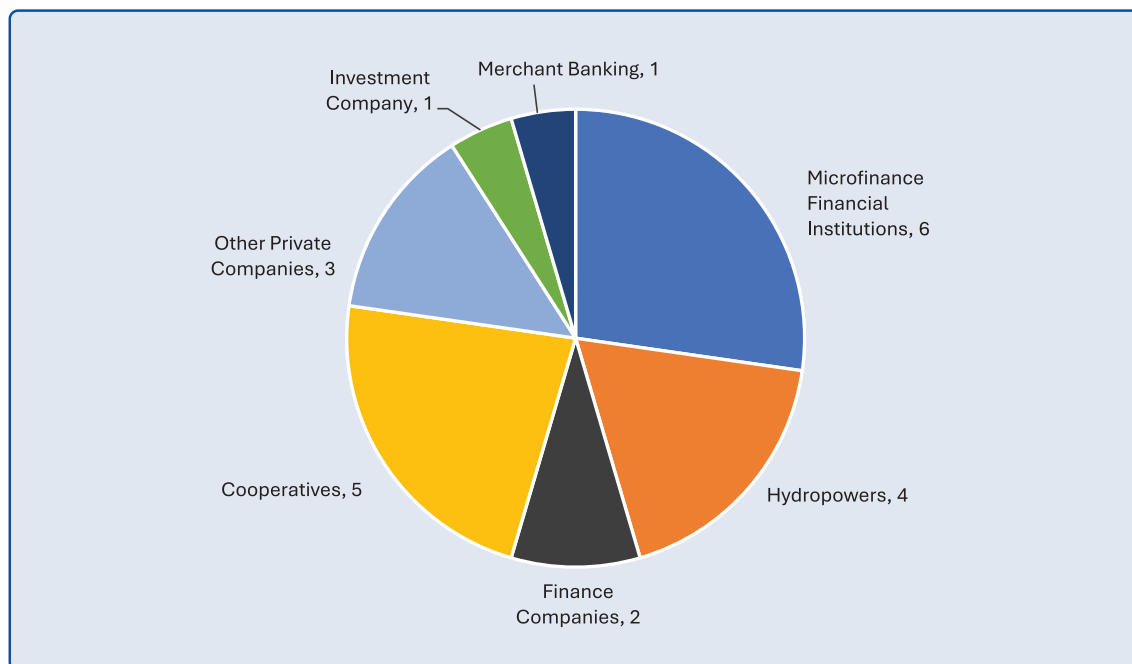
Final grading has been provided to firms after completion of the reporting process and approval from the QAB. Details of final grading provided by QAB to the CA Firms during 2023/24 are as under:

Grade	Number of CA firms receiving the grade	Percentage of Firms falling in each grade
Satisfactory	0	0%
Generally Acceptable	7	64%
Need Improvement	4	36%
Need Significant Improvement	0	0%

Category of Files Reviewed in F.Y. 2023/24

Starting from F.Y. 2020/21, two completed audit engagement files were reviewed during each visit to the audit firm. Out of the two selected files, one file was selected from among the listed public entities.

The QAB has reviewed a total of 22 audit engagements relating to diverse economic and business sectors of 11 firms in the year 2023/24.



Findings from Review

QA Review is a general regulatory function which is undertaken to assess the firm's system of quality control and compliance with professional standards during the conduct of audit engagements.

QA Review is not a fault-finding activity on the part of the entity preparing the financial statements as well as auditors expressing an opinion on those financial statements, rather it is carried out to enhance the quality of audit. QA Review primarily considers non-compliance on the part of auditor rather than the client of the auditor.

The objective of summarizing the findings identified by the QA Division in this annual report is to give an idea to the practicing audit firms about the areas where special attention is required by the firms to create awareness on improving the quality of audit.

