

Guidance Notes 203:

Guidance Notes to Implement Nepal Standards on Quality Control 1

Preface

We all agree that the auditing profession worldwide commands respect and demand for its services primarily on account of the faith of the public, at large on its work. Therefore, irrespective of the size and nature of services it is providing, an audit firm or professional accountant should always ensure that its services are of greatest quality and adhere to various legal requirements and code of ethics and other pronouncements of the regulators, including the Institute of Chartered Accountants of Nepal

In this connection the Auditing Standards Board (AuSB), going hand in hand with the developments in the international scenario, developed the Nepal Standard on Quality Control (NSQC) 1: "Quality Control for Firms that Perform Audits & Reviews of Historical Financial Information, and Other Assurance & Related Services Engagements". This Standard is a mother Standard for all other Standards and is an all pervasive Standard in respect of quality control. The Institute of Chartered Accountants of Nepal (ICAN) issued this Standard partially mandatory effective from July 16, 2008 (corresponding to 1st Shrawan 2065) and fully mandatory from July 16, 2010 (corresponding to 1st Shrawan 2067). The NSQC 1 contains extensive requirements in relation to establishment and maintenance of a system of quality control (QC) in the audit firms, whether partnership or sole practitioners.

As we know, the members of the Institute are required to (a) comply with the Technical Standards made mandatory for application by the Institute and (b) have in place proper systems (including documentation systems) for maintaining the quality of the attestation services work they perform. NSQC guides members to establish such proper systems in respective of:

- a) Leadership responsibilities for quality control within the firm
- b) Ethical Requirements
- c) Acceptance and Continuation of Client Relationships and Specific Engagements
- d) Human Resources
- e) Engagement Performance, and
- f) Engagement Quality Control Review & its Documentation

While each firm's specific approach regarding documentation, outside consultation, professional development, etc. depends largely on its size and organisational structure, it is envisaged that each of those elements must be present in one way or the other to ensure implementation of technical standards and that the staff and partners must understand the complexities of issues involved therein. It is beyond doubt that while establishing systems and procedures, an audit firm, particularly a SMP, is likely to see the compliance cost increasing in the short-term. However, the increased cost will be an investment in assisting the firm in adhering to technical standards and improving the overall quality of audit. In addition, the firm will also benefit through gains in its overall reputation and image.

With an intention to help understand the Standards on Quality Control and for its easier implementation and greater acceptance among the membership at large, the AuSB has brought out this implementation guidance notes on quality control standards. This guidance notes provides a set of illustrative policies and procedures that an audit firm may adopt, with or without modification. This Guidance Notes also encourages the firms to tailor their Quality Control policies to make them relevant according to their size, composition, number and nature of employed or contracted professionals, services rendered, kind of clientele, etc. The Annexures to this Guidance Notes provide the illustrative forms, checklists and templates that a firm may adopt, with or without modification.

Last but not the least, I wish to place on record my sincere appreciation to former chairman and members of the AuSB for their initiation to publish this Guidance Notes. I also wish place on record my appreciation to the members of the Board for providing valuation suggestion to improve upon the draft and Mr. Lokman Maskey, Secretary and his team of officers, for their efforts to prepare the draft and ensuring the quality of the published material.

I am sure that this Guidance Notes will help the Professional Accountant firms in implementing NSQC 1 more effectively and also in ensuring the quality of the services provided by them to its clients, in particular and economy as a whole.

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Kathmandu

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July 2010

Auditing Standards Board

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Introduction

Nepal Standard on Quality Control (NNSQC) 1, *Quality Control for Firms that Perform Audits & Reviews of Historical Financial Information and Other Assurance & Related Services Engagements*, developed by Auditing Standards Board and issued by the Institute of Chartered Accountants of Nepal (ICAN), deals with a professional accountant firm's responsibilities for its system of quality control for audits and reviews of financial statements, and other assurance and related services engagements undertaken by the firm.

NSQC1 applies to all firms of professional accountants in respect of audits and reviews of financial statements, and other assurance and related services engagements. The nature and extent of the policies and procedures developed by an individual firm to comply with the NSQC 1, however, will depend on various factors such as the size, composition, number and nature of employed or contracted professionals, services rendered and operating characteristics of the firm, and whether it is part of a network.

The text of NSQC 1 is given in Appendix to this Guidance Note. The nature, extent and formality of a firm's quality control (QC) policies and procedures should be sufficiently comprehensive and suitably designed in relation to the firm's size, the nature and complexity of the firm's practice and appropriate cost-benefit considerations.

The objectives of the firm shall be to establish and maintain a system of quality control to provide it with reasonable assurance that:

- a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
- b) Reports issued by the firm or engagement partners are appropriate in the circumstances.

A system of quality control adopted by the firm should consist of policies designed to achieve the said objectives and the procedures necessary to implement and monitor compliance with those policies. Because circumstances may vary widely and all such circumstances cannot be anticipated, the firm shall consider whether there are particular matters or circumstances that

require the firm to establish policies and procedures in addition to those required by the NSQC 1 to meet the stated objective.

NSQC 1 should be read in conjunction with the requirements of the Chartered Accountants Act, 1997, the Code of Ethics and any other relevant pronouncements of the Institute of the Chartered Accountants of Nepal (ICAN) and relevant legal or regulatory requirement (together referred to as "the Code"). Other Auditing Standards set out additional standards and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. For example, NSA 220 deals with quality control procedures for audits of financial statements.

THE SIX ELEMENTS OF NSQC1

NSQC 1 requires a firm to establish and maintain a system of quality control that includes policies and procedures addressing each of the following six elements:

- a. Leadership responsibilities for quality within the firms;
- b. Relevant ethical requirements;
- c. Acceptance and continuance of client relationships and specific engagements;
- d. Human resources;
- e. Engagement performance; and
- f. Monitoring.

These six elements of QC are interrelated. For example, for a firm to maintain ethical requirements that include independence, integrity, and objectivity, it must continually assess client relationships that affect policies and procedures related to acceptance and continuance of clients and engagements to ensure that it does not have negative impact on compliance with the ethical requirement. Similarly, the human resources element of QC encompasses recruitment, capabilities and competence of firm personnel which all affect policies and procedures related to engagement performance i.e. need of a specialized knowledge and skill, hiring of experts, etc..

NSQC 1 requires the firm's QC policies and procedures to be documented and communicated to its personnel. Such communication describes the QC policies and procedures and the objectives they are designed to achieve, and includes the message that each individual has a personal

responsibility for quality and is expected to comply with these policies and procedures. In addition, the firm should recognize the importance of obtaining feedback on its QC system from its personnel. Therefore, the firm should encourage its personnel to communicate their views or concerns on QC matters.

SCOPE OF THE GUIDANCE NOTE

This Guidance Note aims to provide further explanation of the requirements of NSQC 1 and guidance for implementing them. In particular, it:

- i) Explains more precisely what a requirement means or is intended to cover; and
- ii) Includes examples of policies and procedures that may be appropriate in the circumstances.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. Where appropriate, additional considerations specific to public sector audit organizations or smaller firms are incorporated in this Guidance Note. Those additional considerations assist in the application of the requirements of the NSQC 1. However, they do not limit or reduce the responsibility of the firm to apply and fully comply with the requirements in the NSQC 1 and it should not be considered substitute for the requirement of NSQC 1.

As mentioned above, the professional accountant firms are encouraged to tailor their QC policies to make them relevant to their size, composition, number and nature of employed or contracted professionals, services rendered, kind of clientele, etc.

This Guidance Note also provides, in the Annexure, the following illustrative forms, checklists and templates that a professional accountant firm may adopt, with or without modification:

- Annual firm personnel independence confirmation;
- Model independence policies;
- Client/engagement acceptance and continuance form;
- Engagement planning memorandum template;
- Engagement summary memorandum template;

- Engagement QC review report template; and
- Firm QC inspection checklist.

The policies and procedures established by firms and their updates need to be communicated in writing to and are binding on all their partners and professional staff, including articulated trainees. Further, the document(s) containing such policies and procedures should also be made available to a reviewer appointed by the Peer Review Board of the Institute of Chartered Accountants of Nepal.

Element 1

Leadership Responsibilities for Quality within the Firm

INTRODUCTION

- 1.1 The objective of this element of QC is to promote an internal culture based on the recognition that quality is essential in performing engagements. Policies and procedures should require the Firm's Principal (PR) or Managing Partner (MP) or Senior Partner (SP) or equivalent¹ to assume ultimate responsibility for the firm's system of QC.
- 1.2 Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all engagements that the firm performs.
- 1.3 The promotion of a quality oriented internal culture depends on clear, consistent and frequent communications of the QC policies and procedure and importance to its personnel. Firm's actions and messages encourage a culture that recognises and rewards high quality work. These actions and messages may be communicated by training/seminars, meetings, formal or informal dialogue, mission statements, newsletters or briefing memoranda. They may be incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.
- 1.4 The Firm satisfies this objective by establishing and maintaining the policies and procedures described below.

POLICIES AND PROCEDURES

Policy 1: Fixing ultimate responsibility for the Firm's system of QC.

¹ Person designated to assume overall responsibilities of the firm and its operations and referred to as MP throughout this guidance note.

- 1.5 The Firm implements this policy through the following procedures:
- Indicating the person responsible for QC in firm's operation document².
 - Having the managing partner ultimately responsible for the design, implementation and operating effectiveness of the firm's system of QC and for setting a tone that emphasizes the importance of quality.
 - Educating professional personnel³ about the requirements and importance of following a system of QC.
 - Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.

Policy 2: Commercial considerations do not override the quality of the work performed

- 1.6 The Firm implements this policy through the following procedures:
- Having the MP continually evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of QC.
 - Emphasizing to all personnel that fee considerations and scope of services should not infringe upon quality of work, documentation and other QCs.

Policy 3: Assigning Operational Responsibility for the Firm's System of Quality Control

- 1.7 The Firm implements this policy through the following procedures:

² Office Operating Manual or Partnership Deed, where roles and responsibilities of the partners are stated.

³ The term "professional personnel" includes sole proprietor, partners, qualified chartered accountants (employed or contracted), others involved in performing audit and trainees.

