

ANNUAL REPORT

F.Y 2079/80 (2022/23)

Quality Assurance Board (QAB)

Strengthening Audit Practices



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 FY 2022/23 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 2017 and for general information.

CONTENTS

MESSAGE FROM CHAIRPERSON	3
ABOUT US	5
Quality Assurance Division (QAD)	5
About Audit Quality Assurance	6
QUALITY ASSURANCE WORK PROCESSES	8
Planning, Execution and Completion	8
Understanding Grades, their Limitations and Resulting Action	9
QUALITY ASSURANCE REVIEW VISITS AND GRADES TILL F.Y. 2022/23	12
SYNOPSIS OF THE QUALITY ASSURANCE ACTIVITIES OF F.Y. 2022/23	15
Overview of Review Results in FY 2022/23	16
Findings from Review	20
Weaknesses Observed at Client's End	28
Potential Root Causes	29
The Institute of Chartered Accountants in England and Wales (ICAEW) Evaluation of the QA Review System	31
Quality Assurance Review Workshop- 2022	31
Visit to the Institute of Chartered Accountants of Bangladesh	32
GOVERNANCE AND MANAGEMENT	33
Quality Assurance Board	33
Composition of QAB	33
DISCLAIMER	36

MESSAGE FROM CHAIRPERSON



It is my privilege to present this fifth Annual Report of Quality Assurance Board (QAB) that comprises of a quality assurance review process and summary of activities that took place during the F.Y. 2079/80 (2022/23) in the Institute of Chartered Accountants of Nepal pursuant to Clause 12 of Audit Quality Assurance Review Procedure 2017. QAB has completed its eight years of service in providing Quality Assurance Reviews of audit firms for the purpose of promoting and ensuring audit quality.

The quality of audit work is of great importance to the Institute and its members, as it affects their reputation, credibility and, ultimately, demonstrates their ability to fulfil their conferred responsibility. Ensuring the quality

of audit performed by its practicing members is a significant challenge for the Institute. With this in view, the Institute is increasingly emphasizing quality assurance review activities and has included this activity in its annual work plan and intends to support audit firms in enhancing quality control systems, procedures and working methods.

Altogether, 183 Practice Units were reviewed till the end of F.Y. 2022/23 that consisted of 157 Chartered Accountants Firms and 26 'B' class Registered Auditor Firms of which 61% obtained 'Need Improvement' grading.

This report provides detailed overview of the quality assurance review procedure, quality control issues, review results, deficiencies in documentation, major review observation, potential causes of deficiencies and so on in audit system of practicing firms. The annual report of Quality Assurance Board reflects the knowledge gaps resulting from Quality Assurance visits.

This indicates that firms are required to upgrade their operational system at firm and assignment level by procedural improvement and proper documentation of audit performed so as to maintain quality of audit and upholding public interest to restore public trust which is the ultimate goal of the accounting profession.

Based on the review results the Institute

has to relook on the existing regulatory system to strengthen regulatory apparatus or standards enforcement mechanism to encourage firms to establish/enhancing quality control systems, procedures and working method so as to meet audit quality requirement and able to demonstrate professional behavior as per the international standards.

In the view of findings emanating from quality assurance review of the practicing firms, some major areas where audit firms need to focus includes: leadership should be responsible to maintain quality of audit in the firm by proper management of audit practice; enhance skill set of staffs involved in audit by preparing training calendar, audit fee considering the nature of business, size, complexities transaction etc., of the entity being audited; improve the audit practice management by using audit engagement software etc.

In the ever-changing landscape of economic change, regulatory compliances, technological disruption and client expectations, auditing profession has become more complex with the auditor needing to unlearn and re-learn different skills set and assume new responsibilities. QAB always strives for improvement in the audit system of the audit firms. The reports issued by QAB should be taken by the audit firm in a positive light and as an opportunity to find lacunas in their workflow thereby allowing for prompt and remedial response. However, the response from audit firms is lackadaisical as they see QAB as yet another regulatory

they have to comply with. This perception needs to change and QAB should be viewed as an advisor or friend suggesting the firms change or improve their workflow as mandated by the extant laws and regulations.

Finally, on behalf of the Board, I express gratitude to the Council of ICAN for entrusting us with the responsibility of running the Board for a period of three years which shall be completed with the term of existing Council. We believe that the Board has been successful in fulfilling its assigned task to a large extent but we admit much more could have been achieved. Appreciation is due to the members of the Board for their valued contribution, participation and support in fulfilling the responsibility as part of our mandate to conduct quality assurance review. The QAB staffs deserve appreciation for demonstrating their ability in performing the quality assurance review despite the limited resources.

Mr. Dev Bahadur Bohara

Chairperson, Quality Assurance Board

ABOUT US

Quality Assurance Board and Quality Assurance Division

Quality Assurance Board (QAB)

Quality Assurance Board (QAB) is the independent Board formed by the Council that provides direction, oversight, and control of operations of Audit Quality Assurance Activities. Rule 103 of Nepal Chartered Accountants Rule 2061 (along with amendments) has provisioned for the structure, governance, and operation of quality assurance activities. The Audit Quality Assurance Review Procedures 2017 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 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 having experience of at least 10 years and not holding COP, the Chairperson of the Securities Exchange Board of Nepal or the director nominated by him, and the representative from the Office of Auditor General. 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 Quality Assurance Board are to prepare the policies and program of Quality Assurance Review of the Audit Firms, to carry out or cause to carry out the Quality Assurance Review of the Audit 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 whole of the sector based upon the gravity of non-compliance or issues observed within the Audit Firm.

Quality Assurance Division (QAD)

Quality Assurance Division (QAD) is the unit within ICAN consisting of staff reviewers and other staffs for carrying out quality assurance reviews of the Audit Firms as per the QA Policy 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 decisions, supervision, and oversight of QAB from time to time.

The Quality Assurance Division is equipped with 5 Chartered Accountants working in the position of Director to Assistant Director, 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 Institute. The operations normally constitute the quality assurance reviews and all the processes in relation thereto connected with audit quality monitoring and assisting firms to improve their systems and audit processes.