The most common findings and weakness as identified by the QA reviews is depicted here under:

I. Planning of Audit

1. Acceptance of Client:

(Relevant Criteria: NSQC-1, NSA 220 and Code of Ethics)

- The firms lacked a formal process of client screening which is generally carried out by evaluating the integrity of key personnel and those charged with governance of

the client, firms' ability to comply with relevant ethical requirements and the firm's competence to perform the engagements.

- The auditors have failed to communicate with the predecessor auditors in a few cases while accepting new clients. Further, prior approval of the client was not obtained in cases where communication was established with predecessor auditors.
- In instance, the auditor had not determined whether the precondition for the audit is present as per NSA 210 Terms of Audit Engagements while deciding on acceptance of the engagement: like application of NFRS as the applicable financial reporting framework.
- In one of the firms, reasons for the acceptance of a client relationship were not documented even when the predecessor auditor communicated about the management being non-cooperative/ difficult to work with.
- Familiarity threat was not considered while forming the audit team in case of continuing clients.

2. Auditor Appointment:

(Relevant Criteria: Applicable Legal Provision and NSA 210)

- Acceptance of appointment contrary to the provision of Section 113 of Companies Act, 2063.
- Auditor remuneration not specified in the appointment and engagement letter.
- Non-obtaining of appointment letter or Annual General Meeting minutes related to auditors' appointment.

3. Audit Strategy and Audit Plan:

(Relevant Criteria: NSA 300)

- Many firms still have not brought into the practice of formulating audit strategy and audit plans as a basic part of audit planning. The audit strategy is normally the type of audit approach planned to be adopted which includes test of controls and substantive tests that include (test of detail and substantive analytical procedures), across various audit areas.
- In a few cases, the audit time plan was also not prepared. Similarly, was not detailed enough to guide the audit team.

4. Understanding the Environment of the Entity and Risk Assessment:

(Relevant Criteria: NSA 315 and NSA 330)

- The risk assessment procedures were not carried out in most cases. However, in few cases, though it has been done, they were not carried out systematically before the audit fieldwork.
- In some cases, instead of determining audit risks at the financial statement level and assertion level, the business risks of clients were noted down without reference to how they gave rise to audit risks.
- In most cases, the risk related to revenue fraud, management override of controls and other fraud risks were not assessed and documented.
- Audit planning memorandum was not prepared for documenting detailed understanding of the client business, key management personal and risk assessment procedure performed, and the risk and response schedule devised.

5. Engagement Letter:

(Relevant Criteria: NSA 210)

- Practice of not issuing engagement letter was common to private companies or companies with low profiles.
- In some cases, though engagement letters were issued, those were not acknowledged by the client. Further, in many instances the engagement letter issued were not in the standard format as per NSA 210 and few of the issued letters lacked even some important elements.

6. Other Issues Regarding Planning Related Procedures:

(Relevant Criteria: NSA 300, NSA 320, NSA 530, NSA 600)

- Preliminary analytical reviews were not conducted.
- Audit team formation was not documented, and their competencies were assessed in very few cases.
- Planning meetings were not conducted, and it was not clear if the proper guidance to audit team members was communicated and discussed as to the financial statement's susceptibility of material misstatements.
- Audit materiality and performance materiality was not determined in many cases and, in the cases where they have been determined, the materiality level didn't resemble international benchmarks.

- Materiality level was not considered during the determination of the type and extent of audit procedures and while evaluating the misstatements.
- Audit sampling techniques were not ascertained and documented. In cases where sampling sizes were determined, its adequacy to reduce sampling risk could not be verified.

