

FINANCIAL AUDIT MANUAL

Office of the Auditor General Nepal
Babermahal, Kathmandu, Nepal

2015

**Auditor General
of Nepal**



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Foreword

The Constitution of Nepal recognizes the Office of the Auditor General of Nepal (OAGN) as one of the constitutional organs of the country. As per the constitutional provision OAGN is empowered to carry out audits of the accounts of the office of the President and Vice-president, the Supreme Court, Federal Legislature-Parliament, Provincial Parliament, Provincial Government, Local Bodies, Constitutional bodies and their offices, the Courts, the Office of the Attorney General, Nepal Army, Nepal Police, Armed Police Force including all federal and provincial government offices and other entity as prescribed in the law with due consideration given to the regularity, economy, efficiency, effectiveness and the propriety thereof. In addition to this constitutional provision, OAGN is also mandated to carry out audit of other several entities as per the provision contained in the relevant laws of such entities. As a result of audit work, the Auditor General (AG) submits annual report to the president who subsequently causes the reports to be tabled and deliberated in the Parliament.

The Audit Act 1991 authorizes AG to determine the scope, methodology and timing of auditing and reporting. AG, through its impartial and independent audit and evaluation of the use of public resources, promote and uphold public accountability.

OAGN has framed its Vision, Mission, Core Values and objectives to have focused approach in conducting audit in effective and timely manner. The office has developed several guidance documents to provide guidelines to the staffs to enable them in completing audit work in more efficient, timely and effective manner.

In this context the office has developed this financial audit manual realising the need of risk based audit to meet the quality gap by the stakeholders. This manual has been developed by the consultant hired under Strengthening OAGN Project financed under Multi-Donor Trust Fund. The office has also received technical support of SAI, Norway. The manual has been developed in compliance, in material respects, with International Standards of Supreme Audit Institutions (ISSAIs) issued by Professional Standards Committee of the International Organisation of Supreme Audit Institutions (INTOSAI).

The Manual mainly focuses on audit process; pre-planning, planning, execution, reporting and follow up of audit. Standard Audit Working Papers have been developed for each process to ensure consistency and uniformity in the implementation of the audit processes and to comply with international standards.

I am sure that the implementation of this manual would lead to improve audit practices and improve professionalism in public sector auditing.

I would like to thank the Consultant, MDTF, SAI Norway and my staffs for their effort to develop this manual.

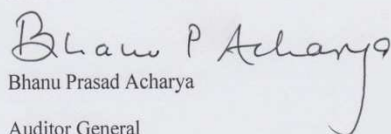

Bhanu Prasad Acharya
Auditor General

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ACRONYMS AND ABBREVIATIONS

| | |
|---------|--|
| AG | Auditor General |
| DAG | Deputy Auditor General |
| AAG | Assistant Auditor General |
| AFS | Annual Financial Statements |
| CAATs | Computer-Assisted Audit Techniques |
| HRD | Human Resource Development |
| IFAC | International Federation of Accountants |
| IFRS | International Financial Reporting Standards |
| INTOSAI | International Organisation of Supreme Audit Institutions |
| IPSAS | International Public Sector Accounting Standards |
| ISQC | International Standards on Quality Control |
| ISSAI | International Standards of Supreme Audit Institutions |
| IT | Information Technology |
| NAS | Nepal Accounting Standards |
| NEPSAS | Nepal Public Sector Accounting Standards |
| OAGN | Office of the Auditor General of Nepal |
| SAI | Supreme Audit Institutions |

INTRODUCTION

Background information on public sector auditing

The Mandate of the Auditor-General

The Office of the Auditor General (AG) is a constitutional body. It derives its mandate from the Constitution of Nepal(2015) and the Audit Act, 2048 (1991).

Article 241 of the Constitution of Nepal (2015) has defined the functions, duties and powers of the Auditor General. Accordingly the Auditor-General is empowered to undertake audit of The accounts of the Office of the President and Vice-President, Supreme Court, the Federal Parliament, Provincial Assemblies, Provincial Governments, Constitutional bodies or their offices, courts, the Office of the Attorney General and the Nepal Army, Nepal Police and Armed Police as well as of all other government offices and courts shall be audited by the Auditor General in the manner determined by law, with due consideration given to the regularity, economy, efficiency, effectiveness and the propriety thereof.

Similarly the Auditor General shall be consulted in the matter of the appointment of auditors for carrying out the audit of any corporate body of which the Government of Nepal or Provincial Government owns more than fifty percent of the shares or assets. The Auditor General may also issue necessary directives setting forth the principles for carrying out the audit of such corporate bodies.

The Constitution has also empowered the Auditor General, at all times, to have access to documents concerning the accounts for the purpose of carrying out the functions as specified above. It shall be the duty of the Head of the office in question to provide all documents or information which may be demanded by the Auditor General or her/his employees.

The accounts to be audited by Auditor General shall, subject to the Federal law, be maintained in such form as is prescribed by the Auditor General. In addition to the accounts of the offices referred above, the Federal law may also require that the accounts of any other office or institution be audited by the Auditor General.

Article 294 of the Constitution of Nepal (2015), the Annual Report of Constitutional Bodies, formed in accordance with this Constitution, shall submit the annual report about its works to the President, who in turn shall have it presented at the federal legislature, through the Prime Minister.

The details to be included in the report shall be as determined by law. Notwithstanding anything contained above, the constitutional bodies may prepare separate reports with regard to its functions in each province and submit the report to the Head of the Province. Audit objectives and functions

Matters to be audited

As per article 4 of the Audit act, the Auditor General, with due regard to the regularity, economy, efficiency, effectiveness and propriety, shall audit following matters to ascertain whether:

- a) the amount appropriated in the concerned heads and subheads by the Appropriation Act for respective services and activities have been expended for the specified purposes of designated services or activities within the approved limit;
 - b) the financial transactions comply with the existing laws and the evidence relating to items of income and expenditure are sufficient;
 - c) the accounts have been maintained in the prescribed forms and such accounts fairly represent the position of the transactions;
 - d) the inventory of government assets is accurate and up to date and the arrangement for protection and management of governmental property is adequate;
 - e) the arrangements for internal audit and internal control of cash, kind and other governmental property against any loss, damage and abuse are adequate and if so, are they pursued;
-

- f) the accounts of revenue, all other incomes and deposits are correct and the rules relating to evaluation, realization and methods of book keeping are adequate and if so, are they followed;
- g) the accounts relating to public debts, security, deposit, debt relief fund and the amounts set aside for debt services and repayment of debts are accurate;
- h) The accounts of income and expenditure of industrial and business services, and their balance of cash and kind, and the arrangements and rules relating to their financial transactions are adequate and if so, are they observed;
- i) The organization, management and job allocation of the office are sufficient and proper and are that operating accordingly;
- j) Any function is being unnecessarily performed in duplication by any employee or agency or any essential function is being omitted;
- k) The available resources, means and assets are properly utilized and the maintenance and perspiration thereof against any loss or damage has been properly arranged;
- l) The progress has been achieved within scheduled time and the quality and quantity of the work is satisfactory;
- m) The objective and policy of the Office is explicit and the program is delineated conforming to the specified objective and policy;
- n) The program is being implemented within the limits of approved cost estimate and the proceeds received in comparison to the cost is reasonable;
- o) The arrangements for maintaining data relating to target, progress and cost are adequate and reliable.

Types of audit

The AG conducts mainly the following types of audit:

Financial Audits

It includes Financial Statement audits, finance related audits, and regularity audits.

Performance Audits

It considers aspects of economy, efficiency, and effectiveness of programmes and services provided by the government. The performance audit guide should be referred to in the execution of performance audits.

Other Audit

The Office of the Auditor General also has the responsibility to perform IT audits, which includes the examination of Management controls within an Information Technology (IT) infrastructure. The evaluation of the evidence will determine whether the information systems are safeguarding assets, maintaining data integrity, and operating effectively to achieve the organization's goals and objectives.

CHAPTER 1: GENERAL CONCEPT ON AUDITING

This part of the chapter provides the general concepts for financial audit.

1.1 Auditing Standards

Auditing Standards are developed to improve the auditing practices. They shall be consistent with the generally accepted principles of auditing. Auditing standards provide a framework for auditing steps and procedures. Auditing Standards constitute the criteria or yardsticks against which the quality of audit results is evaluated. When adhered to they give assurance whether an audit has been conducted in accordance with certain procedures for attesting the financial statements. They also provide guidance for the auditor that helps determine the extent of auditing steps and procedures that should be applied in the audit and for audit reporting.

Auditing standards useful for our purpose are described below.

1.1.1 IFAC Standards

The accounting bodies of various countries established the International Federation of Accountants (IFAC) in 1977 to develop and enhance worldwide accountancy profession. The IFAC has issued a number of standards on accounting as well as on auditing. The auditing standards issued by the IFAC are known as International Standards on Auditing (ISAs). Though the ISAs provide the basis for internationally recognized auditing practices of private and public sector auditing, they are still not mandatory for the auditors of a Supreme Audit Institution (SAI). The ISAs do not override the statutory, regulatory or professional statutes of the countries.

1.1.2 INTOSAI Standards

The Auditing Standards Committee (changed now to Professional Standards Committee) of the International Organization of Supreme Audit Institutions (INTOSAI) issued the auditing standards at the XIVth Congress in 1992 in Washington DC. The INTOSAI standards represent the best auditing practices among the SAIs of various countries. The INTOSAI standards provide the necessary framework and overriding principles for financial audit by SAIs.

The INTOSAI auditing standards consist of four parts- Basic principles, General standards, Field standards and Reporting standards. The *basic principles* for auditing standards are basic assumptions, consistent premises, logical principles and requirements, which help in developing auditing standards and serve the auditors in forming their opinions and reports, particularly in cases where no specific standards apply. The *general standards* describe the qualifications of the auditor and/or the auditing institution so that they may carry out the tasks related to field and reporting standards in a competent and effective manner. The *Field Standards* regulate the audit activity by establishing the framework for conducting and managing audit work. The *Reporting standards* relate to the forming audit opinion after completing the audit works.

1.1.3 ISSAI Framework

The INTOSAI has taken initiative to provide an up-to-date framework of professional standards to its members and to adopt the basic framework of ISAs. The International Standards of Supreme Audit Institutions (ISSAI) consist of all documents endorsed by the Congress of INTOSAI with the purpose of guiding the professional standards of SAIs. The ISSAIs provide a framework for auditors, which include the International Standards on Auditing, and additional practice notes for the application of ISAs in the public sector. This includes recommendations on the legal, organizational, and professional prerequisites as well as on the conduct of the auditing and any other tasks with which SAIs may be entrusted. The ISSAI documents include descriptions or examples of good auditing practices.

The ISSAIs documents are codified in 1-4 digit numbers adding one more number before ISA number. The last three positions in the ISSAI number indicate the corresponding number of the ISA (for example, ISSAI 1800 includes ISA 800 and Practice Note for ISA 800). The hierarchical level of ISSAI number is mentioned below:

Level 1: Founding Principles- contains the founding principles of INTOSAI i.e. The Lima Declaration.

Level 2: Prerequisites for the functioning of SAIs- state and explain the basic prerequisites for the proper functioning and professional conduct of SAIs.

Level 3: Fundamental Auditing Principles- contains the fundamental principles in carrying out auditing of public entities.

Level 4: Auditing Guidelines- translate the fundamental auditing principles into more specific, detailed and operational guidelines that can be used on a daily basis for auditing tasks.

The INTOSAI Financial Audit Guidelines (ISSAI 1000- 2999) represent the fourth level of the ISSAI Framework. They provide guidance for conducting financial audits of public sector entities. The INTOSAI Financial Audit Guidelines include the ISAs issued by the International Auditing and Assurance Standards Board (IAASB). Practice Notes, which are included in the guidelines, provide relevant guidance on applying each ISA in financial audit of public sector entities. In applying the INTOSAI Financial Audit Guidelines, SAIs should recognize that the ISAs and Practice Notes together form the guidance.

The INTOSAI Compliance Audit Guidelines (ISSAI 4200) provides guidance for compliance audits performed together with an audit of financial statements. They build upon INTOSAI's Fundamental Auditing Principles and have been designed to assist public sector auditors having responsibilities related to compliance with authorities. The ISSAI 4200 supplements, and should be read together with the INTOSAI Financial Audit Guidelines.

Compliance with ISSAI

If referring in the auditor's report to the fact that the audit was conducted in accordance with the ISSAIs, public sector auditors should comply with all the ISSAIs relevant to audit. The auditor may only claim compliance with ISSAIs in the auditor's report when all the requirements including the ISSAIs (1000-2999) relevant for the audit have been complied with during the audit.

Auditor should understand the objective of each ISSAI and identify any additional procedures required to achieve these objectives. The auditor should also evaluate whether sufficient appropriate audit evidence has been obtained.

If any law or regulation of a country prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of ISSAIs, the auditor should provide additional explanations to mitigate possible misunderstanding. If this is not possible, the audit conducted in accordance with such law or regulation does not comply with ISSAIs the auditor's report cannot include reference that the audit having been conducted in accordance with ISSAIs.

Each SAI determine their level of compliance with the ISSAIs and need to identify the standards that have been complied with.

1.1.4 Auditing Standards of the Office of the Auditor General-Nepal¹

The Office of the Auditor General of Nepal (OAGN), as a member of INTOSAI, has adopted the auditing standards, practices and procedures of INTOSAI. The mission of the office is to provide trustworthy, effective and independent audit for the efficient management and utilization of public resources.

Audit objectives and policies of the Office of the Auditor General are:

- To promote public accountability and transparency;
- To bring forth economy in the mobilization of public resources and enhance efficiency;
- To enhance effectiveness of public entities;

¹ Refer to Government Auditing Standards- Part 1: Policy Standard and Part 2: Operational Guidelines

- To improve and assure clean practices in the working system of administrative, financial and managerial system;
- To assist in compliance of the existing laws;
- To encourage abandonment of the discretionary work-style;
- To recommend practical suggestions for improvement by identifying weaknesses and lacunae in the existing approaches, processes, practices and legal provisions; and
- To encourage the practice of taking actions against delinquents

The first auditing standards "Government Auditing Standards" of OAGN were issued on 29 June 1996 in line with the INTOSAI auditing standards. The standards were comprehensively reorganized and restructured in October 2005 with the adoption of the "Government Auditing Standards- Policy Standards". The Policy Standards is comprise of four parts- Basic principles, General standards, Field standards and Reporting standards.

- *Basic Principles*- comprise of the assumptions of OAGN for carrying out audit.
- *General Standards*- describe to the professional standards such as independency and objectivity, competence, due care, confidentiality of information, quality assurance review, professional judgement and other general standards.
- *Field Standards*- cover the framework for conducting and managing audit work.
- *Reporting Standards*- describe about the types of audit opinions and provide guidance on preparing audit report and forming audit opinions.

The OAGN also promulgated "Government Auditing Standards- Operational Guidelines" in October 2005 to streamline the basis of financial audit of public entities. The guidelines comprise of separate Chapters for Audit strategy and planning, Effective audit evidence, Review and interpretation of audit findings, Reports and presentation, Peer review and Debrief. This financial audit manual should be taken as the supplementary part of the operational guidelines for carrying out financial audit of government entities. The chapters of this manual are designed to assist in the implementation of auditing procedures envisaged by the operational guidelines.

1.2 Understanding the purpose and framework of financial audit and its environment

'Financial audit' and 'Regularity audit' are terms which are used interchangeably. However, Regulatory audits cover both financial statements audits as well as compliance audit depending on the mandate of the supreme audit institution.

As a part of a financial audit mandate, a SAI should express an opinion as to whether the financial statements fairly present the financial position and the results of the entity's operation in line with the legal and financial reporting frameworks. A financial audit conducted in accordance with the ISSAIs and relevant ethical requirements enables the auditor to express an opinion as to whether or not the financial statements are prepared, in all material respects, in accordance with an identified/applicable financial reporting framework and/or statutory requirements.

Compliance audit focuses on whether the activities of the entity have been conducted in accordance with the applicable laws and regulations. The result of the audit may be a conclusion or if it is related to an audit of financial statements a limited or reasonable assurance opinion.

1.2.1 Financial Audit objectives

As financial audit includes financial statement audits, finance related audits, and regularity audits, the objectives for financial audit are:

- To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement;
 - To obtain reasonable assurance that financial systems are in compliance with the accounting standards;
-

- To evaluate the level of compliance with applicable statutes and regulations;
- To report on the financial statements and communicate as required by applicable standards in accordance with auditor's findings, and
- Communicate to users, management those charged with governance or parties outside the entity, in relation to matters arising from the audit as required by the standard or by legislation.

1.2.2 Reasonable assurance

The basic objective of the financial audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. The entire audit process relates to providing such reasonable assurance. An audit provides reasonable assurance but not absolute level of assurance due to following limitations:

- Only a sample of transactions or balances is selected for the audit;
- The inherent limitations of the accounting and internal control system;
- The fact that most audit evidences are persuasive rather than conclusive

The decision pertaining to the nature, timing and extent of auditing procedures and drawing conclusions based on audit evidences, in many instances, rely on professional judgment of the auditor. The auditor needs to decide on the reasonableness of the financial statements and give assurance to it by expressing an opinion on it. If reasonable assurance cannot be achieved with, the evidence provided the auditor should consider the impact or scope limitation on the audit opinion expressed.

The overall audit process is directed towards forming an opinion on the fairness of financial statements. The auditor's opinion on the financial statements:

- Enhances the credibility of the financial statements;
- But - does not guarantee the future viability of the entity; and
 - does not guarantee the efficiency or effectiveness with which management has conducted the affairs of the entity; and
 - does not guarantee that the entity is free of fraud

1.2.3 Attainment of financial audit objectives

The attainment of the above objectives is dependent upon the auditor's competency and use of his/her professional judgment and scepticism. While exercising professional judgment and maintaining professional scepticism, the auditor should exercise the following procedures:

- Based on an understanding of the entity and its environment, including the entity's internal control, identify and assess risks of material misstatement, whether due to fraud or error,
- Obtain sufficient appropriate audit evidence about whether material misstatement exists, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements and any additional objectives on which reporting is mandatory based on the conclusions drawn from the audit evidence obtained.

The audit objectives of the public sector are, however, broader than described above. Additional audit objectives need to be set out in accordance with the audit mandate or obligations that are required for public sector entities arising from legislation, regulation, government policies, resolutions of the parliament, or ministerial directives, etc. The auditors may require reporting on instances of non-compliance with authorities including budget and accountabilities and/or reporting on the effectiveness of internal control. These additional objectives may lead public sector auditors to assess additional risks of material misstatement.

1.3 Public Sector Accounting Standards

Public sector entities are required to present financial statements in accordance with applicable financial reporting system. Public sector entities prepare accounts either in cash basis or in accrual basis. Cash based accounts include only the transactions relating to those transactions which actually take place within the period covered by the accounts. Accrual based accounts, on the other hand, reflect all the transactions relating to the period of the accounts without regard to the actual date of receipt or payments.

- ❖ International Public Sector Accounting Standards (IPSAS) is extensively used as accounting framework by public sector entities for their fair presentation of financial statements. The auditor's report should give attention to including the required elements of presentation in line with IPSAS. The financial statements prepared in terms of IPSAS on a cash basis or on accrual basis of accounting include the following:

IPSAS -Cash basis

- A statement of cash receipts and payments
- Accounting policies and explanatory notes; and
- A comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments

IPSAS-Accrual basis

- A statement of financial position;
 - A statement of financial performance;
 - A statement of changes in net assets/equity;
 - A cash flow statement;
 - A comparison of budget and actual amounts either as a separate additional statement or as a reconciliation;
 - Notes, comprising a summary of significant accounting policies and other explanatory information; and
 - Other reports such as reports on performance and appropriation reports.
- ❖ Nepal Public Sector Accounting Standards(NPSAS) – The Accounting Standard Board of Nepal in association with Financial Comptroller General Office has developed the Nepal Public Sector Accounting Standards in line with the IPSAS. These standards provide for accounting and reporting of financial information in general purpose financial statements to be issued by the government entities based on cash basis of accounting.

The standards are divided into two major parts:

- The first part of the standards is mandatory. It provides a definition for cash basis accounting, the requirements for the disclosure of information in the financial statements, and supporting notes and information on a number of specific issues.
- The second part is not mandatory. It identifies additional accounting policies and disclosures that an entity is encouraged to adopt to enhance its financial accountability and the transparency of its financial statements, including explanations of alternative methods for presenting certain information.

1.4 Nepal Financial Reporting Standards (NFRSs)

The Institute of Chartered Accountants of Nepal has issued a number of Nepal Financial Reporting Standards (NFRS) as prepared and recommended by Accounting Standard Board of Nepal. NFRSs are based on International Financial Reporting Standards (IFRS) under convergence process, which are issued by the International Accounting Board (IASB). The NFRSs are designed to apply to

general-purpose financial statements and other financial reporting of all profit-oriented entities and are based on IFRS with modifications to suit the accounting practices of Nepal. The NFRS prescribes the criteria for identification, measurement, presentation, and disclosure of a financial statement. It also sets out the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.

All companies including public sector business entities apply these Standards. The application of NFRSs encompasses not only the members of ICAN but also all external users that prepare financial statements. The development of NFRSs has contributed in regulating the presentation and reporting of financial statements and in bringing out financial transparency and financial discipline in Nepal.

1.5 Audit Approach

The approach plays a significant role in determining the scope of audit works. If the audit fails to adopt the correct approach it will affect the success of audit works and consequently lead to damage the reputation of the auditors. Primarily, there are four different types of approaches that can be followed in carrying out an audit.

1.6 The Risk-based Approach

A risk-based audit conceptually is to audit the things that really pose the greatest risks to an organization. In this approach, the audit is carried out by focusing in the areas of financial statements that may contain misstatements either by error or by omission, as a consequence of the risks faced by the business. A risk-based approach is adopted focusing on the major activities of an organization, concentrating on its objectives rather than the controls and looking at the threats to their achievements. This audit approach helps the auditor to evaluate the level of risk to a particular area of audit, i.e. specific accounts and transactions.

The essence of a risk-based audit starts with the objectives of the activity being audited, then moving on to the threats or risks to the achievement of those goals and then to the procedures and processes to mitigate the risks. This approach requires auditors to identify the key risks faced by a business, to consider the impact these risks could have on the financial statements and then to plan their audit procedures accordingly.

The risk-based audit approach that gives emphasis on the system of assessing risk and focusing audit on the high-risk areas minimizes the auditor's risk against the credibility of audit through negligent work. This audit approach avoids both over auditing and under auditing, which will lead to cost effectiveness without compromising the quality of audit.

Compared to the substantive testing and system based auditing, the risk based auditing takes account of substantive test risks and includes inherent risk, control risk, detection risk, sampling risk, and other analytical procedures. If an organization has already identified its key risks then it may be used as a basis for identifying risks for auditing purpose. If such risks have not been identified and assessed, then the auditor needs to work with management to create this information for identifying and evaluating business risk.

With tremendous growth in affairs and volume of transactions in the Government of Nepal, it has become almost impossible to audit each and every entity or transactions of the government. In this perspective, the risk-based approach may be applied, selecting audits at different levels e.g. entity-level or project-level or transaction-level. The basic philosophy behind this approach is choosing a few entities, projects, or transactions having high risks out of the total population. This audit approach is imperative for the improvement of the quality of government auditing. Please refer Risk Based Audit Manual of OAGN brief summary of which is in Appendix 1 (Chapter 1).

1.7 The Substantive Procedure Approach

This is also known as the vouching or the direct verification approach or direct substantive testing approach. In this approach, audit objectives are achieved without relying on the systems of controls in place and thus without undertaking tests of control. The audit is focused on testing large volumes of transactions and account balances without particular focus on specified areas of the financial

statements. Substantive procedures are intended to create evidence that an auditor assembles to support the assertion that there are no material misstatements in regard to the completeness, validity, and accuracy of the financial records of an entity. Thus, an auditor performs substantive procedures to detect whether there are any material misstatements in accounting transactions.

The tests may involve the examination of a sample of transactions and is from inductive reasoning where reasonableness of the aggregate results is inferred from the evidence of reliability of the individual details that have been tested. Substantive procedures include the following general categories of activity:

- Testing classes of transactions, account balances, and disclosures
- Agreeing the financial statements and accompanying notes to the underlying accounting records
- Examining material journal entries and other adjustments made during the preparation of the financial statements

At a general level, substantive procedures related to testing transactions can include the following:

- Examining documentation indicating that a procedure was performed
- Re-performing a procedure to ensure that the procedure functions as planned
- Inquiring or observing regarding a transaction

The substantive approach is presumed to be appropriate for those audit objectives that relate to valuation, presentation and disclosures assertions and non-routine transactions.

The approach:

- where internal controls are strong, auditors typically rely more on Substantive Analytical Procedures (the comparison of sets of financial information, and financial with non-financial information, to see if the numbers 'make sense' and that unexpected movements can be explained)
- where internal controls are weak, auditors typically rely more on Substantive Tests of Detail (selecting a sample of items from the major account balances, and finding hard evidence (e.g. invoices, bank statements) for those items)

1.8 The Financial Statement Approach

In this approach, substantive procedure is focused on balance sheet account with only very limited procedures being carried out on income statement/profit and loss account items. All balance sheet accounts are tested and verified. The justification for this approach is the notion that if the relevant management assertions for all balance sheet accounts are tested and verified, then the profit/loss figure reported for the accounting period will not be materially misstated.

This approach can be used in the organizations where accounts are kept in accrual accounting system and a balance sheet is prepared to show the financial positions. In public sector perspective, like our country, this audit approach is only useful for those corporate bodies that maintain accounts in accrual basis and prepare balance sheet.

1.9 The Systems-based Approach

This approach relies upon the entity's internal control system. In this approach, the auditor is required to assess the effectiveness of the internal controls of an entity and then to direct substantive procedures primarily to those areas where it is considered that systems objectives will not be met. This approach is used for the evaluation of systems and processes rather than locations or branches. This approach is a horizontal rather than vertical approach, reviewing an activity across the organization and looking for the areas where there are inconsistencies or interfaces are incomplete.

Government generally establishes systems of control designed to assure the accuracy and completeness of financial statements, the legality and regularity of underlying transactions and economy and efficiency of operations. If an auditor is satisfied about the adequacy of these controls,

the work of auditor in respect to substantive checking of financial statement and transactions or the performance of audited organization can be reduced accordingly. The system-based approach is presumed to be appropriate for the audit objective that relate to financial statement assertions to completeness, existence and accuracy of systematically processed routine transactions.

1.10 Audit Process Flow

The Audit team has to complete a set of sequential audit processes. An auditor must obtain a clear understanding of the audit process flow from planning right through to reporting. A brief description about the audit process is given below:

- *Pre-engagement activities*- This includes activities required prior to the start of the audit work including auditors' understanding of and compliance with the established code of ethics, identifying competent audit team and arranging for other resource requirements and clarifying audit objectives, scope and terms to the client through engagement letter, etc.
- *Strategic Planning*- Strategic plan ensures that the auditor has considered all relevant factors surrounding the environment within which the auditee or client operates and assists in establishing overall audit strategy and developing audit plan.
- *Detailed Planning* -Detailed plan determines the audit responses to assessed risks by defining the nature and audit tests. It consists of detailed audit program to address the identified risks.
- *Audit Execution or Fieldworks*- This includes the actual execution of the audit works by undertaking the procedures like tests of controls, substantive audit procedures, analytical procedures, getting representation from the management of auditee, etc.
- *Reviews, Conclusions and Reporting* - Issuing preliminary and final audit report, audit opinions, and management letter after evaluating audit evidence and observation.
- *Quality Assurance and Controls*- Throughout the whole audit process, quality control of the audit work performed and conclusions reached is undertaken by audit supervisors.
 - Quality assurance may be undertaken for individual audit assignments by the experienced and qualified reviewer and for institutional level review by a group of auditors or by peer reviews by another Supreme audit institutions

The following table provides a picture of the complete audit process to be followed by each audit team while carrying out the financial audit. The audit team has to document in the prescribed working paper (template) to evidence that each stage of the audit process is completed adequately with full compliance to the audit standards, guide, and this manual. Included in each working paper are the relevant review requirements and the references to working papers where applicable.