- Having the MP designate a QC partner⁴ who is responsible for designing, implementing, and monitoring the Firm's QC system.
- QC partner to have sufficient and appropriate experience and ability that enables the person (s) to identify and understand quality control issues and to develop appropriate policies and procedures.
- Delegating necessary authority to enable the QC partner to implement those policies and procedures.

Policy 4: Recognizing and Rewarding High Quality Work.

1.7 The Firm implements this policy through the following procedures:

- Designing and implementing performance evaluation and advancement systems that reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards.
- Establishing a compensation system that provides incentives to accounting and auditing partners and senior level employees for the quality of their accounting and auditing work. The compensation system does the following:
 - Takes into consideration the Firm's feedback based on monitoring results and peer reviews of the work performed.
 - Rewards partners and personnel for timely (a) identification of significant and emerging accounting and auditing issues and (b) consultation with Firm designated experts.

Policy 5: Allocating sufficient and appropriate resources for the development, communication and support of firm's QC policies and procedures

⁴ In case of sole proprietorship, the sole practitioner is the QC partner. He may assign this job to a senior most qualified staff within the firm.

1.9 The firm implements this policy through the following procedures:

- Providing the designated QC partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's QC policies and procedures.
- Providing the firm's QC documentation and briefing to the personnel when they are initially hired and reviewing the documentation with them.
- Reviewing the Firm's QC policies and procedures with personnel at firm training sessions or otherwise at least annually and updating them, if required.

Element 2

Ethical Requirements

INTRODUCTION

- 2.1 One of the objectives of this element of QC is to provide the Firm with reasonable assurance that it and its personnel comply with relevant ethical requirements. Ethical requirements relating to audits and reviews of historical financial information, and other attestation engagements are contained in the Code of Ethics issued by the Institute of Chartered Accountants of Nepal as well as other relevant pronouncements of the Institute or relevant laws⁵.
- 2.2 The other objective of this element of QC is that the personnel maintain independence in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.
- 2.3 The fundamental principles of professional ethics include integrity, objectivity, professional competence and due care, confidentiality and professional behavior. The conceptual approach to independence follows a threats and safeguards approach where threats to independence⁶ are identified, assessed, and appropriate safeguards applied to eliminate or reduce the threats to an acceptable level. Where it is not possible to reduce the threats to an acceptable level, the firm considers withdrawing from the engagement or from the client or both.
- 2.4 The fundamental principles of ethics and independence are achieved by the actions of firm's leadership, education and training, monitoring policies and by establishing and implementing a process for dealing with non-compliance. The Firm satisfies these objectives by establishing and maintaining the policies and procedures described below:

POLICIES AND PROCEDURES

⁵ For instances, Banking and Financial Institutions Act, Securities Exchange Act, etc.

⁶ Threats to independence are Self-interest threat, Self-review threat, Advocacy threat, Familiarity threat and Intimidation threats

Policy 1: Ensuring that firm personnel adhere to ethical requirements.

2.5 The firm implements this policy through the following procedures:

- Having the MP designate an Independence and Ethics partner⁷ who is responsible for all aspects of the independence and ethics of the Firm's partners and professional staff. The designated Independence and Ethics Partner may be the same individual as the designated QC partner/staff, if the Firm so desires.
- Empowering the Independence and Ethics partner to perform such checks as may be required to ensure that all personnel respect and follow the independence and ethics policies of the Firm and takes disciplinary action as is warranted for any breaches thereof.
- Establishing a system for identifying all services performed for each client and evaluating whether any of those services might impair independence.
- Regularly consulting the ICAN's and AuSB's journal/publications and websites for information about changes in professional ethics and independence standards/requirements.
- Ensuring that firm includes topics on professional ethics on its training programs and all professional personnel attend such trainings.

Policy 2: Communicating independence requirements to Firm personnel and, where applicable, others subject to them.

2.6 The firm implements this policy through the following procedures:

- Informing personnel of their responsibilities with regard to independence by doing the following on a timely basis:
 - Preparing and maintaining a list of entities⁸ with which Firm personnel and

⁷ In case of a sole proprietorship, the sole proprietor is the Independence and Ethics Partner

⁸ Entities are Firm's audit and attest clients

- Others⁹, if any, are prohibited from having a financial or business relationship.
- Making the list available to the concerned personnel so they may evaluate their independence.
 - Notifying personnel of changes in the list as soon as such changes occur.
- Providing frequent reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity.
 - Obtaining of list of entities from firm's professional staff and others where they have direct business relationship, like business transactions (credits or loans), shareholding or their close relatives work in the higher level management responsible for making business decisions that may impair independence.

Policy 3: Identifying and evaluating possible threats to independence and objectivity, including the familiarity threat.

2.7 The Firm implements this policy through the following procedures:

- Requiring the engagement partner to consider relevant information about client engagements, including the scope of services, to enable him to evaluate the overall impact, if any, on independence requirements.
- Providing training to partners and professional staff on what constitutes threats to independence and the nature of safeguards that may be taken to eliminate or reduce the threats to an acceptable level¹⁰.
- Accumulating and communicating relevant information to appropriate personnel so that:
 - The Firm, the engagement partner, Firm personnel and others, if any, can readily determine whether they satisfy independence requirements of the Firm.

⁹ Experts or other than firm's professional staff engaged in firm's business

¹⁰ It shall include ICAN's responses to matters dealing with ethical conduct.

- The Firm can maintain and update information relating to independence.
- The Firm and the engagement partner can take appropriate action regarding identified threats to independence, in consultation with the Independence and Ethics partner.
- Requiring personnel to promptly¹¹ report circumstances and relationships that create a threat to independence and independence breaches of which they become aware to the Independence and Ethics partner so that appropriate action can be taken.
- Establishing criteria to determine the need for safeguards¹² for engagements where the following have taken place:
 - The Firm's monitoring procedures or quality control or peer review has identified weaknesses in previous year(s).
 - The same senior personnel have been used for 7 years on an audit or attestation engagement
 - The client pressurizes the engagement partner to take a particular position on an accounting or auditing issue.
- Promptly communicating identified breaches of these policies and procedures, and the required corrective actions by the following personnel:
 - The engagement partner needs to address the breach to the Independence and Ethics partner.
 - The Independence and Ethics partner, after examining the issues referred to, should report the breaches to the MP for necessary action.
 - The MP should take appropriate action to resolve breach of the independence.
- Requiring the engagement partner and the other individuals referred to in the previous list to confirm to the Firm that the required corrective actions have been taken.
- Establishing additional procedures that provide safeguards when the Firm performs audit or other attest work for:

¹¹ By establishing a system of reporting independence on an annual basis or when there is change in situation, which occurs earlier (refer policy no 5).

¹² Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review, in the case of engagement of public listed companies.

- significant clients, or
- clients at which partners or other senior personnel are offered key management positions or have accepted offers of employment.
- Documenting the threats and the safeguards applied to eliminate or reduce them to an acceptable level in each instance.

Policy 4: Withdrawing from the engagement, if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

2.8 The Firm implements this policy through the following procedures:

- Consulting within the Firm, and with legal counsel and other parties if necessary, when the Firm believes that safeguards to reduce threats to independence to an acceptable level cannot be effectively applied.
- Withdrawing from the engagement if safeguards to reduce threats to independence to an acceptable level cannot be effectively applied.
- Writing to the appointing authority and statutory body or regulatory authority, if required, about its inability to continue provide its services stating the threats to independence by the MP.

Policy 5: Obtaining written confirmation of compliance with its policies and procedures on independence from all Firm personnel and others.

2.9 The Firm implements this policy through the following procedures:

- Obtaining written representations from Firm personnel, upon joining the firm or hired and on an annual basis¹³ and when changes in situation happens, which occur earlier, stating that they have read the Firm's independence, integrity, and

¹³ Refer Annexure A for the illustrative format of annual personnel independence confirmation

objectivity policies¹⁴, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation.

- Requiring Firm's personnel or others making these representations to declare any exceptions to Firm's independence policy.
- Reviewing these independence representations and resolving reported exceptions by the Independence and Ethics partner in consultation with the MP.
- Requiring the engagement partner to sign a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.

Policy 6: Confirming the independence of another Firm that performs part of the engagement.

2.10 The Firm implements this policy through the following procedures:

- Obtaining written confirmation from another firm engaged by the Firm to perform part of the engagement that their engagement will comply with Firm's independence policy.
- Requiring that such representations be documented in the engagement working papers file.

Annexures A and B contain illustrative annual firm personnel independence confirmation and illustrative independence policies, respectively.

¹⁴ Refer Annexure B for the illustrative format of Firm's independence policies

Element 3

Acceptance and Continuance of Client Relationship and Specific Engagements

INTRODUCTION

- 3.1 The objective of this element of QC is to provide the Firm with reasonable assurance that it will undertake or continue relationships and engagements only where it:
- Is competent to perform the engagement and has the capabilities, time and resources to do so; and
 - Can comply with the ethical requirements.
 - Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity.
- 3.2 The firm satisfies this objective, in each of the following circumstances:
- before accepting an engagement with a new client;
 - when deciding whether to continue an existing client relationship and/or engagement; and
 - when considering acceptance of a new engagement with an existing client.
- 3.3 The Firm should determine whether it is appropriate to accept the engagement, if a potential risk of conflict of interest is identified.
- 3.4 If the Firm decides to accept or continue the client relationship or a specific assignment even after issue related to conflict of interest is identified, it should document how the issues were resolved.
- 3.5 The Firm satisfies the objectives by establishing and maintaining the policies and procedures described below:

POLICIES AND PROCEDURES

Policy 1: Evaluating management's integrity and considering the risks associated with providing professional services in particular circumstances.

3.6 The Firm implements this policy through the following procedures:

- Developing and informing Firm personnel of the Firm's policies and procedures for accepting and continuing clients.
- Obtaining and evaluating relevant information such as the following before accepting or continuing a client:
 - The nature and purpose of the services to be provided and management's understanding thereof.
 - The identity and business reputation of the client's principal owners, key management, related parties, and those charged with its governance by way of public means like internet searches, print and electronic media, etc.
 - Information obtained from inquiries of third parties who have business relationships with the entity about management's reputation and integrity.
 - The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, income tax returns, credit reports and websites.
 - Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control environment.
- Evaluating the risk of providing services for the following engagements:
 - Engagements for entities operating in highly specialized or regulated industries, (including financial institutions, technology companies, and governmental entities) or in industries or environments that are traditionally perceived to be operated in a manner that is less than ethical.
 - Engagements where the client is aggressively concerned with maintaining the firm's fees as low as possible.