II. Execution of Audit

1. Use of Adequate Audit Procedure and Collection of Sufficient Appropriate Audit Evidence:

(Relevant Criteria: NSA 230 and NSA 500 series of Standards)

- There were various instances where it was observed that the audit team had not applied adequate procedures for verification of financial line items of material amount.
- Physical verification of the fixed assets, cash balances, Capital WIP, and inventories in most cases was not conducted. The alternative procedures applied couldn't justify the sufficiency and appropriateness of audit evidence in the absence of physical verification.
- An audit procedure for verification of opening balance in case of initial engagement was not obtained in a few cases.
- An audit procedure was not performed for verification of management estimates and conclusion e.g., provision on loans and advances, and impairment losses.
- External confirmation procedure requirement was not assessed in case of material receivable and payable balances.
- Audit procedures and checklist to review compliance with laws and regulation were not used by the firms, in few cases, it was noted that substantial transaction with directors and shareholders which were against provision of Companies Act, 2063 were neither communicated with the management nor its impact were considered in auditor's opinion.
- Assessment of going concern of the client was not conducted, neither its impact on audit report was considered.
- Likewise, the proper documentation of audit evidence for a material class of transaction and account balances was not maintained. Though auditors tried to verbally justify those instances, proper evidence to support justifications was not present in most cases.

2. Audit Documentation:

(Relevant Criteria: NSA 230)

- Audit documentation of almost all firms requires strengthening to ensure compliance with NSA 230 and various other standards.
- The audit file wasn't ensured to have been maintained in the form that a suitably qualified external person not connected with the audit could understand all the audit activities and the judgements applied in forming the audit opinion.
- Nature, timing, and extent of audit procedures applied were not noted down either separately or in the form of audit program. Where audit programs were developed, in many cases, it was developed in a generic way, and not customized to reflect the nature and size of client and related requirements.
- Findings observed, judgment made, and conclusion reached were also not present in a documented form.
- Identification of performer of audit procedures and date such procedures were performed and identification of reviewer and date of such reviews were not disclosed.
- Audit files were not properly organized; there was neither a system to keep track of changes in audit documentation.
- The details of man days spent by the audit team were not recorded and kept in file. Likewise, the analysis of the fee charged to the client and its compliance with the guidelines issued by ICAN is also not kept in file.
- Lead schedule and sub schedule were not prepared for line item of financial statements.

3. Communication with Management and Those Charged with Governance:

(Relevant Criteria: NSA 260, NSA 265)

- In most of the firms, documentation of communication with management was not found other than preliminary audit report or management letter. The other communication could be required to discuss the planning related matters, and significant findings arising during the audit.
- In some cases, meeting minutes of exit meeting were not available, and in some cases, management letter was not issued, or response thereupon not obtained.
- In a few cases, communication with management regarding prospective modification of audit report was also not done.

- In most cases, auditors didn't have any meeting with the Audit Committee or Board of Directors.
- In a few instances, involvement of the engagement partner was not seen while communicating with the management and those charged with governance, instead only team leader and team members were involved in the communication process.

4. Management Representation Letter:

(Relevant Criteria: NSA 580)

- The management representation letters were obtained much earlier than the date of signing of the auditor report. Additionally, in a few instances, the representation letters were obtained after the date of the auditor's report.
- Management representation letters were not obtained at all in some cases.
- Most of the contents of the management representation letter were generic in nature and audit team wasn't found to have considered obtaining representation on matters specific to the entity which involved accounting estimates and where evidence had to be complemented with such representation.
- Furthermore, in some cases, no audit procedures were performed to evaluate the representation and resolve the matter of inconsistency when inaccurate representation was provided by the management.

5. Summary of Misstatement and Their Resolution Status:

(Relevant Criteria: NSA 450)

- Summary of material misstatements identified, and resolution status of misstatements were barely documented and evaluations of impact of uncorrected misstatements in financial statements were not documented by most of the firms. For example, fines and penalties pertaining to the tax assessment of previous fiscal years was charged in the statement of profit and loss under the administrative expenses; the materiality of such misstatement was not considered and documented for forming the basis of opinion.

6. Non-compliance with Relevant NSAs:

- Most of the firms didn't have the practice to document the procedures applied for litigation and claim (as per NSA 501), related parties (NSA 550), subsequent events

(NSA 560), going concern (NSA 570), audit of consolidated financial statements of group companies (NSA 600), use of work of internal auditors (NSA 610), and use of work of management expert (NSA 500).