1.11 Audit Process Flow Table (To be reviewed once the pilot audits are completed)

| ACTIVITY | PURPOSE | DOCUMENTATION |
|--|---|---|
| Pre-engagement activities | <ul style="list-style-type: none"> Assess ethical and resource requirements Determine the terms of the engagement | <ul style="list-style-type: none"> Code of Ethics Programmed vs. Actual man days Audit Engagement Letter |
| Strategic Planning | <ul style="list-style-type: none"> Understand the entity Determining Materiality Identify and assess risks Review of Internal Control Reliance on key controls | <ul style="list-style-type: none"> Understanding the entity Planning materiality Review of internal controls Review of IT controls Preliminary analytical review Prior years audit matter Fraud checklist Risk of material misstatement Risk description audit component Reliance on key controls |
| Detailed Planning | <ul style="list-style-type: none"> Determine an appropriate response to assessed risks Develop overall audit approach Identify nature and extent of audit tests | <ul style="list-style-type: none"> Response to risk of material misstatement Overall Audit Strategy Audit Program |
| Audit Execution of Field Work | <ul style="list-style-type: none"> Perform audit procedure identified | <ul style="list-style-type: none"> Tests of controls Reliance on key controls Substantive audit procedures and analytical procedures Audit Differences Management Representation letter Audit Summary Memorandum Issue Log Final analytical review |
| Reviews, concluding and reporting | <ul style="list-style-type: none"> Evaluate audit evidence Communicate to the auditee Compile audit opinion | <ul style="list-style-type: none"> Preliminary Audit Report Final Audit Report Management Letter Matters for the attention during next years audit Code of Ethics compliance |
| Quality Assurance | <ul style="list-style-type: none"> Quality control and quality assurance of audit | <ul style="list-style-type: none"> Quality control checklist and peer review |

Figure 1: Audit Process Flow Table

1.12 Documentation and Responsibility

The following table shows the purpose/ outcome of each audit activity and responsibilities of audit team and auditors for documenting the evidences to ensure that every audit activity is completed during the audit:

| PRE-ENGAGEMENT ACTIVITIES | | | | |
|----------------------------------|--|--|--|---|
| | Documentation on audit activity | | Purpose / Outcome | Completed by |
| 1 | PE-1 | Programmed vs. actual days | Establish the programmed days for the audit and actual days spent on the audit | Audit Supervisor: Director/AAG |
| 2 | PE-2 | Code of ethics | Conclude on the audit team's independence | Audit team members |
| 3 | PE-3 | Audit Engagement letter | Common understanding and agreement about the terms of the engagement and management's responsibility | Audit team leader |
| 4 | PE-4 | Competency Matrix | Identifies the academic qualifications and service experience (years) for each team member. | Team Leader |
| 5 | PE-5 | Audit Engagement Letter | Common understanding and agreement about the terms of the engagement and management's responsibility. | Audit Team Leader (EL to be signed by AAG or DAG) |
| STRATEGIC PLANNING | | | | |
| 6 | SP-1 | Understanding the entity and its environment | Compiles basic information on the auditee, its business and its environment. | Audit Team Leader |
| 7 | SP-2 | Materiality and Planning Lead Schedule | Assess materiality for planning purpose. | Auditor |
| 8 | SP-3 | Analytical Procedures for Planning | Review the current financials with the budget and previous period for risk identification.(also could use ratios and trends for analysis). | Auditor |
| 9 | SP-4 | Understanding the entity's control environment | Assess the control environment of the entity for risk of material misstatement due to inadequacy or ineffectiveness of controls. | Audit Team |
| 10 | SP-5 | Identifying Risks of Material Misstatement | Identify risks of material misstatements through frauds or deficient or weak internal controls. | Audit Team |
| 11 | SP-6 | Using the work of others | Assess whether reliance can be placed on work of others. | Audit Team |
| 12 | SP-7 | Risk Analysis and Audit Approach | Identifies risks of material misstatement and develops audit approaches to address risks. | Audit Team Leader |
| 13 | SP-8 | Audit Planning Memorandum | Formalize audit planning summary for review/approval. | Audit Team Leader |
| DETAILED PLANNING | | | | |
| 14 | DP-1 | Audit program | Design appropriate audit procedures for the risks identified through risk assessment indicating nature, extent, and timing of the audit. | Auditor |

| AUDIT EXECUTION or FIELD WORKS | | | | |
|--|-------|--|--|--------------------|
| 15 | AE-1 | Entrance conference | Format for recording results of entrance conference | Audit Team |
| 16 | AE-2 | Performance, Materiality and Execution Lead Schedule | Identify performance level materiality. | Auditor |
| 17 | AE-3 | Test of Controls | Document the performance of tests of control (existence, operation, and effectiveness), to place the extent of reliance on controls. | Auditor |
| 18 | AE-4 | Sampling for Substantive Procedures | Use sampling in performing audit procedures and document the performance of substantive procedures. | Auditor |
| 19 | AE-5 | Analytical procedures as substantive procedures | Documenting use of analytical procedures as a tool of substantive procedure for obtaining audit conclusions. | Audit Team Leader |
| 20 | AE-6 | Audit Difference and Issue Log | Summarize the audit differences and audit issues (to be discussed in the exit conference and to include in Draft Management Letter) | Auditor |
| 21 | AE-7 | Written Representations | Obtain written representations in accordance with ISSAI 1580 for matters where normal audit procedures could not generate sufficient audit evidences. | Auditor |
| 22 | AE-8 | Exit Conference | Format for recording results of exit conference (including audit issues discussed and concerns raised by management). | Auditor |
| REVIEWS, REPORTING and CONCLUDING | | | | |
| 23 | AR-1 | Final Analytical Review | Review the audit work carried out to assess whether the audit results are in line with the audit reviewer's knowledge of the auditee. Reviewer to use ratios and trends. | Reviewer (DDG/AAG) |
| 24 | AR-2 | Draft Management Letter | Present preliminary audit issues to the management in the form of a draft management letter for the management to provide its comments. | Audit Team Leader |
| 25 | AR-2a | Final Management Letter | Issue final management letter including management's response to the issues identified. | Audit Team Leader |
| 26 | AR-3 | Format for Audit Report (based on type of opinion) | Form and audit opinion on the financial statements. | Audit Team Leader |
| 27 | AR-4 | Matters for Attention (next year) | Identify issues that will be relevant for next year's audit as a follow-up and/or for next year's risk assessment. | Audit Team |
| QUALITY CONTROL and ASSURANCE | | | | |
| 28 | QC-1 | Audit Quality Control Review Form | Ensure that audit was conducted in accordance with ISSAIs and complies with OAG audit policies and procedures. | Director / AAG |

1.13 Communication with audited entity

The audit team aims at having good communications with the audited entity. It is so because the effectiveness of audit also depends on the extent and clarity of communication with the audited entities. The audit processes that relate to communication with the audited entities are provided below:

- *Audit Authorization Letter*: indicating the team authorised to conduct the audit and the time of the audit
 - *Engagement Letter*: to explain about the nature and scope of audit before the commencement audit work.
 - *Overall Audit Strategy*: to explain the audit approach (set out based on the preliminary evaluation of the audited entity) at the end of planning.
 - *Entrance Meeting*: meeting conducted with the management of audited entity when beginning the audit.
 - *Written Representation*: Obtain written representations from the management
 - *Exit/Discussion Meeting*: meeting conducted with the management of the audited entity to discuss information about the audit findings and provide the opportunity to management to respond and/or produce evidences regarding the audit findings. This is also a time to identify to the entities' management that the fieldwork is completed and that we are entering inn the reporting phase.
 - *Preliminary Audit Report*: the audit report issued to the management of the audited entity to communicate all significant issues found during audit and to provide management with an opportunity to respond, if they have not provided a response during the exit meeting, as per Financial Procedure Act.
 - *Final Audit Report*: the audit report issued to the management of the audited entity stating all unsettled audit issue seven after considering the auditee's management responses and the evidence for the audit issues stipulated in the preliminary audit report. An overall audit opinion on the financial statements may also be provided at this time.
 - *Annual Audit Report*: Auditor General's annual report prepared as per constitutional requirements to submit to the parliament covering the audit findings of major final audit reports and the activities performed by his/ her office during a specified period.
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CHAPTER 2: PRE-ENGAGEMENT OF ACTIVITIES

2.1 Introduction

Performing the preliminary engagement activities specified by ISSAI1300.6 at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement. The sections of ISSAI 1300.6 which are applicable, identify that the auditor shall undertake the following activities at the beginning of the current audit engagement:

- a) Evaluating compliance with relevant ethical requirements, including independence; and
- b) Establishing an understanding of the terms of the engagement

2.2 Code of ethics

The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.

A code of ethics is a comprehensive statement of the values and principles that should guide the daily work of auditors. The independence of the SAI places high ethical demands on the audit staff that is engaged for the audit works.

The code of ethics recognizes that the objective of auditors is to work to the highest standards of professionalism and to attain the highest levels of performance.

The following four basic principles need to be addressed:

- **Credibility**- the need or credibility in information and information systems;
- **Professionalism**- the need for persons to be perceived as professional in the audit field by the stakeholders.;
- **Quality of service**- the need for assurance that all services obtained from a professional auditor are carried out to the highest standards of performance; and
- **Confidence**- the need for assurance that all stakeholders, as receivers of audit report, are confident that a framework exists for professional ethics and the fairness and impartiality of the audit works.

2.2.1 INTOSAI Code of ethics

According to the code of ethics of INTOSAI, government auditors should comply with the ethical requirements relating to all audit engagements, such as the following fundamental principles:

- **Integrity**: honesty;
 - **Objectivity**: the auditor should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.
 - **Independence**: the auditor should not have personal or financial dealings which may cause a conflict of loyalty or interest;
 - **Conflict of interest**: auditors should avoid all relationships with managers and staff of the audited entity and other parties which may influence, compromise or threaten the ability of auditors to act and be seen to be acting independently;
 - **Confidentiality**: auditors should not disclose information obtained in the auditing process to third parties;
 - **Professional competence and due care**: auditors must not undertake works that they are not competent to perform.
 - **Technical standards**: the auditor should carry out professional services in accordance with the relevant technical and professional standards.
-

- *Political neutrality*: the auditor should be politically non-bias in providing professional services.

2.3 Auditors in the public sector

A code of ethics for auditors in the public sector should cover the ethical requirements of civil servants in general, as well as, particular or additional professional requirements for auditors. For instance, the auditors of OAG –Nepal should comply with the general requirements of the code of ethics of Civil Service Act as well as the professional ethical requirements specially designed for auditors.

2.4 OAG Nepal Code of Ethics

Based on the INTOSAI standards, the OAG-Nepal has also developed the Code of Ethics 2011 for its auditors². All auditors should comply with the codes while carrying out their audit engagement. The fundamental principles envisaged in the Code of Ethics include the following matters:

- Independence
- Impartiality
- Due care
- Integrity
- Competence
- Professional secrecy
- Reliability
- Conflict of interest
- Professional development
- Prudence
- Political neutrality

The audit team members, prior to beginning the audit work, should assess the relation with the audited entity and sign the declaration to the Code of Ethics³. The competent officials, i.e. Director or AAG, after scrutiny of the declaration, should authorize audit team members for the audit engagement.

2.5 Competency of Audit team

The OAG Nepal should establish policies and procedures to ensure that it assigns sufficient personnel with competence, capabilities, and commitment to ethical principles necessary to perform the audits in accordance with professional standards and applicable legal and regulatory requirements and to issue reports that are appropriate in the circumstances. The responsibility for each audit engagement should be assigned to a person with the appropriate competence, capabilities and authority to perform the role. The identity and role of such person should be communicated to management of the audited entity.

2.5.1 Qualification of the audit team

Each audit supervisor, audit team leader, and audit subordinate should have the minimum academic qualification and service experience as defined by Human Resource Development Policy of OAG-Nepal. The responsibility for each person in audit engagement should be given only based on fulfilment of the required academic qualification and service experiences.

Each audit supervisor, audit team leader, and audit subordinate should fulfil the annually fixed minimum credit hour of training (Continuous Educational Program, (CEP)) as provisioned in HRD Policy for becoming illegible for the audit assignment.

2.5.2 Professionalism

Auditors should maintain and consider the following requirements throughout the audit works:

Professional Scepticism or recognizing that circumstances may exist that cause material misstatements. Professional scepticism enhances and broadens the concept of due care and is fundamental for planning and performance of the audit.

² Please refer to OAG-Nepal's Code of ethics 2011 for more details

³ Form available in Appendix A

Professional judgment by auditors leading to informed decisions and the appropriate application of relevant knowledge and experience to the facts and circumstances.

Sufficient and appropriate audit evidence should be obtained to reduce audit risk to an acceptably low level and enable the auditor to draw conclusions and to base the audit opinion thereon.

2.6 Programmed vs. Actual time

The OAG-Nepal, as per the direction of the Auditor General, should prepare an Annual Work Plan or Schedule of auditing works prior to the commencement of fiscal year. The Annual work plan is prepared disclosing the OAG-Nepal's annual auditing policy, program, and timetable of different audit activities and made available to all central level ministries, departments, and corporate bodies to facilitate the preparatory works associated with the audit.

The Annual Work Plan of OAG-Nepal provides the following information:

- Auditing policy adopted by the OAG-Nepal in carrying out financial audit, performance audit, IT audit, concurrent audit etc.
- Description and time schedule of the OAG-Nepal's audit work:
 - overall audit plan and strategy,
 - appointment of auditors for corporate bodies,
 - auditing of government offices, boards & public institutions and corporate bodies,
 - follow up of previous audit observations and recommendations,
 - drafting of Auditor General's annual audit report
 - submission of Auditor General's annual audit report
 - quality assurance activities planned
 - peer reviews of OAG-Nepal
- Audit Team arrangements for conducting field audit in different parts of the country. e.g. Auditing through Single Composite Team, Audit through different sectorial audit departments,
- Risk-based audit approach adopted by the office, including substantive tests and system tests,
- Documents, information, and other arrangements necessary to be furnished or made available to the audit team,
- Description and time-schedule for:
 - submission of the entity-level financial statements to the auditors,
 - details of previous years' audit observations settled by the entity,
 - presentation of the consolidated statement of unsettled advances by the entity,
 - preparation and presentation of different financial statements by central level ministries/departments,
 - preparation and presentation of different financial statements by Financial Comptroller General Office etc.

2.6.1 Division / Directorate responsibilities

Each audit division/directorate should make division of work to its staff. Based on the OAG-Nepal's Annual Work Plan, each audit division/ directorate should assign audit team as well as prepare programmes (time schedule) for conducting audit. Such audit programmes are to be made available to the concerned ministry, department, and audited entities as necessary prior to commencement of the audit.

Based on the work division, the audit director/audit officer leading the audit team or responsible for other allied works should also prepare an Annual Work Schedule by including programmed overall work and time schedule for each audit activity to be performed. The Annual Work Schedule of an audit team may include audit activities mentioned below:

Declaration of code ethics

Signing audit engagement letter

Completing work regarding understanding of auditee's business

Identification and assessment of audit risks
Preparing entity level audit plan and audit programme
Conduct of entrance meeting
Execution of audit works
conducting of exit meeting/ discussion on audit findings
Issuing of preliminary audit report
Issuing of final auditreport
Preparing drafts for Auditor General's Annual Report

Each audit team leader (Director or Audit Officer) shall maintain a record of audit team's activities in each audited file by evaluating whether or not the audit activities are completed within specified date or time period. The record should be presented to the audit supervisor during file review process.

2.6.2 Record of Audit Activities

The audit supervisor i.e. Director or AAG shall check the record of audit activities while evaluating the performance of each audit team/ auditors and provide suggestions and instructions to the concerned as necessary. The "Record of Audit Activities"⁴ is to be completed for the documentation and recording of the activities for each audit engagement.

2.7 Audit Engagement Letter⁵

Prior to the commencement of each audit work, an audit engagement letter, using the PE-3 working paper, should be prepared and issued to the management of the audited entity and a signature is to be obtained from the management so as to ensure that it has been duly received and accepted. This letter is to be regarded as an agreement or understanding between the auditor and the audited entity.

2.7.1 Objective of the engagement letter

The basic objective of the engagement letter is to agree with the management of the audited entity on the basis upon which the audit is to be conducted. The engagement letter will avoid any probable misunderstanding between the auditor and management of auditee in respect to basic audit assumptions, practices, and procedures. This letter facilitates audit through:

Establishing whether any preconditions for an audit are present; this refers to the use of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management to the premise on which an audit is conducted; and confirming that there is common understanding between the auditor and management on the terms of the audit engagement in writing (ISSAI -1210.10)

2.7.2 Acknowledgement from the audited entity

Auditors should identify the applicable financial reporting framework and assess whether such framework is acceptable to prepare the financial statements. An agreement should be obtained from the management of audited entity acknowledging its responsibility for the preparation of financial statements, establishing internal control, and providing the auditor with access to all information. If auditor finds the financial reporting framework identified inadequate or misleading, the auditor should evaluate the effect on the audit reporting.

2.7.3 Content of engagement letter

The scope of audit engagement of OAG-Nepal is regulated by legislation. The Auditor General of Nepal is mandated to carry out financial audit of public sector entities and is not in a position to

⁴Please refer to Appendix B – PE-2 Record of Audit Activities

⁵Please refer to Appendix C – PE-3 Audit Engagement Letter

decline or resign from an engagement. The engagement letter should be communicating to the management of audited entity the audit objective and scope of the financial audit and OAG-Nepal's obligation as established by statutes. The engagement letter should be signed by the Auditor General or the competent person authorized by him/her.

Professional judgment should be used while finalizing the list of subject matters to be included in the engagement letter. Attention should be given not to include any subject matters that may bring differences in the understanding between the auditor and the audited entity.

The basic subject matters that are to be included in an audit engagement letter include the followings:

- The Objective and scope of the financial audit;
- The responsibilities of the auditor;
- The responsibilities of the management of the auditee;
- Identification of the applicable financial reporting framework for the preparation of the financial statements;
- Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form or content;
- Reference where applicable to the fact that the audit is contracted out;
- Any additional reporting responsibilities for the entity established by the legislature that may influence the scope and timing of the audit; and
- Target dates for the audit stating each main event including all communication with management.

The specimen of the audit engagement letter can be found in Appendix PE-3.

2.8 Amendments to the terms of the engagement letter

If any amendment or suspension is to be made in audit engagement before the completion of audit, the auditor and audited entity should agree on such terms. Any terms should not be accepted if they are against the existing law, audit standard, and prevailing practice.

2.8.1 Factors to consider

The following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

Any indication that the entity misunderstands the objective and scope of the audit,

Any revised or special terms of the audit engagement,

A recent change of senior management,

A significant change in nature or size of the entity's operations,

A change in legal or regulatory requirements,

A change in the financial reporting framework

A change on other reporting requirements

The scope of an engagement in public sector is defined by legislation. In such cases, no changes may be effected to the engagement letter on the request of the entity. If legislation allows such changes, the new terms of engagement should be reported to the audit supervisors and properly documented.

2.8.2 Disagreement in the terms of the letter of engagement

If the auditor is unable to agree the terms of engagement or if management of audited entity imposes a scope limitation on the audit, the auditor should report this fact to the concerned audit supervisors. Impacts of the disagreements and/or scope limitations imposed by management should

be evaluated during the risk assessment process of the audit and reflected in the formulation on the audit opinion. In some instances, this may also involve informing legislature.

2.9 Supervisor responsibility

Before the commencement of an audit, the person responsible for the audit should confirm and document that the audit team, and any experts who are not part of the audit team, collectively and individually:

comply with relevant ethical requirements including independence,

have appropriate competence and capabilities to perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements, and

have sufficient time to perform the audit

CHAPTER 3: AUDIT PLANNING

3.1 Introduction

This chapter provides an understanding about the basic concepts and practices of audit planning and tools for the preparation of strategic planning and detailed audit planning for the audit of entities.

The auditor should plan the nature, timing and extent of direction and supervision of the engagement team and the review of their work (ISSAI 1300.11). The nature, timing and extent of planning activities will vary according to the size and complexity of the entity, the area of audit, the risks of material misstatement, and the capabilities and competence of personnel performing the audit work.

3.2 Understanding the planning processes of OAGN

Based on their vision and mission statement, Supreme Audit Institutions usually prepare a periodic strategic plan to drive the institution. OAGN has started preparing periodic strategic plans since 2009. The strategic plan provides the bases of the institution's policy including the frameworks of the overall auditing policy and strategy for the institution.

The Planning process consists of the following steps:

3.2.1 The Strategic Plan

Strategic plan is intended to provide direction to OAGN. It reflects the existing position of OAGN and the targets to be achieved during the plan period. The Strategic Plan is usually a long term plan; two to five years. It is an action plan which determines goals, objectives and process or programme for achieving those goals within the planned period. Usually such a plan will have broad objectives - to accomplish timeliness, high quality audit, enhance independence, professional development, audit methodology improvement, and relationship with stakeholder. The plan requires various indicators to be set to measure the achievement of goals.

OAGN prepared its first strategic plan as separate official document form for FY 2009 to 2012 and second strategic plan for FY 2013 – 15 is being implemented now. This document discusses, in addition to other matters, about OAGN's strategic goals, objectives and implementation matrix and required resources.

3.2.2 The Annual audit plan—Tier I

OAGN develops an annual audit plan which sets the overall audit approach for the public account in the financial year. This includes a risk-based selection of the entities where a detailed audit is required and the identification where a limited review procedure would be sufficient. This selection is to follow the procedures in accordance with the Risk Based Audit Manual 2068 (2012).

The annual Work Plan or schedule of the OAGN is formulated each year and disseminated to the Chief Accounting Officer i.e. secretaries of all ministries and constitutional bodies prior to beginning of audit works. This Work Plan or schedule is prepared each year and includes the major audit policies, strategies and tentative time schedule for the performance and the reporting activities that are required for completing the statutory audit. Such Annual Work Plan generally includes the following matters:

- Auditing policy adopted by the OAG-Nepal in carrying out financial audit, performance audit, IT audit, concurrent audit, etc.;
- A determination of the optimal audit mix by using the risk based approach to audit selection as noted in the Risk Based Audit Manual and the Annual Audit Planning Guidelines;
- Description and time schedule of the OAG-Nepal's overall works:
 - Overall audit plan and strategy,
 - Appointment of auditors for corporate bodies,
 - Auditing of government offices, boards & public institutions and corporate bodies,
 - Follow up on previous audit observations and recommendations,

- Drafting of Auditor General's annual audit report
- Submission of Auditor General's annual audit report
- Peer reviews and quality assurance of audit
- Audit Team arrangements for conducting field audit in different parts of the country. e.g. Auditing through Single Composite Team, Audit through different sectoral audit directorates;
- Audit approaches adopted by the office e.g. substantive test approach, system based approach, risk-based approach;
- Documents, information, and other arrangements necessary to be furnished or made available for the audit team;
- Description and time-schedule for the:
 - Presentation of the entity-level financial statements,
 - Details of previous year's audit observations settled by the entity,
 - Presentation of the consolidated statement of unsettled advances by the entity,
 - Preparation and presentation of different financial statements by the central level ministries / departments,
 - Preparation and presentation of different financial statements by Financial Comptroller General Office, etc.

The concerned Directorate General prepares Ministry-specific audit plan and Directorate entity-level audit plan for each entity to be audited in line with the operational plan. Most of the audit is carried out at field level. Ministry specific and entity-wise audit plans are approved by senior management.

For preparing the annual Audit Plan, OAGN selects auditees under the following headings after setting up appropriate criteria like the expenditure incurred in previous years, relative importance of the auditee, requirements from various donor agencies and nature and type of the auditee. All these units are selected for audit during the year.

1. Strategic Offices
2. Project Financial Statements (Project Accounts)
3. Other Public Sector units

A risk based approach is carried out on the remaining auditees. These are further classified as “High risk”, “Medium Risk” and “Low Risk”.

3.2.3 The Ministry level (or, Directorate level) plan—Tier II

This planning process is performed at the Directorate General/ or Directorate level. The AAG is responsible to ensure ministry level audit plan is prepared for the audit of concerned ministry in discussion with the directorate staffs. This plan should be approved by Deputy Auditor General. This plan should consider the preliminary financial information, risk assessment of entities within the directorate general, OAGN strategic plan, resource availability at the directorate, and time constraints.

OAGN is structured on the Directorate basis. An audit directorate is responsible for all audit activities relating to the particular ministry. Each Directorate maintains a list of all auditees within their jurisdiction. It conducts a risk based analysis of all its auditees based on certain selected parameters and prepares an Annual Audit calendar for that particular Ministry. This plan is used for assigning audits to various audit teams. These teams are formed from within the man power deployed in the particular directorate. An audit team is expected to complete all the audits assigned to it within the audit annual cycle, which usually begins around the 15 August and continues up to 15 February. For this purpose a date wise schedule is prepared for all teams within each directorate and teams are expected to visit the assigned auditees as per the schedule. In case of deviations from original schedule, it is approved by the respective AAGs. The audit teams are provided with an authorization letter from the concerned Supervisor along with a Travel Order.

The Directorate wise plan should begin by identifying risk at the Ministry level. It is advisable to follow a risk based approach in selecting various auditees under a Ministry for audit during a year. The audit objective should be set in a manner so as to enable OAGN express an opinion on the Financial Statements of that Ministry.

The Plan at ministry-level shall be prepared by including the following topics:

- Ministry-level Budget allocation and expenditure for the fiscal year
- Ministry-level Revenues realized for the fiscal year
- Deposits and other transactions of the ministry for the fiscal year
- Audit objectives and strategies to be adopted for conducting audit of different entities- financial, performance, IT audit, concurrent audit, etc.
- Detailed and sampling based audit approached to be undertaken
- Audit methodologies to be adopted for the audit of entities
- Audit issues targeted to be reported in forthcoming Auditor General's annual report
- Time schedule for completing audits
- Manpower planning for completing audits

3.2.4 The entity level plan (or, detailed audit plan or Audit programme)—Tier III

Individual audit plans (detailed audit plans – Audit Programme) for each entity to be audited are to be completed by the audit team. This includes a risk assessment at entity level, thus providing the nature, extent, and timing of the audit. This process of planning is described in detail in the next section.

3.3 Understanding the Entity Level Strategic Plan

The entity level strategic plan is the first activity in the audit process. It may be defined as the process that sets the direction of the audit and links the understanding of the entity's operations to the focus of the audit work.

3.3.1 Objective of Entity Level Strategic Plan

The objective of entity level strategic plan is to plan the audit so that it will be performed in an effective manner. It is acknowledged that the planning phase of the audit will take a substantial amount of time. This is because the auditor has a responsibility to understand the systems and processes of the entity in order to assess risks (ISSAI 1300.4)

The entity level strategic plan serves a number of purposes:

as a source of reference when carrying out the audit work;

to help measure progress toward completion; and

to communicate between members of the audit team.

The entity level strategic plan will assist the auditor to:

- Devote appropriate attention to important areas of the audit.
- Identify and resolve potential problems on a timely basis.
- Properly organize and manage the audit engagement and to stay "on top of things"
- Select and assign team members to tasks.
- Facilitating directing, supervision and the review of audit work.
- Co-ordinate work done by auditors of components and experts (ISSAI 1300.2)

3.3.2 Content of Entity Level Strategic Plan

The auditor should develop and document a strategic plan for the audit including the nature, timing and extent of planned risk assessment procedures. The entity level strategic planning stage of the audit includes the following:

- Determination of materiality
- Identification of significant components
- Performing risk assessment procedures
- Assessment of internal control on an overall level
- Assessment of risk of material misstatement on a financial statement level
- Establishing the overall audit strategy

3.3.3 Activities to be performed

During the entity level strategic planning stage, the auditor should address the following matters;

- Understand the entity's business and operations;
- Identify the risk facing by the entity's business;
- Identify the critical audit objectives and the audit approach to be adopted;
- Study the preliminary financial statements and identify transactions and balances to be examined;
- Identify material matters for the audit and set the level of planning materiality;
- Identify areas of risk for material misstatement. This is done through performing the following procedures:
 - analytical review
 - assessing the internal control environment of the entity
 - evaluating the work of internal audit
 - assessing the sustainability of entity's service
 - assessing the existence of frauds and manipulation if any
- Identify the need for Electronic Data Processing (EDP) audit specialist for the audit;
- Consider the financial reporting issues; and
- Compile and communicate the overall audit strategy to entity to be audited.

3.4 Overall Audit Strategy

The overall audit strategy must set the scope, timing and direction of the audit. It should also guide the development of the detailed audit plan. The establishment of the overall audit strategy involves the summary of the audit work completed during the strategic planning phase of the audit. (ISSAI 1300.7)

The overall audit strategy provides understanding and summaries of all aspects and risks that may influence the audit. These aspects have mostly been already covered and concluded in other strategic planning working papers and should include the following;

- Scope, timing and direction of the audit including characteristics of the engagement that define its scope;
 - Ascertain the reporting objectives of the engagement so as to plan the timing of the audit and the nature of the communications required;
 - Significant factors affecting the audit;
-

- Results of preliminary engagement activities and any relevant previous knowledge gained; and
- The nature, timing and extent of resources necessary to perform the rest of the engagement (ISSAI 1300.8)

The auditor should document the overall results of their strategic review to address the risks of material misstatement on the financial statements and the nature, timing and extent of the further audit procedures. The auditor should document the linkage of those procedures with the assessed risks at the assertion level and the results of the audit procedures performed so far. (ISSAI 1330.28)

The overall audit strategy and the detailed audit plan should be updated and changed as necessary during the course of the audit. Planning an audit is a continual and iterative process throughout the period of audit engagement. As a result of unexpected events, changes in conditions or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan, (for one or more components) and thereby the resulting planned nature, timing and extent of further audit procedures. All changes made to the audit plan should be documented.

3.4.1 The role and timing of planning

The auditor should plan the nature, timing and extent of direction and supervision of the engagement team and the review of their work. (ISSAI 1300.11) The nature, timing and extent of planning activities will vary according to the size and complexity of the entity, the area of audit, the risks of material misstatement, and the capabilities and competence of personnel performing the audit work.

3.5 The audit plan

The audit plan is more detailed than the overall audit strategy in that it includes the nature, timing and extent of audit procedures to be performed by the engagement team members. The basic purpose of detailed planning is to provide guidance on determining overall conclusions to date and designing and performing further audit procedures. This is done in order to respond to the identified risks of material misstatement at the financial statement and assertion levels done at the preliminary planning stage. The auditor's understanding of the entity and its environment, including its internal control and assessment of the risks of material misstatement are described below.