- Engagements where there is an inappropriate limitation in the scope of work.
- Engagements where there are indications that the client might be involved in un-ethical practices like, money laundering or other criminal activities.
- Engagements that require an inordinate amount of time to complete relative to the available resources of the firm.
- Communicating with the existing or previous providers of professional accountancy services to the client in accordance with relevant ethical requirement. This communication also includes inquiries regarding the nature of objections, if any.
- Conducting a background check of the business, its officers, and the person(s) in question, and evaluating the information obtained regarding management's integrity. Background checks are conducted when the firm is unable to obtain sufficient information about the prospective client after taking the steps described above, or there is an indication that management or someone affiliated with prospective client may be less than reputable.
- Evaluating the risk of providing services to significant clients or to other clients for which the firm's objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a Firm refers to relationships that could diminish an auditor's objectivity and independence in performing attest services. In determining the significance of a client, the Firm considers:
 - (a) the amount of time the partner devotes to the engagement,
 - (b) the effect on the partner's stature within the Firm as a result of service to the client,
 - (c) the manner in which the partner is compensated, and
 - (d) the effect that losing the client would have on the partner and the Firm.

Policy 2: Evaluating Competence, Capabilities and Resources of the Firm to perform the engagement.

3.7 The firm implements this policy through the following procedures:

- Evaluating whether the firm has obtained or can reasonably expect to obtain the

knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.

- Reviewing the specific requirements of the engagement and evaluating whether:
 - The Firm’s personnel have knowledge of relevant industries or subject matters
 - The Firm’s personnel have experience with relevant regulatory or reporting requirements, or ability to gain the necessary skills and knowledge effectively.
 - The Firm has sufficient personnel with the necessary capabilities and competence.
 - Specialists/experts are available, if needed.
 - Individuals meeting the criteria and eligibility requirements to perform an engagement QC review are available, when needed, whether internally or externally.
 - The firm is able to complete the engagement within the agreed reporting deadline.
- Specifying conditions that trigger the requirement to re-evaluate a specific client or engagement. For instances:
 - Significant changes in the client’s senior personnel, ownership, advisers, nature of business, or the financial stability of the client, etc.
 - Changes in the nature or scope of the engagement, including requests for additional services or expansion of the business operations into an area where the Firm does not possess necessary expertise.
 - Changes in the composition of the Firm, such as the loss of and inability to replace key personnel who are particularly knowledgeable about a specialized industry.
 - The Firm's decision to discontinue services to clients in a particular industry.
 - The existence of conditions that would have caused the Firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
 - The client's delinquency in paying fees. (This may also affect the firm's independence.)

- Engagements for entities operating in highly specialized or regulated industries, such as financial institutions, technology companies and governmental entities.
 - Engagements for entities in which there may be substantial doubt about the entity's ability to continue as a going concern.
 - Engagements in which the client has ignored prior recommendations, such as those that address deficiencies in internal control.
 - Reasons for the proposed appointment of the Firm and non-compliance of the previous firm.
- Obtaining relevant information to determine whether the relationship should be continued and establishing a frequency for evaluations (for example, continuance decisions are made at least annually).
 - Evaluating the information obtained regarding acceptance or continuance of the client or engagement through the following activities:
 - The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the Firm, and makes a recommendation about whether the client or engagement should be accepted or continued.
 - The engagement partner completes a client acceptance form and submits it to the MP for approval.
 - The engagement partner signs a step in the planning program noting consideration of client continuance and completes a form documenting the rationale and conclusion regarding client continuance if conditions exist that triggers the requirement to re-evaluate a client or engagement between annual audits.
 - The MP assesses and approves the recommendation made by the engagement partner. If the MP recommends not accepting a client or discontinuing a client relationship, the MP discusses reasons for the acceptance or continuance decision with the other partners.

- Establishing procedures for dealing with information that would have caused the Firm to decline the engagement, if the information had been available earlier.

Policy 3: Obtaining an understanding with the client regarding the services to be performed.

- 3.8 The Firm implements this policy by requiring that, for all engagements, the Firm prepare a written engagement letter¹⁵ documenting the understanding with the client and obtain the client's signature on that letter, thus minimizing the risk of misunderstanding regarding the nature, scope, and limitations of the services to be performed.

Policy 4: Withdrawing from an engagement or from both the engagement and the client relationship.

- 3.9 The Firm implements this policy through the following procedures:
- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the Firm might take based on the relevant facts and circumstances.
 - Considering whether there is a professional, regulatory, or legal requirement for the Firm to remain in place or for the Firm to report to regulatory authorities its decision of withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal.
 - Discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement, or from both the engagement and the client relationship, if the Firm determines that it is appropriate to withdraw.

Policy 5: Resolving issues relating to acceptance or continuance of client relationships and specific engagements.

¹⁵ Refer to NSA 210 for the format of Engagement Letter for Audit

- 3.10 The Firm implements this policy by documenting, in a memorandum to the engagement working papers file, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements. Alternatively, such memoranda may be preserved at a common location for the Firm as a whole e.g. in the custody of the designated QC partner.

Annexure C contains illustrative client/engagement acceptance and continuance form.

Element 4

Human Resources

INTRODUCTION

- 4.1 The objective of this element of QC is to provide the Firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to
- a) perform its engagements in accordance with professional standards and regulatory and legal requirements, and
 - b) enable the Firm or engagements partners to issue reports that are appropriate in the circumstances.
- 4.2 Attributes or qualities that enhance the competency of personnel who perform, supervise, or review work include integrity, objectivity, intelligence, judgment, experience and motivation.
- 4.3 Policies and procedures related to human resources normally address the following personnel issues:
- Recruitment;
 - Performance evaluation;
 - Capabilities;
 - Competence;
 - Career development;
 - Promotion;
 - Compensation; and
 - The estimation of personnel needs and
 - Assignment of Engagement Teams
- 4.4 The Firm satisfies the objectives related to Human Resources by establishing and maintaining the policies and procedures below:

POLICIES AND PROCEDURES

Policy 1: Determining the characteristics of the hired personnel that enable them to perform competently.

- 4.5 The Firm implements this policy through the following procedures:
- Designating an individual in the Firm to be responsible for the following activities:
 - Managing the human resources function.
 - Evaluating the Firm's personnel needs by considering factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement.
 - Developing criteria for determining which individuals will be involved in the interviewing and hiring process.
 - Establishing an understanding among the partners about the qualifications, attributes, achievements, and experiences desired in entry-level and experienced personnel.
 - Setting guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background/reference checks and inquiring about any outstanding regulatory actions.

Policy 2: Determining capabilities and competencies required for an engagement, including those required of the engagement partner.

- 4.6 The Firm implements this policy by specifying the competencies that the engagement partners of the Firm's accounting, auditing, and attestation engagements should possess. These competencies include having an understanding of the following:
- The role of the Firm's system of QC and the Code of Ethics issued by the Institute in ensuring the integrity of the accounting, auditing, and attest functions to users of reports.
 - The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through training or participation in similar engagements.
 - The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with

the engagement and to evaluate the reasonableness of industry-specific estimates.

- The professional standards applicable to the engagement and the industry in which the client operates. Such standards include accounting, auditing, and attestation standards, relevant to the accounting and auditing framework applicable to the engagement as well as rules and regulations issued by applicable regulators.
- The skills that contribute to sound professional judgment, including the ability to exercise professional skepticism.
- How the auditee uses information technology and the manner in which information systems are used to record and maintain financial information.

Policy 3: Determining the capabilities and competencies possessed by Personnel.

4.7 The Firm implements this policy through the following procedures:

- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation.
- Evaluating personnel at least annually to determine their capabilities and competencies

Policy 4: Assigning the responsibility for each engagement to an engagement partner.

4.8 The Firm implements this policy through the following procedures:

- Assigning responsibility for each engagement to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role.
- Communicating the identity and role of the partner to client's management and those charged with governance.
- Monitoring the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities.

Policy 5: Assigning personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.

4.9 The Firm implements this policy through the following procedures:

- Designating an appropriate person to be responsible for assigning personnel to engagements based on such factors as the following:
 - Engagement type, size, significance, complexity, and risk profile.
 - Specialized experience and expertise required for the engagement and competencies gained through prior experience.
 - Personnel availability.
 - Timing of the work to be performed. Continuity and rotation of personnel.
 - Opportunities for on-the-job training.
 - Situations for which independence or objectivity concerns exist.
- Designating a partner to be responsible for partner and manager assignments.
- Requiring approval of partner and manager assignments from the MP in the case of high-risk or significant client engagements.

Policy 6: Participating in general and industry-specific continuing professional education and training activities that enable them to accomplish assigned responsibilities.

4.10 The Firm implements this policy through the following procedures:

- Assigning responsibility to a partner to maintain a CPE training program that does the following:
 - Requires personnel, including articled trainees, to participate in CPE training programs in accordance with Firm guidelines and in subjects that are relevant to their responsibilities.

- Takes into account the requirements of the ICAN and other regulatory agencies in establishing the Firm's CPE requirements.
- Provides CPE course materials to, and maintains records of completed CPE for, professional personnel.
- Provides an orientation and training program for new hires, including articulated trainees.
- Encouraging participation by personnel at each level in the Firm in other CPE activities such as completing external CPE programs including self-study courses, becoming members of professional organizations, serving on professional committees, writing for professional publications, and speaking to professional groups.
- Communicating and distributing to personnel, including articulated trainees, when applicable, changes in accounting, auditing, attestation, and QC standards, as well as independence requirements and the Firm's guidance with respect to those standards and requirements

Policy 7: Promoting personnel on the basis of qualifications to fulfill the responsibilities they will be called on to assume.

4.11 The Firm implements this policy through the following procedures:

- Assigning responsibility to partners to jointly make advancement and termination decisions. Such responsibilities include the following:
 - Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.
 - Informing Firm personnel about the criteria for advancement to the next higher level of responsibility.
 - Designating personnel responsible for preparing evaluations and determining when they should be prepared.