The objective of audit quality assurance 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 achievement of the objective, Quality Assurance Reviews (QARs) of the audit firms are carried out to make an objective assessment of:

1. Whether or not the practicing member and audit firms have complied with Nepal Standards on Quality Control and provisions on quality control have been constantly applied.
2. Whether or not the practicing member and audit firms have complied with applicable Nepal Standards on Auditing and Code of Ethics in engagement performances.
3. Whether or not the practicing member and audit firms have complied with relevant laws and regulations applicable to the engagement performances.

Standards of Quality Assurance Review (IFAC SMO1)

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 – Quality Assurance requires every Professional Accountancy Organizations (PAOs) 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 Quality Assurance 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 Quality Assurance Review System is one of the regulatory apparatuses of the Institute and should not be construed as an audit or investigation. It attempts to provide a limited assurance to the Institute for taking regulative decisions and as inputs

for policy drives and the QA report is limited to the use of the concerned firm and the Institute. The Quality Assurance 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 partners bear the same level of responsibility, legal or otherwise, as to their opinion expressed in the audit engagements. The Quality Assurance Division, the Quality Assurance Board and the Institute do not guarantee or assure members and stakeholders that the files reviewed are an 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 Quality Assurance 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, CA Firms performing an audit of listed entities and other CA Firms and 'B' Class Registered Auditor's Firms performing audit of entities that exceed NRs 500 million of total assets have been prioritized for quality assurance review.

QUALITY ASSURANCE WORK PROCESSES

Planning, Execution and Completion

Audit Quality Assurance Review Process can be summarized as under:

Chapter I: Preparation and Planning

- Selection of Firms for review
- Notice to Firms regarding QA Visit along with information request or status request for follow-up review
- Agreeing on visit dates and reviewer allocation, 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
- Formulate strategy and action plan for review and identify risk areas, if any and document these 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 firm personnel about the system of quality control in the firm and review of documentation related to those
- 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

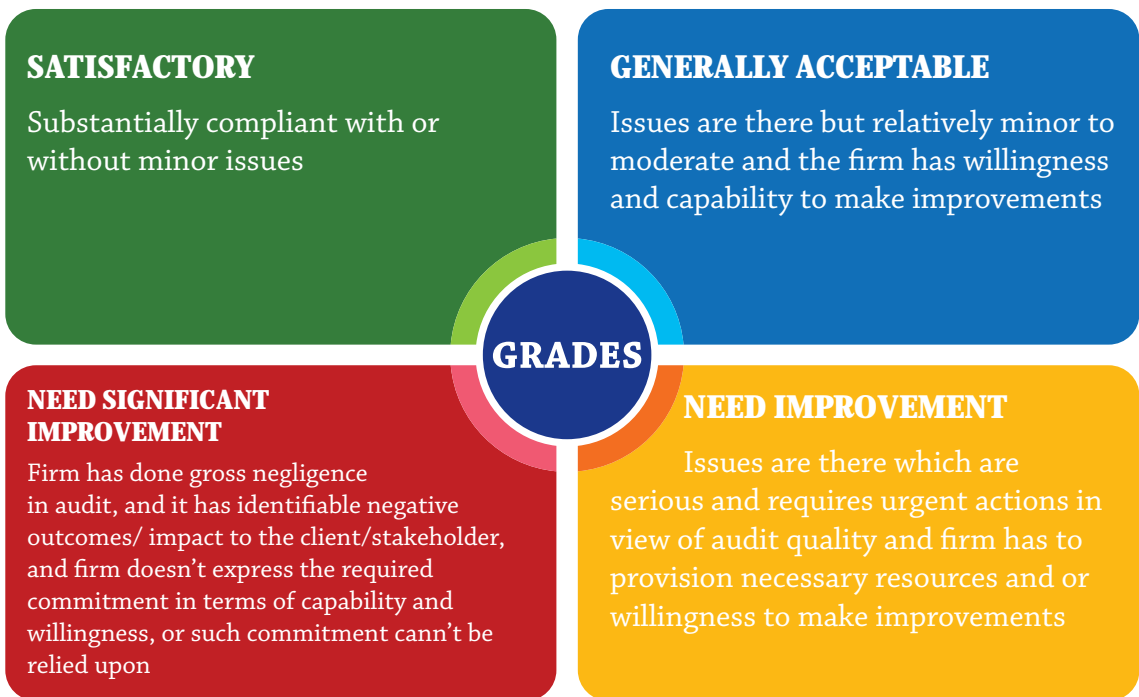
Chapter III: Reporting and Closure

- Draft QA report is prepared by the reviewer and reviewed by the Head of 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 neccisited 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 QA Division 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. The Board assign 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 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 number scored represents the higher grade as above.

The score obtained by the firms is a measure of, to what extent the requirement of all areas of firm's system and audit quality has been complied with and takes into account the responses of the firm in the issues identified. 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 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 sample 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 Quality Assurance Division 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 Registered Auditors, as they are reviewed based upon simplified checklists, considering overall scenario of Firms of Registered Auditors, in terms of number of partners, size of the firm, resources, nature and size of clients etc.