The auditors need to establish the overall audit strategy before developing the detailed audit plan. However, the audit procedures and processes of the strategic planning and detailed planning activities are interrelated. The changes in one may result in changes in the other. For example, though planning of auditor's risk assessment procedures is generally made at an early stage, the planning of the nature, timing and extent of audit procedures depend on the outcome of the risk assessment procedures. The performance of audit procedures identified in the detailed plan should only begin once the procedures and coverage have been reviewed and approved.

3.6 Planning documentation (The Working Papers)

The auditors should document the operations of each audited component of the entity and the nature and type of audit tests to be completed. This documentation is to be kept in the relevant Working papers, which an audit team is required to maintain.

The system description is the first step to the detailed planning and should be completed for all components. It starts with the identification of key activities in the transaction life cycle. After this, inherent and control risks and management controls to mitigate these risks should be documented.

The auditor should determine the responses to address the risks of material misstatement at the financial statement level. Such responses may include emphasizing to the audit team the need to maintain professional scepticism in gathering and evaluating audit evidence. This may also include the assignment of staff that are more experienced or those with special skills. Other consideration may include using experts, providing more supervision, or incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.

When carrying out audits of public sector entities, the auditor should take into account the legislative framework and any other relevant regulations, ordinances, or ministerial directives that affect the audit

mandate and any other special auditing requirements before completing the system description procedures. This commonly includes the understanding about the legislation or policies issued by government and internal policy or procedures relating to the audited entity. The auditor should also evaluate the actual practices of the audited entity to both the legislation and the internally generated instructions which would help to understand the activities comprising the transaction life cycle.

3.7 Understanding the Entity's Business and Environment

The auditor should obtain an understanding of the audited entity's environment and internal controls. This enables the auditor to assess the risk of material misstatement whether due to fraud or error and to determine the relevant audit approach to be followed. (ISSAI 1315.1 and 3) The working paper (WP), SP-1 Understanding the Entity and its Environment, guiding the auditor on the information that should be collected is available in *Chapter 2 Appendices: SP-1*.

The auditor should obtain an understanding of the nature of the entity's operations, locations, its management and governance, the types of services it is offering and plans to offer, the way that the entity is structured and the sources of its finances. An understanding of the nature of an entity contributes towards understanding the classes of transactions, account balances and disclosures to be expected in the financial statements. The auditor should develop an understanding of the entity's business sufficient to plan and perform the audit in accordance with applicable auditing standards and requirements.

In the entity level strategic planning phase, the auditor shall gather information to obtain an understanding of the following:

- a) overall understanding of the entity;
- b) the entity's accounting policies;
- c) the entity's control environment, and internal controls;
- d) the measurement and review of the entity's financial performance.

Understanding the entity's operations at the planning phase enables the auditor to identify, respond to, and resolve accounting and auditing problems for the audit.

3.7.1 Overall understanding of the entity

The auditor should provide a short description of the entities including the size and locations where that entity is operating. Key members of management should also be identified and a general understanding of the organizational structure should be included in the documentation. The auditor's main objective is to understand how the entity is managed and how the organization is structured for the particular management style. The auditor's understanding of the entity and its operations does not need to be comprehensive however, this should be sufficient to understand where some of the risks of material misstatements could exist. The auditor should understand the entity and its environment including the following aspects:

- Applicable legislative frameworks and considering the compliance with laws and regulations also including any frameworks applicable due to the broader objectives of the audit; (ISSAI 1315 P12 b; 1300 P4)
- Nature of the entity and its operations, financing and governance structures. The auditor should consider decisions due to political processes such as new geographic locations or closures of existing locations, reorganizations, including transfer of activities to other entities, new program areas, budgetary constraints or cutbacks. (ISSAI 1315 P12 a, g);
- Planning activities, objectives and strategies and the related operations and risks that may result in a material misstatement of financial statements. (ISSAI 1315 P12 d, e; ISSAI 1300 P4);
- Measurement and review of the entity's financial performance;
- The applicable financial reporting frameworks, the transactions and balances to be audited;

- Relevant internal controls including any operating manual and the information technology (IT) environment. A review of IT should include information on the evaluation of the design and implementation of the controls if available;
- Specific consideration should be given to fraud, litigations and claims against the entity, related parties transactions and the sustainability of service delivery (going concern); and
- Expectations of the legislature and other users of the auditor's report. (ISSAI 1315.11, 12; 13).

3.7.2 The entity's accounting policies

The auditor should obtain an understanding of the entity's application of accounting policies and consider whether they are appropriate and consistent with the prescribed financial reporting framework. The auditor should understand the issues and policies related to accounting. While identifying accounting policies and issues, the auditor shall consider:

- applicable accounting policies, principles and pronouncements, including whether the entity is likely to be in compliance;
- changes in accounting policies and principles that affect the entity; and
- whether entity's management is likely to be aggressive or conservative in implementing accounting policies. (ISSAI 1315.11 (c))

3.7.3 The entity's control environment and internal controls

In obtaining an understanding of internal controls, the audit should take into consideration the following:

- a) Any additional reporting responsibilities regarding internal controls;
- b) Relevant controls that relate to compliance with authorities;
- c) Controls related to monitoring performance against budget;
- d) Controls related to transferring budgetary funds to other entities;
- e) Controls of classified data related to national security and sensitive personal data, such as tax and health information;
- f) Supervision and other controls may be performed by parties outside the entity and relate to areas such as:

Compliance with procurement regulations;

Execution of the budget;

Other areas as defined by legislation or audit mandate;

Management's accountability. (ISSAI 1315.P14).

3.7.4 The measurement and review of the entity's financial performance

The auditor may include non-financial information such as achievement of outcomes (for example, number of people helped by the program under audit) in their measurement and reviews. Also, in the public sector there are additional external parties who may measure and review performance that the auditor should be aware of. These external parties include the legislature, other public sector entities, and the media. (ISSAI 1315.P13).

3.8 Materiality

Misstatements, including omissions, are considered material if individually or in the aggregate could influence the economic decisions, of users, taken on the basis of the financial statements. Materiality

can be divided into two categories namely quantitative and qualitative materiality. When judgments about materiality are made in light of surrounding circumstances and are affected by the size or value of financial statement values, that materiality is referred to as quantitative materiality. The term qualitative materiality is used when the judgments are measured in terms of the nature of the item in question. For examples, procurement in a particular ministry may not be material in terms of the total value of the financial statements but may be deemed material because of poor procedural practices in past years or a government wide wish to review all procurement or the non-compliance of legal requirements (ISSAI 1320).

3.8.1 Determining overall materiality

The objective of the auditor is to apply the concept of materiality appropriately throughout the audit, especially when:

- Identifying the components to be audited (strategic planning);
- Determining the nature, timing and extent of audit procedures (detailed planning); and
- Evaluating the effect of misstatements (reporting).

During planning, the auditor should establish an acceptable materiality for the financial statements as a whole so as to plan to detect quantitative material misstatements. The auditor should calculate the quantitative materiality level as a numerical value based on professional judgment. There are various guidelines to assist the auditor in assessing materiality but materiality is usually a matter of professional judgment.

In government entities, the basis of calculating materiality is usually based on gross expenditure in case of spending entities and gross revenues collection in case of revenue earning entities. The auditor may also use initial budgeted figures, estimated financial statement amounts or interim financial information for calculating materiality. If the auditor does so, a revision of materiality may be required after review of the final data or information. Part A of the working paper SP-2 Materiality and Planning Lead Schedule, found in *Chapter 3 Appendices: SP-2*, provides the auditor a table to calculate the overall materiality. This working paper also provides the opportunity for the auditor to identify qualitative factors that would influence materiality.

In part A2 of the Materiality and Planning Lead Schedule working paper, the auditor should identify significant external and internal factors that affect the entity's operations. This should be used to identify qualitative materiality. External and Internal factors might include the followings:

External factors:

- Current political and social climate
- Relevant legislation
- Source(s) of financing; and
- Seasonal fluctuation

Internal factors:

- Size of the business operations;
- Number of locations;
- Structure of the entity's business operations (centralized or decentralized);
- Complexity of operations;
- Qualifications and competence of key personnel; and
- Turnover of key personnel.

This information will also be used to complete the risk assessment for the entity.

3.8.2 Supporting information for determining materiality

As part of the documentation for determining materiality, the auditor should identify the quantitative and qualitative lead areas. Using items from the financial statement or budget, the auditor need to provide his/her assessment of the significance of each account area. Part B of the working paper SP-2 Materiality and Planning Lead Schedule, found in *Chapter 3 Appendices: SP-2*, provides a format for the auditor to summarize the analysis and to identify the audit strategy for each area. This document also allows the identification of qualitative areas that need to be reviewed during the execution of the audit. The Materiality and Planning Lead Schedule document is used as a guide for the risk assessment, which includes the assessment of internal controls, fraud risk, and the review of prior years' audit matters and work of others.

3.8.3 Additional information regarding materiality

Materiality identified during the planning stage does not necessarily determine an amount under which all misstatements are deemed immaterial in the reporting stage. Both the amount (Quantity) and nature (Quality) of misstatements need to be considered to identify material misstatements. Qualitative materiality refers to the nature or inherent characteristic of the error or misstatement and not necessarily to the amount involved. Instances of qualitative materials include; existence of fraud relating to transactions or balances; non-compliance with applicable laws and regulations; matters of high public interest or sensitivity etc.

The auditor's assessment of risk affects the level of materiality that will be used for the audit. There is an inverse relationship between risk and materiality. When the level of risk for an entity has been assessed high, the materiality should be set low and vice versa. The purpose of setting lower materiality levels is to reduce the probability that the total of uncorrected and undetected misstatements in the financial statements exceeds the materiality level. Entities with a high risk of material misstatements are more likely to have qualifications in their audit report which will reduce the auditor's risk of expressing an incorrect (unqualified instead of qualified) audit opinion.

During reporting, the auditor should revise final materiality for the financial statements as a whole and where applicable, the materiality level or levels for particular classes of transaction, account balances or disclosures. Revision is only necessary when there have been changes to either the level of risks identified or the financial information on which the calculation was based. If a revised materiality has been determined, the reasons for the revision and the revised materiality should be documented in AE-9 - Audit Difference working paper completed during the fieldwork phase.

3.9 Risk Assessment

Risk assessment procedures assist the auditor in obtaining an understanding of the entity and its environment. The procedures should be sufficient to identify and assess the risks of material misstatement both on the financial statements as a whole and for each relevant assertion relating to account balances. The risk assessment procedures alone do not provide sufficient or appropriate audit evidence to base an audit opinion on. They may however assist auditors to focus their resources on the important or high-risk areas, which should be subject to increased substantive testing. (ISSAI 1315.3 and 5)

3.9.1 Major risks in the public sector

ISSAI 1315 provides a list of 16 major risk issues that auditors should consider when performing the risk assessment for public sector audits. These are listed below:

- Budget overspending due to weak budgetary controls;
 - Privatizations;
 - New programs;
 - Major changes to existing programs;
 - New financing sources;
 - New legislation and regulations or directives;
 - Political decisions such as relocation of operations;
-

- Programs without sufficient resources and funding;
- Increased public expectations;
- Procurement of goods and services
- Outsourcing of government activities;
- Operations subject to special investigations;
- Changes in political leadership;
- Indications of waste or abuse;
- Higher than normal expectations to meet budget;
- Public and private partnerships.

3.9.2 Risk Assessment general approach

The nature, timing and extent of the risk assessment procedures performed depend on the circumstances of the engagement such as the size and complexity of the entity and auditor's experience with it. In addition, the auditor may be required to look at the measurement and review of the entity's non-financial performance. (ISSAI 1315 P13)

The auditor needs to follow the following process relating to identification and assessment of risks for the audit:

Risks are identified on a financial statement level by performing risk assessment procedures with the help of the working papers;

Existence of management controls relating to these risks are evaluated on the strategic level. This is done by considering and testing aspects of the internal Control Checklist and analytical procedures; and

The risks on a financial statement level are considered for each audited component and assertion during detailed planning.

The auditor can perform the following (or a combination of the following) risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control: (ISSAI 1315.6)

Inquiries of management and others within or outside the entity: this may include discussions with personnel on different levels within the entity (top managers, program managers, internal auditors, legal experts etc.), knowledgeable persons outside the entity, other auditors involved in other audits running within the entity.

Analytical procedures whereby relationships between the following is considered:

Expenditure versus appropriation

Benefit payment such as child support and pensions versus demographic allocations

Interest as a percentage of debt compared to the established borrowing rate; (ISSAI 1315 P7).

Observing or inspection of documentations such as:

Legislative reports or minutes

Additional documents prepared by management for the legislature, such as performance reports or funding requests (internal audit report, consultant reports, donors' mission reports, etc.)

Testimonies of agency officials

Ministerial and other directives

Official records of proceedings of the legislature

published materials in newspapers, magazines and other publications

3.9.3 Identification of risks at the financial statement level

The auditor is to perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial and assertion levels. During the strategic planning stage of the audit, the auditor should concentrate on only identifying the risk at the financial statement level. This will be the basis for the documentation of the major inherent risks associated with the audited entity. The auditor is to start completing the working paper *SP-7 Risk Analysis and Audit Approach*, found in *Chapter 3 Appendices: SP-7*, with these inherent risks. The other steps that are part of the strategic planning process will provide the information allowing the auditor to complete the risk assessment.

3.10 Planning analytical procedures

Analytical procedures are helpful in identifying matters that have financial statement and audit implications. These analytical procedures may include procedures such as identifying the existence of unusual transactions, the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or deviations from predicted amounts. (ISSAI 1520).

Analytical procedures are performed to assist in planning the audit and to enhance the overall understanding of the entity's operations. To the extent that it has not been covered during the development of audit strategy and planning, the auditors should use analytical procedures to:

- analyse relevant information;
- discuss results with management.

The analytical procedures, which are based on the auditors' judgement, may vary widely depending on the size and complexity of the entity and the existence of meaningful relationships. For some entities, the analytical procedures may consist of reviewing changes in account balances between the previous year and the current year using the general ledger or the preliminary or unadjusted working trial balance. In contrast, for others, the analytical procedures may involve an extensive analysis of trimester financial statements, if available. In both cases, the analytical procedures, combined with the auditors' knowledge of the operations, serve as a basis for additional enquiries.

Typical information the auditor considers when planning analytical procedures include:

- management reports and analytical data prepared routinely by the entity to manage the operations;
- current and prior period financial data i.e. financial statements;
- non-financial information; and
- the entity's annual budget and release of budget.

Often, the entity's management applies analytical procedures as part of its monitoring of the operations. Management's analytical procedures may be considered to identify trends, fluctuations, and unusual relationships.

During the strategic planning stage of the audit, the auditor should complete the working paper *SP-3 Preliminary Analytical Review*, found in *Chapter 3 Appendices: SP-3*. This document is to be used to identify trends and variances between the budget, current year and previous year results. This document should also be used to identify leads for the audit, which would be based on the auditor's analysis and judgment regarding the variances.

3.11 Assessment of internal and IT controls

The auditor shall obtain an understanding of internal and IT controls relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. (ISSAI 1315.12).

When obtaining an understanding of controls that are relevant to the audit, the auditor shall evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to inquiry of the entity's personnel. The Internal Control Questionnaire (ICQ) completed during the annual planning process should be used to assist the auditor to complete this documentation. (ISSAI 1315.13).

To document the results of this understanding and the evaluation the auditor should use the working paper SP-4 Understanding the entity's control environment, found in *Chapter 3 Appendices: SP-4*.

3.11.1 Internal Controls

Internal controls are the whole system of financial and other controls, including the organizational structure, methods, procedures and internal audit, established by management within its corporate goals, to assist in conducting the business of the audited entity in a regular economic, efficient and effective manner; ensuring adherence to management policies; safeguarding assets and resources; securing the accuracy and completeness of accounting records; and producing timely and reliable financial and management information.

The auditor should obtain an understanding of the system of internal controls put in place relevant to the financial statement audit. This is followed by an assessment to determine if internal controls are designed and implemented to address identified risks that threaten the achievement of any of these objectives. An Internal control system consists of the following components:

- The control environment;
- The entity's risk assessment process;
- The information system, including the related business processes, relevant to financial reporting, and communication;
- Control activities; and
- Monitoring of controls

(See ISSAI 1315.14-24).

3.11.2 Evaluating internal controls

For every audit entity, regardless of its size, the concerned audit manager, the Audit Director or Assistant Auditor General, shall obtain an understanding of internal control, mainly through the assessment of the control system and discussions with management. The details of the internal control systems and its documentation are to be taken into consideration as part of audit strategic planning process by the members of the audit team.

The information that the AAG or Audit Director obtained and documented on the Internal Control Questionnaire (ICQ) about internal control for the purposes of developing the audit strategic plan may include information for which details are to be developed in the audit-planning phase. If so, the information shall be communicated to the other members of the audit team for purposes of developing the audit plan to understand, document and test relevant activities that can be identified with audit objectives.

The auditor should obtain or update the understanding of the internal control system using a combination of the following procedures:

- enquiries of management, supervisory and staff personnel;
- observation of an entity's activities and operations; and
- limited inspection of documents and records.

Internal control may be judged effective for each of the categories of internal control objectives if management have reasonable assurance that:

- they understand the extent to which the entity's operations objectives are being achieved (operations objectives);

- published financial statements are being prepared reliably (financial reporting objectives); and
- applicable laws and regulations are being complied with (compliance objectives).

For the evaluation of the internal control system, some of the categories of control will be performed on a financial statement level (control environment, risk assessment process), and some of it such as control activities will be documented and evaluated for each audited component. Internal controls systems are adequately designed when they can prevent or detect misstatements and errors in the financial statements. If control systems are not designed appropriately, the auditor should not consider placing reliance on these systems but should report the ineffective design to management.

The purpose of obtaining an understanding of internal control is:

- to develop an understanding of how the entity responds to risks facing the operations;
- to assess the effectiveness of internal controls system;
- to decide the overall audit approach to internal control; and
- to identify areas where the audit team may be able to develop useful recommendations.

In obtaining understanding of internal controls, auditors should consider the following:

- Relevant controls that relate to compliance with laws and regulations;
- Controls related to monitoring performance against the budget;
- Controls related to transferring budget to entities;
- Controls related to secrecy and national security;
- Reporting responsibilities regarding internal controls;
- Controls by concerned ministry and supervising agencies related to procurement regulation, program and budget implementation, legislation of laws, regulation, and management accountability.

Management seeks to monitor and mitigate the operations' risks that an entity's objectives will not be attained as the result of all the chiefly external factors, pressures and forces brought to bear on the entity. Internal control depends on the risks management perceives to be the greatest. Perceptions of risks and appropriate responses to the risks differ from operations to operations and from individual to individual.

Internal controls can only provide a limited assurance about achieving the entity's financial reporting objectives. No matter how well designed and operated, controls will not be able to prevent faulty human judgment in decision-making, human errors or management override of the internal control process.

Obtaining or updating the understanding of internal control is not a linear process, in which one-step always follows another. Nevertheless, an approach likely to be efficient is as follows:

- first, complete or update the understanding of the entity's risk assessment process and the control environment which was initially obtained during the development of the strategic planning process via the Internal Control Questionnaire (ICQ);
- second, identify how the entity's information system supports the entity's significant classes of transactions (working paper SP-4 Understanding the entity's control environment);
- third, consider control activities as they relate to the financial statements generally and, if appropriate, as they relate to specific audit objectives. The SP-4 Understanding the entity's control environment working paper to assess internal control is given in Chapter 3 Appendices.

In summary, internal controls should ensure:

- Safeguard of Assets
 - Prevention and Detection of fraud and errors (misstatements)
-

- Orderly and Efficient conduct of operation
- Timely preparation of reliable financial statements
- Adherence to management policies and procedures
- Adequacy and accuracy of accounting records

Internal control review should cover the following:

- Assess whether controls exists or not(Existence)
- Assess whether the controls are adequate commensurate with the size and the nature of the organisation (Adequacy)
- Assess whether the controls have been in operational for the entire period under the audit (Operation)
- And have been operated as intended (Effectiveness)

This assessment can be conducted in different ways; however, the most common one is the use of an Internal Control Questionnaires (ICQ).An IQC has been developed by the OAG and is available internally.

Control Environment

The auditor should obtain an understanding of the control environment.The control environment includes aspects of governance, management functions, behaviour and attitudes, actions to prevent and detect fraud and error, commitment to ethical values and competence. (ISSAI 1315.14).

The assessment of the control environment should not only be based on inquiries and discussions, conclusion drawn thereon should also be linked back to documented policies and procedures or lack thereof.

The control environment consists of those factors that set the tone of an entity's operations and thereby influence the control consciousness of people in the entity's operations.The factors reflected in the control environment include the following:

- Integrity and ethical values;
- Commitment to competence;
- Management's philosophy and operating style;
- The entity's organisational structure;
- Methods of assigning authority and responsibility;
- Human resource policies and practices; and
- Control methods over budget formulation and execution.

The control environment is the foundation for the other components of internal control, providing discipline and structure.It provides an atmosphere in which people conduct their activities and carry out their control responsibilities.

For purposes of developing audit strategy and planning, the AAG or Audit Directors' understanding of the entity's risk assessment process and the control environment is fundamental to judgements about the extent to which a systems-based approach may be applied.

A satisfactory control environment implies that:

- a systems-based approach to some or many audit objectives relating to systematically processed routine transactions is likely to be appropriate; and
- management's judgement concerning the non-routine transactions are less likely to be unintentionally or intentionally biased.
- An unsatisfactory control environment implies that:

- people in the entity's organisation may have little regard for internal control;
- financial information may be affected by errors or deliberate misstatements;
- a substantive audit approach to most audit objectives is likely to be appropriate; and
- there is a possibility that management decisions concerning non-routine transactions are influenced by the desire to report certain results.

Control activities

The auditor should obtain an understanding of the control activities to assess the risk of material misstatement at the assertion level and to design further audit procedures responsive to assess the risks. Control activities are the policies and procedures that help ensure that management directives are carried out. They help to provide assurance that necessary actions are taken to address the risks that threaten the achievement of the entity's objectives. (ISSAI 1315.20).

Control activities, whether within IT or manual systems, have various objectives and are applied at various organizational and functional levels. Examples of specific control activities include control by authorization, performance reviews, information processing, physical controls, segregation of duties and the like. A list of typical control activities can be found in *Chapter 3 Appendices: SP-4-2*. The control activities relevant to specific audit objectives may include:

- proper authorisation of transactions;
- separating the responsibilities of authorising transactions, recording transactions, and maintaining custody of related assets so that individuals are not in positions to both perpetrate and conceal errors or irregularities in the normal course of performing duties;
- safeguards over access to and use of assets and records only by authorised personnel, including access to computer programs and data files;
- design of documents and records that promote complete and accurate recording of transactions and events and use of such documents and records to prevent or detect errors; and
- independent checks of performance and proper valuation of recorded amounts.

Control activities implemented by management may be categorized as either preventative or detective. Preventative controls are controls which functions to prevent errors and misstatements from happening. Detective controls are controls with functions to detect and correct errors and misstatements after they already happened.

An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance and disclosure in the financial statements or to every assertion relevant to them. The auditor's emphasis is on identifying and obtaining an understanding of control activities that address the areas where the auditor considers that material misstatements are more likely to occur. (ISSAI 1315.20)

In obtaining a detailed understanding of internal control, it is usually efficient to consider first the control activities that management routinely applies to monitor and mitigate the entity's operations risks. These activities carried out at higher levels of the organization often include detective controls that apply to many processes within an information system.

Examples of specific control activities that may be effective to detect certain misstatements include:

review of financial reports by operations management responsible for the transactions on an on-going basis through operating reports that are integrated or reconciled with the financial reporting system; and

internal audit activities.

Detective controls often are applied to account balances that are the result of several classes of transactions.

Examples of detective controls that may be relevant include:

following up on exception reports that identify transactions that do not comply with the operations rules built into the application system

comparing recorded amounts to third-party records, such as reconciling the amount in the general ledger to statements received (in electronic form or otherwise) from banks.

If the auditor does not identify specific activities at these higher levels that provide sufficient assurance about the effective design and operation of internal control for individual audit objectives, the auditor may extend the understanding to identify more detailed activities, such as preventive controls applied at lower levels of the entity's operations.

Understanding Entity's IT Environment

Documentation of an auditors understanding of IT should generally include the following:

- the specific hardware and software comprising the computer configuration, including the type, number, and location of primary central processing units and whether any such units are interconnected;
- whether processing is primarily centralized or decentralized and whether data are entered only at processing locations or also at remote sites;
- the general nature of software utilities used at computer processing locations that provide the ability to add, alter, or delete information stored in data files, data bases, and program libraries;
- the general nature of software used to restrict access to programs and data at computer processing locations;
- significant computerized communications networks, interfaces to other computer systems, and the ability to upload and/or download information;
- the overall impact of microcomputers on the entity's operations, including the extent of integration of microcomputers in the accounting system (such as whether microcomputers are used to generate or process information for financial reporting);
 - relative number of microcomputers in use,
 - general nature of microcomputer use (such as word processing, spread sheets, or data base), and
 - adequacy of policies and procedures to control the access to microcomputers and use of software;
- the significant changes since any prior audits/reviews;
- the general types and extent of significant purchased software used;
- the general types and extent of significant software developed in-house;
- the method of data entry (interactive or non-interactive);
- the types of computer processing performed (stand alone, distributed, or networked);
- the use of service bureaus; and
- the approximate number of transactions processed by each significant system (as considered appropriate).

While the auditor is ultimately responsible for assessing inherent and control risk, understanding the impact of a computerised financial management system may require the assistance of a person with specialised technical skills. Such IT audit specialists should possess sufficient technical knowledge and experience to understand the IT concepts and to apply them to the audit. The AAG of the concerned audit directorate shall recommend / approve the need for procuring IT audit specialists as per the requirements.

General IT controls are usually pervasive, covering most applications. Effective design and operation of general IT controls may provide assurance that application controls are designed appropriately and function consistently over time. Therefore, before the auditor looks to application controls, the auditor

obtains an understanding of whether and to what extent general IT controls apply to those audit objectives for which the auditor plans a systems-based approach to testing.

Because it is important that processing of data take place using authorised applications, the auditor needs to understand, with respect to these same audit objectives, how the general IT controls operate to provide assurance that:

- only authorised applications are used; and
- those applications meet appropriate criteria for design, performance and acceptance by users.

When general IT controls provide reasonable assurance on these points, the auditor may limit the extent to which the auditor seeks an understanding of specific IT application controls.

The auditor's documentation and review of some of the IT controls should be included in the SP-4 Understanding the entity's control environment part B of the working paper

Consideration of the effectiveness of Internal Audit

An internal audit function is the functional means by which the managers of an entity receive an assurance from internal sources that the processes for which they are accountable are operating in a manner, which will minimize the probability of the occurrence of error, inefficient and uneconomic practices, or fraud. (INTOSAI GOV 9100). Internal auditors examine and contribute to the on-going effectiveness and efficiency of the internal control structure through their evaluations and recommendations and therefore play a significant role in effective internal control. An effective internal audit function may cover the review, appraisal, and reporting on the adequacy of controls in order to contribute to the improvement of the internal control system. As external auditors, SAIs have the responsibility of evaluating the effectiveness of the internal audit function. If an internal audit function is judged to be effective, cooperation between the SAI and the internal auditor will likely benefit both parties (ISSAI 1/3 and 16).

In preparing the audit plan and determining the audit strategy, the SAI may evaluate the effect, if any, that the internal auditor's work may have on the external audit procedures. In this stage, the auditor should perform a risk assessment to identify areas of significant risk.

When the SAI intends to use the work of the internal auditor, the SAI should evaluate:

- The independence of the internal audit activity;
- The objectivity and professional and technical competence of the internal auditor;
- Whether the work of the internal auditor is carried out with due professional care (conclusions are based upon audit objectives, audit scope, acceptable audit methodology, and sufficient audit evidence); and
- The effect of any constraints or restrictions placed on the internal audit function by any party or individual. (ISSAI 1610.9).

The SAI should evaluate the internal auditor's work for the following:

- Whether the work was performed by persons having appropriate skills and expertise;
 - Whether the work was properly supervised, reviewed, and documented;
 - The suitability of the working methods employed by the internal auditor;
 - Whether sufficient, appropriate, and relevant evidence was obtained to draw reasonable conclusions;
 - Whether the conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed; and
 - Whether any findings reported on by the internal auditor have been properly addressed by the audited organisation. (ISSAI 1610.12).
-

When internal audit work significantly affects the audit procedures, ordinarily the auditor plans to coordinate their work with the work of the internal auditors. The auditor may request assistance from internal audit. For example, the auditor may hold periodic meetings, jointly schedule audit work, arrange for reciprocal access to certain work papers, read internal audit reports and discuss accounting and auditing issues.

The auditor may take assistance or the internal auditors in obtaining an understanding of the internal control structure or in performing tests of controls or substantive tests.

The auditor shall use the SP-4 Understanding the entity's control environment Part F, found in *Chapter 3 Appendices: SP-4*, and SP-6 Using the work of Others Part C, found in *Chapter 3 Appendices: SP-6*. working papers to evaluate the works of the internal auditors.

Reporting internal control deficiencies

When the auditor obtains or update an understanding of the internal control system, the auditor should become aware of deficiencies in internal control, which do not comply with the existing Financial Procedural Act and Rules. The auditor may find that:

- management fails to recognise some risk of significant misstatements and fails to put effective control activities in place;
- management recognises the risk of significant misstatements, but the design of the related control activities is ineffective;
- the control activities in place are inefficient or ineffective in operation; or
- the control activities that might otherwise be effective are undermined by a weak control environment.