- Informing personnel that failure to adhere to the Firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.
- Using forms that include the applicable qualifications when evaluating the performance of personnel. Such forms contain qualifications related to performance quality and adherence to ethical principles.
- Reviewing evaluations on a timely basis with the individual being evaluated.
- Counseling personnel regarding their progress and career opportunities by doing the following:
 - Evaluating employees annually and at the end of each assignment lasting four weeks or longer to provide feedback on performance.
 - Summarizing and reviewing with personnel annually the evaluation of their performance, including an assessment of their progress with the Firm.
- Considerations include past performance, future objectives of the individual and the Firm, the individual's assignment preferences, and career opportunities.
- Evaluating partners periodically by means of counseling, peer evaluation, or self-appraisal, as appropriate.

Element 5

Engagement Performance

INTRODUCTION

- 5.1 The objective of this element of QC is to provide the Firm with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the Firm or the engagement partner issues reports that are appropriate in the circumstances.
- 5.2 This includes establishing policies and procedures around matters such as consistency in the quality of engagement performance, supervision, review, consultation, engagement QC review, dealing with differences of opinion, and engagement documentation.
- 5.3 The Firm satisfies the objectives by establishing and maintaining the policies and procedures described below:

POLICIES AND PROCEDURES

Policy 1: Planning for engagements meets professional, regulatory, and the Firm's Requirements.

- 5.4 The Firm implements this policy by maintaining and providing personnel with the Firm's practice aids that prescribe the factors the engagement team should consider in the planning process for an engagement and the extent of documentation of those considerations. Planning considerations may vary depending on the size and complexity of the engagement.
- 5.5 Planning generally includes the following activities:
- Assigning responsibilities to appropriate personnel during the planning phase.
 - Developing or updating background information on the client and the engagement.
 - Considering client significance to the Firm.
 - Developing a planning document that includes the following:

- Proposed work programs tailored to the specific engagement.
- Staffing requirements and the need for specialized knowledge.
- Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement.
- The risks, including fraud considerations, affecting the client and the engagement and how the risks may affect the procedures performed.
- A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's QC policies and procedures.

Policy 2: Conducting and communicating the result of assignment in accordance with the requirements of professional standards, applicable regulators, and the firm.

5.6 The firm implements this policy through the following procedures:

- Ensuring that relevant auditing standards such as those dealing with risk assessment, fraud, etc., that deal with the planning phase of an engagement are duly complied with.
- Providing adequate supervision during the course of an engagement, including briefing the engagement team on the objectives of their work. The training, ability, and experience of the personnel are considered when assigning supervisors to the engagement.
- Requiring that a written work program be used and monitored for all engagements.
- Requiring that there is consistency in the quality of engagement performance. Consistency may be accomplished through written or electronic manuals, software tools, checklists, templates, models or other forms of standardized documentation, and industry or subject matter-specific guidance material.
- Requiring that a suitable audit summary memorandum is documented and kept among the engagement working papers to provide a history of the planned risks (including fraud risks), by what audit procedures those risks were mitigated,

conclusions on controls and substantive testing, and whether the extent and quality of audit evidence examined supports the audit opinion.

- Addressing significant issues and newly identified risks arising during the engagement, considering their significance, and appropriately modifying the planned approach. Adhering to the guidelines set forth by the firm for the form and content of documentation of the work performed and conclusions reached. Such documentation includes standardized forms, checklists, and questionnaires used in the performance of engagements and explanations, when required, of how the Firm integrates such aids into engagements.
- Requiring engagement documentation in accordance with professional standards, applicable regulatory requirements, and the firm's policies.

Policy 3: Reviewing work performed by other team members on a timely basis by qualified personnel.

5.7 The Firm implements this policy by adhering to the following guidelines established by the Firm regarding review of the documentation of the work performed and conclusions reached, the financial statements and reports, and documentation of the review process:

- All reviewers have appropriate experience, competence, and responsibility.
- For each engagement, there exists evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.
- Engagement documentation is reviewed to determine whether the following have occurred:
 - The work has been performed in accordance with professional standards and regulatory and legal requirements.
 - Significant findings and issues have been raised for further consideration.
 - Appropriate consultations have taken place, and the process and resulting conclusions have been documented and implemented.
 - The nature, timing, and extent of work performed are appropriate and do not

need revision.

- The work performed supports the conclusions reached and is appropriately documented.
- The evidence obtained in support of financial statement assertions and disclosures is sufficient and appropriate to support the report.
- The objectives of the engagement procedures have been achieved.

Policy 4: Completing the assembly of final engagement files on a Timely basis

- 5.8 The Firm implements this policy by completing the assembly of final engagement files
- in accordance with professional standards (within 60 days of issue of reports) and applicable regulatory requirements, if any.

 - Signing of the file assembly by the engagement partner.

Policy 5: Maintaining the confidentiality, safe custody, integrity, accessibility, and irretrievability of engagement documentation.

- 5.9 The Firm implements this policy through the following procedures:
- Establishing and applying controls to accomplish the following:
 - Clearly determine when and by whom engagement documentation was prepared and reviewed.
 - Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.
 - Prevent unauthorized changes to the engagement documentation.
 - Allow access to the engagement documentation by the engagement team and

other authorized parties as necessary to properly discharge their responsibilities.

- Implementing procedures for properly distributing engagement documentation materials to engagement teams at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.
- Implementing procedures to restrict access to, and enable proper distribution and confidential storage of, hardcopies of the engagement documentation.
- Requiring the use of passwords by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users.
- Implementing appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
 - Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
 - Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.
 - Enable the copies to be retrieved and printed as necessary

Policy 6: Retaining engagement documentation for sufficient time.

5.10 The Firm implements this policy through the following procedures:

- Retaining engagement documentation for a period of time sufficient to meet the requirements of the applicable professional standards, laws and regulations.
- Establishing procedures that:
 - Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation

because the underlying technology may be upgraded or changed over time;

- Provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed; and
- Enable authorized external parties to access and review specific engagement documentation for QC or other purposes.

Policy 7: Requiring consultation in an appropriate way and maintaining documentation thereof.

5.11 The Firm implements this policy through the following procedures:

- Consulting with those having appropriate knowledge, authority, and experience within the Firm (or, where applicable, outside the Firm) on significant technical, ethical, and other matters. The Firm uses advisory services provided by other Firms, professional and regulatory bodies, and commercial organizations that provide such services. Before using such services, the Firm evaluates whether the external provider is qualified for that purpose.
- Informing personnel of the Firm's consultation policies and procedures.
- Requiring sufficiently experienced engagement team members to identify matters for consultation or consideration during the engagement.
- Requiring consultation in specialized areas or situations with appropriate individuals within and outside the Firm when matters such as the following arise:
 - The application and interpretation of technical pronouncements.
 - Industries with special accounting, auditing, or reporting requirements.
 - Emerging practice problems.
 - Choices among alternative generally accepted accounting principles.
 - Re-issuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the date a report was issued.
 - Filing requirements of regulators.

- Meetings with regulators at which the Firm is to be called on to support the application of generally accepted accounting principles or generally accepted auditing standards that have been questioned.
- Providing all professional personnel with access to adequate and current reference materials including all relevant facts, circumstances, the professional literature used, and conclusions reached in the engagement documentation of the work performed and conclusions reached.
- Documenting the issue on which consultation was sought and the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented. If there is an unresolved disagreement, an outside source may be consulted to assist in determining the appropriate application of accounting or auditing principles

Policy 8: Dealing with and resolving differences of opinion, documenting and implementing conclusions reached, and releasing the report only after the matter is resolved.

5.12 The Firm implements this policy through the following procedures:

- Requiring that all differences of professional judgment among members of an engagement team be resolved by the engagement and the QC partners, and the MP if necessary, and that the report not be released until the matter is resolved.
- Requiring that conclusions reached are appropriately documented. If members of the team continue to disagree with the resolution, they may disassociate themselves from the resolution of the matter and may document that a disagreement continues to exist.

Policy 9: Determining criteria for an engagement QC review, complying with the same, and completing the review before the report is released.

5.13 The firm implements this policy through the following procedures:

- Establishing criteria such as the following:
 - The identification of unusual circumstances or risks in an engagement or class of engagements as determined by the engagement partner or QC partner.
 - An engagement QC review is required by law or regulation.
- Evaluating all engagements against the criteria and documenting the evaluation.
- Performing and documenting an engagement QC review for all engagements that meet the criteria.

Policy 10: Establishing procedures addressing the nature, timing, extent, and documentation of the engagement QC review.

5.14 The Firm implements this policy through the following procedures:

- Establishing procedures addressing the nature, timing, and extent of the review. The Firm's procedures require that for audit and attestation engagements, the engagement QC reviewer do the following:
 - Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.
 - Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions and account balances.
 - Confirm with the engagement partner that there are no significant unresolved issues.
 - Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.
 - Review documentation of the resolution of significant accounting, auditing, or financial reporting issues, including documentation of consultation with Firm personnel or external sources.
 - Review the summary of corrected and uncorrected misstatements.

- Review other engagement documentation to the extent considered necessary
- Read the financial statements and the report and consider whether the report is appropriate.
- Complete the review before the release of the report.
- Resolving conflicting opinions between the engagement partner and the engagement QC reviewer regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report.
- Implementing procedures addressing documentation by the engagement QC reviewer.
 - The procedures required by the Firm's policies on engagement QC review have been performed.
 - The engagement QC review has been completed before the report is released.
 - No matters have come to the attention of the engagement QC reviewer that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

Policy 11: Establishing criteria for the eligibility of engagement QC reviewers.

5.15 The Firm implements this policy by establishing the following criteria:

- An engagement QC reviewer:
 - Is selected by the QC partner or the MP.
 - Has sufficient technical expertise and experience.
 - Carries out responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the engagement QC reviewer.
 - Meets the independence requirements relating to the engagements reviewed, even though the engagement QC reviewer is not a member of the engagement

team.

- Does not make decisions for the engagement team or participate in the performance of the engagement except that the engagement partner may consult the engagement QC reviewer at any stage during the engagement.
- When the Firm does not have suitably qualified personnel to perform the engagement QC review, the Firm contracts with a suitably qualified external person to perform the engagement QC review.