- Several audit reports failed to provide sufficient details regarding the evaluation of management's assessment of going concern, despite financial statements clearly indicating potential issues regarding the entity's ability to continue as a going concern.

II. Reporting and Conclusion

1. Audit Opinion and Basis of Opinion:

(Relevant Criteria: NSA 700 series of standards, NSA 450, and NSA 230)

- Most of the audit firms did not maintain documentation for forming the basis of opinion and their judgement on how the opinion expressed might be appropriate in the given circumstances.
- Adequate documentation was not in place for substantiating the auditor's opinion where material non compliances were identified such as:
 - ❖ Accounting of land in excess of the limit allowed by the Act relating to land which was purchased in the name of the directors was done under Project Assets. Additionally, such information was also not disclosed in the notes to account.
 - ❖ Procurement of high value equipment by a public listed company without any policy and standard system for procurement.
 - ❖ High valued unreconciled and negative bank balances.
 - ❖ Loan disbursed by a co-operative in excess to the Single Obligor Limit in contrary to the Sahakari Mapdanda 2068 and one of such excess loans being disbursed to the Director.
 - ❖ Concentration of 45.86% of the total loan portfolio to only 15 members of the co-operative thereby exceeding the single obligor limit.

2. Independent Auditor's Report:

(Relevant Criteria: NSA 700 series of standards)

Even though most of the auditors' reports reviewed seemed satisfactory, some issues mentioned below were noted:

- The Auditor's Reports were not in an exact format prescribed by NSA 700.

- Basis of Opinion paragraph was not included in a few reports and in case of inclusion, basis was not described properly.
- KAM (Key Audit Matters) were neither included in some audit reports of listed entities nor clearly stated that there is nothing to report under KAM.
- Instead of communicating matters considered to be significant during the audit as KAM, the auditor communicated discrepancies as noted during the audit regarding the regulatory non-compliance.
- KAM and Other Information section included in the audit report even after the expression of disclaimer of opinion. Further, the responsibility of the auditor para was also not modified as per NSA 705.
- The basis of disclaimer opinion was provided through two paras: “Basis of opinion” and “Basis of Disclaimer of Opinion”
- Other Information paragraph not included and procedures for NSA 720 not adopted.
- Incomplete information in section of “Report on Other Legal and Regulatory Requirements”. Basically, few information required by the Companies Act and Bank and Financial Institutions Act was missing.
- Cases of clerical errors in the auditor’s report were also frequent.
- Audit report issued without expression of clear audit opinion.
- The period covered by the financial statements reported incorrectly in the audit report.

3. Other Issues in Reporting and Conclusion

- There was no indication of critical evaluation of financial statements and auditor’s report for verification of date, names, titles, year, presentation issues, names of signatories etc.
- Final analytical review not carried out.
- Management Letter or Preliminary Audit Report not issued. In cases when issued for private companies generally, response was not received on the misstatement identified.
- Firms have not reported to ICAN for quality review purposes if the fees charged to the client is less than that as specified in the guidelines related to minimum audit fees issued by ICAN.

4. Firm's System of Quality Control

(Relevant Criteria: NSQC-1)

- Most of the firms reviewed were not found to have formulated a Quality Control Policy. Even if formulated, they were not customized according to the size and nature of the client of the firm. Procedures for client acceptance and continuance were not formally documented.
- Engagement Quality Control Reviews (EQCR) were not conducted in most of sole practitioner's firms as required in case of listed entity audits and in cases where such were conducted, documentation of work of EQCR was not done. In some cases, EQCR responsibilities was performed by the staff other than the appointed reviewer.
- Possible impairment of the independence of EQCR was noted in few instances due to his/her active involvement in the audit execution process.
- Written confirmation of compliance with firm's policies on independence by the staff required to be independent were not obtained in some of the firms reviewed,
- Audit Practice Manual is yet to be adopted by many firms. The engagement performance doesn't involve a systematic process.
- Analysis of adequacy of human resources, provision of training to them, appraisal and opportunities for career development was seen to be lacking in many of the firms.