The auditors are required to report to management those material weaknesses that come to their attention. Because of their potential effect, it is usually important to report them promptly. (ISSAI 1265.7-11).

The auditors are also require to report on other control deficiencies related to financial reporting that are not as serious as a material weakness but nevertheless may be important. These control deficiencies are defined as significant deficiencies in the design and/or operation of internal control, which could adversely affect the entity's ability to record, process, summarise and report financial data consistent with assertions in financial statements. (ISSAI 1265.10(b)).

The auditor should also become aware of control deficiencies that affect the ability of the entity to attain its operating and compliance objectives. The auditor may report them to management, as appropriate.

3.12 Consideration of fraud

Misstatements in the financial statements can rise from either fraud or error. The distinction is that fraud is caused intentionally while an error is unintentional. (ISSAI 1240.2) There are two types of frauds- fraudulent financial reporting and misstatement of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. (ISSAI 1240.3).

Fraudulent financial reporting

Fraudulent financial reporting may be accomplished as follows;

- Manipulation, falsification (including forgery), or alteration of accounting reports or supporting documentation from which the financial statements are prepared;
 - Misrepresentation or omission of transactions, events or other significant information from the financial statements;
 - Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure;
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- Abuse, including the misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. (ISSAI 1240 P6).

Misappropriation of assets

Misappropriation of assets can be accomplished in a variety of ways including:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a supplier by disclosing technological data in turn for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

3.12.1 Reasons for fraud

Usually fraud is committed when there are certain factors present such as:

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure to achieve an expected (and perhaps unrealistic) target. In the public sector employees or management may be under pressure to deliver high quality services with few resources and to meet budgets.
- There is an opportunity to commit fraud when internal control can be overridden. Lack of employee skill or high volume and low value cash transaction cash transactions may be opportunities for fraud.
- Rationalisation of the act of fraud when staff (including management) has ethical values allowing them to commit a dishonest act. Lower salaries in the public sector may lead employees to justify misuse of funds. (ISSAI 1240 P5).

3.12.2 Responsibilities for fraud prevention and detection

The primary responsibility for both fraud prevention and detection rests with management and those charged with governance or oversight. (ISSAI 1240.4) Auditors are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. (ISSAI 1240.5) The prime objectives of the auditor are:

- To identify and assess the risks of material misstatement of the financial statements due to fraud;
- To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud; and
- To respond appropriately to fraud or suspected fraud identified during the audit through designing and implementing appropriate responses. (ISSAI 1240.10).

3.12.3 Auditor's responsibilities in relation to fraud

The auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level of audited components. (ISSAI 1240.25). The audit team should discuss the susceptibility of the entity's financial statements due to fraud. The auditor responsible for the audit should make sure that important matters are communicated to members of the audit team that was not involved in the discussion. The basic matters to be assessed and reviewed by an auditor are given in the SP-5 Identifying Risk of Material Misstatement Part C found in *Chapter 3 Appendices: SP-5*.

3.13 Using the work of others

Due to technicalities of audit work, involving experts may also be necessary. These experts, in the form of a person or firm possessing special skills, knowledge and experience in a particular field other than accounting and auditing, may also be used by the auditor to obtain sufficient and appropriate audit evidence and to draw conclusion on a specific issue. The use of an expert is necessary in activities like; valuation of assets, actuarial valuation by using certain techniques, legal opinion concerning interpretation of the clause of agreement, statutes etc. In making audit plan of a specific entity, the auditors should consider whether there is need to use the work of an expert. The approval of specified authority should be taken when required. While procuring an expert, the nature, scope and objectives of the expert's works and the responsibilities of the auditor and the expert should be determined and defined. In addition, the competencies of the experts in terms of academic qualification, experience and reputation and the status of expert in terms of independency, objectivity and neutrality should also be considered so the audit works can be performed effectively. Auditors should obtain audit evidence in the form of opinions, valuations and statements from the expert appointed. The auditor, if using the work of an expert, would need to document the result of the evaluation in the Part B of the SP-6 Using the Work of Others working paper found in *Chapter 3 Appendices: SP-6* (ISSAI 1620).

In addition, if the auditors need to assess if they could use the work performed by another auditor, a similar evaluation regarding the independence, competencies of the auditor in terms of academic qualification, experience and reputation and the status of auditor in terms of independency, objectivity and neutrality, should also be considered. The result of this evaluation need to be documented in the Part A of the SP-6 Using the Work of Others working paper found in *Chapter 3 Appendices: SP-6*. (ISSAI 1620.9).

3.14 Identification of significant financial statement accounts and assertions

Using the information already collected during the planning analytical procedures and documented on the SP-3 Preliminary Analytical Review working paper found in *Chapter 3 Appendices: SP-3*, the analysis of relevant information and discussions with management, the auditor should identify the significant financial statement account balances and classes of transactions.

The Financial Procedure Act and Regulation provides the provisions relating to submission of the government's central level financial statements. Major provisions include followings:

- Financial Comptroller General Office is required to submit financial statements of consolidated funds including appropriation accounts, revenue, deposits, foreign grants and loans within the time limit specified by the OAGN.
- Every responsible Chief Accounting Officer (i.e. secretary of each department/ministry and constitutional bodies) is responsible to submit the consolidated financial statements of their subordinate office for each financial year to the FCGO and OAGN within a specified period.
- Every office is responsible to submit the annual financial statements to the District Treasury Controls Office (DTCO) and concerned department/ ministries within 35 days from the expiry of the financial year.
- Each DTCO is required to reconcile the annual approved budget (i.e. by the appropriation head and source), disbursement and expenditure against the bank statements and financial statements provided by the entities.
- Each department/ ministry or constitutional body shall maintain the central accounts based on financial statements received from the subordinate offices on a trimester basis.
- All departments/ministries or constitutional bodies are required to reconcile their central accounts with the records maintained by FCGO and proceed to prepare the consolidated central annual financial statements.
- The above annual financial statements are subject to audit by the OAGN. This forms the basis for OAGN to conduct the audit and prepare the annual report.

Management asserts to the auditor that the financial statements are fairly presented. In making this general statement, management also implicitly makes other assertions about individual account balances, classes of transactions, and other data presented in the financial statements.

3.14.1 Assertions

Assertions are elements of financial statement components that the auditors use to focus their audit. Audit components have different risks that are material to the audit. The auditors should be in a position to identify which assertion is relatively more important. For example, testing the existence of assets is more important than testing completeness. The auditor should use assertions in assessing risks by considering the different types of potential misstatements that may occur, and thereby designing audit procedures that are responsive to the assessed risks. The following is a list of possible assertions: (note not all may apply to each financial statement components):

- Completeness – there are no unrecorded assets, liabilities or classes of transactions or events that require recognition in the financial statements;
- Existence or occurrence – a recorded transaction or events have occurred during the period covered by the financial statements;
- Accuracy – accounts and other data relating to recorded transactions and events have been recorded appropriately;
- Cut-off – transactions and events have been recorded in the correct accounting period;
- Valuation – assets, revenue or expenditures have been recorded at their proper value;
- Ownership – the entity has the appropriate rights (for example, title) to the assets reflected in the financial statements;
- Presentation and disclosure – appropriate information is disclosed, classified and described in accordance with acceptable accounting policies and, if applicable, legal requirements.
- Compliance – transactions and events have taken place in compliance with all relevant laws and regulations.
- Value for money- transactions or events relating to expenditure represents the economical acquisition as well as efficient and effective use of resources.

The control assertions for the processing of data are:

- Record – Complete records of actual transactions
- Real - Fictitious or duplicate transactions are not recorded
- Value - Correct monetary amounts are assigned to transactions in the records
- Time - Transactions are recorded in appropriate accounting period
- Classification - transactions are recorded in the correct ledgers and subsidiary ledger account
- Summarised - all changes in the financial records are correctly accumulated
- Posted - accumulated totals are correctly transferred to the general and subsidiary ledger where applicable
- Compliance - compliance with relevant laws and regulations relating to government's financial management procedures
- Value for money - economical, efficient and effective conduct of entity's operations
- A line item or an account should be considered significant if it has one or more of the following characteristics:
 - its balance is material (exceeds planning materiality) or comprises a significant portion of a material financial statement amount;

- a high combined risk (inherent and control risk) of material misstatement (either overstatement or understatement) is associated with one or more assertions relating to the line item or account; and
- special audit concerns, such as regulatory requirements, warrant added consideration.

The auditor should determine that any accounts considered insignificant are not significant taken together. An assertion is significant if misstatements in the assertion could exceed materiality for the related line item, account, or disclosure. Certain assertions for a specific line item or account, such as completeness and disclosure, could be significant even though the recorded balance of the related line item or account is not material. For example:

- the completeness assertion could be significant for an accrued payroll account with a high combined risk of material understatement even if its recorded balance is zero; and
- the disclosure assertion could be significant for a contingent liability even if no amount is recordable.

If the financial statements include a monetary amount for fixed assets, management asserts that this amount is fairly stated at the time of acquisition. This general assertion can be broken down into assertions that are more detailed. For example, fixed assets are complete, they exist, related property rights are owned by the entity, and they are properly classified, described, and valued in accordance with stated accounting policies, which are appropriate in the circumstances. Inventory records of capital goods should be maintained and physical verification is to be carried out yearly/half-yearly.

The above activities should result in the auditor identifying risk of material misstatement at the financial statement level and at the assertion level. These risks are to be documented in SP-5 Identifying Risk of Material Misstatement Part A & B, found in *Chapter 3 Appendices: SP-5*.

3.15 Audit procedures responsive to risks of material misstatement

The auditor should design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the assertion level. The purpose is to provide a clear linkage between the nature, timing, and extent of the auditor's further substantive audit procedures and the risk assessment. In designing further audit procedures, the auditor considers such matters as the following:

- The significance of the risk;
- The likelihood that a material misstatement will occur;
- The characteristics of the class of transactions, account balance, or disclosure involved;
- The nature of the specific controls used by the entity and in particular whether they are manual or automated;
- Whether the auditor expects to obtain audit evidence which will be used to determine if the entity's controls are effective in preventing, or detecting and correcting, material misstatements. The nature of the audit procedures is of most importance in responding to the assessed risks.

The auditor's assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. In some cases, the auditor may determine that only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion. (ISSAI 1330.6-7).

3.15.1 Considering the Nature, Timing, and Extent of Further Audit Procedures

Nature of audit procedures

The nature of further audit procedures refers to their purpose (tests of controls or substantive procedures) and their type, that is, inspection, observation, inquiry, confirmation, recalculation, re-performance, or analytical procedures. The auditors normally have two options i.e. perform a

combination of tests of controls and substantive testing or get assurance through substantive testing where reliance cannot be placed on the internal control.

Certain audit procedures may be more appropriate for some assertions than others. For example, in relation to revenue, tests of controls may be most responsive to the assessed risk of misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of misstatement of the occurrence assertion.

The auditor's selection of audit procedures is based on the assessment of risk. The higher the auditor's assessment of risk, the more reliable and relevant is the audit evidence sought by the auditor from substantive procedures. This may affect both the types of audit procedures to be performed and their combination. For example, the auditor may confirm the completeness of the terms of a contract with a third party, in addition to inspecting the document. (ISSAI 1330.10; A9-A10).

Timing of the audit procedures

Timing refers to when audit procedures are performed or the period or date to which the audit evidence applies. The auditor may perform tests of controls or substantive procedures at an interim date or at period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis).

On the other hand, performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters. If the auditor performs tests of controls or substantive procedures prior to period-end, the additional evidence required for the remaining period should be considered. (ISSAI 1330.11; A11-A14).

Extent of the audit procedures

Extent includes the quantity of specific audit procedures to be performed e.g. a sample size or the number of observations of a control activity. The extent of an audit procedure is determined by the judgment of the auditor after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. The auditor needs to increase the extent of audit procedures as the risk of material misstatement increases. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is appropriate to assess the specific risk. In addition, the auditor has to take in consideration the type of transactions being audited. Understanding if these are routine or not routine transactions will have a significant impact on the extent of the audit procedures. Refer to section 3.15 for the description of routine and non-routine transactions.

Valid conclusions may be drawn using a sampling approach. However, the auditor's conclusion based on sampling may not be correct from the conclusion reached if appropriate sampling techniques are not selected. To be considered an appropriate sampling technique, sampling must be done in such a way to be representative of the entire population. If a sampling technique is not judged to be representative of the entire population, the auditor will not be able to extrapolate any errors found to the population as a whole. The auditor should consider whether or not sampling risks is reduced to an acceptably low level. (ISSAI 1530).

The use of computer-assisted audit techniques (CAATs) such as IDEA or ACL may enable more extensive testing of electronic transactions and account files. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, to perform analytical procedures or to test an entire population instead of a sample. (ISSAI 1330.A-16).

The audit approaches for the identified risk are to be identified by the auditors in the SP-7 Risk Analysis and Audit Approach working paper found in *Chapter 3 Appendices: SP-7*.

3.16 Routine and Non-routine transactions

The account balances reflect the classes of transactions (including internal transfers and allocations) recognised during the period. These include:

- routine transactions; and
- non-routine transactions.

3.16.1 Routine transactions

Routine transactions record the entity's day-to-day operations transactions with the outside world, such as its ordinary purchases, cash payments and cash receipts. Routine transactions are likely to be:

- numerous;
- recurring;
- objectively measurable, requiring little or no judgement in determining the amount to be recorded; and
- processed in a similar way each time they occur.

Despite these characteristics, in the absence of effective internal control, the risk of significant misstatements for many routine transactions may be high. Many routine transactions are classes of transactions that involve:

- cash receipts or disbursements;
- negotiable items;
- items susceptible to theft such as inventory items; and
- transactions or items that are susceptible to theft or conversion to cash indirectly through fictitious transactions with/to employees, suppliers or contractors.

Ordinarily, the auditor plans a systems-based approach for audit objectives relating to the completeness, existence and accuracy of significant classes of transactions resulting from routine transactions.

For example routine purchases, cash receipts and cash payments.

Nevertheless, it may sometimes be more efficient to plan a substantive approach for audit objectives relating to the completeness, existence and accuracy of significant account balances resulting from routine transactions when the related classes of transactions are not significant.

For example, if the procurement of capital goods/expenditure is significant but there may be few transactions during the year.

The auditors presume that a substantive approach is appropriate for audit objectives relating to valuation, ownership and presentation and disclosure assertions for significant account balances resulting from routine transactions.

For example, audit objectives relating to revenue receivables/arrears additional procedures to extend understanding of internal control.

For those audit objectives for which the auditor plans a systems-based approach:

- the auditor makes preliminary assessments of control risk as low or moderate based on the understanding of internal control as discussed in above Section of Internal control; and
 - the auditor identifies the specific activities in the internal control process that are the basis for the systems-based approach.
 - It is important that the specific activities are linked to the audit objectives for which the auditor plans a systems-based approach.
 - the auditor plans and performs tests of controls to obtain audit evidence about the effectiveness of design and operation of such specific activities;
-

- based on the audit findings, the auditor confirms or revises the preliminary assessment of control risk and modify the audit plan and audit programme if required; and
- the auditor reports the findings to the entity, as appropriate.

3.16.2 Non-routine transactions

Non-routine transactions are transactions that are unusual either due to size or nature, or that occur infrequently. Non-routine transactions may:

- be relatively few in number;
- be unpredictable;
- require judgement to determine amounts and the accounting period for recording; and
- involve questions of intent or economic substance.

Non-routine transactions include:

operations transactions that are unusual in some respect;

For example, non-allocated but approved budget, i.e. foreign delegates to Nepal (separate budget allocation – contingent budget), retirement benefits, insurance schemes etc.

operations transactions outside the routine activities of the entity;

For example, dispositions/auctions of capital goods, sale or privatisation of public enterprises, expenditure relating to exchange visits of dignitaries.

accounting entries outside the normal course of operations.

For example, closing entries made only at year-end or other external reporting dates, entries to correct misstatements, adopt new accounting policies, and re-allocations of amounts between different account balances.

The nature of non-routine transactions may make it difficult for management to implement effective internal control for non-routine transactions as compared to routine transactions. Consequently, the risk of significant misstatements may be higher than routine transactions that are handled systematically. Even though it may be difficult for management to implement effective internal control for non-routine transactions, management has a responsibility to ensure that these transactions are processed properly.

For example, monitoring and control activities may include policies and procedures for authorisation and approval of non-routine transactions.

In the absence of effective internal control, the auditor needs to use a substantive approach for audit objectives relating to non-routine transactions. Even if internal control is established, the recording, processing, and reporting of non-routine transactions often involves questions about accounting principles, valuation, presentation and disclosures. Accordingly, the auditor should presume that a substantive approach is appropriate for audit objectives relating to non-routine transactions. Tests of details ordinarily are appropriate to obtain audit evidence about non-routine transactions. When the entity has entered into an unusual or complex transaction and the risk of significant misstatements is high, the auditor needs an understanding of the substance of the entity's arrangements and transactions with third parties to determine whether confirmation of the terms of the transactions with the other parties is warranted in addition to examining documentation held by the entity.

3.17 Risks assessment process

Management sets both entity-wide objectives and activity-level objectives, identifying and analysing the risks that these objectives will not be achieved. All entities, regardless of size, structure, nature or industry are subject to operational risks. Operational risks affect each entity's ability to survive, compete successfully within its entity, maintain its financial strength and positive public image and safeguard the overall quality of its products, services for the well-being of its people.

Risks are the set of circumstances that hinder achievement of objectives. There are three components of risk which include: Risk Event, Probability of the Risk Event, and Impact of Risk Event (Risk Event Value). Risk Event is a discrete occurrence that may affect the project for better or for worse.

Mathematically it is said as: $R = P * I = (\text{Risk Score})$

3.17.1 Audit risk

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when financial statements are materially misstated. Audit risk is a function of the risk of material misstatement (i.e. the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (i.e. detection risk).

Audit risk is the product of the following risk factors:

Audit Risk (AR) = Inherent Risk (IR) x Control Risk (CR) x Detection Risk (DR)

Auditor to manage the AR and bring it down to the acceptable level assesses IR and CR. IR and CR are beyond auditor's control to manipulate and manage. Therefore, auditor assesses those two risks and manipulates DR. The way to minimise DR (to manage DR) auditor will change the Nature, Extent and Timing of the audit.

3.17.2 Risk based approach

A Risk-based approach to accomplish the audit objectives involves identifying the monitoring and control activities specific to the audit objective and considering whether these activities are effective to prevent, or detect and correct, significant misstatements. The auditors can follow the risk-based audit approach for selecting the entity to be audited or transaction to be audited. The auditor shall use the methodologies, processes, templates and checklists prescribed in the OAGN risk-based audit guide for the purpose of assessing risks.

The Risk analysis used in this approach may be qualitative and/or quantitative. Qualitative risk analysis is a subjective approach to organizing and prioritizing risks. Quantitative Risk Analysis is an attempt to assess numerically the probability and impact of the identified risks. The basis of quantitative risk analysis is as follows:

- Assess Likelihood of Risks
- Assess Consequence of Risks
- Assign Risk Score

Risk monitoring and control is an active process that requires participation from the Audit manager, team members, key stakeholders, and risk owners within the process. The objectives of this process are as follows:

- To confirm risk responses are implemented,
- To determine the effective risk response,
- To confirm policies and procedures are followed as planned
- To monitor new risks and responses properly.

3.17.3 Risk of material misstatement

Risk of material misstatement refers to the condition where the financial statements may be materially misstated. The risk of material misstatement consists of two components, namely inherent risk and control risk. The third risk, detection risk, is related to the risk associated with auditor's procedures.

- Inherent risk – The susceptibility if a class of transaction, account balance or disclosure to a misstatement that could be material, individually or when aggregated with misstatement in other balances or classes, assuming that there were no related internal controls.

- Control risk – The risk that a material misstatement could occur and go undetected by the entity's internal control system.
- Detection risk – The risk that an auditor's audit procedures will not detect a misstatement, existing in an account balance or class of transaction, that could be material, individually or when aggregated with other misstatements.

Inherent risk and control risk must be estimated by the auditors, while audit risk is set by the auditor during the planning process. Setting audit risk also determines detection risk. The calculation of detection risk determines the nature and extent of substantive tests the auditors must conduct.

Inherent risks

Inherent risk is the risk that significant misstatements, both intentional and unintentional, may occur, disregarding the effectiveness of internal control to prevent or detect and correct such misstatements. The audit cannot, in the short term, influence inherent risk: the main task of the audit is to assess the risk. Misstatements occur when there is a failure to capture process or report data correctly or misstatements are introduced into the data at any time. The number and size of misstatements depend on many conditions or events relating to the entity's operations. These conditions or events can be divided between those that are:

- ministry/department/agency-wide; and
- specific to individual financial statement assertions.

When assessing inherent risk, the auditor should consider the combined effect of both ministry/agency and specific conditions or events. The assessment of inherent risk is an audit judgment – the risk that significant misstatements may occur, disregarding internal control.

Indicators of inherent risk that the auditor may consider for each audit objective include the following:

| <i>Indicators of higher inherent risk</i> | <i>Indicators of lower inherent risk</i> |
|---|---|
| <p>Susceptibility to misappropriation:</p> <p>Classes of transactions and related account balances involve:</p> <ul style="list-style-type: none"> ▪ cash receipts or disbursements ▪ negotiable items ▪ items susceptible to theft such as inventory items ▪ items that are susceptible to misappropriation either directly or indirectly through devices such as kickback arrangements or fictitious transactions, employees, vendors or customers | <p>No susceptibility to misappropriation:</p> <p>Classes of transactions and related account balances involve:</p> <ul style="list-style-type: none"> ▪ intangible or tangible assets not susceptible to theft or conversion to items susceptible to theft ▪ liability or valuation accounts not ultimately settled by cash, negotiable items or items susceptible to misappropriation |
| <p>Nature of items included in classes of transactions and account balances:</p> <ul style="list-style-type: none"> ▪ fewer, large items ▪ complex calculation ▪ manual intervention is required | <p>Nature of items included in classes of transactions and account balances:</p> <ul style="list-style-type: none"> ▪ many small items ▪ amounts are straight forward |

Inherent risk may be high where there is:

- greater management intervention to specify accounting;
- greater manual intervention for data collection and processing;
- greater judgement required in determining amounts; and
- complex calculations or accounting principles are required.

Control risks

The auditor should assess the effectiveness of internal control to provide reasonable assurance that significant misstatements are prevented, detected and corrected. The intrinsic limitations of internal control mean there is, even with the best internal control system, always a risk that some significant misstatements may occur and remain undetected. These limitations may be due to:

- resource constraints and the need to consider the cost of internal control in relation to expected benefits;
- the limits of human judgement and such human failures as simple errors or mistakes due to carelessness, distraction, mistakes or the misunderstanding of instructions;
- the ability of management to override internal control;
- the possibility of collusion of two or more people inside or outside the entity; and
- the reality that breakdowns may occur.

The internal control failure to prevent, detect and correct, material misstatements is to be considered as control risk. If the auditor considers internal control to be effective in preventing, detecting or correcting significant misstatements, the control risk is to be assessed as low. If the auditor finds some controls (but not all) to be effective, the control risk would be considered moderate. If the auditor considers internal control to be ineffective or the auditor considers that it would not be efficient to evaluate the effectiveness of internal control, the auditor should assess control risk as high. In such a case, the auditor would not be able to rely on the internal control system and will have to place increase reliance on substantive procedures.

During audit planning, the auditor should obtain an understanding of internal control and make preliminary assessments of control risk for each audit objective. The assessments are to be considered as preliminary until the tests of controls are completed.

The auditor should consider the components of internal control individually and together to make preliminary assessments of control risk. These assessments are made for each audit objective when the auditor has obtained or updated the understanding of internal control.

The auditor should make preliminary assessments of control risk as low or moderate if, based on the understanding, the internal control process appears to be effective for the financial statement assertions addressed by those audit objectives.

For the audit objectives for which the auditor plans a substantive approach, both the preliminary and the final assessments of control risk are understood to be assessed as high. It is not necessary to state such assessments in the work papers. The automatic assessment of control risk as high for these audit objectives ordinarily is not because the auditor believes internal control is ineffective. The assessment may be because the auditor chooses to address the audit objective by means of substantive audit procedures because this is the most cost-effective way of achieving their audit objective.

Detection risks

Detection risk is the risk of material/significant error or loss going undetected by the auditor's substantive audit procedures. Detection risk expresses the extent of the audit evidence that must be procured through substantive tests. Tests of controls are carried out to confirm the assurance auditors ascribe to the internal control system. If the internal control does not function as intended, detection assurance must be increased and the possible number of substantive tests should be raised

3.18 Risk of significant misstatement

The risk of significant misstatements on the financial statements when they are received by the auditor is the combination of inherent risk and control risk. While developing the audit strategy and planning, the auditor should consider the entity-wide conditions or events that may increase the risk of significant misstatements. The risks facing the entity's operations need to be considered, and whether these risks are likely to affect the financial statements and therefore have audit implications. The

cause of these risks may be factors affecting the operations environment of the entity, or factors affecting the industry or economy generally.

Discussions with management will enable the auditor to understand management's perceptions of the risks facing the operation and to analyse these in the broader context of the national economy. The risks facing the operations that have significant implications for the audit are then translated into critical audit objectives and determine the approach to these audit objectives.

The auditor should assess the internal control system based on the available information in the planning stage. The audit team members should discuss with their audit supervisors i.e. AAG and Directors while assessing the inherent risk and control risks. The auditor should specify the nature, time and extent of the audit issue based on the outcomes of assessed risks. The format of risk assessment is given in SP-7 Risk Analysis and Audit Approach, found in *Chapter 3 Appendices: SP-7*.

The auditor should refer to OAGN Risk Based Audit Manual for details on performing a risk assessment

If the auditor assesses the risk of significant misstatements as low, it is believed that a significant misstatement in the financial statement assertions covered by the audit objectives is unlikely. If the auditor assesses the risk of significant misstatements as high, it is believed that a significant misstatement in the financial statement assertions covered by the audit objectives is likely.

The following examples may be useful for understanding:

if the risk of significant misstatements is low, usually it is because internal control is effective;

For example, most entities provide for internal control to prevent theft, misappropriation, and other irregularities involving cash receipts, cash disbursements, cash balances, negotiable items and inventory items involved in many or most of an entity's routine transactions.

the higher the inherent risk, the more assurance management requires from the internal control process;

when inherent risk is low, management requires less assurance from the internal control process;

For example, the auditor expects to find few control activities directed to preventing theft of an office building (existence). However, the auditor may expect to find control activities directed to preventing unauthorised liens and protecting title (ownership). Risk of significant misstatement always exists, at some level, for an audit objective. Substantive audit procedures are required to address the risk that is present.

There is a direct relationship between the risk of significant misstatements in financial statement assertions and the audit evidence the auditor requires from their substantive audit procedures. The higher the risk of significant misstatements the more persuasive the audit evidence is required from the auditor.

The relationship between the risk of significant misstatements, the audit evidence obtained from analytical procedures and the audit evidence required from tests of details is illustrated below:

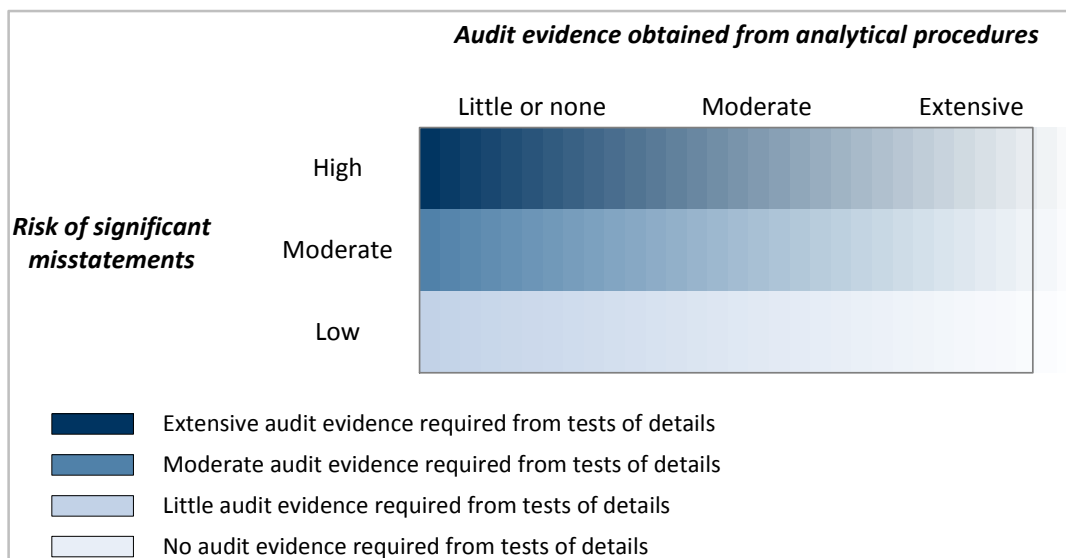


Figure 2: Risk of Significant Misstatements

As the risk of significant misstatements decreases, the auditor may modify the substantive procedures by altering their nature, timing and/or extent. For example:

- perform more analytical procedures and fewer tests of details;
- perform more audit procedures in advance of year-end; or
- confirm fewer accounts receivable balances from the concerned parties.