Annexure D and E contain illustrative engagement planning and illustrative engagement summary memorandum, respectively.

Element 6

Monitoring

INTRODUCTION

- 6.1 The objective of this element of QC is to provide the Firm with reasonable assurance that its policies and procedures relating to the system of QC are relevant, adequate, operating effectively and duly followed in practice. Such policies and procedures should include and ongoing consideration and evaluation of the Firm's system of QC, including a periodic inspection of a completed engagement for each engagement partner.
- 6.2 The Firm satisfies this objective by establishing and maintaining the policies and procedures below.

POLICIES AND PROCEDURES

Policy 1: Assigning responsibility for the monitoring process.

- 6.3 The Firm implements this policy through the following procedures:
- Designating a QC partner or a competent person, who is responsible for monitoring the Firm's QC system.
 - Fixing responsibilities of QC partner to ensure that the Firm's QC policies and procedures and its methodologies remain relevant and adequate. Factors to be considered include the following:
 - Changes in professional standards or other regulatory requirements applicable to the Firm's practice.
 - Results of inspections and peer review.
 - Review of litigation and regulatory enforcement actions against the Firm and its personnel.
 - Determining whether personnel have been appropriately informed of their responsibilities for maintaining the Firm's standards of quality in performing their duties.
 - Identifying the need to do the following:

- Revise policies and procedures related to QC because they are ineffective or inappropriately designed.
- Improve compliance with Firm policies and procedures related to QC.

Policy 2: Performing comprehensive monitoring procedures to assess compliance with all applicable professional standards and the Firm's QC policies and procedures.

6.4 The Firm implements this policy through the following procedures:

- Designating one or more partners or competent persons to be responsible for performing an annual inspection.
- Inspection procedures to include reviewing a cross-section of engagements using the following criteria in selecting engagements:
 - Significant specialized industries with emphasis on high-risk engagements.
 - First-year engagements.
 - Significant client engagements.
 - Level of service performed (that is, audit and attest, review, or compilation).
 - Engagements performed by all partners.
 - Engagements for which there have been complaints or allegations from Firm personnel, clients, or other third parties that the work performed by the Firm
 - failed to comply with professional standards, regulatory requirements, or the
 - Firm's system of QC.
 - Engagements in which there were significant disagreements between the quality review partner and the engagement partner.
- Establishing an approach and timetable for performing the inspection procedures and determining the forms and checklists to be used during the inspection and the extent of documentation required.
- Deciding how long to retain detailed inspection documentation (as opposed to

summaries).

- Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters and acceptance and continuance decisions.
- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.
- Selecting a sample of engagements for review to determine compliance with the Firm's QC policies and procedures and reviewing the selected engagements.
- Preparing a summary inspection report for the MP or QC partner that evaluates the overall results of the inspection and sets forth any recommended changes that should be made to the Firm's policies and procedures.
- Reviewing the recommended corrective actions and reaching final conclusions about the actions to be taken.
- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).
- Reviewing and evaluating Firm practice aids, such as audit programs, forms, and checklists, and considering whether they reflect the most recent professional pronouncements.
- Providing information during staff meetings regarding new professional standards, regulatory requirements, and the related changes that should be made to Firm practice aids.
- Reviewing, or designating a manager-level individual to be responsible for reviewing the CPE policies and procedures to determine whether they are appropriate, effective, and meet the needs of the Firm.
- Reviewing, or designating a manager-level individual to review summaries of the CPE records of the Firm's professional personnel to evaluate each individual's compliance with the CPE requirements of the ICAN.
- Reviewing other administrative and personnel records pertaining to the QC elements.
- Soliciting information from the Firm's personnel during staff meetings regarding the

effectiveness of training programs.

Policy 3: Communicating results of monitoring process

6.5 The Firm implements this policy through the following procedures:

- Discussing the engagement related observations of the inspection with the engagement partner and seeking his concurrence therewith.
- Preparing a summary report that evaluates the overall results of the monitoring and sets forth any recommended changes that should be made to the Firm's policies and procedures.
- Reviewing the recommended corrective actions and reaching final conclusions as to the actions to be taken.
- Communicating to all professional personnel (engagement partner and QC partner) the deficiencies noted and the related changes in QC procedures.
- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).

Policy4: Dealing appropriately on complaints and allegations

6.6 The Firm implements this policy through the following procedures:

- Having the MP inform personnel that they may raise any concerns regarding complaints or allegations about non-compliance with professional standards, regulatory and legal requirements, or the Firm's system of QC with him without fear of reprisals.
- Having a partner who is not otherwise involved in the engagement or suitably qualified external person or any other firm to carry out investigate the following:
 - Complaints and allegations that the work performed by the Firm fails to comply with professional standards and regulatory and legal requirements.
 - Allegations of non-compliance with the Firm's system of QC.
 - Deficiencies in the design or operation of the Firm's QC policies and procedures, or non-compliance with the Firm's system of QC by an individual

or individuals, as identified during the investigations into complaints and allegations.

- Documenting complaints and allegations and the responses to them.

Policy 5: Preparing appropriate documentation to provide evidence of the operation of each element of its system of QC.

6.7 The Firm implements this policy by designing its summary monitoring report to provide evidence of the operation of each element of its system of QC, including the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected.
- A record of the evaluation of the following:
 - Adherence to professional standards and regulatory and legal requirements.
 - Whether the quality control system has been appropriately designed and effectively implemented.
 - Whether the Firm's QC policies and procedures have been appropriately applied so that reports that are issued by the Firm or engagement partners are appropriate in the circumstances.
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be.

Policy 6: Retaining documentation providing evidence of the operation of the system of QC for an appropriate period of time.

6.8 The Firm implements this policy by

- Requiring retention of the summary monitoring report for a period of time sufficient to meet the Firm's peer review or other regulatory requirements.

- Documenting matters such as independence confirmations, performance evaluations and results of monitoring inspections by using electronic databases or manual notes.

Policy 7: Striving to get itself "peer reviewed" by an external reviewer under the "Peer Review" process established by ICAN or through other firm on resource sharing basis

6.9 The Firm implements this policy by:

- Voluntarily offering itself for peer review by application to the Peer Review Board of ICAN, if it has not already been selected or is not required to go through the quality assurance program mandatorily, or
- Using suitably qualified external person or another firm to carry out engagement inspection and other monitoring procedure, or
- Establishing arrangements to share resources with other appropriate organizations to facilitate monitoring activities.

Annexure E contains illustrative firm quality control inspection checklist.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Annexure

Annexure I

Illustrative Annual Firm Independence Confirmation

Annexure II

Illustrative Independence Policies

Annexure III

Illustrative Client/Engagement Acceptance and Continuance Form

Annexure IV

Illustrative Engagement Planning Memorandum

Annexure V

Illustrative Engagement Summary Memorandum

Annexure VI

Illustrative Firm Quality Control Inspection Checklist

Annexure VII

Nepal Standards Quality Control - 1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements

ILLUSTRATIVE ANNUAL FIRMS PERSONNEL INDEPENDENCE CONFIRMATION

INSTRUCTIONS

All partners and employees are required to complete a confirmation regarding their independence.

This declaration covers the period from(date) to (date). This confirmation should reach(MP) on or before(date).

DETAILED DECLARATIONS

Make the declarations below. If you do not agree, explain in a separate annexure why the 'disagree' responses are not independence-impairing situations

S.N.	Declaration,	Agree	Disagree
1	During the period, I or my immediate family members ¹ did not have investments in an entity ⁸ to which I rendered any assurance services		
2	During the period, I or my immediate family members did not have a borrowing from an entity ² to which I rendered any assurance services		
3	During the period, I or my immediate family members did not give a loan to an entity to which I rendered any assurance services or to an officer, director, or major shareholder of that entity		
4	During the period, I and my immediate family members were not an executor, administrator, or trustee of a trust/estate, and have authority to make investment decisions for the trust/estate, that had an investment in an entity to which I rendered any assurance services		
5	During the period, I and my immediate family members were not associated with an entity to which I rendered any assurance services, in an accounting or financial reporting oversight role.		
6	During the period, I and my immediate family members did not obtain a new, or make significant changes to an existing, insurance product of any kind, from an insurance company to which I rendered any assurance services		
7	During the period, to the best of my knowledge, I and my immediate family members did not have a business relationship with or joint investment (e.g, partnership interests) in (a) an entity to which I rendered any assurance services or with (b) an officer, director, or major share holders of that entity		
8	During the Period, I have advised the Independence and Ethics Partner of the Firm if I have been engaged in employment negotiations with an entity to which I rendered any assurance services		

¹ Immediate family members" means the partner or employee's spouse and dependents

² Entity", wherever referred to in this table, includes its holding and subsidiary companies

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Explain below why, in your opinion, a 'disagree' response to any of the declarations above is not an independence-impairing situation:

REPRESENTATION

FOR THE PERIOD FROMTO

By submitting this independence confirmation, I represent that:

- I have read and understand the Firm's independence policies applicable to me and my immediate family, and understand the applicable independence restrictions.
- To the best of my knowledge, I have provided accurate and complete responses to the items in this confirmation. Except as otherwise indicated by my answers above, I have complied with the applicable independence policies, including those policies that pertain to my immediate family.
- I understand that it is my responsibility to comply with the Firm's independence policies and to seek appropriate consultation within the firm when I have any questions relating to my compliance with the Firm's independence policies.
- I understand that my responses are an element of the Firm's independence quality control system and are subject to review by firm management. Further, I understand I will be subject to disciplinary action if I do not cooperate or comply with Firm's independence policies.

Sign :

Office :

Name :

Date :

ILLUSTRATIVE INDEPENDENCE POLICIES

.....
(Name of Firm)

Application

1. These Independence Policies ("Policy" or "Policies") are applicable, without exception, to all partners and employees ("firm personnel") of: ("the Firm").