5. Issues Related to Other Regulations Applicable to Member and Firm

- Instances were noted whereby UDIN were not generated for all engagements specifically related to verification and certifications engagements.
- Change of address of the firm was not communicated to ICAN.
- UDIN was not generated for tax audit report, Long Form Audit Report (LFAR), Section 78 report of the Companies Act in few cases.
- Secondment of article trainee or sharing of the article trainee between the firm without communication to ICAN.

Weaknesses Observed at Client's End

During our review, we came across some weaknesses in the audit clients as well, which ultimately have implications for the credibility of the financial statement and audit. Auditors have sometimes been unable to respond to such issues appropriately in the auditor's report. Such weaknesses identified are:

1. Major Non-compliance with Accounting Framework

- Non-adoption of NFRS Framework by few microfinance institutions and private companies.
- Effect of correction of prior period error given in the current period's financial statements
- Disputed Receivables for long period not considered for impairment

2. Specific Presentation and Disclosures Issues in the Financial Statement including Accounting Treatment

Various issues were observed about incomplete disclosures or irrelevant disclosures. Complication in compliance with disclosure requirement was seen such as:

- Relevant Accounting Policies and Notes to Accounts lack appropriate disclosures related to every material items of the statement of financial position and the statement of profit and loss including property plant and equipment, capital WIP, prior period tax expenses, movement of reserves, share capital, inventories, and investment property.
- Sufficient disclosure for: related parties, change of ownership, contingent liabilities relating to litigations and claims, key management personnel and their benefits and non-controlling interest were not found.
- Date of authorization of the financial statements and name of the director authorizing the financial statements not mentioned.
- Non-disclosure of material non-adjusting event like merger and start of joint operation of the entity.
- Notes to accounts of the financial statements did not contain an unreserved statement on compliance to NFRS and the statement that the entity is a going concern.

3. Non-Compliance with Laws, Rules, and Regulations

- Bonus amount not allocated as per Bonus Act 2030 in case of private companies and inconsistent application of bonus provision in hydropower sector i.e., Bonus

Act 2030 and Electricity Regulation 2050. In some cases, a mixed approach was used in calculating staff bonus in hydropower business.

- Non-compliance with Cooperative Act and Rules regarding maintaining of proportion of loan and advances. Further, insufficient provision was made on loan and advances contrary to the requirement of Cooperative Rules and Mapdanda (Regulator's Standard).
- Calculation and disclosure of impairment on loans and advances as per NAS 39 not done in case of Micro Finance Institutions
- Audit Committee as required by the Companies Act not formed.

Potential Root Causes

QAB has identified some of the root causes that limit the firms to adhere with the standards and maintain quality of audit engagements. This is presented to assist firms in locating and addressing the causes giving rise to the quality issues in the firm and this may help stakeholders to gain some insight into the operating environment of the audit firms.

1. Resource Issues

- Quality and number of audit staff not recruited or hired commensurate with the nature, number, and size of the clients.
- Qualification and experience of engagement teams not ensured for specialized audit clients like Banks and Insurance Companies.
- Staff training is less structured, infrequent, and inadequate.

2. Personal, Ethical and Attitude Issues

- Over dependence and reliance over the engagement teams by the partners,
- Minimal or no timely supervision of engagement performance/ process and outcomes not documented,
- Standardization of audit documentation not a priority,
- A mindset that auditing standards are overly complex, or they place too many requirements than required,
- Client's overall impression and experience from previous relationship given importance over engagement-wise audit evidence and issues,
- Proper and effective communication with client not prioritized as required by

standards so as to enable client understands the limitation and expectations out of audit,

- Focus is on identifying issues and reporting them rather than forming proper basis for opinion,
- Less orientation and refreshment training to staff on ethical issues and requirements,
- Fear of losing client or prospective client resulting into overriding the requirement of the standards
- Lack of application of high degree of professional judgment to determine the scalability of the compliance to standards across clients of different size and nature.