As the need for tests of details increases, the auditor may modify the audit procedures by altering their:

- Time - For example, perform tests of details closer to the year-end; and
- Extent - For example, circularise more account balances.

The auditor should refer to OAGN Risk Based Audit Manual for details on performing a risk assessment.

3.19 Critical audit objectives

The purpose of a financial statement audit is to achieve reasonable assurance that the financial statements are fairly stated. In assessing this, the auditor will note that there are usually some items that carry a greater risk of significant misstatements. This situation will involve considerable judgement or are difficult to verify by the auditor. An audit objective is considered to be critical when inherent risk is high, and:

- the related financial statement assertion requires a considerable degree of judgement; or
- it is difficult to obtain audit evidence or to apply audit procedures.

As part of the audit strategy and planning, the Assistant Auditor General (AAG) is responsible to provide overall direction for the audit approach to critical audit objectives. Audit strategy and planning addresses the audit approach to critical audit objectives broadly, including:

- the nature, timing and extent of audit procedures;
- the involvement of more experienced audit staff; and
- use of external experts.

The auditor shall identify those audit objectives that may benefit from the judgements of the most experienced members of the audit team.

Critical audit objectives are more likely to relate to account balances and classes of transactions resulting from processing non-routine transactions, rather than from systematically processed routine transactions.

Critical audit objectives often involve a high risk of significant misstatements and subjectivity in the evaluation of audit evidence. Audit objectives relating to non-routine transactions may also involve higher risk of significant misstatements or subjectivity in the evaluation of audit evidence.

3.20 Audit planning memorandum

The Audit Planning Memorandum usually includes the following items as a minimum:

- technical aspects:
 - background information, a brief history of the entity, (ministry/department/project) and current financial position;
 - recent developments, performance during the year, changes in entity's operations, acquisitions, and dispositions/auctions;
 - objectives and duties of the operations (ministries) highlighting analysis of key areas of the development plan and long term plans;
- incorporation and analysis of the operation's (Ministry's) budget and work plan for the year and comparison of budget against the actual results of the entity;
 - a summary of the approach to obtaining an understanding of internal control;
 - a summary of the nature, timing and extent of audit procedures for critical audit objectives; and
 - a summary of work to be performed by internal auditors and/or specialists.
- audit logistic aspects:
 - staffing, including details of the audit team members and other auditors
 - key people in the entity's organisation to be contacted
 - the required type and timing of report on the audit of the financial statements and other reports to the entity; and
 - timetable.

The format for the Audit Strategy Planning memorandum is provided in SP-8 Audit Planning Memorandum found in *Chapter 3 Appendices: SP-8*.

The AAG shall approve the Audit Strategy Planning Memorandum of entity level before the start of significant fieldwork. If audit planning decisions are modified as the audit progresses, the auditor should document the changes and the AAG approves them when the changes are made. Changes usually are to be documented in the Audit Completion Memorandum.

Audit planning decisions are communicated to members of the audit team, as appropriate. For example, a meeting may be held at the level AAG and Director to discuss the planned audit approach with the audit team and document the discussion minutes in audit file.

3.20.1 Communicating with the entity

Effective communication between auditors, management and those charged with governance is essential part of audit. Communication is essential in the following matters:

- in understanding the audit in context and developing constructive working relationship without affecting the auditor's independence and objectivity;
- to obtain information relevant to the auditor in understanding the entity's environment ;
- in identifying appropriate source of audit evidence and in obtaining information about specific transactions or events; and

- to provide timely audit observations to the entity's financial management.

Auditors should communicate the following matters to those charged with the governance in course of an audit:

- the responsibilities of the auditor in relation to audit;
- the nature, scope and timing of audit works to be performed defined by audit mandate;
- the significant findings noted during entity's audit; e.g. cases of material misstatement, fraud cases etc.;
- the significant problems and difficulties encountered during the audit;
- the limitation of auditor scope due to accessibility of information and document; and
- the ethical requirements including auditor's independency and objectivity.

Auditors should communicate the matters on a timely basis. The matters relating to audit planning and scope should be communicated early in the audit. The form, matters and persons involved in the communication should be in accordance to OAGN policy and guidelines. Communication should be made in written form as far as possible. When communication is made orally, the auditors need to document the date, place and details of such communication. All written correspondence relating to communication with the entity should be retained and documented in the audit file.

3.21 Audit programme

As part of the planning stage and before any fieldwork can be performed, the auditor need to create the audit programmes which will identify the test and the procedures required to meet the audit objectives identified in the audit planning memorandum.

The auditor needs to identify the areas, which are going to be audited and the associated assertions being tested. For each assertion, the auditor is to identify the control environment. This means that the auditor will identify what management has put in place to ensure that the assertions are achieved. For example:

For inventory, if the assertion is existence, how does management ensure those assets that are to be included in the inventory really do exist?

Based on the assessment of internal controls, the auditor may test the internal controls that were identified. If the assessment was that, the auditor reliance on internal controls was low, additional substantive procedure would be required.

The D-1 Audit Programme working paper allows the auditor to document, the area being audited, the associated assertions, the control environment and the level of reliance on these controls, and finally the test of detail and analytical procedure for each area and assertions, which need to be tested.

The test developed by the auditor should include the nature, extend, and timing for each test. This allows the auditor to ensure that the developed test will gather the information that will meet the audit objectives.

For documentation purposes, the auditor can separate each audit programme to correspond with the area audited. This allows the distribution of the work within the audit team members.

CHAPTER 4: AUDIT EVIDENCE AND FIELDWORK

4.1 Introduction

Audit execution (fieldwork) should be conducted in a manner to ensure that appropriate sufficient audit evidence is obtained in accordance with applicable (specify standards applicable at OAGN) auditing standards to form the basis of audit opinions, conclusions and recommendations.

The audit execution phase in the audit process starts with the Entrance Conference, implementation of the Audit Strategy developed at the Planning Phase and ends with the Exit Conference and entails the following sequential steps which should be followed in the order indicated below:

- A) Entrance conference;
- B) Confirmation and documentation of the understanding of the entity and its business;
- C) Implementation of Audit Strategy:
 - Test of controls,
 - Application of audit programmes and steps,
 - Substantive analytical procedures,
 - Compilation of audit summary memorandum,
 - Identification and evaluation of subsequent events,
 - Ensuring appropriate disclosure requirements,
 - Performance of final analytical procedures,
 - Obtaining management representation letter, and
 - Evaluation of audit differences.

The basic purpose of this chapter is to provide an understanding about audit evidence and the quantity and quality of audit evidence to be obtained in course of an audit of financial statements, and the audit procedures that auditors should use for effective audit execution. This chapter of the Financial Manual details OAGN's guidance to ISSAI 1500 on Audit Evidence. In addition, several other sections of the 1500 series of ISSAI will be discussed and referenced here.

4.2 Entrance Conference

The Entrance conference is conducted to achieve the following purposes;

- Introduce members of the audit team to management;
- Discuss the Overall Audit Strategy (audit objectives, scope, approximate timelines, responsibility of management and the audit team, mode of communication, etc.)
- Solicit management concerns

The Entrance Conference working paper is available in *Chapter 4 Appendix: AE-1*.

4.2.1 Confirmation and documentation of the understanding of the entity and its business

The auditor, after the Entrance Conference, should undertake activities to confirm one's understanding of the entity, its governance structure, business environment and risks, etc., and where necessary, revise the Overall Audit Strategy established at the Planning Phase. This include touring the premises to obtain an overview of the operating environment

4.3 Audit evidence

"Audit evidence" is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based, and includes the information contained in the accounting records underlying

the financial statements and other information. Evidence is information which will corroborate assertions or contradicts them.(ISSAI 1500.5(c))

Audit evidence, which is cumulative in nature, includes audit evidence obtained from audit procedures performed during the course of the audit and may include audit evidence obtained from other sources such as previous audits and quality control procedures. The auditor should obtain sufficient and appropriate audit evidence to be able to express a reasonable conclusion on an audit section leading to the expression of an audit opinion.

4.3.1 Sufficient appropriate audit evidence

The auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.

Sufficiency is the measure of the quantity of audit evidence.The quantity of audit evidence needed is affected by the following:

- Risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of internal control over financial reporting).As the risk increases, the amount of evidence that the auditor should obtain also increases.For example, ordinarily more evidence is needed to respond to significant risks.
- Quality of the audit evidence obtained.As the quality of the evidence increases, the need for additional corroborating evidence decreases.Obtaining more of the same type of audit evidence, however, cannot compensate for the poor quality of that evidence. (ISSAI 1500.5c & 6).

Appropriateness is the measure of the quality of audit evidence, i.e., its relevance and reliability.To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based.It may be relating to detecting misstatements in the classes of transactions, account balances, and disclosures and related assertions. (ISSAI 1500.5(b)).

(See also ISSAI 1500.A1 to A6).

As the quantity of audit evidence needed is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required), the sufficiency and appropriateness of audit evidence are interrelated.However, merely obtaining more audit evidence may not compensate for its poor quality.

4.3.2 Relevance and Reliability of audit evidence

Relevance:The relevance of audit evidence refers to its relationship to the assertion or to the objective of the control being tested.The relevance of audit evidence depends on:

- The design of the audit procedure used to test the assertion or control, in particular whether it is designed to (1) test the assertion or control directly and (2) test for understatement or overstatement; and
- The timing of the audit procedure used to test the assertion or control.

Reliability: The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained. For example, in general:

- Evidence obtained from a knowledgeable source that is independent of the entity is more reliable than evidence obtained only from internal sources.
 - The reliability of information generated internally is increased when the entity's controls over that information are effective.
 - Evidence obtained directly by the auditor is more reliable than evidence obtained indirectly.
 - Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized, or otherwise
-

converted into electronic form, the reliability of which depends on the controls over the conversion and maintenance of those documents.

- Documented evidence is more reliable than verbal confirmations.

The auditor is not expected to be an expert in document authentication. However, if conditions indicate that a document may not be authentic or that the terms in a document have been modified but that the modifications have not been disclosed to the auditor, the auditor should modify the planned audit procedures or perform additional audit procedures to respond to those conditions and should evaluate the effect, if any, on the other aspects of the audit.

The auditor should consider the relationship between the cost of obtaining audit evidence and the usefulness of the information obtained. However, the matter of difficulty or expense involved is not in itself a valid basis for omitting an audit procedure for which there is no alternative. (ISSAI 1500.A26 to A43).

4.3.3 Use of assertions in obtaining audit evidence

In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of the various elements of financial statements and related disclosures.

The auditor should use assertions for classes of transactions, account balances, and presentation and disclosures in sufficient detail to form a basis for the assessment of risks of material misstatement and the design and performance of further audit procedures. The auditor uses assertions in assessing risks by considering the different types of potential misstatements that may occur, and thereby designing audit procedures that are responsive to the assessed risks. (*Reference Chapter 3 Section 3.14.1 for more information on assertions*)

The auditor should take into account the legislative framework and any other relevant regulations, ordinances or ministerial directives that affect the audit mandate and any other special auditing requirements. In making assertions about the financial statements, management asserts that transactions and events have been in accordance with legislation or proper authority in addition to the assertions noted in Chapter 3 Section 3.14.1.

4.3.4 Sources of Audit Evidence

Some audit evidence is obtained by performing audit procedures to test the accounting records, for example, through analysis and review, re-performing procedures followed in the financial reporting process, and reconciling related types and applications of the same information. Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements. Generally, audit evidence can be obtained from:

- the accounting records, minutes of meetings, or a management representation (internally generated)
- the sources independent of the entity (confirmations from third parties, analysts' reports, and comparable benchmarking data from similar private sectors)
- the information generated by auditor himself/herself. (ISSAI 1500. A7 – A9).

4.4 Audit Techniques

The audit techniques help the auditor in performing the risk assessments and in obtaining audit evidence to draw an opinion.

The audit techniques described below may be used by the auditor during the risk assessment process and performing tests of controls or substantive procedures depending on the nature, type, and context of audit procedures and environment of the audit works.

- a) Examination or Inspection of records or documents

Inspection consists of examining records or documents, whether internal or external, in paper form, electronic form, or other media. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records or documents for evidence of authorization such as appropriate signatures etc. (ISSAI 1500. A14 – A16).

b) Physical examination or Inspection of tangible assets

Inspection of tangible assets consists of physical examination of the assets. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items ordinarily accompanies the observation of inventory counting. (ISSAI 1500. A16).

c) Observation

Observation consists of looking at a process or procedure being performed by others. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed. (ISSAI 1500. A17).

d) Inquiry

Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, throughout the entity or outside the entity. Inquiry is an audit procedure that is used extensively throughout the audit and often is complementary to performing other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process. (ISSAI 1500. A22 to A25).

e) Confirmation

Confirmation, which is a specific type of inquiry, is the process of obtaining a representation of information or of an existing condition directly from a third party. It may be internal as well as external. Management representation is a form of internal confirmation. External confirmation is taken from related third parties ordinarily in writing to corroborate information contained in the accounting records. An example of an external confirmation would be a confirmation letter sent to a bank to confirm the cash balance of an entity at period end. (ISSAI 1500. A18).

f) Recalculation

Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation can be performed through the use of information technology, for example, by obtaining an electronic file from the entity and using CAATs to check the accuracy of the summarization of the file. (ISSAI 1500. A19).

g) Re-performance

Re-performance is the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, either manually or through the use of CAATs. (ISSAI 1500. A20).

h) Analytical procedures

Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. It also encompasses an investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts. Analytical procedures consist of the application of audit techniques like; comparisons, computations, inquiries, inspections and observations to analyze and develop expectations about relationships among financial and operating data. Section 4.10 – Analytical Procedures - provide further guidance on this important audit technique. (ISSAI 1500. A21).

4.5 Computer-Assisted Audit Techniques

The auditor may use the computer as an audit tool to apply some of the audit techniques described in Section 4.4. The use of the computer as a tool for auditing is known as Computer-Assisted Audit Technique (CAATs). In the circumstances when the application of computerised system are highly automated and when transaction volumes are high, the CAATs can reduce much of the routine audit work. They can be used to apply tests of controls, analytical procedures and tests of details. The auditor should always consider using CAATs if the auditee's accounting system is highly computer-based.

A number of factors influence the use of CAATs, such as whether:

- file interrogation may permit an efficient 100 percent examination of accounting data; For example, an interest calculation can be made in full rather than on a sample basis.
- file interrogation may allow the auditors to define and efficiently select unusual items and accounting data. This leaves the auditor more time to concentrate on investigating and following up such items. A file interrogation that confirms that there are no unusual items provides useful information; and
- data interrogation may allow the auditors to apply audit procedures that would otherwise be very time consuming, because of the sheer volume of information to investigate the complexity of the procedures, or a combination of both; and
- data interrogation may permit audit procedures that are not possible using manual method. For example, in Electronic Data Interchange (EDI) systems or other paperless systems, data may exist only in electronic format; there may be no audit trail in paper form; or detailed accounting transactions are aggregated before entry in the general ledger and the details exist only in a database.

The auditor should consider changes in the entity's environment attributable to IT and IT business risks where they affect the financial statements. While obtaining and assessing the entity's business, the auditor should acquire knowledge about the entity's IT strategy, the extent of entity's IT activities and entity's outsourcing arrangements, where applicable. The auditor should identify and assess the risks involved in the IT application and its result in a material misstatement of the financial statements or the effect on the audit report.

4.6 Audit procedures for obtaining audit evidence

Audit evidence to draw reasonable conclusion, as required by professional standards, on which to base auditor's opinion is obtained by performing:

- a) Risk assessment procedures; and
- b) Further audit procedures, which comprise:
 - i. Tests of controls, when required by the standards or when the auditor has chosen to do so; and
 - ii. Substantive procedures, including tests of details and substantive analytical procedures.

The risk assessment procedures are performed to provide a satisfactory basis for the assessment of risks at the financial statement and assertion levels. Risk assessment procedures by themselves do not provide sufficient appropriate audit evidence on which to base the audit opinion, however, they are supplemented by further audit procedures in the form of tests of controls and substantive procedures.

When designing and performing audit procedures, the auditor should consider the relevance and reliability of the information used as audit evidence. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes as to accuracy and completeness of the information.(ISSAI 1330.25-27).

4.7 Test of controls

Test of controls are the audit procedures designed to evaluate the operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level. Tests of controls usually consist of some combination of enquiry, observation, and inspection of documents.

Tests of controls are performed to obtain sufficient audit evidence that the controls that were identified during the planning stage (see section 3.11.2) are operating effectively during the period for which audit is conducted. Test of controls should be performed to evaluate the operating effectiveness of controls throughout the audit period. If controls are tested for the interim period, evidence regarding the functioning of the controls after the period is also to be obtained. Test of controls are performed when:

- There is an expectation of the operating effectiveness of controls or when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level.
- When controls suitably designed for a specific assertion have been assumed to be operational by performing a walkthrough.

Tests of controls are applied to obtain audit evidence about:

- The design of specific activities in internal control process: Is the design of control activities suitable to prevent, or detect and correct, significant misstatements?
- The operation of specific activities in the internal control process: Are the control activities applied as designed? Audit evidence about effective operation relates to how control activities are applied, the consistency with which they are applied and by whom they are applied.

The auditor should obtain audit evidence about the preliminary assessments of control risk by performing tests of controls. Tests of controls represent the application of audit procedures to obtain audit evidence about the effectiveness of design and operation of those activities, within the framework of the internal control process, that are the basis for a systems-based approach for one or more audit objectives.

Enquiry is an important technique both in understanding internal control and in performing tests of controls to obtain audit evidence that internal control is effective.

The auditor recognises that enquiry is more than simply asking auditee staff to confirm that they perform specified activities.

For example, enquiry involves:

- considering the knowledge, independence and qualifications of the individual to be interviewed;
- Asking clear, concise and open questions. Open questions promote complete and detailed answers. Closed questions restrict the interviewee's response and are better used when wishing to confirm a point
- Listening actively and effectively. The auditor encourages information by active listening. Good listeners have a powerful appeal as they encourage people to talk. Effective listening requires an open mind.
- Considering the interviewee's response and asking follow-up questions. This requires an attitude of professional skepticism. The auditor does not accept important answers at face value; similarly the auditor does not reject answers out of hand. If the interviewee provides a seemingly inappropriate answer or misunderstands the point, the auditor should follow up their original with another question.
- Concluding with a short summary of the understanding of the facts. This allows the interviewee to confirm the understanding.

Re-performance is a term often used to refer to a test of controls involving performing an activity a second time to ascertain that the employees assigned the responsibility has correctly performed the activity. Re-performance ordinarily consists of a combination of computation, comparison, inquiry,

inspection, and observation. Other audit technique, confirmation, may also provide evidence, directly or indirectly, about the effectiveness of internal controls.

A walk-through is a term often used to refer to a combination of enquiry, inspection and observation that the auditor performs to obtain an understanding of internal control. A walk-through does not, by itself, ordinarily provide sufficient persuasive audit evidence about the effectiveness of design and operation of internal control. However, a walk-through is a useful technique to confirm that the auditor understands the system accurately. (ISSAI 1330.A20-A31).

4.7.1 Performing tests of controls

Sufficient appropriate audit evidence about the effectiveness of internal control depends on the nature, timing and extent of the tests of controls. In considering what constitutes sufficient appropriate audit evidence about the effectiveness of design and operation of internal control, the auditor may consider audit evidence from tests of controls in prior years.

Some control activities within the internal control process that are the basis for the final assessment of control risk as moderate or low do not change, or change very little, from one year to the next.

For example, automated control procedures continue to operate consistently until the procedures are changed. The auditor may test control activities for systems development in the period that management implements a system. In subsequent periods, the auditor may focus on control activities relating to security and maintenance of the system.

The auditor needs audit assurance about the effectiveness of design and operation of internal control for each audit objective for which the auditor applies a systems-based approach. Within this constraint, the auditor may choose to vary the nature, timing and extent of audit procedures applied as tests of controls from year to year.

For example, the auditor may vary the combinations of audit procedures such as enquiry, observation and inspection. The auditor may vary the dates the auditor performs tests of controls prior to year-end. The auditor may choose to apply more extensive tests to certain controls in some years and to other controls in other years. When an auditee has many locations subject to the same control activities, the auditor may often vary the locations selected for tests of controls.

Nature of the tests

The choice of audit procedures is influenced by the type of activity the auditor is testing.

For example, for IT-based systems, internal control places more emphasis on general IT controls, exception reports, and other monitoring activities. Tests of controls tend to involve enquiry, observation and inspection techniques.

For example, if internal control is based on control activities such as segregation of duties, re-performance of procedures by a second individual, and reconciliations tests of controls tend to involve inspection of documents and re-performance techniques.

A single audit procedure may not be effective.

For example:

- Individuals being interviewed may provide the answers they think the auditor wants to hear rather than telling the auditors what really happens. The auditor may unconsciously lead the interviewee and elicit answers the auditor expects, but that may not be correct
 - Observation provides direct audit evidence about the observed activity only at the time of observation. In extending conclusions to time periods when the activity is not observed, the auditor needs to be aware of the possibility that the activities may not be performed or be performed with less care when the auditor is not present
 - Inspecting documents that indicate performance (by initials or signatures) does not always mean that performance actually occurred
-

- The fact that the auditor finds no errors when re-performing a control activity is not conclusive if the items the auditor tests do not contain misstatements.

A combination of audit procedures overcomes some of the limitations of individual audit procedures and usually provides more persuasive audit evidence than one type of audit procedure alone.

For example, the auditor may combine inspection of exception reports with enquiries of the person responsible for follow-up of exceptions. The enquiry provides the auditors with information not available from the inspection of documents alone, such as impressions of the individual's skill, knowledge, judgment, and motivation.

(See ISSAI 1330. A9-A10).

Timing of the tests

Timing refers to when audit procedures are performed or the period or date to which the audit evidence applies. For example, audit tests such as testing compliance with laws and regulations may be carried out during the year while others such as testing budget execution may be completed at year end (ISSAI 1330 P5).

The auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

On the other hand, performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters.

The auditor's understanding of internal control is cumulative and is based on information and audit evidence obtained both in the current and prior years. This is also the case when the auditor is making the assessments of the effectiveness of the design and operation of activities in the internal control process. The auditor builds on this cumulative knowledge each year by:

- developing the overall approach to internal control during the audit strategy and planning stage of the audit (see section 3.11.2);
- enhancing the understanding of internal control during audit planning;
- obtaining audit evidence by performing tests of controls; and
- obtaining audit evidence by performing substantive audit procedures.

The auditor generally performs tests of controls in advance of the period-end. The auditor also obtains audit evidence that the relevant activities remain effective during the remainder of the period.

It may be efficient to perform tests of controls at the same time as the auditor updates the understanding of internal control.

Audit procedures performed during the remainder of the period are often different in nature and extent from those performed earlier. For the remainder of the period, the audit procedures usually consist of:

- enquiries of auditee personnel as to whether the design of control activities was changed; and
- tests of monitoring activities that provide management with assurance that internal control remains effective as to design and operation.

The factors the auditor should consider in determining the nature, timing and extent of audit procedures in the remainder of the year are:

the length of the remaining accounting period;

Control activities may become ineffective over time if they do not address changing operations conditions.

changes to the information system;

If the information system is altered it is likely that the specific control activities also change.

the importance of the audit objective;

The more important the audit objective is to the audit opinion, the more persuasive the audit evidence needs to be.

the consideration of the control environment;

The auditor considers whether the control environment continues to support the effective design and operation of relevant control and monitoring activities.

monitoring activities;

Effective monitoring activities may provide reasonable assurance that control activities continue to be effective.

audit evidence from results of substantive audit procedures.

The auditor considers whether the results of substantive procedures corroborate the assessments of the effectiveness of internal control.

(See ISSAI 1330. A11-A14)

Extent of the tests

The extent of tests of controls is a matter of professional judgment. When making this judgment the auditor should consider:

- the importance of the relevant activity to the assessment of the effectiveness of internal control for the audit objective; and
- the importance of the audit objective to the overall audit opinion.

The working paper AE-2 Test of Control found in *Chapter 4 Appendix: AE-2* is to be used by the auditor to summarize the results of the testing of controls.(ISSAI 1330.A15-A16).

4.8 Considering the implications of the findings

For each of the activities that the auditor tests, the auditor should document:

- the nature, timing and extent of the tests of controls; and
- the audit findings.

When performing tests of controls, the auditor may identify conditions that suggest the control activities may not be designed and operating as effectively as the auditor first thought. If so, the auditor should investigate the nature and cause of the condition. After discussions with appropriate auditee staff, the auditor may sometimes identify other activities that the auditee is doing to provide the same assurance. After testing the other activities, the auditor may be able to conclude that the preliminary assessment of the effectiveness of internal control is appropriate for specific audit objectives.

If the audit findings from the tests of controls support the preliminary assessment that internal control is effective as to design and operation, the auditor should proceed with the substantive audit procedures as planned.

It may be possible to apply substantive audit procedures to obtain audit evidence that specific control deficiencies have not allowed significant misstatements to remain undetected or uncorrected and, thereby, still form a conclusion consistent with the preliminary assessments of control risk.

As a result of performing substantive procedures, additional information may come to light that differs significantly from the information on which the auditor based the assessments of the effectiveness of internal control. If so, it may be necessary to revise the assessments of the effectiveness of internal control and re-evaluate the nature, timing and extent of the substantive audit procedures for the audit objectives affected.

If the auditor concludes there are no effective control activities or mitigating factors, the auditor revises the preliminary assessments of the effectiveness of internal control. The auditor then modifies the nature, timing and extent of the substantive audit procedures accordingly. The auditor documents revised assessments of the effectiveness of internal control as appropriate.

4.9 Substantive Procedures

Substantive procedures are direct tests of transactions and accounting items including Analytical Procedures. The auditor should carry out substantive procedures while certifying accounts and financial statements. These procedures are intended to verify that the accounting information complies with decisions and intentions, as well as with legislation, regulations and relevant rules. Substantive procedures are particularly necessary in cases where the auditor cannot base their work on the entity's risk management measures (internal control). Substantive procedures are performed in order to detect material misstatements at the assertion level. Substantive procedures comprise of:

- a) Tests of details of classes of transactions, account balances, and disclosures; and
- b) Substantive analytical procedures.

The extent of substantive procedures will depend on whether the entity has established internal control measures and on whether such measures function appropriately. The less the entity's control measures appear to function, the higher the assurance that the auditor must achieve through their substantive procedures to come to the same overall level of assurance in their assessments.

The following illustration identifies the level of substantive procedures that the audit team should perform depending on their assessment.

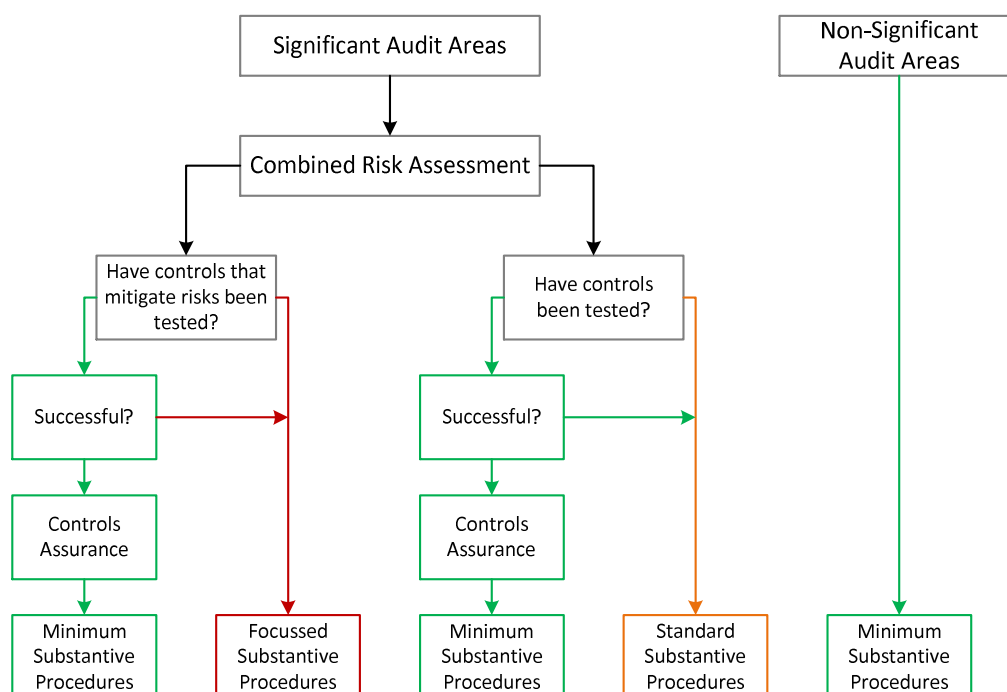


Figure 3: Level of substantive procedures to be performed by the audit team

The auditor needs to plan and perform substantive procedures to be responsive to the related assessment of the risk of material misstatement. Irrespective of the assessed risk of material misstatement or tests performed of the controls, the auditor should design and perform substantive

procedures for each material class of transactions, account balance and disclosure. This requirement reflects the fact that the auditor's assessment of risk is judgmental and may not be sufficiently precise to identify all risks of material misstatement. In other words, no matter how strongly the auditor places reliance on management's system of internal control, the auditor must perform substantive procedures to ensure that the class of transactions, account balances and disclosures are fairly stated.

The auditor shall consider whether external confirmation procedures are to be performed as one of the substantive audit procedures. This would typically be done to confirm bank balances, loans, debtors, and creditors. Since external confirmations are a very reliable source of evidence auditors should consider obtaining confirmation as much as possible and practical.