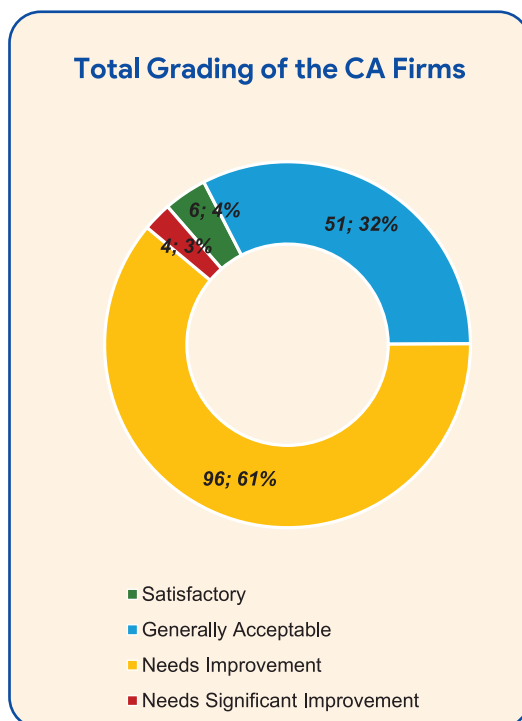
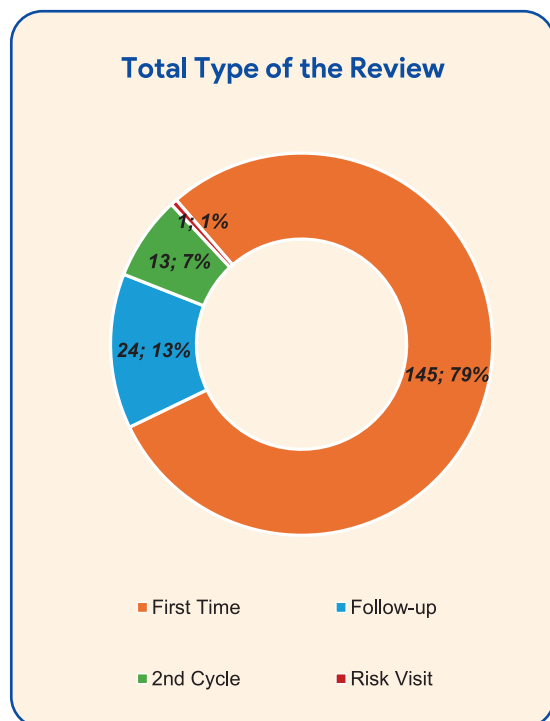
Resulting Actions on Closure of Reviews



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 want 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 make improvements.

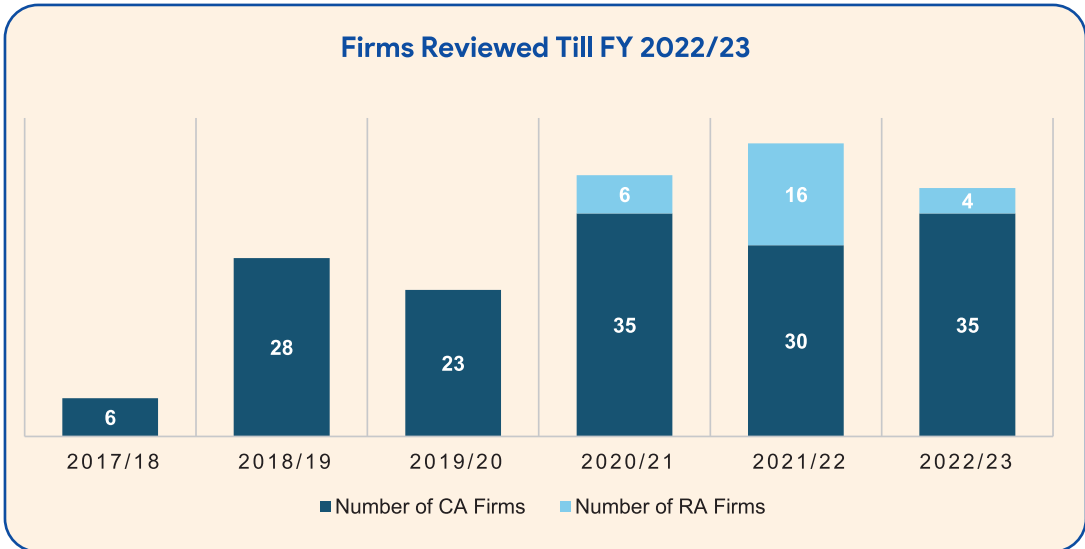
QUALITY ASSURANCE REVIEW VISITS AND GRADES TILL F.Y. 2022/23

Synopsis of Review conducted over last six years beginning from FY 2017/18 till the end of FY 2022/23



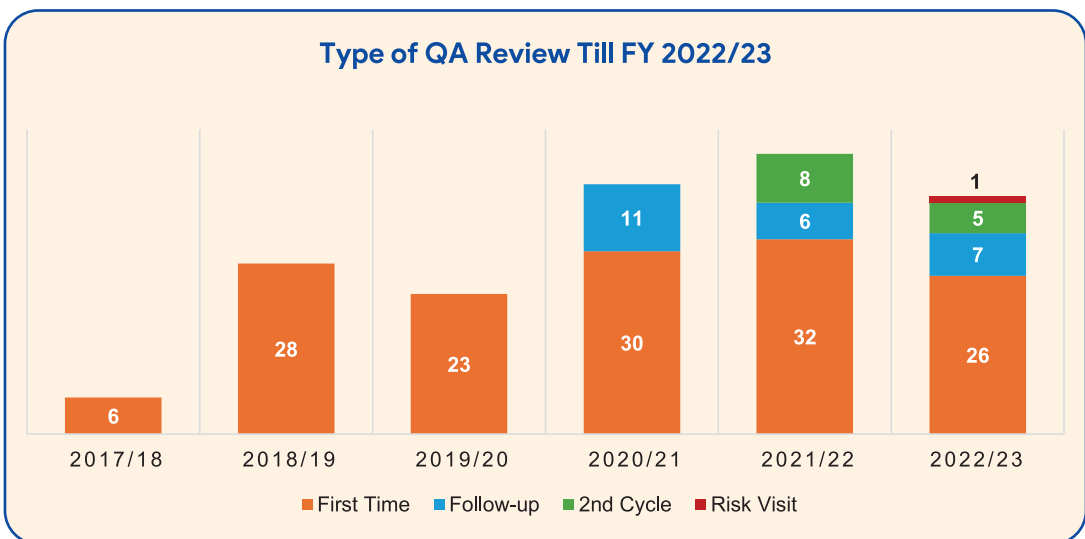
Reviews Carried Out Till F.Y. 2022/23

Quality Assurance Review visits started from FY 2017/18 and a total of 183 Practice Units were reviewed till the end of FY 2022/23. The practicing firms reviewed consisted of 157 Chartered Accountants Firms and 26 'B' Class Registered Auditor firms.