3. Process Issues

- Few firms only use standard audit system
- Some firms use conventional audit practices which comprise only to be a partial audit system
- Quality Control Policy as per NSQC-1 requirements is not developed by many firms
- Material legal compliances are not audited using checklists even for highly regulated clients
- Partner's instructions are themselves believed to be firm's processes and policies for small firms and they don't emphasize the need for formalized structure and firm processes
- Absence of policy and audit system resulting thereby to ad-hoc processes and limited scope for evaluating standard of actual work

4. Leadership Issues

- Effective leadership traits emphasizing standards of quality audit may have been poorly demonstrated
- Usually, incentives to promote quality of audit work based on formalized performance appraisal process are discretionary and not emphasized
- Some firms are not keen on making improvements over issues identified as repetition of the issues have been noted in our follow up visits.

5. Client Issues

- Sometimes client place unusual deadlines to firms and auditor feel that they have no option other than to compromise to the extent they can

- Clients do not understand the value created out of audit and take it as a mere formality
- Clients who are private companies are more concerned with determination of tax liability and completion of tax return processes than compliance to accounting standards and fair presentation of the financial statements
- Level of Fees not commensurate with the level of Quality Standards to be complied with.

In the backdrop of matters as reflected in the two preceding sections (Key Finding from the Review and Potential Root Cause), it is advised that audit practicing firms relook on their audit procedure applied to confirm that NSA requirements are being considered during the course of their audit assignments.

Training on Audit Practice/Audit Documentation Manual

The Institute organized two-day training on Audit Practice Manual on 6th and 7th May 2024 at ICAN premises for the CA Members in practice. The objective of the training was to assist audit firms to carry effective and efficient audit by introducing the Audit Practice Manual and system designed to be used on audit of all general audit clients, with few customizations required for specialized audits. Altogether 46 CA members participated in the training.

In addition to this, with the objective of introducing the audit documentation manual and improving QA review amongst the RA whose firm were identified for QA review two separate two days training on audit documentation manual was organized on 13th & 14th June and 25th & 26th June 2024 whereby 77 practicing RA members participated.

Challenges to the QA Review Program

The QA review program is not free from challenges for ensuring compliance to cycle of visits as prescribed by SMO-1, and for ensuring the effectiveness, efficiency and integration of international best practice. Most importantly, the yardstick of the effectiveness of this program is the awareness amongst firms and their action to emphasize quality in the policies and procedures adopted by firms to ensure audit quality.

- Equipping the QAD with an adequate number of qualified reviewers and supervisors
- Accumulating Experience in the QAD
- Knowledge Enrichment of Reviewers in areas of NFRS and NSAs and their application in complex scenarios
- Coverage of verification of compliance to Accounting Standards/NFRS

- Ensuring clarity and consistency in the issues reported
- Sensibility in the evaluation of responses on the QA Report particularly whether the willingness and ability to improve have been demonstrated or not.
- Evaluation of the extent and quality of improvements during the follow-up visit based on review of audit files for different clients
- Scalability in the overseeing of compliance regarding difference in nature and size of firms
- Clarity on criteria based on which reference should be made to the Council for Disciplinary Investigation

Key Message to the Audit Firms to improve audit quality

Based on the observations in the QA visit reports, it is recommended that the Audit Firms should be mindful of the fact that:

- Audit Documentation includes not only documentary evidence collected from clients but also the checklists, analysis, audit notes, prepared by the audit team
- Audit Evidence is required to be obtained not only for issues observed during audit but for the financial statement items where it is fairly recognized and presented, and the basis how it is fair
- Standards are principle based and what is appropriate in the circumstances is matter of professional judgement at many times, but that should be documented and justified
- Audit Documentation can be understood by suitably qualified and experienced person having no previous connection with the audit engagement
- Needs for formalization of communication, supervision and review process
- Adoption of ICAN recommended or any audit practice manual and suitable customization based upon nature and size of clients
- Systematic organization of soft copy files and clear reference and linkage to documents in hard copy file
- Use of compliance checklists for ensuring compliance with Laws, NFRSs and NSAs