The auditor's substantive procedures should include the following audit procedures related to the financial statement closing process:

- Agreeing the financial statements to the underlying accounting records; and
- Examining material journal entries and other adjustments made during the course of preparing the financial statements.

For significant risks the auditor should design and perform substantive procedures that are specifically responsive to that risk.

When substantive procedures are performed at an interim date, the auditor should perform further substantive procedures or substantive procedures combined with tests of controls to cover the remaining period that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

If the auditor believes internal control may not be effective after the interim date, the auditor should consider whether the effectiveness of substantive audit procedures required to cover that period is impaired.

For example, if there were no effective control activities over the preparation of documents for goods received, substantive audit procedures that are based on such documents for the remaining period may be ineffective because the documents may be incomplete.

Likewise, substantive audit procedures applied to the remaining period that relate to the existence assertion at the completion date of financial year (July 16 to July 15) may be ineffective if control activities over the custody and physical movement of assets are not effective.

In both of the above examples, if the auditor concludes that the effectiveness of the substantive audit procedures may be impaired, the auditor seeks additional audit assurance. Otherwise the auditor performs substantive audit procedures at the completion of financial year (July 16 to July 15). (ISSAI 1330.A42-A57).

4.10 Analytical procedures

These sections details OAGN's guidance in reference to ISSAI 1520 on Analytical Procedures.

Analytical procedures are used to evaluate financial information through analysis of plausible relationships among financial and non-financial data. These procedures also include any investigation relating to identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by significant amount. Analytical procedures consist of the application of comparisons, computations, enquiries, inspections and observations to analyse and develop expectations about relationships among various financial and operating data.

Analytical procedures may be applied at various stages of an audit:

to assist in the planning stage for assessing the risks;

For example, to identify significant financial statement accounts, classes of transactions and financial statement assertions with a relatively higher risk of significant misstatements.

- to obtain effective audit evidence in a form of substantive testing (audit execution stage);
- to assist in the review and interpretation of audit findings and in developing information useful for audit reports (reporting stage);

For example, the auditor may compare the auditee's financial statements to common performance indicators for the entity.

For example, analytical procedures may improve the understanding of the operations and insights about relationships to the auditor and these matters can be presented in audit reports.

The relationship between individual items of the financial statements as traditionally practiced in business entities may not be sufficient in the audit of government or other public sector entities. For example, many public sector entities usually have direct relationship between revenues and expenditures. Likewise, there may be relation between the cost of per kilometre of road construction with number of equipment or vehicle used.

Analytical procedures do not normally provide evidence about certain additional objectives, such as compliance with authorities. They should be considered together with other audit tests and with the results of other audits. In addition, analytical procedures are not usually effective to obtain audit evidence for some audit objectives.

For example, analytical procedures generally cannot replace confirmations of loan balances, interest receivable, confirmations from banks for revenue deposited in government accounts, advances to contractors.

An analytical procedure generally consists of three components:

prediction;

The auditor may predict an account balance, a class of transactions, or a ratio involving financial and/or operating data.

comparison;

comparing figures and information of audit with related transactions to identify significant difference.

use of professional judgement in investigating and concluding on the differences observed.

The following examples of analytical procedure can give reasonable assurance through comparison figures and information:

- Comparison between budgeted and actual.
- Month on month comparison, for example on salaries and wages.
- Comparison between prior year and current year expenditure.
- Comparing expected results.
- Comparing the information and data between similar entities, programs or projects.

4.10.1 Categories of analytical procedures

There are three main categories of analytical procedures:

A) Reasonableness tests

A reasonableness test is a term often used to refer to a computation used to estimate an amount such as an account balance or class of transactions. The auditor develops a model, computes a prediction of the amount through the use of relevant financial and operating data and compares the prediction with the recorded amount.

B) Trend analysis

A trend analysis is a term often used to refer to the analysis of the changes in a given account balance or class of transactions between the current and prior periods or over several accounting periods. This contrasts with a reasonableness test which involves an analysis of the changes within one accounting period.

The auditor should obtain an understanding of what causes the trend in the account balance and class of transactions. Using this knowledge, the auditor requires computing what the auditor expects the current year's amount to be, based on the past trend and the knowledge of the auditee's current transactions. The auditor then compares this prediction with the recorded amount. In this way, the auditor may identify potential problems when there is little or no change in the current balance from the prior period but a significant change would reasonably be expected to occur.

The predictions range from simple calculations of a single variable based on the trend in annual data to more complex analyses using many variables.

It is important to understand the reasons why the auditor expects a trend to be predictable, since data sometimes appear to be causally related when they are not.

For example, there may be no reason to expect expenditures for legal fees in one year to be indicative of legal expenditures for the next year.

C) Ratio analysis

A ratio analysis is a term often used to refer to the analysis of the ratio of:

an account balance to another account balance;

For revenue and expense accounts, the auditor may analyse the ratios of investment income to investments

- a class of transactions to an account balance;
- financial data to operating data.

The auditor may analyse the ratio of payroll expense to average employee numbers.

The auditor may analyse the changes in ratios within the auditee's operations over time or analyse the ratios of different entities or different segments within the auditee's operations.

4.10.2 Performing analytical procedures

There are five stages in performing analytical procedures these are described below:

A) *Considering the independence and reliability of financial and operating data used in the model*

The independence and reliability of the financial and operating data used directly affects the accuracy of the prediction and hence the auditor should ensure to the extent possible the reliability of the audit evidence to be used in the analytical procedure.

As far as possible, the auditor should develop the prediction using data independent of the account being predicted.

The judgment about the reliability of data required should consider whether:

- the data comes from independent sources outside the auditee or from sources within the auditee;
 - the sources within the auditee are independent of those who are responsible for the amount being audited;
 - the data are subject to effective internal control;
-

- the data are subject to audit procedures in the current or prior year; and
- the auditor develops the predictions using data from a variety of sources.

B) *Computing the prediction and comparing it to the recorded amount.*

While comparing the prediction with the recorded amount, the auditor should consider the following matters:

- the frequency with which the relationship is measured. The more frequently the auditor observes a particular relationship, the more the auditor can be assured of the consistency of that relationship.
- expected variations and abnormal fluctuations. In analytical procedures, the auditor is attempting to distinguish between expected variations and abnormal fluctuations. While comparing monthly amounts, the auditor often expects to see seasonal variations and not a constant amount each month.
- the absence of expected variations. This highlights the importance of understanding the auditee's operations.

C) *Considering whether the difference is significant*

Differences may exist because:

- the account or class of transactions contains a misstatement; or
- the account or class of transactions does not contain a misstatement but the prediction is inaccurate.

For example, the auditor has used inaccurate data or made an incorrect prediction.

D) *Obtain explanations for significant differences and corroborate important matters*

Whenever there is a significant difference between the prediction and the recorded amount, the auditor should seek explanations from management. Other appropriate auditee staff could also be requested to provide explanations as to corroborate important matters.

If there are no reasonable explanations, the auditor should reconsider the data and assumptions the auditor used to calculate the prediction and the consequent range of acceptable values. The auditor may perform the computation again, using a refined model to see whether the difference is still unacceptable.

If significant differences still exist, tests of details ordinarily are performed to obtain audit evidence as to whether significant misstatements are present.

E) *Consider significance of Audit findings*

The auditors should evaluate the audit evidence obtained from analytical procedures. The audit findings may include not only misstatements in the account but also observations about the functioning of internal control, the information system and other matters.

If the auditors identify an audit finding, the auditor should investigate its nature and cause and should consider whether it indicates a significant misstatement in the financial statement assertions addressed by the audit objective and its implications for the auditee's operations.

The template to be used by the auditor for analytical procedure is given in *Chapter 4 Appendix: AE 4 - Substantive analytical procedures*

4.10.3 Rotation with tests of details

Sometimes, analytical procedures and tests of details are alternative approaches to obtaining sufficient appropriate audit evidence for a given audit objective. If so, the auditor may choose to apply tests of details in one year and choose to apply analytical procedures in another year.

For example, in the first year of an audit, the auditor may apply tests of details to payroll. In the second year, the auditor may choose analytical procedures recognising that tests of details in the prior year provided persuasive audit evidence about data on which the auditor makes a prediction.

In the example, tests of details in the first year provide an anchor for analytical procedures in the subsequent year.

It may be useful to rotate analytical procedures and tests of details among locations or among audit objectives for which analytical procedures and tests of details are acceptable alternative approaches.

Rotation may improve the audit, over time, in the following ways:

- audit evidence is more persuasive because it is derived from different types of audit procedures;
- the audit procedures are less predictable to the auditee's employees; and
- by varying the approach, the auditor is more likely to develop useful suggestions for the auditee.

4.11 Test of Details

Tests of details are the application of one or more of the types of audit techniques to individual items or transactions that make up an account balance or class of transactions. The following techniques are most often applied as tests of details:

- Computation or Recalculation;
- Confirmation;
- Inspection of records/ documents; and
- Physical examination (inspection).

Vouching is a term often used to refer to tests of details using a combination of computation and inspection techniques. Inspections involve the auditors themselves checking the financial information, transactions and documents (voucher tests) or assets (physical examination) to ensure that the information are correct.

Computations or recalculations involve auditors checking the calculations in documents – for example verifying that the rates used for calculating dues are correct.

The auditor may use CAATs to increase the effectiveness or efficiency of tests of details by:

- producing reports;
- combining data in two or more files to produce new analyses;
- comparing data in two or more files;

For example, comparing the payroll with the personnel files to identify employee numbers appearing on the payroll not in personnel files, and vice versa.

performing computations;

For example, computing variances of income and expense accounts compared to budgets and prior periods or computing payroll by multiplying average pay rates x hours worked by payroll category.

selecting confirmations;

For example, selecting balances as well as preparing the confirmation requests. The selection may be made using criteria such as size or age, or it may be a representative sample.

inspecting files.

4.11.1 Planning tests of details

When planning tests of details, the auditor should define:

- the objectives of the test;
- the population from which the auditor selects individual items; and
- those differences that may require further investigation.

The objective of tests of details may be either:

- to obtain audit evidence as to whether the financial statement assertions addressed by the audit objective include significant misstatements; or
- to estimate the amount of the audit difference for the financial statement assertions that the auditor believes do include significant misstatements.

The auditor may need to select items to be tested from a population. In such circumstances, the auditor should define the population in advance, considering the following:

- the auditor cannot obtain audit evidence about the completeness of a population by examining items drawn from that population because omitted items have no chance of selection;
- the auditor may be able to improve the effectiveness of the audit procedures by subdividing a population, performing different tests for each subdivision; and
- the period covered is important for tests of details applied to classes of transactions.

The conclusion does not relate to the entire period unless the items for the test of details are selected from a population that covers the entire period.

When planning tests of details, the auditor should define what constitutes a difference requiring investigation and follow-up. Typical reasons for differences are:

differences in timing of the recording of transactions;

For example, inclusion of transaction items in the wrong period.

differences in description; and

For example, maintenance expense coded to an asset account.

differences in amounts for data captured or processed.

For example, transposed digits or other numerical errors

4.11.2 Selecting items for tests of details

The auditor may apply tests of details to every item in the population or to a selection of the items. If the auditor applies tests of details to a fewer item than every item in an account, the auditor should accept some uncertainty in the audit evidence obtained, because:

- the audit evidence obtained by the auditor is persuasive rather than conclusive ;
- the audit evidence obtained by auditor may be gathered from more than one source performing analytical procedures in addition to the tests of details; and
- even if the auditor examines all the individual items, there may still remain some uncertainty about completeness of transactions.

When the auditor considers selecting fewer instead of all items from an account, the auditor may select the items on the basis of:

Selection of key items/high value items;

That is, reading through documents and files of transactions or balances, selecting items that the auditor believes to be prone to misstatement because they are unusual, unexpected or in excess of a designated monetary amount.

This audit procedure provides little or no audit evidence about the remaining portion of the population.

- Representative sampling; that is selecting items representative of the population as a whole.
- Combination of both methods; the auditor may sometimes select items over a predetermined amount and select a representative sample from the remainder of a population.

The auditor should judge whether to select key items for further investigation or whether to apply representative sampling. The following general factors may affect which method is appropriate:

selecting key items is likely to be more effective when:

the auditor applies a systems-based approach and the auditor has substantive audit evidence from analytical procedures for the population and, therefore, requires relatively little substantive audit evidence from the test of details;

the population contains a small number of individually significant items; therefore, testing a relatively small number of key items efficiently addresses a relatively high proportion of the account; and

the population mainly contains non-routine transactions; therefore, the account is unlikely to consist of similar items that could be sampled.

representative sampling is likely to be more effective when:

- the auditor has selected a substantive approach and has little or no audit evidence from analytical procedures and, therefore, requires relatively more substantive audit evidence from the test of details;
- the population contains a large number of individually insignificant items; therefore, testing a relatively large number of key items is required to address a significant proportion of the account; and
- the population mainly contains routine transactions; therefore, the account is likely to consist of similar items that may be efficiently sampled.

The auditor should be aware of the fact that key items having a high value can be other unusual or suspicious items, such as:

- multiple transactions with very similar values/dates/suppliers;
- apparently duplicate transactions;
- items which are unmatched; or items with other specific characteristics that catch the auditors' attention.

When performing tests of details, the auditor should apply audit procedures to the population from which the auditor selects individual items to obtain audit evidence that the data reconcile to the financial statements.

For example, the auditor may check the additions of the account listing and compare the total with the recorded amount in the financial statements.

4.12 Audit Sampling

This section details OAGN's guidance relating to ISSAI 1530 on Audit Sampling.

Auditors can hardly test 100 percent of the items identified for testing. **Audit Sampling involves applying audit procedures to less than 100 percent of items within a population. The key importance in selecting an audit sample is that all items have an equal chance to be selected.** Proper audit sampling will enable the auditor to obtain and evaluate audit evidence about characteristic of the items selected in order to form a conclusion on the population as a whole.

The terminologies given below are frequently used in designing an audit sample, which the auditors need to understand:

- Population-The population is the entire set of data from which auditors wish to sample in order to reach a conclusion. Therefore, the population from which the sample is drawn has to be appropriate and complete for the specific audit objective. For example, the audit population for monthly payroll cheques would be all monthly cheques paid by the entity being audited.
- Sample size-Sample size is the number of sample items selected from the given population for testing. When determining sample sizes, auditors should consider sampling risk, the amount of error that would be acceptable and the extent to which the auditors are willing to accept.
- Sampling risk-Sampling risk arises from the possibility that the auditors' conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same testing.

After designing the audit steps and programmes (tests of controls and substantive tests), the auditor should identify the items or transactions on which to perform the audit tests. This needs to be completed so that it would be appropriate to the audit objective. The options available to the auditor for selecting items for testing are:

- (a) Selecting all items (100% examination). This may be appropriate when for example:
 - The population constitutes a small number of large value items;
 - There is a significant risk and other means do not provide sufficient appropriate audit evidence; or
 - The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective. (ISSAI 1500. A53).
- (b) Selecting specific items such as high value or abnormal items (ISSAI 1500. A54 and A55); and
- (c) Audit sampling. (ISSAI 1500. A56)

Sampling can be selected using either statistical or non-statistical approach. When applying statistical sampling, the sample size is to be determined by using either probability theory, which is mathematical and complex for auditors to understand it, or professional judgement. With non-statistical sampling, the auditor uses professional judgment to select the sample size. The sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

The decision whether to use statistical or non-statistical approach is a matter of the auditor's professional judgement regarding the most efficient manner to obtain sufficient appropriate audit evidence in a particular circumstances. For example, in the case of tests of controls, the auditor's analysis of the nature and cause of errors will often be mere presence or absence of errors.

4.12.1 The sampling process

When designing the size and structure of an audit sample, auditors should consider the specific audit objectives, the nature of the populations from which they wish to sample, and the sampling and selection methods. The main objective of auditor in selecting audit sample should be reducing the sampling risk to an acceptably low level.

When selecting the sample size, the auditor should give attention to the matter that the sample selected is representative of the population. The auditor should select sample items in such a way that the sample can be expected to be representative of the population in respect of the characteristics being tested. For a sample to be representative of the population, all items in the population are required to have an equal or known probability of being selected.

The sampling process usually to be followed by an auditor involves the following:

- 1) Identification of the population to be tested- the identification of class of transactions or transactions underlying an account balance,
- 2) Identification of high value and abnormal value- analysing the attributes of population, sub-grouping to population with similar characteristics and determining sampling units;
- 3) Determining the sample size- use of statistical or professional judgement with objectivity to determine the sample size to be tested by using audit techniques such as tests of controls, substantive procedures;
- 4) Selecting items for testing- identifying the items of the population to be tested with objectivity for the use of various sampling methods such as; random sampling, interval sampling, judgemental sampling etc.;
- 5) Performing the audit procedures- actually performing audit procedures selected for testing and reviewing the audit procedures; and
- 6) Evaluation of sample result- evaluating the sample results, the nature and cause of deviations or misstatements identified, projecting errors of sampling and the effects of any estimated errors in achieving the audit objectives.

Auditors usually face the following sampling risks in application of both tests of control and substantive audit procedures due to sampling errors:

- risks involved in tests of controls
 - the risk of placing a higher than necessary assessment on control risk, because the error in the sample is greater than the error in the total population; or
 - the risk of placing a lower than required assessment on control risk, because the error in the sample is less than the error in the population as a whole.
- risks involved in substantive tests
 - the risk of concluding that a recorded account balance or class of transaction is materially misstated when it is not, because the error in the sample is greater than the error in the population as a whole, or
 - the risk of concluding that a recorded account balance or class of transactions is acceptable when it is materially misstated, because the error in the sample is less than the error in the population as a whole.

The degree of sampling risk that the auditor is willing to accept from the results of the sample affects the sample size, which depends upon the importance of the results of the audit procedure involving sampling to the auditor's conclusions. The greater reliance on the results and the lower the sampling risk auditors are willing to accept, the larger the sample size needs to select. The auditor should consider sample size in the context of the overall risk assessment.

Step 1: Identifying the population to be tested

The population to be tested is a class of transactions or transactions underlying an account balance. It is the entire set of data on which the auditor must obtain assurance for the audit opinion.

Transactions constituting the population should cover the entire financial year. If sampling is done for an interim audit that includes only part of the financial year, additional sampling will have to be done during the final audit. The auditor may sample from the same population to perform different kinds of audit tests. In this case, samples already drawn from the relevant population may be used to perform all applicable audit tests.

Auditors should also take samples, where appropriate, from non-financial information when considering additional public sector audit objectives. For example, where number of patients treated in a government hospital was used as a basis to calculate key performance measures (such as cost per patient) in the financial statements, public sector auditors might also take samples to test the accuracy and completeness of the number of patients reported. Judgmental sampling approach may be appropriate in this case in drawing a sample from non-financial information. (ISSAI 1530. P6)

Step 2: Identification of high value and abnormal items

The population is stratified to select high value and abnormal items. Stratification is the process of dividing a population into sub-populations with similar characteristics for substantive testing. High value transactions are separated from the population and included in the sample for testing. For example, when auditing valuation of accounts receivable, the account area can be stratified by ageing the population and separating long outstanding debtors for testing.

Step 3: Determining the sample size from the remaining items

The auditor should adopt judgmental sampling in determining the sample size by applying statistical formula and using professional judgement.

This means selecting a sample of appropriate size on the basis of the auditor's judgment of what is desirable.

The sample selection should be done in such a manner that all sampling units in the population would have equal chance of being selected. There are a number of sample selecting methods, the following methods commonly used in auditing:

Random selection- Random numbers can be generated by a computer (CAATs) or from a random number table. The use of this selection method ensures that all items in the population have an equal chance of being selected. The main drawback of this selection method is that a high value item is no more likely to be selected than one of low value and one with low risk item has same probability of inclusion as a high risk item.

Monetary Unit Sampling (MUS) - This type of statistical sample uses a monetary unit as a basis of selection (such as the Nepal rupee) rather than a physical sample. MUS samples are usually selected by using a CAAT such as IDEA or ACL. One key advantage of using an MUS sample is that large items are automatically selected. Another advantage is that the CAAT can be used after the test of the sample is complete to extrapolate the sample results over the entire population.

Systematic selection- Systematic sampling is normally applicable for large numbers of transactions in the population with similar characteristics. This method can be applied to both expenditure and revenue transactions. Interval sampling method involves selecting item at a constant or uniform interval throughout the population, the first interval beginning random start. The sizes of population and sample determine the extent of intervals. The number of items in the population is divided by the required sample size to determine interval. For example, in the circumstances where there is a population is 1000 items and a required sample is 50 items, the interval of sampling will be 20 items.

When using systematic selection, auditor should ensure that the population is not structured in such a manner that the sampling interval corresponds with a particular pattern in the population. Stratification i.e. dividing a population into sub- population with similar characteristics may also be applied before starting interval sampling.

Examples of stratification are dividing population in groups such as high value items, key item and low value items.

Haphazard (Judgemental) selection- In haphazard selection, the auditor selects sampling units with no particular reason for including or excluding particular items. The auditor is warned, however against distorting the sample by selecting only unusual items, items having one physical characteristic or omitting items such as the first or the last. This method requires care to guard against making an unbiased selection. Haphazard (Judgemental) selection is not the best approach to Audit Sampling, proper audit sampling requires that all the units in a population have equal chance of selection.

Normally some form of judgemental sampling is applied when; relatively large error- rates are anticipated; account balance to be tested has relatively few transactions; or when the total population or financial amount is not known. This method may be an acceptable alternative to random selection provided auditors are satisfied that the sample is representative of the entire population.

For example, towards items which are easily located, as they may not be representative.

Block Selection- In this selection method the auditor selects all items of specified type processed on a particular day, week or month. For example, the auditor may examine all transactions of specific month (Ashadh/July). The auditor gives special emphasis on the transactions for the selected month due to substantial expenditure or irregularities or risks observed in previous years. The basic problem with this selection is that the sampling units are selected for a period of time rather than the value or importance of transaction and a valid sample size may also appear impractically large. As a result, the sampling period selected under this method may not be representative of the population.

The template to be used by the auditor for sampling is given in Appendix AE 3 - Sampling for substantive procedures

Step 4: Selecting items for testing

The objective of sample selection is to provide a sample that is representative of the population as a whole so that the results of the sample can be projected to the population. All items in the population should have equal chance of being selected and the sample characteristics should be typical of the population. This is true for either statistical or non-statistical sampling.

In practice, simple random sampling, interval sampling, haphazard sampling and block sampling methods of sample selection are commonly used.

Step 5: Performing the audit procedures

The auditor should perform audit procedures appropriate to the particular audit objective on each item selected. If the audit procedure is not applicable to the selected item, the auditor should perform the procedure on a replacement item.

If the auditor is unable to apply the designed audit procedures or suitable alternative procedures to a selected item, the auditor should treat that item as a deviation from the prescribed control, in the case of tests of controls or a misstatement, in the case of tests of details. An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation relating to that item is lost. In relation to the voided cheque, an example of a suitable alternative procedure might be the examination of subsequent cash receipts together with evidence of their source and the items they are intended to settle when no reply has been received in response to a positive confirmation request. (ISSAI 1530.11)

Step 6: Evaluating sample results

Having carried out the audit procedures to each sample item, which are appropriate to the particular audit objective, the auditor should evaluate the sample results, the nature and cause of any deviations or misstatements identified, and their possible effect on the particular audit objective and other areas of the audit. Additionally, the auditors should evaluate whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (ISSAI 1530.12; 15)

In tests of controls, an unexpectedly high sample error rate may lead to an increase in the assessed risk of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor should obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population. (ISSAI 1530.13)

The auditor should:

- analyse any errors detected in the sample, and
- draw inferences for the population as a whole.

In analysing the errors detected in the sample, the auditor first should determine that an item in question is in fact an error. In designing the sample, the auditor should define those conditions, which constitute an error by reference to the audit objectives.

For example, wrong posting between accounts of advances to staff and suppliers/contractors does not affect the total figures.

When the expected audit evidence regarding a specific sample item cannot be obtained, auditors may be able to obtain sufficient appropriate audit evidence through performing alternative procedures. In analysing the errors discovered, the auditors may observe that many have a common feature.

For example, type of transaction, location, product line or period of time.

In such circumstances, the auditor may decide to identify all items in the population, which possess the common feature, thereby producing a sub-population, and extend audit procedures in this area. The auditor may then perform a separate analysis based on the items examined for each sub-population, so that they have sufficient appropriate audit evidence for each sub-population.

The auditor should apply appropriate audit techniques to each item selected for the test of details, to determine whether a difference requiring investigation and follow-up exists.

For tests of details, the auditor should project misstatements found in the sample to the entire population. However, projected rate of misstatement should only be used to evaluate whether the original assessment of control reliance is still applicable. (ISSAI 1530.14)

In substantive testing, an unexpectedly high rate of misstatements in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated. High deviation or misstatement rates will result in the initial reliance on controls to be revised and the auditor may need to obtain additional coverage on the audited item. In such cases additional items have to be selected from the population for testing.

4.13 Obtaining Confirmations

Confirmation is the process of obtaining a representation of information or of an existence of condition directly from the third party. Confirmation can be internal as well as external. Obtaining a Management representation letter from the auditee is a form of internal confirmation, whereas external confirmation to a particular transaction of the audited may be received from the related third parties such as bankers, debtors, creditors, investors etc. (ISSAI 1505).

4.13.1 External confirmations

The auditor should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level. The auditor should consider the assessed risk of material misstatement at the assertion level and the planned audit procedures that will reduce the risk of material misstatement to an acceptable low level.

External confirmation may be used to fulfil an audit mandate arising from legislation, regulation, directives. Examples of matters for which external confirmations can be obtained are given below:

- The presence or absence of agreements
- The commitment of expenditures;
- The presence of business dealings as a supplier, purchaser and dealings of a particular order;
- The existence business and individual liabilities such as payment dues, the receipt of pensions, assistance etc.

In the circumstances where confirmation is necessary, the auditor should also consider:

- determining the information that needs to be confirmed;
 - selecting the confirming parties;
 - designing the confirmation request;
 - sending the request, follow up and evaluating the results; and
 - determining other procedures, if necessary.
-

For example, the auditor considers whether there is sufficient basis for concluding that the confirmation request is being sent to a respondent from whom the auditor can expect the response to contribute meaningful, appropriate audit evidence.

The audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable or persuasive than evidence generated internally by the entity. However, auditors should keep in mind the objectivity and independence of the third party especially within government and in light of the relationship between the audited entity and the third party.

If responses to requests for confirmation are prepared by the respondent from its own sources, they are also independent of the auditee's records.

The auditor should request confirmations only of matters about which the respondent can reasonably be expected to be knowledgeable.

For example, confirmations from banks for revenue deposited in government accounts, advances to contractors and confirmations from District Treasury Offices on revenue deposits, confirmations of loan balances, interest receivable etc.

Ordinarily, the auditor asks the auditee to request the confirmation from the respondents since the respondents would generally be expected not to disclose information to the auditor (a third party) without the auditee's permission. Respondents ordinarily are requested to reply directly to the auditor. The auditor should maintain control over the confirmation letters, mailing procedures and reported exceptions throughout the process to minimize the possibility of interference by auditee personnel.

The following sequence of steps is ordinarily appropriate for providing confirmation requests:

- prepare confirmation requests (the selection and preparation of requests can often be efficiently combined by CAATs), or request the auditee to prepare them;
- check confirmation requests and addresses for accuracy and mail them in envelopes that bear the auditors address and contain a postage-paid return envelope addressed (with departmental reference, when appropriate) to the auditors;
- investigate confirmation requests returned undelivered by checking the addresses and seeking corroborative audit evidence that the customer exists; and
- take appropriate follow-up action for non-responding accounts. Consider second and, sometimes, third requests (oral or written). If appropriate, perform other audit procedures.

The requests for confirmation may be positive or negative as described below:

Positive confirmations- Positive confirmations request for a direct response from respondents to the auditor in respect to agreeing or disagreeing of the data or information provided by the auditee or providing the requested information or data. The respondent is requested to response in all cases. Non-responses provide little or no audit evidence. Confirmation of specific details, such as individual invoices, rather than account balances, may increase response rates. The more closely the confirmation request follows the respondent's information system, the more likely a response becomes. This confirmation provides more reliable audit evidence.

Negative confirmations- These confirmation request the respondent to respond directly to the auditor only if the respondent disagrees with information stated on the request. This method provides less persuasive audit evidence than the positive confirmations since the auditor would be unable to distinguish between those non-respondents who agree with the confirmation request and those who have ignored it. The auditor ordinarily does not use this method as a primary source of audit evidence. However, negative confirmation may be appropriate when the risk of significant misstatements is low and when a very low exception rate is expected.

Confirmations responses of the auditee management, either oral or written, should be documented in the auditee's file as audit evidence. Oral confirmation responses are to be documented in the audit work papers. If the oral information confirmed is significant, the auditor should request the respondent to send a written confirmation of the specific information directly or sign off on the auditor's note.

If the management (auditee) refuses to allow the auditor to send a confirmation requests, the auditor should inquire as to the management reasons for the refusal and should evaluate its implications on the auditor's assessment of relevant risk of material misstatement. In such circumstances the auditor should also perform alternative audit procedures to obtain reliable and relevant audit evidence.