THE CONCEPTUAL APPROACH

2. If a Policy addresses a specific situation or relationship, such policy should be followed. Where the Policies do not cover a particular circumstance, the conceptual approach requires that threats to independence be identified, evaluated and addressed.
3. Under this approach, when the Firm provides assurance services to an entity ("auditee"), all firm personnel have an obligation to make their best efforts to:
 - a) Identify circumstances or relationships that might create threats to independence,
 - b) Evaluate whether these threats are clearly insignificant, and
 - c) In cases where the threats are not clearly insignificant, consult with the Ethics and Independence Partner and the Assurance Engagement Partner to identify and apply appropriate safeguards to eliminate the threats or reduce them to an acceptable level.
4. If an inadvertent violation occurs, it would generally not compromise independence with respect to an auditee provided the Firm has appropriate quality control policies and procedures in place to promote independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied.

Identifying Threats to Independence

5. The generally recognised threats to independence³ are:
 - Self interest threat;
 - Self-review threat;
 - Advocacy threat;
 - Familiarity threat; and
 - Intimidation threat.
6. When threats to independence are identified, other than those determined to be clearly insignificant, safeguards should be identified and applied to eliminate the threats or reduce them to an acceptable level. The nature of the safeguards to be applied will vary depending upon the

³ These threats have been explained in the Chapter, "Introduction" in this Guide.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

circumstances. Consideration should be given to what a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude to be unacceptable.

7. When threats to independence are identified that are not clearly insignificant, and the Firm decides to accept or continue the assurance engagement in accordance with its engagement acceptance or continuance processes, the decision should be documented. The documentation should include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.
8. When the safeguards available are insufficient to eliminate the threats to independence or to reduce them to an acceptable level, or when a Firm chooses not to eliminate the activities or interests creating the threat, the only course of action available will be the refusal to perform, or withdrawal from, the assurance engagement.
9. Some examples of safeguards that might be applied are:
 - a) Involving an additional partner or professional staff member to carry out reviews of the work done or to otherwise advise as necessary. This individual could be someone in another Firm or someone within the Firm who was not otherwise associated with the assurance engagement.
 - b) Rotation of senior partners or professional staff.
 - c) Discussing independence issues with the auditee's audit committee or others those charged with governance.
 - d) Removing an individual assigned to the assurance engagement team when that Individual's economic or financial interests or other relationships create a threat to independence.

Complying With the Independence Policies and Procedures

10. Partners, professional staff and all others persons employed by the Firm are responsible for understanding and complying with all applicable independence policies and procedures.
11. Partners, professional staff and all others persons employed by the Firm are required to:
 - a) Read all relevant independence policies.
 - b) Understand the extent to which they apply to them and their immediate family members.
 - c) Understand that the financial and employment relationships of immediate family members can threaten or impair independence with respect to an auditee.
 - d) Provide information to their immediate family members about the independence policies.
 - e) Understand that there are limitations or restrictions on our ability to provide services to auditees.
 - f) Comply with applicable independence policies and procedures at all the times.
12. To enable partners and employees to be in compliance with the policies, the Firm leadership

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

shall establish a system that enables each of them to be aware at all times of the most recent list of auditees and, where such auditees are listed companies, of their holding and subsidiary companies, even if the Firm does not render any assurance services to such holding and subsidiary companies.

13. This will be particularly relevant if partners and employees desire to:
 - a) Make an investment in the auditee;
 - b) Make a borrowing from or give a loan to the auditee
 - c) Obtain or modify an insurance policy with an insurance company auditee;
 - d) Accept employment with an auditee; and
 - e) Enter into a business relationship with an auditee.
14. Partners and employees of the Firm are required to consult others when they need assistance identifying possible threats to independence or resolving independence issues or concerns.

Confirming Compliance with Independence Policies

15. Partners and employees of the Firm must, upon request, confirm in writing their Compliance with all applicable independence policies.

Understanding the Consequences of Non-Compliance

16. Partners and employees of the Firm who fail to comply with all applicable independence policies and procedures should be subject to the Firm's disciplinary process. The range of possible disciplinary actions may include memos to the individual's personnel file, reductions in compensation and termination. The severity of the disciplinary action will depend on the nature of the violation and other facts and circumstances unique to each case. Ignorance of the policies is not considered a legitimate defense for failure to comply.

Financial Interests

17. Partners and employees of the Firm and their immediate family members are prohibited from making investments in equity or debt instruments in the auditee if they are members of the assurance engagement team ("AET").
18. Should any such investment be made inadvertently (e.g., upon receiving an inheritance or gift), the partner/employee shall ensure that it is disposed of within a period of one month from the date of investment.
19. Partners and employees of the Firm and their immediate family members, if they are members of the AET, are prohibited from making a borrowing from an auditee, unless the auditee is a financial institution that lends in the normal course of business, and the borrowing was on its normal lending terms.
20. Partners and employees of the Firm and their immediate family members, if they are members of the AET, are prohibited from giving a loan to an auditee or to an officer, director, or major

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

shareholder of an auditee.

21. Partners and employees of the Firm and their immediate family members, if they are members of the AET, are prohibited from being an executor, administrator, or trustee of a trust/estate, and have authority to make investment decisions for the trust/estate, that had an investment in an auditee.
22. Partners and employees of the Firm and their immediate family members, if they are members of the AET, are prohibited from obtaining a new, or make significant changes to an existing, insurance product of any kind, from an insurance company auditee.

Employment Relationships

23. Partners and employees of the Firm, if they are members of the AET, should not serve as an officer or director on the board of an auditee.
24. Partners and employees of the Firm and their immediate family members, if they are members of the AET, are prohibited from being associated with an auditee in an accounting or financial reporting oversight role.
25. Partner and employees of the Firm, if they are members of the AET, are prohibited from being engaged in employment negotiations with or taking up employment with the auditee without first informing the Ethics and Independence Partner. In such situation, they should forthwith withdraw from the assurance engagement.

Business Relationships

26. Partner and employees of the Firm, if they are members of the AET, are prohibited from having a business relationship with or joint investment (e.g., partnership interests) in an auditee or with an officer, director, or major shareholder of that auditee.

Long Association

27. Using the same partners and professional staff on an assurance engagement for an auditee over a long period of time may create a familiarity threat.
28. The Firm shall establish a personnel rotation policy so that members of the AET, including the partner where possible, rotate off the engagement upon rendering assurance services for a determined period of time (e.g., seven years).
29. The Firm's personnel rotation policy shall state that a person who rotates off an engagement does not get reinstated on that engagement except after a specified "cooling off period"

Gifts and Hospitality

30. Partner and employees of the Firm, if they are members of the AET, should not accept gifts or hospitality from the auditee, unless the value is clearly insignificant.
31. If there are any questions regarding receipt of the gift or hospitality, the Ethics and Independence Partner should be consulted.

Scope of Services

32. The laws and regulations governing the auditee (eg., the Companies Act, 2063 or rules made thereunder) or a regulator may specifically prohibit the Firm from rendering

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

certain services to an auditee (e.g., internal audit services). In such cases, the proscribed services cannot be provided at all.

33. Besides this, it is not possible to draw up an all-inclusive list of non-assurance services which, if provided to an auditee, might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level.
34. Because the provision of a non-assurance service may create threats to independence, the engagement partner, in consultation with the Ethics and Independence Partner, should evaluate the significance of any such threat before the Firm agrees to provide the service.
35. Where a threat to independence is assessed, the Ethics and Independence Partner shall determine if providing the service after applying suitable safeguards would eliminate or reduce the threat to an acceptable level. If not, the Firm should decide whether it makes better business sense to provide the non-assurance service and withdraw from the assurance engagement or vice versa.
36. The following activities should not be performed:
 - a) Acting in a capacity equivalent to that of a member of management.
 - b) Reporting, in a management role, to those charged with governance.
 - c) Determining which recommendation of the Firm should be implemented.
 - d) Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the auditee, or having the authority to do so.
37. The assurance engagement partner, in consultation with the Ethics and Independence Partner, should consider the self-review or self-interest threats that may be created by the following activities and the appropriate safeguards to reduce the threats to an acceptable level:
 - a) Having custody of an auditee's assets.
 - b) Supervising the auditee's employees in the performance of their normal recurring activities.
 - c) Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).
38. The following safeguards may be particularly relevant in reducing, to an acceptable level, threats created by the provision of non-assurance Services to auditees:
 - a) Discussing independence issues related to the provision of non-assurance services and the nature and extent of the fees charged for such services with those charged with governance, such as the audit committee.
 - b) Consulting with the Ethics and Independence Partner on the potential impact of the non-assurance engagement on the independence of the AET and the Firm and acting on the recommendations.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

- c) Involving an additional partner or professional staff member to provide assurance on a discrete aspect of the assurance engagement.
- d) Obtaining the auditee's acknowledgement of responsibility for the results of the work performed by the Firm.
- e) Making arrangements so that partners and professional staff members providing non-assurance services do not participate in the assurance engagement.

Fees

- 39. Total fees generated by an auditee should not represent a large proportion of the Firm's total fees.
- 40. A self-interest threat may be created when the fees generated by an auditee represent a large proportion of the revenue of an individual partner
- 41. If fees for services provided to an auditee remain unpaid over an extended period of time, it may appear that the Member Firm has a loan to the auditee. Because of the significance of the overdue fees, the Firm should consider if it is appropriate for the Firm to be re-appointed. Therefore, fees for a specific accounting period should be received before issuance of an assurance report for the following year. If this is not possible, then consideration should be given as to whether adequate safeguards can be applied.
- 42. The Firm should not enter into a contingent fee arrangement with an auditee to provide assurance services where the amount of the fee is contingent on the result of the assurance work or on items that are the subject matter of the assurance engagement.