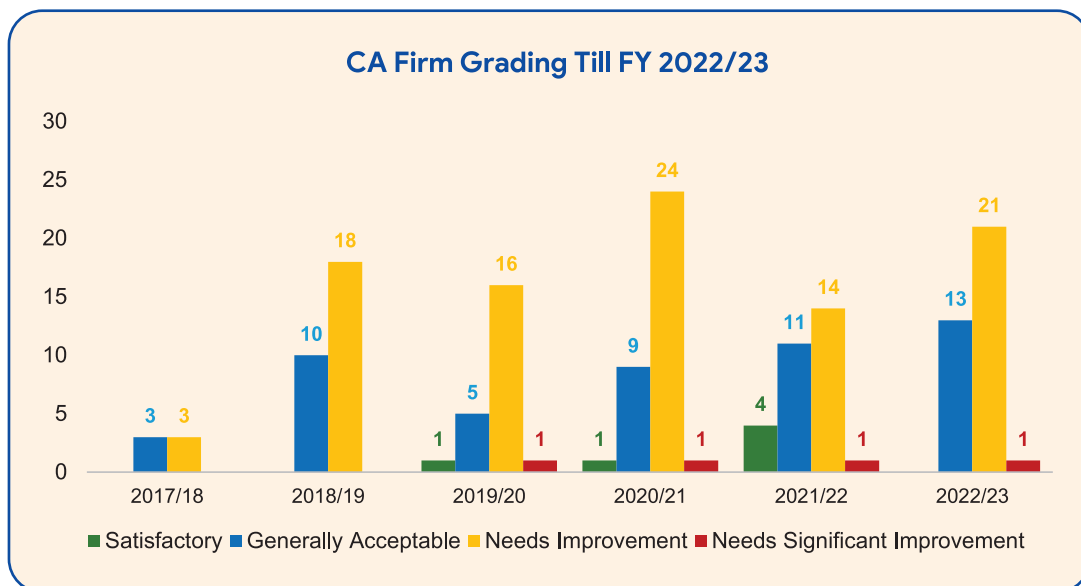
Types of Reviews Carried Out Till F.Y. 2022/23

Out of total 183 firms reviews conducted till fiscal year 2022/23, 145 were first time reviews, 24 were follow-up reviews conducted generally in one year's time, 13 were reviews of the 2nd cycle, 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.

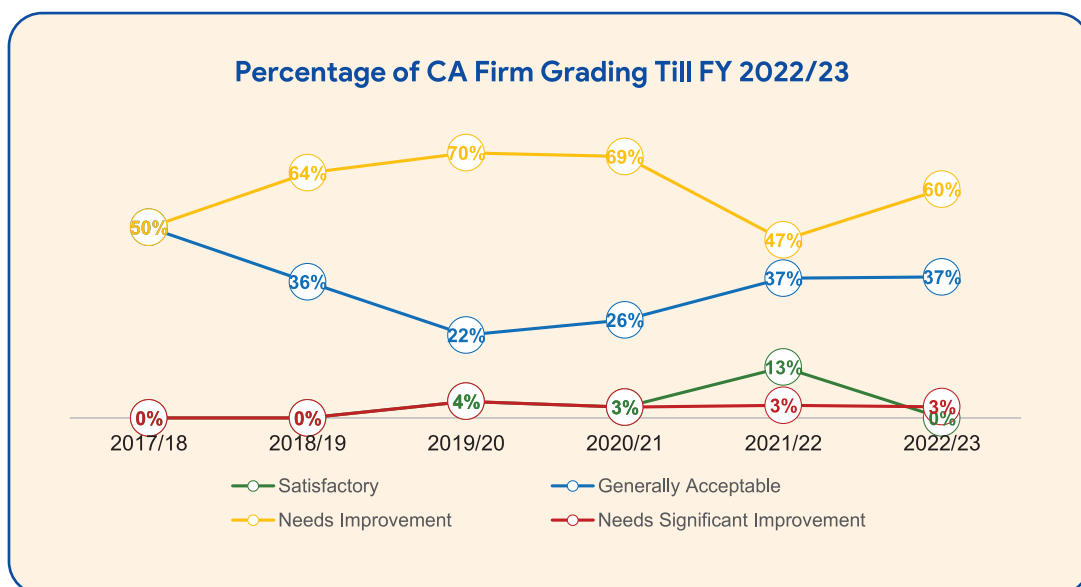


Grading Provided till F.Y. 2022/23

The total of 157 CA firms reviewed till the end of FY 2022/23 has been rated in different grade categories as per the decision of QAB as under.



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



SYNOPSIS OF THE QUALITY ASSURANCE ACTIVITIES OF F.Y. 2022/23

Altogether 8 meetings of the QAB were conducted during the year for discussion and decision on various Quality Assurance related matters.

Review of 39 practicing firms (35 Chartered Accountants Firms and 4 Registered Auditor Firms) were completed.

Review of 4 practicing CA firms outside Kathmandu valley was performed

Several other procedural activities incidental to strengthening of the review process were also carried out during the year.

Quality Assurance Workshop conducted in technical support of the Consultant from the Institute of Chartered Accountants in England and Wales (ICAEW) where the findings from Quality Assurance Review were discussed with the partners of the reviewed audit firms and the technical sessions on ISQM-1 and ISQM-2 were conducted.

Evaluation of QA System by ICAEW teams under RETA -2 completed and response on Evaluation Report provided to the evaluation team.