The auditor usually applies alternative audit procedures to the data for which the auditor does not receive responses to confirmation requests or the auditee management refuses to allow the auditor to send the confirmation requests. The auditor may consider not performing alternative audit procedures if:

- non-responding confirmation requests in the aggregate may not affect the decision about whether the financial statements are free of material misstatements even if the data were 100 percent in error; and
- there is no indication of unusual characteristics of the non-responding confirmation requests. (ISSAI 1505. 7-16).

4.14 Written representations

This section of the Financial Audit Manual details OAGN's guidance in reference to ISSAI 1560 on Subsequent Events.

Written representations are statements that auditee management makes to the OAGN concerning matters relating to the financial statements. Written representations may be oral or written, formal or informal. They should not be considered as a substitute for other audit evidence the auditor requires to satisfy the audit objectives.

4.14.1 Responsibility for presentation of financial statements

The auditor should obtain management's written acknowledgment of its responsibility for the appropriate presentation of the financial statements and that management has approved the financial statements. (ISSAI 1580.10)

4.14.2 Written Representations

Throughout the audit, the auditors should obtain written representations in response to the enquiries. When the representations relate to matters that are material to the financial statements, the auditor should:

- perform audit procedures to obtain audit evidence to support the representation; and
- consider whether the representations appear reasonable and consistent with other audit evidence obtained, including other representations.

The auditor should obtain a written representation on statements from the auditee management as audit evidence using the standard letter template. The template of management representation is given in Appendix AE 6 - Written Representation Letter. Usually, the auditor should perform other audit procedures to obtain audit evidence to corroborate management's written representations.

There may be limited occasions when the auditor is not able to obtain corroborative audit evidence and could not reasonably expect it to be available. Such instances may be when knowledge of the facts is confined to management.

For example, when an auditee plans to discontinue an area of operations, the auditor may not be able to obtain information through other auditing procedures to corroborate the plan or intent; accordingly, the auditor obtains written representations to provide confirmation of management's intent.

In these situations the auditor should:

- obtain written confirmation of the representation;
- obtain reasonable assurance that other audit evidence available does not conflict with the representation; and

- consider whether the representation, together with such other audit evidence the auditor has obtained, is sufficient and appropriate to meet the audit objectives.

The auditor should request that written representations from management on matters material to the financial statements be documented and signed by members of management who have primary responsibility for the operations and its financial aspects. Such letters are ordinarily dated on the same date as the audit report.

Written representations with respect to matters directly relating to the financial statements may be limited to items, either individually or collectively, in excess of a certain amount, provided the auditor has reached an understanding with management on this amount.

If the auditor expects sufficient appropriate audit evidence to be available and yet are unable to obtain it, there may be a limitation in the scope of the audit, regardless of whether the auditor has obtained a Written representation or not.

Management may refuse to provide the written representations that the auditor considers necessary, either because of management's own uncertainty regarding the particular matter or because of a refusal to co-operate. Such circumstances may constitute a limitation in the scope of the audit sufficient to preclude an unqualified opinion. In such cases, the auditor should consider the effects of management's refusal on the reliability of other oral representations obtained throughout the audit.

Sample template of Written Representation is in ISSAI 1580. Annex AE-6, which has to be tailor made to include and exclude issues where representation is sought.

4.15 Subsequent events

Subsequent events are events occurring between the date of financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report. Financial statements may be affected by certain events that occur after the date of the financial statements or even after the auditors' report. These events provide evidence of:

- Conditions that existed at the date of the financial statements; and
- Conditions which arose after the date of the financial statements. (ISSAI 1560.2)

In order to adequately consider the events subsequent to the audit of financial statements, the auditor should:

- Obtain sufficient appropriate audit evidence about whether all events which have occurred between the date of the financial statements and the date of the auditor's report and require adjustment of, or disclosure in, the financial statements are appropriately reflected in accordance with the applicable financial reporting framework; and
- Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report. (ISSAI 1560.4)

4.15.1 Events occurring up to the date of the auditor's report

The auditor should perform audit procedures designed to ensure that all events that may require adjustment of, or disclosure in, the financial statements have been identified including those after the financial year-end up to date of the auditor's report. These procedures are in addition to procedures which may be applied to specific transactions occurring after period end to obtain audit evidence as to account balances as at period end. Auditors in public sector should also refer to any additional legislative requirements regarding auditing events subsequent to balance sheet date. (ISSAI 1560 P4; P5)

Public sector auditors may also consider the events that occurred have relevance in the performance of program objectives and its impact in the presentation and disclosure of financial statements. For such event identified, the auditor should ensure that whether events have been adequately disclosed in line with relevant reporting frameworks.

4.15.2 Facts discovered after the date of the audit report but before the financial statement is issued

The auditor does not have any responsibility to perform audit procedures or make any inquiry regarding the financial statements after the date of the auditor's report. However, if after the date of the auditor's report but before the date the financial statements are issued, any fact known to auditor affects the auditor's report, the auditor should discuss the fact with the management or those charged with governance where appropriate, consider whether the financial statements needed amendments and also inquire how the management intends to address the matter (ISSAI 1560.10).

When management amends the financial statements, the auditor would carry out the audit procedures necessary in the circumstances and would provide management with a new report on the amended financial statements. The new auditor's report would be dated not earlier than the date the amended financial statements are signed or approved and, accordingly, the audit procedures would be extended to the date of the new auditor's report (ISSAI 1560.11).

When management is not required to issue amended financial statements or does not amend the financial statements in circumstances where the auditor believes they need to be amended and the auditor's report has not been released to the entity, the auditor should express a qualified opinion or an adverse opinion. When the auditor's report has been released to the entity, the auditor would notify those charged with governance not to issue the financial statements and the auditor's report thereon to third parties. If the financial statements are subsequently released, the auditor needs to take action to prevent reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyer (ISSAI 1560.13).

4.15.3 Facts discovered after the financial statements have been issued

After the financial statements have been issued, the auditor has no obligation to make any inquiry regarding such financial statements. When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the auditor's report and which, if known at that date, may have caused the auditor to modify the auditor's report, the auditor should consider whether the financial statements need revision, should discuss the matter with management, and should take the action appropriate in the circumstances. The auditor should discuss the fact with the management or those charged with governance where appropriate, consider whether the financial statements needed amendments, and also inquire how the management intends to address the matter.(ISSAI 1560.14)

When management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation and does not revise the financial statements in circumstances where the auditor believes they need to be revised, the auditor would notify those charged with governance of the entity that action will be taken by the auditor to prevent future reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyers.(ISSAI 1560.17) (ISSAI 1560 P8)

4.16 Evaluation of audit differences

The auditor should assess the effect of identified misstatements on the audit and the effects of aggregated uncorrected misstatements in forming an opinion. In addition to this in the public sector, misstatements include instances of non-compliance with legislation which also needs to be assessed. (ISSAI 1450.A19 and A20).

At this point auditors should also:

- Consider whether the nature and occurrence of misstatement indicate that the initial risk of material misstatement identified on a financial statement level is still appropriate. (ISSAI 1450.5;6)
 - Re-calculate final materiality and determine whether it will differ from preliminary materiality. If yes, the impact of any changes to materiality and risk on the audit approach need to be considered.(ISSAI 1450.10)
-

- Aggregate audit findings and evaluate whether the accumulated misstatements approach materiality by considering:

The size and nature of the misstatements, considering quantitative and qualitative materiality factors.

The effect of uncorrected misstatements related to prior periods (ISSAI 1450.11)

Consider whether adequate and sufficient audit evidence was collected during the audit or whether the audit procedures should be extended to identify the extent of certain problems.

The auditor should keep in mind that in certain instances there is also a possibility of misstatements of relatively small amounts that, cumulatively, could have a material effect on the financial statements. For example, an error in a month end procedure could be an indication of a potential material misstatement if that error is repeated each month. In such cases the sample drawn to test the population should be extended to ensure that the account balance audited is not materially misstated.

Audit differences are the differences between the Audit Plan in the overall audit strategy and the results and evidence obtained in Audit Execution. The document to be used to identify these differences can be found in *Appendix AE 5 - Audit differences and Issue Log*.

4.17 Discussion on audit findings or Exit meeting

The auditor should conduct formal discussions with the senior management preferably with the head of the audited entity and/or concerned officials on the audit findings and considerations noticed in course of the audit.

This meeting is very significant in the manner that additional information, explanations, documentary evidence are expected to be obtained from the management to make appropriate judgment on the audit findings. Such meeting can help the auditor in reconfirming or modifying the audit conclusions and enabling the auditor in making suitable modification in audit conclusions based on the management response.

Audit findings can be resolved after obtaining convincing replies, evidence or explanations from the management in the meeting. During the course of the audit, the auditor at different stages will have communicated the audit findings and request for additional evidence to those responsible for resolving those findings. The outcome of the final meeting with the management and discussion minutes should be documented in the audit working files.

Issues discussed should be written in the exit meeting minute to ensure that the auditee do not refute the issue later on (e.g. When certain documents and information's are not available auditees later claim that those were made available for auditor's verification). The format for writing up the results of an exit conference is contained in *Appendix AE-8 Exit Conference*.

CHAPTER 5: AUDIT CONCLUSIONS AND REPORTING

5.1 Introduction

This chapter provides the general concepts on drawing audit conclusions and preparing and issuing audit reports.

5.2 Audit quality control – Level 1

It is understood that prior to the preparation of the preliminary audit report, the audit team leader will perform a review of the file. An Audit Quality Control Review Form will be completed to ensure that the working papers are aligned with ISSAI requirements by confirming that:

- The audit has been performed in accordance with the audit plan and programmes,
- Assignment letter (engagement letter) has been duly acknowledged and documented properly.
- Financial statements along with all schedules have been obtained with signature of the authorized officials.
- Effectiveness of accounting and internal control systems have been reviewed and appropriately documented and communicated to the management for corrective measures.
- Materiality has been determined when drafting the audit plan and programme and appropriately documented.
- Method of selection of samples and substantive audit procedures has been determined and duly implemented.
- Audit conclusions, considerations and findings are documented and properly reviewed by the team leader. Accordingly, working papers should be reviewed to ensure that audit queries of serious nature have been duly communicated to the management and their response has been obtained to resolve the audit queries by obtaining additional evidence, approvals, documentary supports and explanations.
- A written representation letter from the management has been obtained signed, and
- Comments of the team leader and reviewer of the audit working files have been documented and cleared.
- The working paper QC-1- Audit Quality Control Review Form is available in *Chapter 7 Appendix QC-1*.

5.2.1 Completing the audit file

In addition to performing the quality control of the file, the audit team leader needs to prepare documents that would indicate that the current file is complete, matters needing attention for the next audits are identified, and that the work completed by the audit team followed the code of ethics.

For this purpose the following working papers are available to the audit team to complete before the issuance of the final report:

Some matters may be identified which were outside the scope of the present audit or the audit team did not have the time or resources to cover all areas, a table is provided for the team to identify these matters that will need attention during the next year audit. A table is provided in *AR-4 - Matters for attention during next year's audit* allowing the audit team to identify these matters.

5.3 Evaluating the misstatement of financial statements

The auditors overall objective in doing a financial audit is to conclude whether the financial statements are free from material misstatement.

Misstatements can be a difference between the amounts, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework or

legislation. Misstatements can arise from either error or fraud. Auditors need to consider whether financial statements give a true and fair view with due consideration to applicable laws and regulations as required.

The auditor should assess the effect of identified misstatements on the audit and the effect of aggregated uncorrected misstatements in forming an opinion on the financial statements as a whole. In addition to this in the public sector misstatements include instances of non-compliance with legislation also needs to be assessed.

At this point auditors should also:

- Compare (Anomalous Error + Projected Errors) vs. tolerable errors
- *Note: However for Test of Control no projection is necessary (i.e. sample error represents population error rate)*
- Consider whether the nature and occurrence of misstatement indicate that the initial risk of material misstatement identified on a financial statement level is still appropriate.
- Re-calculate final materiality and determine whether it will differ from preliminary materiality. If yes, the impact of any changes to materiality and risk on the audit approach need to be considered and documented.
- Aggregate audit findings (errors) and evaluate whether the accumulated misstatements approach the materiality limit. The auditor should consider the size and nature of the misstatements, taking quantitative and qualitative materiality factors into account. The effect of uncorrected misstatements related to prior periods should also be assessed.
- Consider whether sufficient and adequate audit evidence was collected during the audit or whether the audit procedures should be extended to identify the extent of certain problems.

The auditor should keep in mind that in certain instances there is also a possibility of misstatements of relatively small amounts that, cumulatively, could have a material effect on the financial statements. For example, an error in a month end procedure could be an indication of a potential material misstatement if that error is repeated each month. In such cases the sample size should be extended to ensure that the account balance audited is not materially misstated.

Depending on the audit mandate, audit objectives generally include compliance with laws and regulations and effectiveness of internal control. The following definitions apply to the different types of misstatements identified:

- Control deficiency (control weakness) is a condition in which the design or operation of a control does not allow management or employees to timely prevent or detect material misstatements. Such instances should be noted in the system description.
- Control deviation is the entity's failure to follow or implement a significant control procedure for a transaction. Control deviations will generally be noted via tests of control, non-compliance with authorities, failure to adhere to laws or regulations, including budgetary authority, for a transaction. Non-compliance is usually noted through the identification of control deficiency or the deviation from stated controls.

A conclusion that the financial statements are free of material misstatements, on the basis of sufficient and appropriate audit evidence, means the auditor is satisfied that the risk of material misstatements in the financial statements is considered to be at an acceptably low level.

If there are audit findings, the Director/AAG considers the effects of these findings and whether material misstatements in the financial statements exist or may exist. This judgment includes:

- the surrounding circumstances and qualitative aspects of significant audit findings including their effect on presentation and disclosure in the financial statements; and
 - whether there were audit findings in the prior year and. If so, their nature and effect on the current year's financial statements are assessed.
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In addition to the evaluation of the audit evidence for audit objectives, the auditors read the financial statements after adjustments are made, considering whether:

- the financial statements are prepared in accordance with acceptable accounting policies consistently applied, or, if changed, the changes are presented appropriately;
- appropriate information is disclosed, classified and described in accordance with acceptable accounting policies and, if applicable, legal requirements;
- information in the financial statements is consistent with the auditor's knowledge of the auditee's operations.

The auditors work need to be considered in the light of the audit evidence obtained and the accumulated knowledge of the auditee:

- the auditor has obtained, and corroborated, explanations for significant and unusual or unexpected matters or relationships in the financial statements;
- the current year's financial statements appear to be reasonable in comparison with the prior year; and
- financial statements are likely to make sense from the point of view of a reasonable person.

Auditors should document all misstatements and whether they have been corrected. Identified control deviations and control deficiencies, and instances of non-compliances with authorities should be documented. The impact and materiality of uncorrected misstatements, non-compliances with laws and regulations, and control deficiencies should also be assessed and provide the basis for audit conclusions to be drawn.

5.4 Communication of the audit results

All audit findings should be communicated to the appropriate level of management on a timely basis. As a result of these audit findings, the auditor may need to request management to adjust the financial statements. Even when management does adjust the misstatement identified, the underlying weaknesses of internal control or non-compliances with authorities may still be included in the audit report. Auditors should also communicate non-compliance with legislation and internal control weaknesses to management, those charged with governance and any additional parties as applicable.

5.4.1 Discussion on audit findings or Exit meeting

The auditor should conduct formal discussions with the senior management preferably with the head of the audited entity and/or concerned officials on the audit findings and considerations noticed in course of the audit.

This meeting is very significant in the manner that additional information, explanations, documentary evidence are expected to be obtained from the management to make appropriate judgment on the audit findings. Such meeting can help the auditor in reconfirming or modifying the audit conclusions and enabling the auditor in making suitable modification in audit conclusions based on the management response.

Audit findings can be resolved after obtaining convincing replies, evidence or explanations from the management in the meeting. During the course of the audit, the auditor at different stages will have communicated the audit findings and request for additional evidence to those responsible for resolving those findings. The outcome of the final meeting with the management and discussion minutes should be documented in the audit working files.

Issues discussed should be written in the exit meeting minute to ensure that the auditee do not refute the issue later on (e.g. When certain documents and information's are not available auditees later claim that those were made available for auditor's verification). The format for writing up the exit meeting is contained in *Appendix AE-8 Exit Conference found in Chapter 4*.

5.4.2 Request for clarifications

If the auditors request from management to give further clarifications of the examined transactions, account balances disclosures and corrected misstatements, the auditors shall perform additional audit procedures to determine whether any misstatements remain. This requirement does not apply to instances of non-compliance with authorities or control deviations. Even if a transaction is correctly shown in the financial statements, if the transaction was unlawful or the control was not followed, by its nature it represents an instance of non-compliance with authorities or a control deviation or deficiency.

5.4.3 Refusal to adjust financial statements

If management refuses to adjust the financial statements containing material misstatements the auditor should consider reasons for the refusal by management and evaluate whether the matter will cause the audit report to be modified

The auditor should obtain written representation that management considers the effects of uncorrected misstatements of the financial statements to be immaterial, and in compliance with authorities as well as the effectiveness of internal control systems. When auditors find instances of non-compliance with authorities or control deficiencies, representation may need to be modified.

5.4.4 Material misstatement

If the auditor concludes that, or is unable to conclude whether, the financial statements as a whole are materially misstated; the auditor should consider the effect thereof on the opinion in the auditor's report. When auditors have additional reporting responsibilities, each reporting responsibility may be evaluated separately. For example, if auditors are required to report instances of non-compliance with laws and regulations, their evaluation whether the entity has complied with laws and regulations may be separate from their evaluation whether the financial statements as a whole are free from material misstatement. However, misstatements and instances of non-compliance with laws and regulations can also be interrelated, potentially increasing the risks of material misstatements and vice versa. For example misstatements may represent instances of non-compliance with authorities.

For control deviations, auditors determine whether they represent control deficiencies. In this evaluation, auditors evaluate compensating controls to determine whether the control objective has been met.

5.5 Preparing Draft Management letter

This process relates to ensure that the information contained in the draft Management Letter is appropriately considered and communicated to the management of audited entity before it is finalized. The ideal mechanism for this process is through the use of the management letter. The format for the draft management letter can be found in *Appendix AR-2 – Draft Management Letter*. At this stage of the audit, the transaction testing and related working papers should be completed and reviewed.

The basis for the draft management letter must have been generated through audit queries. Prior to the issuance of the management letter, a draft should be prepared to ensure all findings arising during the course of the audit are included in single draft report logically. This will ensure that the quality and consistency of the information supporting the management letter and ultimately the audit reports is of a high standard.

For each audit finding the following categories of information to incorporate in the draft management letter are required:

- Area of expenditure / revenue;
 - Criteria;
 - Conditions;
 - Causes and consequences, where possible;
 - Recommendations;
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- Management response; and
- Auditor's comments.

5.5.1 The following are the definitions of the elements of a finding:

Criteria:The laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices and benchmarks against which performance is compared or evaluated.Criteria identify the required or desired state or expectation with respect to the program or operation.Criteria provide a context for evaluating evidence and understanding the findings.

Condition:Condition is a situation that exists.The condition is determined and documented during the audit.

Cause:The cause identifies the reason or explanation for the condition or the factor or factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective actions.Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management.Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference between the condition and the criteria.

Effect or potential effect:The effect is a clear, logical link to establish the impact of the difference between the situation that exists (condition) and the required or desired state (criteria).The effect or potential effect identifies the outcomes or consequences of the condition.When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, "effect" is a measure of those consequences.Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

5.6 Issue of preliminary audit report or management letter

The preliminary audit findings must be prepared by the field audit team members. Based on the audit findings and the discussion with the management of auditee, a preliminary report shall be issued to the auditee within given timeframe by OAGN. Preliminary audit reports should be issued to the audited entity at field level upon completion of the audit. Before finalizing the audit reports, audit findings and issues are to be reviewed by the concerned Director and Assistant Auditor General. After the inclusion of suggestions, inputs and comments of the Director and/or the Assistant Auditor General, the audit report should be sent to the Auditee as preliminary audit report to seek their response and a copy to the Auditee's supervisory ministry, concerned Department and District Treasury Controller office.

A timeframe of 35 days or an appropriate period of time as specified by the Financial Procedural Act, 2055 shall be given to the audited entity to revert with its responses and settlement of queries. If the audited entity, as per the prevailing law, requests to OAGN a time extension for giving responses and settlement of queries; a reasonable period of time extension may be granted when the reasons are deemed to be justified.

Conclusions on the auditee's responses and settlement of queries are to be drawn on the basis of reliability of information and evidences produced by the auditee. The auditor needs to discuss or communicate with the senior level of the audit managers – director and AAG for the settlement of audit findings. After getting responses or additional information from the auditee, the auditor shall prepare the audit completion memorandum.

5.7 Preparing Management Letter and Audit Report

Upon completion of the audit fieldwork, the audit team should compile and prepare audit report incorporating the responses received from management of audited entity. The audit reports must be reviewed by the Director and/or Assistant Auditor General and submitted to appropriate level of audited entities along with copies to the Secretariat of the respective Ministry. The audit report may be provided with or without an audit opinion as per the practices of OAGN and signed by Assistant Auditor General. The formats of final audit report without audit opinion are given in the Appendix AR-

3. When there are no material misstatements the report format is provided in Appendix AR-3 - *Format of Final audit report (based on type of opinion)*.

If there are material misstatements, the final report is to be issued as per Appendix AR-3.

The audit opinion, based on conclusions reached, should be classified as either:

- (i) Unqualified,
- (ii) Unqualified (with emphasis of matter),
- (iii) Qualified,
- (iv) Disclaimer or
- (v) Adverse

These are explained in more details in section 5.12.

The format for the final management letter is contained in *Appendix AR-2a Final Management Letter*.

5.8 Format of audit report with audit opinion

Financial statements of government entities shall be prepared in line with a financial reporting framework set out by legislation. Commonly, legislation pertaining to this is guided by the Nepal Public Sector Accounting Standards (NPSAS). Financial statements with disclosure of accounting policies and notes to the accounts and other explanations are subject to audit. The objectives of the audit are to:

1. Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
2. Express clearly that opinion through a written report that explains the basis of the opinion.

The auditor shall perform relevant procedures to form an audit opinion and provide reasonable assurance that the financial statements are free of material misstatements and that all requirements of the applicable financial reporting framework have been correctly applied. The auditor shall follow the approach prescribed in this manual and conclude on the required aspects.

In addition, when the reporting framework allows entities to deviate from the requirements of the reporting framework in order to achieve fair presentation the auditor should also evaluate whether these deviations are required and are adequate for that purpose.

The auditor should comply with the requirements of any of the prevailing auditing standards in order to state the matter in its audit opinion. The auditor can only state that the audit has been conducted in accordance with the International Standards of Supreme Audit Institution (ISSAIs) or International Standards on Auditing (ISAs) when all requirements of standards have been fully complied with. Under the 'auditor's responsibility' paragraph included in the audit report, auditors should state the standards applied during the audit.

5.8.1 Options for providing an audit opinion

There are four different options given below for providing the audit opinion:

- In accordance with the ISSAIs (1000-2999). This means full compliance with all relevant International Standards on Auditing (ISAs) and the additional guidance set out in the INTOSAI Practice Notes to the ISAs.
 - In accordance with the ISAs; which means full compliance with all relevant ISAs;
 - In accordance with the INTOSAI Fundamental Auditing Principles, but not full compliance with the ISSAIs (1000-2999); or
 - In accordance with Nepal Standards on Auditing, NSAs or other relevant Auditing Standards. (ISSAI 1700 P12)
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5.9 Minimum requirements for audit reports

According to the ISSAIs and ISA framework, the auditor's report shall include as a minimum the following elements:

- a. A title clearly indicating that it is the report of an independent auditor;
 - b. An addressee, as required by the circumstances of the engagement. If laws and regulations do not identify the addressee the auditors can address the report to those charged with governance. In the public sector, the distribution of audit reports is normally not restricted. Auditors should refrain from statements that the report is intended solely for the specific users.
 - c. An introductory paragraph that includes the following:
 - Identify the entity whose financial statements have been audited;
 - State that the financial statements have been audited;
 - Identify the title of each statement that comprises the financial statements including additional reports where applicable (such as comparison of actual and budgeted amounts, reports on performance information etc.). The complete set of financial statements should also include any notes to the financial statements;
 - Refer to the summary of significant accounting policies and other explanatory information; and
 - Specify the date or period covered by each financial statement comprising the financial statements;
 - d. A description of management's responsibility for the preparation and fair presentation of the financial statements titled 'Management's Responsibility' for the Financial Statements'. Responsibilities of management should include:
 - Preparation of the audited Financial Statements in line with the financial reporting framework;
 - Instituting necessary internal controls to enable the preparation of financial statements free of misstatements; and
 - Achieving fair presentation where applicable;
 - e. A description of the auditor's responsibility titled "Auditor's responsibility" that includes the responsibility to:
 - Express an opinion on the financial statements based on the audit;
 - Perform the audit in accordance with the International Standards of Supreme Audit Institutions (ISSAIs). Include specific reference to the requirement to comply with ethical requirements (IFAC and INTOSAI Code of Ethics) and the explanation of reasonable assurance that is provided by the auditor that the financial statements are free of material misstatement;
 - The auditor's report should describe the audit by stating that:
 - An audit involves performing procedures to obtain audit evidence regarding the amounts and disclosures in the financial statements;
 - The procedures selected depend on the auditor's professional judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. (In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase
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that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of internal control);

- An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements; and
 - Any other reporting responsibilities of the auditor that may be applicable.
- f. The **auditor's report** should state that the auditor, based on his professional judgement considers that the audit evidence obtained is sufficient and appropriate to provide a basis for the (modified – Qualified / Adverse where appropriate) opinion. Consequently, when a disclaimer of opinion is issued it needs to be stated that evidence could not be obtained.
- A paragraph on the '**Basis for Qualified / Adverse / Disclaimer Opinion**' includes a description of the matter giving rise to the modification and a quantification of the amount of misstatement when practicable should also be included in the paragraph. The description may refer, for example, to a narrative disclosure and explanation will be given on how this disclosure is misstated. It may also refer to an aspect which was omitted. All the matters which would alone warrant a qualification should be included under this heading. For example if a disclaimer of opinion is issued based on the lack of audit evidence, the auditor would describe the scope limitation and also include paragraphs under the same heading with explanations for other material misstatements found during the audit.
 - An opinion paragraph titled '**Opinion**' containing (ISSAI 1700; 1705):
 - The title of this paragraph should clearly state the kind of modified opinion issued when applicable i.e. Qualified Opinion, Adverse Opinion, Disclaimer of Opinion.
 - Reference to the applicable financial reporting framework used to prepare the financial statements.
 - An expression of opinion on the financial statements.
 - For unqualified audit opinion the paragraph will quote
 - The financial statements present fairly, in all material respects, in accordance with [name the applicable financial reporting framework]; or
 - The financial statements give a true and fair view in accordance with [name the applicable financial reporting framework]; or
 - Financial statements are prepared, in all material respects, in accordance with [name the applicable financial reporting framework].
 - For **qualified audit opinion** the paragraph will quote: *'except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph'*
 - For **adverse opinion** state that: *The financial statements do not present fairly - or the financial statements have not been prepared - in all material respects, in line with applicable financial framework.*
 - For **disclaimer of opinion** state that: *because of the significance of the matter described in the Basis for Opinion paragraph the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.*
 - For **other reporting responsibilities** the auditor should include here. *For example, the auditor maybe required to report on the legal or regulatory requirements, or on performance information disclosed.*
- The formats of audit report with audit opinions are provided in **Annex-4**
- '**Emphasis of matters**' paragraphs with clear indication that the audit opinion is not qualified as a result of this paragraph.

- ‘**Other matters**’ paragraphs include Standards, laws or generally accepted practice in a jurisdiction that may require or permit the auditor to elaborate on matters that provide further explanation of the auditor’s responsibilities in the audit of the financial statements or of the auditor’s report thereon. Such matters may be addressed in a separate paragraph following the auditor’s opinion.
- ‘**Other reporting responsibilities**’ – Matters reported relating to reporting responsibilities other than reporting on the financial statements.
- The auditor’s signature;
- The date of the auditor’s report; and
- The auditor’s address.

5.10 Things to be consider when preparing report

Auditors are required to provide a report in accordance with a layout prescribed by law or regulation and to use a specific layout or wording in the report. Understandability of reports---The audit report should be easy to read and understand. Clarity and understandability may be enhanced by:

- Use of non-technical language. All technical terms, unfamiliar abbreviations and acronyms should be clearly defined when used;
- Logical organization of material;
- Accuracy and precision in stating facts and in drawing conclusions;
- Effective use of titles and captions and topic sentences; and
- Use of visual aids (such as pictures, charts, graphs, and maps) to clarify and summarize complex material.
- The audit report should be no longer than necessary to convey and support the message. Needless repetition should be avoided.

5.11 Comparative information disclosed in the financial statements

There are two different broad approaches to the auditor’s reporting responsibilities in respect of comparative information- i.e. corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement. Comparative information is the amounts and disclosures included in the financial statements in respect of one or more prior periods. Corresponding figures refer to comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements.

The essential audit reporting differences between the approaches are:

- For corresponding figures, the auditor’s opinion on the financial statements refers to the current period only; whereas
- For comparative financial statements, the auditor’s opinion refers to each period for which financial statements are presented.

The auditor should obtain sufficient and appropriate audit evidence to be able to report about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting frameworks.

If the auditor identifies a possible material misstatement in the comparative information during the current audit, the auditor should perform additional audit procedures to determine whether a material misstatement exists. If the auditor had audited the prior period’s financial statements, the audit requirements for events after balance sheet date should be followed. If the prior period financial

statements are corrected, the auditor shall determine that the comparative information agrees with the amended financial statements.