Annexure III

ILLUSTRATIVE CLIENT/ ENGAGEMENT ACCEPTANCE AND CONTINUANCE FORM

Client Name :

Engagement Name :

Period End :

Relationship:

Is this a new client relationship? **Yes** **No**

Is this a new engagement **Yes** **No**

If not a new client relationship, age of the relationship

If this is a recurring engagement, year of first performance and periodicity(e.g., annual, quarterly)

Prior Audit Information:

Detailed Current Period Analysis:

(For continuing clients/ engagements, this analysis should be prepared a fresh at the beginning of each period)

S.N.	Does the engagement team have reasons to have concerns about:	Yes⁴	No	Not applicable
1	Management's characteristics and integrity			
2	Management's overall commitment to reliable financial reporting			
3	Management's commitment to reliable accounting process and information system			
4	Organizational structure			
5	Management structure and control			

⁴ For "Yes" answers provide details in a separate workpaper, cross-referenced in the box.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

S.N.	Does the engagement team have reasons to have concerns about:	Yes⁵	No	Not applicable
6	Characteristics and integrity of significant related parties			
7	Nature of services to be provided and reports expected			
8	Ethical considerations in providing the expected service, or in associating the name of the Firm with the client/engagement			
9	Management's methods of assigning authority and responsibility			
10	Senior management control methods			
11	Impact of computers			
12	Activities of those charged with governance			
13	Nature of the business			
14	Business environment			
15	Significant pressure on management to report certain financial results			
16	Going concern assumption			
17	Conditions surrounding the audit engagement			
18	The Firm's ability to comply with auditing standards			
19	Accounting issues that may present unacceptable risk			
20	Significant transactions and business relationships			
21	Financial roles and responsibilities			
22	Likelihood of intentional misrepresentation			
23	Likelihood of fraud			
24	Lack of implementation of appropriate internal controls			
25	Independence and conflicts of interest - threats to independence			
26	The Firm's ability to complete the engagement with professional competence			
27	Any other matters:			
	•			
	•			
	•			

Conclusion on client/engagement acceptance or continuance by engagement partner:

.....
Signature of engagement Partner/equivalent

Date :

⁵ For "Yes" answers provide details in a separate workpaper, cross-referenced in the box.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Concurrence on client/engagement partner acceptance or continuance by firm’s managing partner, risk management partner, or equivalent:

.....
Signature of engagement Partner/equivalent

Date :

Workpaper reference:

Prepared by :

Date :

Reviewed by :

Date :.....

Illustrative Engagement Planning Memorandum

(Where space is inadequate, expand or give reference of separate work paper)

Client Name:

Engagement Name:

Period End:

Deliverables:

Name of Deliverable	Date of Deliverable

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Terms of Engagement (Engagement Letter):

Dated :	Acknowledged on:	File Reference:

Engagement team Members:

Name of Member	Level

Understanding the Entity and its Environment:

Document under the captions below the key features of the engagement team's understanding of the entity and its environment

Understanding with reference to	Description of the understanding	Audit risk identified	Response to identified risk
Prior audit information			
Operations			
Ownership and management structure			
Related parties			
Modes of financing activities			
Business objectives and strategies, and related business risks			
Industry-specific matters and trends			
General business environment			
Laws and regulations			
Other external factors			
Critical accounting policies			
Reporting requirements			
Financial performance			
Taxation			
Needs, expectations and concerns of senior			

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

management			
Key entity personnel (name, designation, location)			
Accounting staff (name, designation, location)			
Main address for correspondence			
Bankers			
Attorneys/solicitors			
Any other matters			

Evaluation of internal Controls:

A. Overall Controls:

Control	Evaluation of design and implementation	Audit risks identified	Response to identified risk
A. Control Environment			
B. Management's risk assessment process			
C. Information Systems and Communication			
D. Monitoring			

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

B. Account balance Specific Controls:

Account balance (provide below financial statement line item captions- e.g. Property Plant and Equipments, Investments, Cash, etc., first for balance sheet and then for statement of profits and loss)	Control (describe below the related key internal controls for each account balance)	Evaluation of designed and implementation (i.e. an evaluation of how the control meets its objective and who owns and monitors the control)	Evaluation of operating effectiveness (i.e. an evaluation of whether the control was found to be operating effectively)	Findings and comments A. Opinion on whether the control can be relied upon by the engagement team; B. Audit risks identified C. Response to risk identified
--	--	--	--	--

Understanding the Accounting Process:

A. The use of Computers

Extent of use of computers		
Limited	Moderate	Pervasive
Complexity of the computer environment		
Simple	Moderate	Complex
Importance to the entity’s business activities		
Limited	Moderate	Very important
Overall evaluation of use of computers		
Insignificant	Substantial	critical

If evaluation of use of computers is at "critical" level, will a computer assurance specialist be involved?

Yes	No
Reason ,if “No”:	

B. Unusual Transactions

Does the entity have non-routine or unusual transactions? (Journal entries)	Yes	No
If “yes”, describe such transactions and the resultant audit risk identified	Response to risk identified	

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

C. Discussion among engagement team members on the susceptibility of the entity’s financial statements to material misstatement due to fraud.

Date of Fraud Meeting:

Names and levels of those who attended:

Name	level
1	
2	
3	
4	
5	
Minutes of discussions at the meeting(give reference to separate working paper)	WP Ref.
Significant fraud risk identified	Response to risk identified

D. Inquiries and obtaining an understanding of oversight exercised by those charged with governance

Date of inquiry by interview	Name of person interviewed and his designation	Reference of separate working papers documenting minutes of the interview	Has the person interviewed exercised oversight of management’s processes for identifying and responding to the risks of fraud and the internal control that management has established to mitigate fraud risks.

E. Based on an analytical review of the most recently available financial information (including from the entity s management information systems) and on a consideration of fraud risk factors, unusual or unexpected relationships, and other information, determine account-balance specific fraud and other audit risks that the engagement team should consider when performing substantive procedures.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Illustrative Engagement Summary Memorandum

(Where space is inadequate, expand or give reference of separate workpaper)

Client Name:

Engagement Name:

Period End:

Changes to Materiality:

(Where the quantitative materiality at the financial statement level was changed during the course of audit, give the old and the new materiality, and reasons for the change)

Changes to Audit Plan:

(Where the audit plan was changed after being made as a consequence of discovery and evaluation of new facts during the course of audit, give reasons for and the nature of the change)

Compliance with Accounting Pronouncements:

(Where standard firm checklists were completed to ensure compliance with accounting pronouncements, give reference to the separate working papers)

Compliance with auditing pronouncements:

(Where standard firm checklists were completed to ensure compliance with auditing pronouncements, give reference to the separate working papers)

Additional risks identified:

(Where additional risks were identified and added to the audit plan as a consequence of knowledge gained during the course of audit, describe the nature of risk)

Conclusion on risks identified in the audit plan

Risk identified	Audit programme tailoring done to address the risk	Results of testing (- whether the risk was eliminated or reduced to an acceptable level?)

Conclusion about the appropriateness of the going concern assumption:

Conclusion about the effect of subsequent event reviews:

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Summary of adjusted misstatements:

(Give details of misstatements due to error/fraud that were discovered during audit and were adjusted by the client in the financial statements)

Nature of misstatement	Amount (Rs)	Account balances affected	Whether adjusted to auditor's satisfaction? Y/N ⁶

Summary of unadjusted⁷ misstatements:

(Give details of misstatements due to error/fraud that were discovered during audit and not adjusted by the client in the financial statements)

Nature of misstatement	Amount (Rs)	Account balances affected
Total		

Conclusion on unadjusted misstatements:

(Un-adjusted misstatements should be aggregated and their combined net effect measured against the overall materiality level. The aggregate net effect of unadjusted misstatements should be reasonably below the materiality level in order for the auditor to conclude that the financial statements are not materially misstated.)

Net aggregate unadjusted misstatements	Rs.
Materiality	Rs.
Conclusion on whether, based on the above, the financial statements are not materially misstated?	

⁶ If "No" consider wholly or partly as unadjusted misstatement.

⁷ Un-adjusted misstatements = items that were considered as errors/fraud by the auditor but which the client either refused to accept as misstatements or refused to adjust, citing materiality or account closure or any other reason. Typically, these would be projected misstatements, disagreements with auditor on estimates, or unexplained differences in substantive analytical procedures.

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Overall conclusion on whether the audit procedures applied and evidence obtained are appropriate and sufficient to support the audit opinion?

Conclusion about independence:

Conclusion about client and engagement continuance in the following period based on findings during the current audit:

Follow-up points (for next audit):

(Describe here matters that the auditor became aware of during the current audit that might have an impact on the audit of the following or a subsequent period)

1	
2	
3	
4	
5	
6	

Illustrative Firm Quality Control Inspection Checklist

Section A- Firm Level Quality Controls

Leadership Responsibilities

Policy	Y/N	Remarks, if "No"
Has the Firm leadership demonstrated that it has assumed ultimate responsibility for the Firm's system of QC ⁸ ?		
Does the Firm have an effective mechanism in place to ensure that commercial considerations do not override the quality of work performed?		
Has responsibility for the Firm's QC been assigned to a QC partner or other duly empowered individual		
Are personnel policies designed to reward quality?		
Are sufficient monetary and human resources applied to maintain and augment QC policies and procedures within the Firm?		

Rating	Full/ near full compliance	Part compliance	No compliance

⁸ QC = quality control

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Ethical Requirements

Policy	Y/N	Remarks, if “No”
Does the Firm have effective mechanisms in place to ensure that its personnel adhere to and do not compromise its ethical requirements?		
Has the Firm regularly communicated its independence requirements to all its personnel?		
Does the Firm have internal processes and effective mechanisms by which it ensures that it identifies threats to independence on a timely basis and takes demonstrable steps to eliminate or reduce those threats to an acceptable level?		
Does the Firm have effective internal processes whereby it exits from an engagement or client relationship where threats to independence are significant and such that cannot be reduced to an acceptable level?		
Has annual written confirmation been obtained from all Firm personnel and whether the Firm has taken steps to address defaults?		
Where another Firm performs part of an engagement, has the Firm confirmed that such other Firm and its related personnel meet the independence requirements?		

Rating	Full/ near full compliance	Part compliance	No compliance

Acceptance and Continuance of Client Relationships and Specific Engagements

Policy	Y/N	Remarks, if “No”
Does the Firm have a process for making inquiries and obtaining information about a client, its personnel and the intrinsic risks of an engagement on a periodic basis that would identify questionable management integrity or high engagement risk?		
Has the Firm undertaken only those engagements which it can perform with professional competence?		
Does the Firm have an effective policy for obtaining written engagement letters for all its engagements and whether the contents of the engagement letter are sufficiently detailed and clear?		
Does the Firm have in place an effective policy for exiting engagements or client relationships if the situation so warrants?		
Has the Firm maintained proper documentation of its client and engagement acceptance and continuance procedures?		