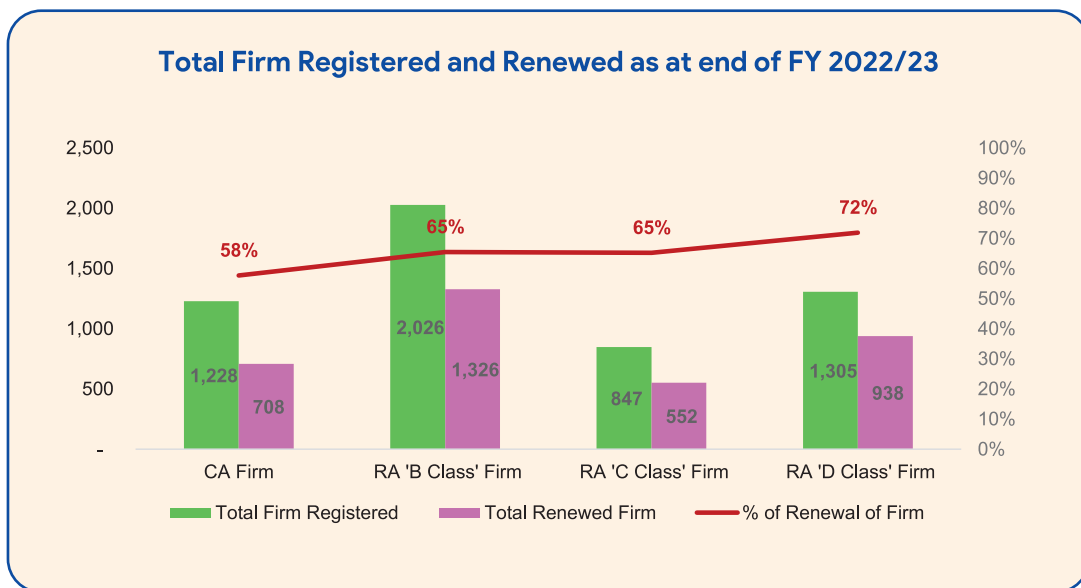
Training to the staffs of QA Division was organized by the Consultants of ICAEW.

Exposure visit of the Team of Reviewers of the Institute to the Institute of Chartered Accountants of Bangladesh.

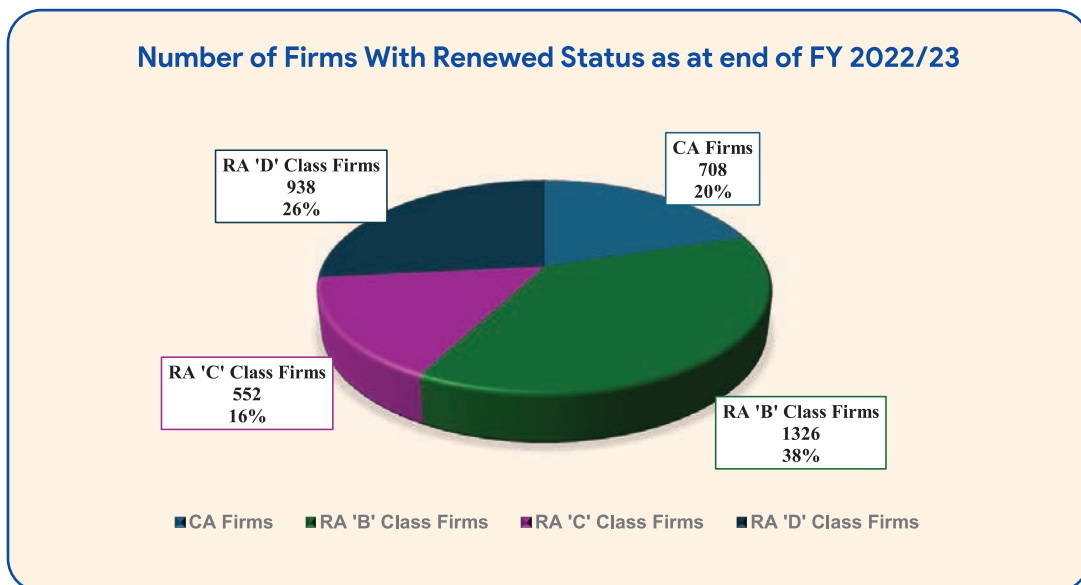
Overview of Review Results in FY 2022/23

Audit Firms Subject to Quality Assurance Review

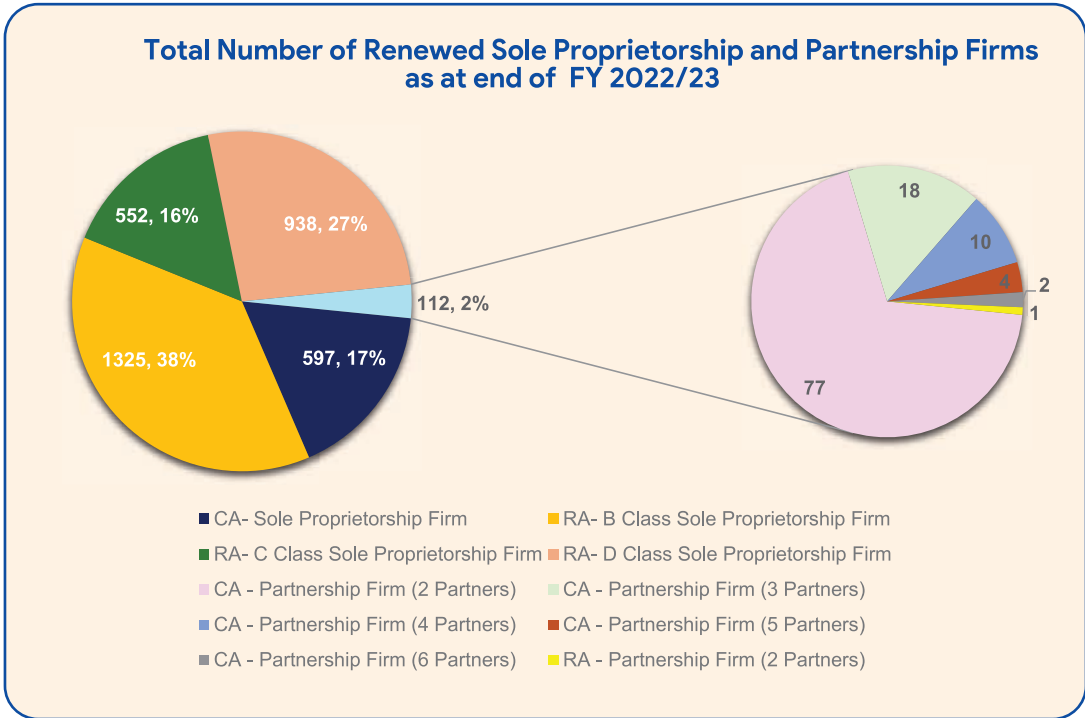
Till the end of F.Y 2022/23 altogether 5,406 audit firms were registered at the Institute out of which 3,524 audit firms have been renewed as at end of FY 2022/23. Total number of audit firms along with the renewed status as at end of FY 2022/23 has been presented below:



The number of audit firms under the purview of quality assurance reviews as of year ended 2022/23 was as follows:

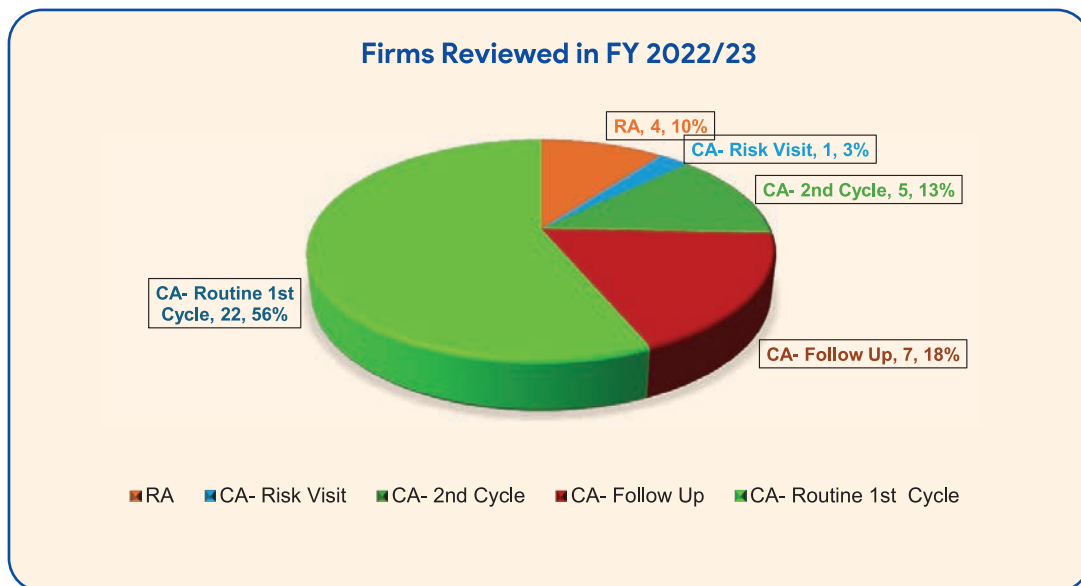


There were 3,524 renewed audit firms as at end of FY 2022/23 out of which only 20% were firms of Chartered Accountants. Likewise, 85% of total CA audit firms in Nepal are operating on proprietorship basis whereas, only 15% of those firms are operating as partnership firms and the maximum number of partners 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.



QA Reviews in F.Y. 2022/23

A total of 39 audit firms were reviewed during FY 2022/23 that includes 35 firms of Chartered Accountants. Out of which 6 reviews were of a follow-up nature and 5 were reviews of the 2nd cycle. Likewise, 3 Practicing Firms of Registered Auditors were reviewed for the first time and 1 Practicing Firm of Registered Auditor was reviewed as a follow up review.



Grades Provided to QA Visits in F.Y 2022/23

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 2022/23 are as under:

Grade	Number of CA firms receiving the grade	Percentage of Firms falling in each grade
Satisfactory	0	0%
Generally Acceptable	13	37%
Need Improvement	21	60%
Need Significant Improvement	1	3%

Status of Grades among the Follow-up and 2nd Cycle Review Visits

The following status was seen of 6 follow-up reviews and 5 firms 2nd cycle reviews of Chartered Accountant firms conducted during the year 2022/23. The firms were selected for follow-up review visits as they obtained the “Need Improvement Grade”, and cycle review was conducted after 3 years from the date of the last scheduled visit.

Grade Status of Follow - up & 2nd Cycle Review Visits in FY 2022/23

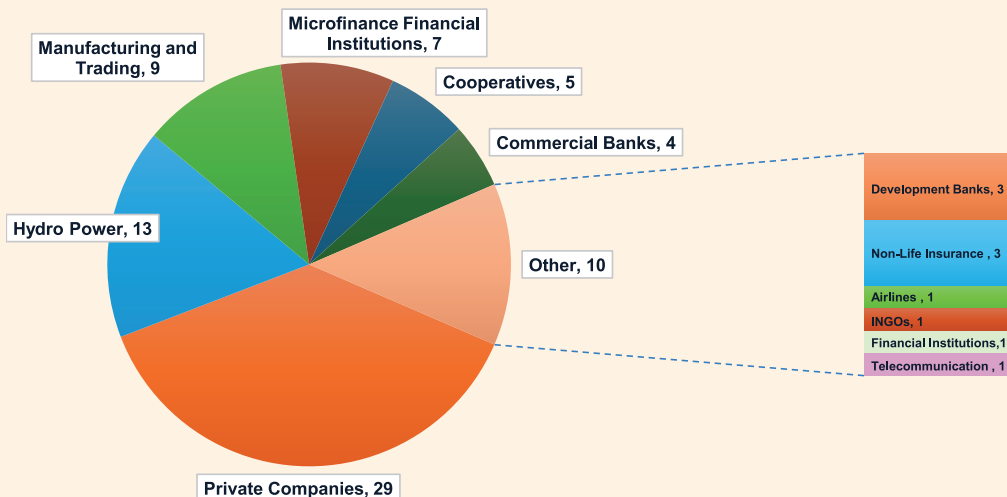


Category of Files Reviewed in F.Y 2022/23

Starting from FY 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 entity audit and the other files were selected based on the nature or size of the business. Since the clients of the registered auditors are all unlisted entities, their files were selected based on the nature and size of the business. During the period, the ‘B’ Class Registered Auditor’s Firms were reviewed along with at least one file whose sum of total assets/liability exceeded 500 million Nepalese Rupees.

The QAB has reviewed a total of 77 audit engagements relating to diverse economic and business sectors of 39 firms in the year 2022/23. The number of audit files of private limited companies reviewed is relatively high in comparison to other sectors.

Category of Files Reviewed Across Categories in FY 2022/23



Findings from Review

Quality Assurance 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.