GOVERNANCE AND MANAGEMENT

Quality Assurance Board

Composition of QAB

The Board is constituted of 7 members from various sectors related to the accounting profession. The Board comprises a Chairperson, two Council Members, two general members other than practitioners, one representative from SEBON and one representative from the OAGN. The Chairperson and all other members except the Council Members are non-practitioners. The tenure of the Board is 3 years and is formed by the new Council of the ICAN.

Composition of QAB in F.Y. 2023/24

The composition of member in the QAB formed by 9th Council from its decision dated 29th July 2022 is depicted below:

S.No.	Name	Position	Affiliation
1	Dev Bahadur Bohara	Chairman	Former Deputy Auditor General at Office of Auditor General
2	CA. Chhetra Gopal Pradhan	Member	Council Member and a Practicing Chartered Accountant member
3	RA. Posh Raj Nepal	Member	Council Member and a Practicing Registered Auditor member
4	CA. Dipak Sharma	Member	Finance Director in a reputed Corporate Group of Organization
5	RA. Laxman Prasad Khanal	Member	Former Under Secretary in Financial Comptroller General Office
6	Muktinath Shrestha	Member	Acting Executive Director at Security Exchange Board of Nepal
7	Narayan M.C.	Member	Assistant Auditor General in Office of Auditor General
8	CA. Sanjay Kumar Sinha	Secretary	Executive Director, ICAN

Meeting and Decision of QAB

Altogether 7 meetings of the QAB were conducted during the year and the number of meetings attended by each member is as under:

S.No.	Member	Number of Meetings Attended
1	Dev Bahadur Bohara	7
2	CA. Chhetra Gopal Pradhan	7
3	RA. Posh Raj Nepal	5
4	CA. Dipak Sharma	3
5	RA. Laxman Prasad Khanal	5
6	Muktinath Shrestha	3
7	Narayan M.C.	4
8	CA. Sanjay Kumar Sinha	6

QAB Decisions across Area of Decisions for last six years

Agenda of the Meeting of the QAB is generally focused on three spectra as depicted below:

S. No.	Area of Decisions	2023/24	2022/23	2021/22	2020/21	2019/20	2018/19
1	Ratification of Quality Assurance Review Reports	5	5	9	7	7	1
2	Policy/Procedures Related Matters relating to QA and Audit Regulation	5	4	2	13	10	4
3	Oversight and decisions related to QA Operations	4	5	3	9	16	9

Composition of Staff

Technical Director of the ICAN lead the QAD comprising of following staff during F.Y. 2023/24:

S.No.	Name	Position	Role
1.	CA. Kiran Kumar Khatri	Director	Technical Director
2.	CA. Nilesh K.C.	Joint Director	Head of Division
3.	CA. Bharat Nepal	Deputy Director	Reviewer
4.	CA. Amrita Thapa	Assistant Director	Reviewer
5.	CA. Prapanna Gautam	Assistant Director	Reviewer
6.	Ms. Sabina Maharjan	Assistant	Administrative Staff

DISCLAIMER

This report is intended for general information only. The information in this report doesn't constitute professional advice and should not be construed upon as such. Further, this report does not provide any guarantee regarding standard of audit quality by practicing firms. The QAB and the Institute don't accept any responsibility for loss of any kind resulting to any person as consequence of decisions taken based on the information contained herein.




नेपाल चार्टर्ड एकाउन्टेन्ट्स संस्था

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NEPAL

Established under the Nepal Chartered Accountants Act, 1997

 ICAN Marg, Satdobato, Lalitpur

 P O Box 5289

 01-5430730, 5430832

 <http://www.ican.org.np>

 ican@ntc.net.np