Rating	Full/ near full compliance	Part compliance	No compliance

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Human Resources

Policy	Y/N	Remarks, if “No”
Does the Firm have procedures that enable it to ensure that it hires only competent personnel?		
Does the Firm have an effective mechanism that enables it to determine the capabilities and competencies that would be required of its personnel for individual engagements?		
Has the Firm established criteria for evaluating both personal and technical competencies of its personnel and has such criteria been applied consistently?		
Does the Firm have an effective mechanism to assign engagements and review responsibilities to partners and professional staff based on their knowledge, skills and abilities?		
Does the Firm provide its personnel with opportunities, resources and encouragement to participate in continuing professional education and development activities?		
Do the Firm's policies ensure that personnel who are selected for advancement have the competencies to fulfill their new responsibilities?		

Rating	Full/ near full compliance	Part compliance	No compliance

Engagement Performance

Policy	Y/N	Remarks, if “No”
Does the Firm have a standard approach to ensuring that engagements are planned as required by the relevant auditing standards and the Firm's policies?		
Does the Firm have a standard approach for performing, supervising, documenting, reporting and communicating its engagements and deliverables in a manner that ensures compliance with the relevant auditing standards and the Firm's policies?		
Does the Firm have a standard approach for timely review of workpapers by competent senior personnel?		
Do the Firm's documentation policies ensure that final engagement files are assembled on a timely basis?		
Does the Firm have standard policies and procedures for maintenance of confidentiality, safe custody, integrity, accessibility and irretrievability of engagement documentation?		
Does the Firm have a document retention policy?		
Does the Firm have an effective policy for consultation within and outside the Firm? Are consultations adequately documented?		
Does the Firm have an effective mechanism to address and resolve differences of opinion?		
Has the Firm established criteria for selection of engagements that qualify for engagement QC review and for the appointment of reviewers,		

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

and does it maintain documentation of engagements that have been subjected to engagement QC review?		
Are procedures addressing the nature, timing, extent, and documentation of the engagement QC review well established, and being followed effectively?		

Rating	Full/ near full compliance	Part compliance	No compliance

Monitoring

Policy	Y/N	Remarks, if "No"
Has an empowered partner or other qualified individual been designated to perform the Firm's quality inspection process?		
Are the Firm's inspection procedures sufficiently comprehensive to enable it to assess compliance with all applicable professional standards and its own QC policies and procedures?		
Are the findings of the inspection duly communicated to all concerned persons, and whether the Firm leadership effectively drives the changes required to strengthen the areas of identified weakness?		
Does the Firm have processes in place to deal with complaints and allegations about noncompliance with professional standards, regulatory and legal requirements, or the Firm's system of QC with him without fear of reprisals.		
Does the Firm prepare and retain appropriate documentation to provide evidence of the operation of each element of its system of QC.		

Rating	Full/ near full compliance	Part compliance	No compliance

Section B- Engagement Level Quality Controls

Client and engagement acceptance and continuance:

Policy	Y/N	Remarks, if "No"
Whether adequate process was followed to conclude on client acceptance/continuance during/for the year?		
Whether adequate process was followed to conclude on engagement acceptance/continuance during/for the year?		

Rating	Full/ near full compliance	Part compliance	No compliance

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Selection of engagement team:

Policy	Y/N	Remarks, if "No"
Did the audit engagement partner properly determine that the engagement team selected, including specialists where necessary, had the qualifications and experience appropriate for the audit engagement?		
Where use of computers by the client was evaluated as "critical" to the accounting system, was a computer audit specialist included on the engagement team in testing the computer general and application controls?		
Where an outside specialist was included as a member of the engagement team, did the engagement partner make an adequate evaluation of his competency to perform the work entrusted to him?		

Rating	Full/ near full compliance	Part compliance	No compliance

Terms of engagement:

Policy	Y/N	Remarks, if "No"
Were the terms of the audit engagement properly agreed with the client and documented in writing?		

Rating	Full/ near full compliance	Part compliance	No compliance

Understanding the entity and its environment:

Policy	Y/N	Remarks, if "No"
Did the engagement team obtain an understanding of the entity and its environment sufficient to enable it to identify and assess the risks and develop an effective audit plan?		

Rating	Full/ near full compliance	Part compliance	No compliance

Understanding and evaluating internal controls:

Policy	Y/N	Remarks, if "No"
Did the engagement team obtain an understanding of the overall entity-level controls and evaluate the components of: control environment, management's risk assessment process, information systems and communication, and monitoring?		
Did the engagement team obtain an understanding of the computer general and application controls and evaluate them to enable identification and assessment of the risks of material misstatement of the financial statements,		

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

and design and perform further audit procedures?		
Did the engagement team obtain an understanding of the account-balance specific manual controls and evaluate them to enable identification and assessment of the risks of material misstatement of the financial statements, and design and perform further audit procedures?		

Rating	Full/ near full compliance	Part compliance	No compliance

Identification and response to fraud risks:

Policy	Y/N	Remarks, if "No"
Were audit procedures, as required by relevant NAS, followed for identification of fraud risks?		
Where pervasive fraud risks ⁹ were identified, did the engagement team evaluate the design of the entity's related internal controls and determine whether they have been implemented?		
Where specific fraud risks ¹⁰ were identified, were audit programmes for substantive testing adequately tailored to eliminate or reduce the risks to a level that would prevent the likelihood of material misstatement		

Rating	Full/ near full compliance	Part compliance	No compliance

Understanding and evaluating the accounting process:

Policy	Y/N	Remarks, if "No"
Did the engagement team obtain a sufficiently detailed understanding of the accounting system, including the transaction and document flows, to be able to evaluate risks of system failure resulting in a material misstatement?		
Was the audit programme at the account balance and significant assertion level suitably tailored to consider the engagement team's findings from its understanding of the accounting system, including the transaction and document flows?		

Rating	Full/ near full compliance	Part compliance	No compliance

⁹ Pervasive risks are risks of material misstatement that are not specific to any individual item or group of related items in the financial statements

¹⁰ Specific risks are risks of material misstatement that are specific to an individual item or group of related items in the financial statements

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Controls Testing:

Policy	Y/N	Remarks, if "No"
Were key general computer controls (where use of computers was determined as "critical") tested for their operating effectiveness?		
Were key application computer controls tested for their operating effectiveness?		
Were key manual controls tested for their operating effectiveness?		

Rating	Full/ near full compliance	Part compliance	No compliance

Developing an Audit Plan:

Policy	Y/N	Remarks, if "No"
As a result of risk assessment and controls testing, did the engagement team conclude on modifying the nature, timing and extent of substantive procedures?		
Was a detailed audit planning memorandum prepared to guide the engagement team through the audit?		
Were detailed audit programmes, tailored to address fraud and other risks, prepared and used to perform tests of controls and substantive procedures such that the objectives of a "risk based" audit are achieved?		

Rating	Full/ near full compliance	Part compliance	No compliance

Internal Audit:

Policy	Y/N	Remarks, if "No"
Was the work performed by the internal auditor reviewed by the engagement team?		
If the engagement team decided to place reliance on the work of the internal auditor, were due procedures as required by the relevant NAS followed?		

Rating	Full/ near full compliance	Part compliance	No compliance

External Confirmation:

Policy	Y/N	Remarks, if "No"
Did the engagement team follow procedures for obtaining evidence from external confirmations to support the existence of certain items of assets, liabilities and contingent liabilities, including attorneys' confirmations?		

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Rating	Full/ near full compliance	Part compliance	No compliance

Audit Sampling:

Policy	Y/N	Remarks, if "No"
In performing tests of account balances and assertions, did the engagement team follow an appropriate method of selecting samples as provided in the related NAS?		
Were the nature and causes of errors detected in testing of samples, and consider their possible effect on the particular audit objective and on other areas of the audit.		
For tests of details, did the engagement team project monetary errors found in the sample to the population, and consider the effect of the projected error on the particular audit objective and on other areas of the audit.		
Did the engagement team evaluate the sample results to determine whether the assessment of the relevant characteristic of the population is confirmed or needs to be revised?		

Rating	Full/ near full compliance	Part compliance	No compliance

Accounting Estimates

Policy	Y/N	Remarks, if "No"
Did the engagement team design and perform adequate audit procedures to obtain sufficient appropriate audit evidence as to whether the entity's accounting estimates are reasonable in the circumstances and, when required, appropriately disclosed.		

Rating	Full/ near full compliance	Part compliance	No compliance

Related Parties:

Policy	Y/N	Remarks, if "No"
Did the engagement team perform adequate procedures to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effect of material related party transactions?		

Rating	Full/ near full compliance	Part compliance	No compliance

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Subsequent Events:

Policy	Y/N	Remarks, if “No”
Did the engagement team perform adequate audit procedures to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified?		

Rating	Full/ near full compliance	Part compliance	No compliance

Management Representations:

Policy	Y/N	Remarks, if “No”
Did the engagement team obtain audit evidence that management acknowledges its responsibility for the fair presentation of the financial statements in accordance with the applicable financial reporting framework, and has approved the financial statements?		
Did the engagement team obtain written representations from management on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist?		
Did the written representations obtained from management include the following: <ul style="list-style-type: none"> • That management acknowledges its responsibility for the design and implementation of internal control to prevent and detect error; and • That management believes the effects of those uncorrected financial statement misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. 		
Whether a summary of such items was included in or attached to the written representations ?		

Rating	Full/ near full compliance	Part compliance	No compliance

Section C- Summary of Ratings

QUALITY CONTROL	RATING		
	Full/ near full compliance	Part compliance	No compliance
Section A:			
Leadership responsibilities for quality within the Firm			
Ethical requirements			
Acceptance and continuance of client relationships and specific engagements			

GUIDENCE NOTES ON NEPAL STANDARDS ON QUALITY CONTROL (NSQC 1)

Human resources			
Engagement performance			
Monitoring			
SECTION B:			
Client and engagement acceptance and continuance			
Selection of engagement team			
Terms of engagement			
Understanding the entity and its environment			
Understanding and evaluating internal controls			
Identification of and response to fraud risks			
Understanding and evaluating the accounting			
process			
Controls Testing			
Developing an audit plan			
Internal audit			
External confirmations			
Audit Sampling			
Accounting estimates			
Related Parties			
Subsequent events			
Management representations			
Total Number			