The 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. Quality Assurance 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 or weakness as identified by the QA reviews is depicted here under :

1. 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 previous auditors in most of the cases while accepting new clients. Further, prior approval of the client was not obtained in cases where communication was established with previous auditors.
- Familiarity threat was not considered while forming the audit team either in case of continuing clients.

2. Auditor Appointment:

(Relevant Criteria: Applicable Legal Provision and NSA 210)

- Acceptance of appointment contrary to the provision of Company Act 2063.
- Auditor remuneration was not specified in the appointment and engagement letter in few cases.
- Few cases of non-receipt of appointment letter or AGM minutes related to Auditors' Appointment were noted.

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 includes (test of detail and substantive analytical procedures), across various audit areas.
- In a few cases, audit time plan was also not prepared or 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 of the 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.

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.
- Audit documents comprising of planning documents, joint team meetings etc. related to communication between joint auditors were not appropriately maintained.

2. 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 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 huge 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 generic way, and not customized to reflect the nature and size of client and related requirements.
- Findings observed, judgment made, and conclusion reached was also not present in a documented form.
- Identification of performer of audit procedures and date such were performed and identification of reviewer and date of such were reviewed were not disclosed.
- Audit files were not properly organized; neither there was 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 complies with the guidelines issued by ICAN is also not kept in file.
- Lead schedule and sub schedule was not prepared for line item of financial statements.
- In some of the audits of Consolidated Financial Statements, no evidence of communication with component auditor in case of consolidated financial statement audits. Also, no additional audit procedure has been performed in the work of component auditor. Besides, cases were noted whereby, the auditor of

parent company has not considered the impact of non-preparation of consolidated financial statements and non-compliance of the reporting framework while consolidation.

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 few cases, communication with management regarding prospective modification of audit report was also not done.
- In most of the cases, auditors didn't have any meeting with the Audit Committee or Board of Directors.

4. Management Representation Letter:

(Relevant Criteria: NSA 580)

- The management representation letters were obtained much earlier than the date of signing of auditor report.
- Management representation letters were not obtained at all in some cases.
- Most of the contents of the management representation letter were generic 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, inaccurate representation has been provided by the management and no audit procedure was performed to evaluate the representation and resolve the matter by auditor for inconsistency.

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.

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 exert (NSA 500).

3. 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 have not maintained documentation for forming the basis of opinion and their judgement on how the opinion expressed might be appropriate in the given circumstances.
- Adequate documentation is not in place for substantiating the issue of unqualified auditor opinion where material non-compliances were identified.
- Clarity on the type of audit opinion to be expressed was seen to be lacking. For example: for non-adoption of IFRIC 12 in hydropower sector and for non-adoption of NFRS in Co-operatives and private sectors, types of audit opinion expressed differed across auditors and audit firms.
- In case of audit of Micro Finance Financial Institutions, practice of issuing two opinions (unqualified opinion for compliance with NRB requirement and disclaimer of opinion for non-compliance with NFRS) on the same audit report of same audit period.
- Cases were noted, whereby auditor has expressed unqualified opinion on incomplete set of financial statements, such as in case of statutory audit of development sector client, audit opinion was expressed on fund accountability statements only without complete set of financial statements as per requirement of NAS 1.

2. Independent Auditor's Report:

(Relevant Criteria: NSA 700 series of standards)

Even though most of the auditor's report reviewed seemed satisfactory, some issues mentioned below were noted:

- Auditor's Reports were not in an exact format prescribed by NSA 700.
- Basis of Opinion paragraph was not included in few reports and in case of inclusion, basis was not described properly.

- The auditor's responsibilities paragraph was not modified in most cases where disclaimer opinion was issued.
- Key Audit Matters were neither included in some audit reports of listed entities nor clearly stated that there is nothing to report under KAM.
- 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 BAFI Act was missing.
- Cases of clerical errors in the auditor's report were also frequent.
- Auditor report not revised in case where financial statement has been revised after the issuance of the auditor's report.
- Audit report issued without expression of clear audit opinion.

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 determinable as per the guidelines related to minimum audit fees issued by ICAN.
- In few cases, there were issues whereby the type of opinion issued was stated otherwise in LFAR submitted to NRB For instance, in case of microfinance the opinion issued in an independent auditor's report was unmodified but the same was stated as disclaimer of opinion for NFRS non-compliance in LFAR.
- In case of audit of Cooperatives, issues were noted whereby, firm has not submitted LFAR to the Cooperative Division as per requirement of Lekha Parikshan Mapdanda 2075.

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 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.
- Written confirmation of compliance with firm's policies on independence by the staffs 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. Cases whereby, there were no any human resources except for partners were only noted.
- System of self-monitoring as required by NSQC-1, or its documentation was not found in most of the firms. However, in few cases, monitoring was found conducted by audit managers, even in a partnership firm.

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

- In some cases, UDIN for statutory audit of private firms were generated under tax audit category and 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.
- 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 many microfinance institutions.
- Non-adoption of NFRS Framework by a private company required to adopt NFRS due to crossing of limit of assets/liabilities fixed for application of NFRS for SMEs framework.
- Investment in Associates was not accounted for as per NAS 28
- Non-compliance with IFRIC-12 by many hydropower companies.

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 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.
- Generally, in NFRS compliant financial statements, those accounting policies not related to the elements of financials are also disclosed thus making the financial statement bulky for no additional benefit to users.

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).

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 staffs recruited or hired doesn't 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 staffs 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.

The Institute of Chartered Accountants in England and Wales (ICAEW) Evaluation of the QA Review System

The Quality Assurance Board of the Institute under the Regional Technical Assistance (RETA 2) project of the Confederation of Asia Pacific Accountants (CAPA) and Asian Development Bank (ADB) has been receiving technical assistance from the Institute of Chartered Accountants in England and Wales (ICAEW). The RETA 2 project completed on 2023 and the delegation QA consultant from the ICAEW, comprising of independent consultant for ICAEW, Mrs. Linda Barnes and Quality Reviewer at ICAEW, Mrs. Karen Cook visited the Institute from 28th November 2022 to 9th December 2022.



Glimpse of Interaction Meeting of ICAEW Delegation with the Council Members, Members of Quality Assurance Board and Officers of the Institute at ICAN Premises on 9th December 2022

During the visit, the team reviewed the quality assurance and disciplinary processes of the Institute, accompanied the quality assurance review visit of the selected audit firms in Nepal, provided training to the Quality Assurance Reviewers of the Institute. The team also facilitated as panelist and paper presenter in the quality assurance workshop that was organized by the Institute.

The team had a meeting with the Quality Assurance Board and Council of the Institute whereby they shared the outcome of their visit and interacted with the Board and Council Members on International Best Practices and way forward of the quality assurance review mechanism of the Institute.

Upon completion of the review, the delegation provided a Final Report comprising of suggestions and feedback for strengthening the QA system of the Institute. The QAB reviewed the report and the QAD prepared course of action along with time plan for addressing the issues reported during evaluation and monitoring visit. The QAB final report was also presented before Council.

Quality Assurance Review Workshop- 2022

The Institute organized a Quality Assurance Review Workshop- 2022 on 30th November 2022 at ICAN premises located at Satdobato, Lalitpur, Nepal. The objective of this workshop was to brainstorm the avenues of strengthening Quality Assurance Review Mechanism of ICAN and improving Audit Firm's System of Quality Management. The

program started with the welcome remarks of ICAN Vice-President, CA. Sujan Kumar Kafle and was organized in two sessions comprising of paper presentation, panel discussion and question answer session. The session in workshop was Chaired by Mr. Dev Bahadur Bohara, Chairman of QAB whereby, CA. Kiran Kumar Khatri, Technical Director, ICAN; Mrs. Karen Cook and Mrs. Linda Barnes, ICAEW Consultants gave paper presentation in the workshop. CA. Anup Kumar Shrestha, Chairman, AuSB, Nepal; CA. Sashi Satyal, CA. Kiran Kumar Khatri along with the Consultant from ICAEW were the panelist in the session. The workshop concluded with the vote of thanks from the Council Member and Member of the QAB, CA. Chhetra Gopal Pradhan. Practicing members, Past Presidents, Council Members and Officials from the Institute participated in the workshop.



Left: ICAWE Consultant, Mrs. Karen Cook; QAB Chairperson, Mr. Dev Bahadur Bohara; ICAEW Consultant, Mrs. Linda Barnes; CA. Sashi Satyal; Chairman AuSB, Nepal, CA. Anup Kumar Shrestha and Technical Director, CA. Kiran Kumar Khatri during the panel discussion in the QA Review Workshop, 2022

The detailed report of the workshop can be accessed from the link below:

https://en.ican.org.np/_browsable/file/qab/Report_on_QAB_Workshop.pdf

Visit to the Institute of Chartered Accountants of Bangladesh

Delegation from the Quality Assurance Division comprising of CA. Kiran Kumar Khatri, Director; CA. Bharat Nepal, Deputy Director and CA. Manoj Ghimire, Assistant Director had an exposure visit to the Institute of Chartered Accountants of Bangladesh on 21st and 22nd March 2023.

The purpose of the visit was to understand the QA system, regulating provision and practices at ICAB. The delegation had a meeting with President, Vice Presidents, CEO, COO, Departmental heads and QA team of the ICAB and visited one of the practicing audit firms in Bangladesh.



Group photo of ICAN delegation presenting a token of love to the Mr. Md. Moniruzzaman FCA President, ICAB at ICAB Premises located at Dhaka, Bangladesh

Upon completion of visit, the delegation presented a visit report about the comparative study of QA practice at the Institute and ICAB before the QAB.

GOVERNANCE AND MANAGEMENT

Quality Assurance Board

Composition of QAB

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

S.No.	Name	Position	Affiliation
1	Mr. 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. Shankar Gyawali	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	Mr. Muktinath Shrestha	Member	Executive Director at Security Exchange Board of Nepal
7	Mr. 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 8 meetings of the Quality Assurance Board were conducted during the year and the number of meetings attended by each member is as under:

S.No.	Member ¹	Number of Meetings Attended
1	Mr. Dev Bahadur Bohara	8
2	CA. Chhetra Gopal Pradhan	8
3	RA. Shankar Gyawali	5
4	CA. Dipak Sharma	4
5	RA. Laxman Prasad Khanal	7
6	Mr. Muktinath Shrestha	6
7	Mr. Narayan M.C.	7

¹ CA. Sanjay Kumar Sinha, Executive Director and CA. Kiran Kumar Khatri, Director attended all meetings of the Quality Assurance Board as Secretary and Invitee respectively.

QAB Decisions across Area of Decisions for last five years

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

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

Composition of Staff

Technical Director of the Institute lead the Quality Assurance Division comprising of following staffs during FY 2022/23:

S.No.	Name	Position	Role
1	CA. Kiran Kumar Khatri	Director	Technical Director
2	CA. Rajan Nepal	Joint Director	Head of Division
3	CA. Bharat Nepal	Deputy Director	Reviewer
4	CA. Manoj Ghimire	Assistant Director	Reviewer
5	CA. Amrita Thapa	Assistant Director	Reviewer
6	CA. Diwakar Giri	Assistant Director	Reviewer
7	Mr. Shiva Bhattarai	Junior Assistant	Administrative Staff
8	Ms. Sabina Maharjan	Assistant	Administrative Staff

Group photo of Members of QAB and Staffs of QAD



1st Row (L to R) : CA. Kiran Kumar Khatri, Technical Director ; CA. Nilesh K. C., Joint Director ; CA. Amrita Thapa, Assistant Director ; CA. Prapanna Gautam, Assistant Director and CA. Bharat Nepal, Deputy Director
 2nd Row (L to R) : CA. Chetra Gopal Pradhan, Member QAB ; RA. Dev Bahadur Bohara, Chairman QAB; RA. Laxman Prasad Khanal, Member QAB and Mr. Muktinath Shrestha, Member QAB
 (Not Covered in above photo - QAB Member : RA. Posh Raj Nepal, CA. Dipak Sharma, Mr. Narayan M.C. and QAB Secretary & Executive Director: CA. Sanjay Kumar Sinha)

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 Quality Assurance Board (QAB) and the Institute doesn'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

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