5.11.1 Reporting on corresponding figures

When corresponding figures are presented, the auditor's opinion should not specifically refer to the corresponding figures, since the audit opinion is on the current period financial statements as a whole, including those figures.

When the auditor's report on the prior period, as previously issued, included a qualified opinion, disclaimer of opinion, or adverse opinion and the matter which gave rise to the modification is resolved and properly dealt with in the financial statements, the current report should not refer to the previous modification. It may, however be appropriate to include an 'Other Matter' paragraph. (ISSAI 1710 P5)

However, if the matter is unresolved it needs to be considered in light of the current year's financial statements. If it is material to the current period, the auditor should modify the current years report accordingly. The Basis for Modification paragraph in the auditor's report should either:

- Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures. (ISSAI 1710.11)

The auditor may identify a material misstatement affecting the previous year's financial statements where an unmodified audit opinion was issued. In such circumstances, the auditor should consider whether the corresponding figures have been restated or not. If the corresponding figures have not been properly restated and/or appropriate disclosures have not been made, the auditor should request management to revise the corresponding figures or if management refuses to do so, appropriately modify the report.

When the financial statements of the prior period were audited by another auditor, the auditor should (if not prohibited by law) refer to the predecessor auditor's report on the corresponding figures stating in an Other Matter paragraph the type of opinion expressed by the predecessor auditor and the date of the report and the reasons for a modified audit opinion. This is not often applicable as the SAI is usually mandated to audit all public sector entities. The scenario is not applicable to contracted out audits, or audits which are moved from one responsible auditor to another within the SAI, but maybe relevant when there is a situation such as nationalization.

If, in very rare circumstances the prior period financial statements were not audited, the auditor should state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. The auditor then should obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

5.11.2 Reporting on comparative financial statements

When the comparatives are presented as comparative financial statements, the auditor's opinion should refer to each period for which financial statements are presented and on which an audit opinion is expressed.

When reporting on the prior period financial statements in connection with the current year's audit, if the opinion on such prior period financial statements is different from the opinion previously expressed, the auditor should disclose the substantive reasons for the different opinion in an emphasis of matter paragraph.

If the financial statements of the prior period were audited by another auditor in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph stating that the prior period was audited by another auditor, the type of report issued by the predecessor auditor and if the report was modified, the reasons therefore and the date of that report.

If material misstatements were found affecting prior period financial statements audited by another auditor the auditor should discuss the matter with management and those charged with governance. After having obtained management's authorization, the auditor should contact the previous auditor and propose that the prior period financial statements be restated. If the previous auditor agrees to reissue the auditor's report on the restated financial statements and the auditor agrees with the report the auditor will only report on the current year's financial statements. In some cases the auditors are required to include an Emphasis of Matter or Other Matter paragraph in the audit report relating to the restatement of information.

When the prior period financial statements are not audited, the incoming auditor should state in the auditor's report that the corresponding figures or comparative financial statements are unaudited as applicable.

5.12 Audit opinions

The audit report should contain a clearly written expression of opinion on the financial information. An auditor's opinion may be: unqualified; qualified; adverse or disclaimer of opinion. An unqualified opinion indicates the auditor's satisfaction in all material respects with the matters dealt with in the paragraphs above. When a qualified opinion, adverse opinion, or a disclaimer of opinion is given, the audit report should state in a clear and informative manner all of the reasons for such an opinion.

INTOSAI provides guidance to auditors on the form and content of the auditor's report issued in connection with the independent audit of the financial statements of any organization. INTOSAI specifies that all audit reports should include title, addressee, identification of the financial information audited, a reference to auditing standards or practices followed, and expression or disclaimer of opinion on the financial information, signature, the auditor's address and the date of the report. The formats for expressing an audit opinion are included in Appendix AR-3 Format for Audit Report (based on type of opinion).

5.12.1 Unqualified opinion

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (*ISSAI 1700.16*)

When expressing an unqualified opinion, the opinion paragraph of the auditor's report should state the auditor's opinion that the financial statements give a true and fair view or present fairly, in all material respects, in accordance with the applicable financial reporting framework (unless the auditor is required by law or regulation to use different wording for the opinion, in which case the prescribed wording should be used).

Auditors should draw users' attention to a matter or matters presented or disclosed in or outside the financial statements that are important for users' understanding of the financial statements or the auditor's report. These matters should be included in an emphasis of matter or an 'other matter' paragraph. The users of the financial statement in the public sectors are the legislators, members of Parliament and oversight committees, representing citizens who are the ultimate users. (*ISSAI 1700 P4*) (*ISSAI 1706.5*)

In the public sector, laws and regulations, the audit mandate or common practice may lead public sector auditors to report findings in the auditor's report according to the ISSAIs. Supplementary information including additional findings, disclosures, conclusions, recommendations and management responses may be reported in a separate report which may be issued together with the auditor's report or separately as prescribed by laws and regulations.

5.12.2 Unqualified opinion with emphasis of matter

The auditor may select to issue an unqualified opinion with an emphasis of matter or with other matter. In this circumstance, the report will have to include a paragraph on the matter.

- **Emphasis of Matter** paragraph refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
- Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard (for example, a new International Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- Bringing attention to the following aspects are properly disclosed in the financial statements:
 - Non-compliance with legislation (when no separate opinion is required)
 - Legislative actions on programs or the budget
 - Contradictive laws, regulations or directives with a significant effect on the entity.
 - Fraud, abuse or losses
 - Significant transactions
 - Significant internal control weaknesses
 - Questionable business practices
 - Transactions entered into without due regard for economy
 - Prior period restatements
 - Lack of fiscal sustainability
 - Environmental Issues
 - Corporate social responsibility issues
 - Propriety issues (proper behaviour by public officials).
- **Other Matter** paragraph includes findings relating to matters relevant to the users of the report listed above (under the Emphasis of Matters paragraphs) but not presented or disclosed in the financial statements. Other matter paragraphs normally include control weaknesses or non-compliance with laws and regulations as applicable.

5.12.3 Modified audit opinions

The auditor should appropriately modify the opinion in the auditor's report when the auditor:

- Concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- Is unable to obtain sufficient appropriate audit evidence.
- Determines that the auditee did not comply with responsibilities prescribed by the financial reporting framework to:
 - Achieve fair presentation of financial information.
 - Fulfil all requirements of the financial reporting framework.
- Any additional audit requirements, such as non-compliance with legislation or internal control weakness which has a material or pervasive effect on the financial statements as it is not adequately disclosed or accounted for. (*ISSAI 1705 P4-P6*)

Pervasive is a term used to describe the effects on the financial statements of misstatements or possible effects, if any, which are undetected due to an inability to obtain sufficient and appropriate audit evidence. Pervasiveness of the finding will determine the kind of modified audit opinion which will be issued. Pervasive effects on the financial statements are those that, in the auditor's judgment:

- Are not confined to specific elements, accounts or items of the financial statements;
- Represent or could represent a substantial proportion of the financial statements; or

- Fundamental to users' understanding of the financial statements.

The auditor should select the most appropriate modified opinion from the 3 options described below (ISSAI 1705.7-9):

- **Qualified opinion-** A qualified opinion should be expressed when the auditor having obtained sufficient appropriate audit evidence concludes that there are material misstatements in the financial statements or if the auditor cannot obtain adequate evidence on aspects of the audit. Qualified opinion is issued when the misstatement or limitation on scope is not as material and pervasive as to require an adverse opinion or a disclaimer of opinion. It is expressed as being 'except for' the effects of the matter to which the qualification relates.
- **Adverse Opinion-** An adverse opinion should be expressed when the effect of a misstatement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements; and
- **Disclaimer opinion-** A disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient and appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. A disclaimer opinion may also be issued considering the potential cumulative effect of uncertainties even when all audit evidence is received.

The decision on which type of modified opinion is appropriate depends upon:

- The nature of the audit finding (quantitative materiality),
- The extent of misstatement of the financial statements (quantitative materiality) and
- The pervasiveness or the possible effects of the matter on the financial statements.

5.13 Limitation on scope imposed by management

If management imposes a limitation of scope on the audit which will affect the audit opinion the auditor should:

- Request management to remove the limitation.
- If limitation persists the auditor will communicate this to those charged with governance and determine whether alternative procedures can be performed to obtain evidence.
- If no alternative procedures are possible and withdrawal from the audit is not an option, as it is the situation in the public sector, the auditor should issue a disclaimer of opinion.
- In certain instances, making a separate report to the legislature may also be applicable or required.

In certain instances, the auditors may find that the scope limitation is imposed by parties other than management, including those charged with governance or legislation and regulations on classification of information for example due to national security.

When the auditor is responsible to form an opinion on one or more specific elements, accounts or items of a financial statement, the auditor cannot issue an unqualified opinion on those particular elements when there is an adverse opinion or disclaimer of opinion issued on the financial statements as a whole. To include such an unmodified opinion on specific elements in the same report would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (ISSAI 1705.A8-A20).

In summary:

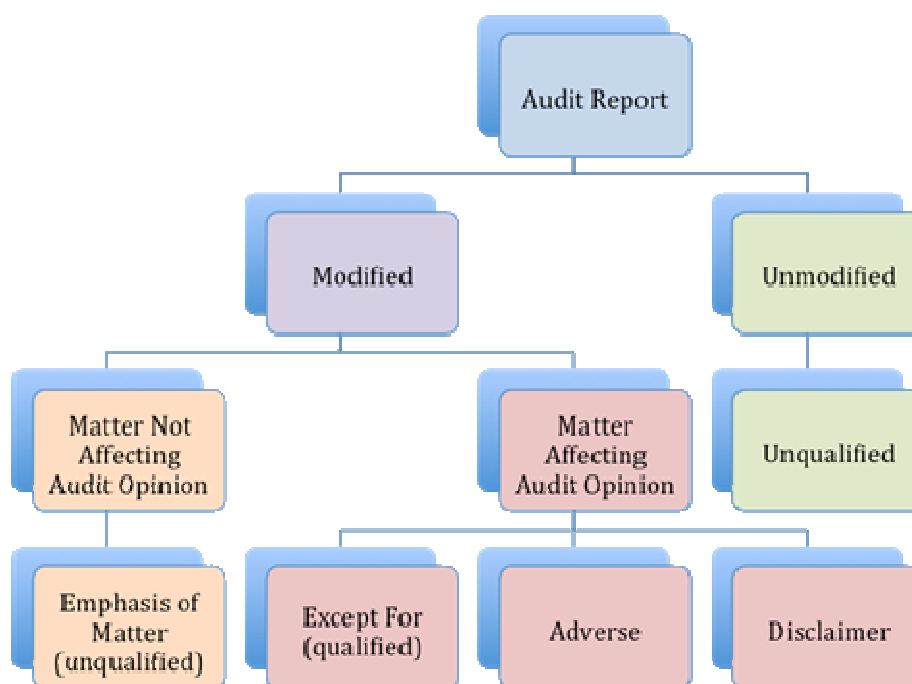


Figure 4: Limitation on scope imposed by management

5.14 Supplementary information presented with audited financial statements

The auditor should be satisfied that any supplementary information presented together with the financial statements that is not covered by the auditor's opinion is clearly differentiated from the audited financial statements. If the auditor concludes that the entity's presentation of any unaudited supplementary information does not differentiate it sufficiently from the audited financial statements, the auditor should explain in the auditor's report that that information has not been audited. (ISSAI 1700.46)

Supplementary information that is not required by the applicable financial reporting framework but is nevertheless an integral part of the financial statements because it cannot be clearly differentiated from the audited financial statements due to its nature and how it is presented shall be covered by the auditor's opinion. (ISSAI 1700.47).

5.15 Final Analytical Review

The purpose of the final analytical review is to compare the final financial statements against the preliminary statements and to account for the variances. Where the amounts in the financial statements have changed since the preliminary analytical review, the audited financial statements again need to be compared to the budget and the prior year figures for each audit/activity area. The auditor should conclude whether or not the nature, timing and extent of the audit programmes were appropriate and determine whether any further audit procedures are to be performed. (Refer to Appendix AR-1 – Final Analytical Review working paper).

CHAPTER 6: DOCUMENTATION AND FILE ARRANGEMENT

6.1 Introduction

This chapter provides the general concepts on documentation and file arrangement of the audit work.

6.2 Audit documentation

The auditor should prepare documentation that provides sufficient and appropriate record of the basis for the auditor's report and evidence that the audit was performed in accordance with ISSAIs, applicable legal and regulatory requirements and Government Auditing Standards, Audit guide/manuals and instruction adopted/issued by the OAGN.

The auditor should prepare documentation so as to enable another experienced auditor, having no previous connection with the audit, to understand significant matters reported from the performed audit, the conclusions reached thereon, and understand the significant professional judgments made in reaching the conclusions. Significant matters in this context may not only be material misstatements in the financial statements, but also matters relating to lack of compliance, violations of contract provisions or grant agreements or any other matters auditors are required to report on.

6.2.1 Purpose of audit documentation

The purpose of audit documentation is to provide a record of how the objectives of an audit assignment were achieved and how the audit was planned and performed. Basically Documents are used for quality control which includes:

- Direction – e.g. planning documents, audit programmes
- Supervision – e.g. the documentation should help the auditor to identify that the work is being carried out as planned
- Control – e.g. should indicate that audit procedures as indicated by ISSAIs have been complied and documented and the results & conclusion drawn are well evidenced

In accordance with OAGN the framework mentioned above, audit documentation is imperative to:

- Assist auditors in planning and performing the audit;
- Assist in discharging supervision and review responsibilities;
- Enable the audit team to be accountable for its work;
- Retain a record of matters of significance to future audits;
- Enable the reviewers to conduct quality control reviews;
- Assist in conducting the internal and external quality assurance reviews in accordance with applicable legal, regulatory and quality assurance handbook requirements.

6.2.2 Nature of audit documentation

Audit documentation refers to all relevant working papers and audit evidence that has been prepared and obtained throughout the audit. Where working papers are not applicable, only the fact that they are not applicable and the reasons therefore should be documented.

Audit documentation may be recorded manually, electronically or in any other media. Electronic working papers, for example, may be generated through using audit software or by preparing working papers on a spreadsheet or word document or any other software.

Audit documentation is obtained to support significant conclusions and judgments. It includes working papers compiled by auditors containing audit programs, analyses, issues memoranda, summaries of significant matters, letters of confirmation and representation, checklists, and correspondence (including e-mails) concerning significant matters. Likewise, audit documentation may include abstracts or copies of the entity's records, for example, significant and specific contracts and agreements.

In addition to working papers, audit documentation may also include documents, reports, and third party confirmations, e.g., bank balance certificates, external confirmations of accounts receivables, reports on the work done by other auditors and other evidence supporting the audit findings etc.

6.3 Permanent and current audit file

Audit documentation either relates solely to the current year or it may be of a more permanent nature. With regard to recurring audits, audit evidences gathered by the auditor should be separated in two audit files, i.e. permanent audit file and current audit file.

The audit file for the current year should include all the working papers and supporting evidence relating to the current year's audit objectives. (*Detailed content of the files provided in section 6.3.1. A).*

A permanent audit file should be retained with the documentation of the working papers and supporting evidence that are applicable for more than one financial year. Working papers, documents and information that may be useful in planning and performing audits for subsequent years should be retained in the permanent file. The permanent audit file may be maintained systematically at an appropriate level such as project-level, ministry-level or audit unit level so that the papers, documents and information can be easily used in subsequent audits. Relevant laws, rules, regulation, applicable policy, directives and official circulars need to be documented in the Permanent Audit file. (*Detailed content of the file is provided in section 6.3.1. B).*

6.3.1 Permanent and current audit file

The following are examples of working papers, documents and evidences to be included in the current audit file and the permanent audit file:

A) Current audit file:

Working papers, documents and evidences obtained during current audit should be arranged in logical sequence in the current audit file. The appropriate audit directorate should maintain the current audit file of every audited unit, preferably on an entity basis or as directed by OAGN. This file may include the following information:

- Evidence of the planning process of an audit and audit programme,
- A record of the study and evaluation of the accounting system and related internal controls,
- Analysis of transactions and balances,
- A record of the nature, timing and extent/scope of audit procedures performed, and the results of such procedures,
- Evidence that the work performed by assistants was supervised and reviewed,
- An indication as to who performed the audit procedures and when they were performed,
- Copies of communication with other auditors, experts and third parties,
- Copies of letter or notes concerning audit matters communicated to or discussed with the client including the terms of the engagement and material weaknesses in internal control systems,
- Letters of representation or conformations received from the client,
- The bank reconciliation statements,
- Conclusions reached by the auditor concerning related audit issues including exceptional and unusual matters (if any) and audit procedure followed for their resolution,
- Copies of the financial information being reported on and the related audit reports.
- Working papers used in the audit as prescribed in the Financial Audit Manual

An index of the documents in the current working file should be presented at the face of the file for easy reference and tracking.

B) A permanent audit file:

The permanent file contains information of continuing nature about the entity's operations, organisational structure, accounting systems and other features (for example loan/funding agreements) that are important to the conduct of the audit. The contents of the permanent file should be reviewed at every audit and schedules updated to show the latest position. Schedules considered to be outdated should be removed. This file may include the following information:

- Information concerning the legal and organizational structure, physical and financial size of the entity,
- Strategic plan, important policies, procedures and functional manuals of the entity,
- Appropriate statutory or legal regulations, extracts or copies of important legal documents, agreements and minutes,
- Loan or grant agreements, project appraisal report, review mission reports, projects' periodic and completion reports,
- A short description of the type of business carried on and the places of business.
- Names, title and responsibilities of Key personnel,
- Analysis of significant long term ratios and trends,
- Notes regarding significant accounting policies,
- Audit History - a brief reference of each audit performed, including nature, date and period of audit, important comments and results and the matters or issues to be reviewed or followed up by subsequent audits.

6.4 File structure

The prime responsibility for maintaining the documentation of the current audit file will be the audit team conducting the audit assignment. The Assistant Auditor General and Directors supervising the audit should also ensure that proper documentation of audit files are sufficiently and appropriately maintained.

The audit directorates should maintain the permanent audit files of the subordinated entities of a ministry and the projects/ programmes having continuous activities with duration of more than a year. The documentation of the audit working papers and evidences mentioned above should be arranged systematically in a permanent audit file along with indexing.

The current audit file should contain documents as specified by the OAGN directives. Audit documents should be divided into sections using section separators as prescribed below. More documents in current audit file may be enclosed in the file as per nature of the business of the entity. The minimum basic documents to be included in a current audit file should be arranged in the chronological order. The order of documents may be extended as per the requirements of the audit by sub-dividing the number of each section.

If additional documents are received, the audit documentation may be maintained by separating the main audit file and supporting audit file. When separate additional supporting files are required for maintaining any of the segments prescribed above, references to the matter in the main audit file should be clearly given/mentioned. In addition, the documentation of audit evidences in supporting audit file should also be systematically indexed.

6.5 Requirements of working papers

Information pertaining to working papers should be correct, clear and concise, without the need for supplementary oral support/explanations. The legend for the tick marks or other symbols used to document performance of audit tests should be explained. Completeness and accuracy of working papers should be maintained and proper support should be provided for contents of the audit report, reflecting nature and extent of audit work performed.

Working papers should be legible and neat with adequate space for additional data, notes and comments. They should contain information which is relevant, important and useful with respect to the audit objectives established for the examination.

Working papers should be duly signed by the auditor conducting the examination. The source of information should be disclosed in every audit working paper. The paper should have enough space for checking and commenting by the reviewers.

With regard to the content of working papers, the auditor should prepare working papers that are sufficiently complete and detailed to provide an overall understanding of the audit.

6.6 Contents and format of working papers and audit evidence

Auditors should use the prescribed writing pad with serial number printed by OAGN to take down notes on audit observations. The note pad is to be arranged systematically and require indexing and cross-referencing.

Working papers should contain at least the following information:

- The client's name, related financial year-end, person preparing and reviewing the working paper, and respective dates for preparation and review;
- Explanations for tick marks used should be provided;
- The work performed, for example description of the audit procedure or review executed;
- The source of information that was used to perform the audit procedure (for example the ledger);
- List the transactions that were selected to be audited or describe the extent/scope of the review performed;
- Sufficient information to enable re-performance of the procedure, e.g. document numbers, dates, names, reference numbers, etc.;
- The value or amount of the sample selected and audit coverage obtained;
- Results of the procedures performed;
- Conclusion on the work performed based on, and warranted by, the work performed and supporting audit evidence;
- Explanations on exercised professional judgment and conclusions reached;
- Indication that all schedules, prepared by the auditee, have been recalculated and that totals have been validated;
- Indication of the purpose of photocopied or scanned documents; and
- References to other working papers or documents.

Auditors should note down the basic information about the entity audited and transactions examined prior to start of vouching of transaction and examination of documents. The *Audit Examination Note*, which can be found in *Chapter 6 Appendix Audit Examination Note*, is suggested for writing down the auditee's basic information before making audit notes on a particular issue/transaction

Auditors, after noting down of above mentioned basic information, should use the printed working paper pad of OAGN for making audit notes on the class of transactions examined. Example of working paper pad and audit note is given in *Chapter 6 Appendix Audit Writing Paper*.

The auditors should also use specific form prescribed by the audit directorate to note down the information about certain specific audit issues as per the nature of auditee's business. In addition, if the Writing pad suggested above is not suitable for making audit notes on transaction details or specific issues, the auditors may use additional formats for making such notes.

6.7 Assembling and modification of audit documents

The auditor should assemble the documentation in an audit file throughout the audit process. The administrative portion of assembling the final audit file must be done as soon as possible upon accomplishment of an audit assignment. The tasks should be completed by no later than 60 days after the date of the audit report.

The audit file must contain all audit documentation relating to a specific audit assignment. The completion of the assembly of the final audit file is an administrative process that does not require/imply additional audit procedures or new conclusions to be performed or drawn. Modification of audit documentation may, however, be done during the final assembly process if they are administrative in nature. Examples of such rearranging include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed, and agreed with the audit engagement team members before the date of the auditor's report.

When the auditor finds it necessary to modify existing audit documentation or add new documentation, the auditor should, regardless of the nature of the modifications or additions, document:

- When and by whom they were made, and (where applicable) reviewed;
- The specific reasons for doing so.

6.8 Cross-referencing and indexing

All working papers of the audit file should be cross-referenced so as to ensure that another auditor can understand where the evidence is coming from or going to. The documentation placed in an audit file should have individual reference numbers. The source documents should be cross-referenced to the summaries and working papers where the audit work has been documented and concluded on and vice versa.

The audit findings will have to be referenced to the original sources of documents and not only to schedules compiled by the auditors. Auditors should throughout the audit be aware of the requirements relating to evidence and file copies of audited source documents where the problems were found.

Working papers should be indexed to facilitate the cross-referencing of working papers to each other and to the report. The relationship of the working papers to the particular areas or segments of the audit finding should also be indicated.

6.9 Reviewing working papers

Reviews of audit documents may be undertaken by audit supervisors in two stages. The first stage reviewer is responsible for going through all audit working papers and reviewing them for completeness and compliance to the quality standards of the OAGN. The first stage reviewer then documents any review comments on the reviewer's sheet or form and also indicates on the working papers any review comments. The first stage review should also provide evidence of their review by initializing or signing off the working papers reviewed. The first stage review should be done during the audit work so to ensure quality and completeness of the information. The second stage reviewer is responsible for ensuring that the first stage reviewer has completed his/her work adequately. These review sheets or forms should be used throughout the audit files. The reviewer should refer to Chapter 7 for the review process and forms to be used.

6.10 Retention and confidentiality of audit files

Audit files should be retained for the period of retention required by relevant law of Nepal or otherwise decided by the Auditor General but not less than 5 years from the date of the audit report. Each

directorates need to observe any legislative requirements for confidentiality of information and balance this requirement with the provisions of transparency which require professional judgment. When requests are made by third parties relating to audit documentation, the responsible auditor should normally consult the competent authority before releasing any information. Legislation may grant access to audit correspondence, for example where electronic or other post journals are open to public scrutiny. Documentation which is of confidential nature should be identified and treated as such.

CHAPTER 7: QUALITY CONTROL AND QUALITY ASSURANCE

This chapter provides the general concepts and tools on evaluating the quality control and quality assurance of audit works.

7.1 Quality control

Quality Control encompasses the review of work performed by auditors throughout all phases of the audit process – the planning, execution and reporting of the audit work by the supervisors and reviewer. The quality control procedures for each audit provide reasonable assurance that:

- a) The audit complies with professional standards and applicable legal and regulatory requirements; and
- b) The audit report issued is appropriate in the circumstances.

The purpose of the quality control is to ensure that the principles of the Financial Audit Manual have been followed during the audit and that sufficient, appropriate audit evidence has been obtained to support the audit opinion including the documentation and justification of significant professional judgments.

Quality control supports the audit in the following ways:

- It enables the identification and sharing of good auditing practices with auditors;
- It discovers weaknesses in the audit process and assists in identifying the training and development strategy requirements; and
- It promotes consistency between audits and consequently reporting, enabling benchmarking between reports.

Quality Control encompasses the system, policies and procedures through which the Office ensures that all phases of an audit process (planning, execution, reporting and follow-up) are carried out in compliance with OAGN auditing standards, rules, procedures and practices in line with the best international practices e.g. International Standards on Auditing (ISA) and the ISSAIs. It is a line function and the responsibility of the management executing the audit. As an example Audit Team Leader exercises quality control of the work done by all audit team members, Audit Directors exercise control procedure over audit teams, Assistant Auditor General exercises control procedures over audit directorate and so on as required.

7.1.1 Quality control approach

The quality control process at the OAGN is performed at two levels: at the organizational level and at the individual audit level.

Quality control at the organizational level

Quality control at the OAGN (organisational) level includes the following requirements:

- Professional: to adhere to the principles of “Code of Ethics”
- Skill and Competence: to maintain technical standards and professional competence
- Assignment: to assign audit work to qualified staff
- Delegation: to direct, supervise and review audit work
- Consultation: to consult within and outside OAGN for appropriate expertise
- Monitoring: To monitor the adequacy and effectiveness of QC policies and procedures

Quality control at the individual audit level

Quality Control at the individual audit level should include the following

- **Direction:** to direct the audit team on their responsibilities, objectives of the audit and Nature, Extent and Timing of the audit.(Tools - Overall Plan, Audit Programme, Time Budget, etc.)
- **Supervision:** to monitor the audit work so that audit team had understood the direction, work is carried out as planned, resolve auditing questions and differences in professional judgements
- **Review:** work of the audit team needs to be reviewed by the supervisor to ensure that work has been conducted as planned, results are adequately documented, significant matters are resolved or reported, conclusions are consistent with the work

7.1.2 Quality control procedures

The engagement team for every individual audit engagement shall perform quality control procedures. These procedures are performed by members of the audit team and by different levels including the person with delegated responsibility for the audit. They are designed to ensure that each team member takes part in the responsibility for ensuring the overall quality of the audit assignment.

The person responsible for the audit should take responsibility for the overall quality on the audit assignment. This person should throughout the audit observe evidence for non-compliance of the audit team with ethical requirements. If any non-compliance becomes known, appropriate actions should be taken.

Audit directorates should provide an emphasis on the quality control during each auditing process. Checklists developed and implemented by OAGN should be used for monitoring the compliance with the auditing standards and provisions of audit guidelines, manuals and directives throughout the audit. The audit procedures specified by them should be carried out by each audit team members and supervisors on different levels. Audit team leader and supervisors are required to give attention in supervising the audit works and reviewing the works of the audit team.

7.2 Quality control at field level

The initial process of maintaining quality control starts from assessment of audit works at the field level. The Audit Team Leader should examine and supervise the audit works performed by his/ her subordinates. The audit field manager should ensure that audits are carried out as per the audit strategy and planning memorandum and appropriate audit procedures and tools are followed in accordance to audit programmes.

Depending on the size of the audit, an Audit Director or Audit Officer will be authorized to act as a Field Audit Team Leader for carrying out the audit assignment. In case of audits of entities located at headquarters of the ministry or directorate, the concerned director of audit directorate/division will be responsible for the quality control as prescribed.

The review should be performed on an on-going basis, for example, each time a working paper is finalized by the preparer it should be reviewed. Audit team leader should exercise quality control procedures throughout the audit. He/she should regularly discuss on work status, problems faced and actions to be initiated for timely and effective audit and ensure that all audit team members are conducting audits as per responsibilities given. All working papers, conclusions drawn, professional judgements made and the related audit evidence on the audit file should be reviewed, which includes the following:

- Adequate and sufficient completion of working papers including clear and understandable language and grammatically correct;
- Consistency of documented information in different working papers to support the audit observations;
- Significant decisions made and audit evidence supporting decisions and findings obtained;

- The planning of the audit, balancing audit risk, tests of control and substantive tests performed, evaluation of the sample sizes, conclusions, preliminary letter issues, audit findings (exceptions), audit report issues, etc.; and
- Evaluation of audit procedures performed and ensuring that all the assertions were addressed.

Subject matters to be assessed and commented by the Audit Team Leader, while assessing the work of audit team members, are to be documented in the working paper *QC-1a Audit Quality Control – Field Level* provided in *Chapter 7 Appendices*.

7.3 Reviews by Higher Level

Normally the second level reviewer should be a Senior person than the person drafting the audit observations. The working papers should be reviewed immediately after each segment of the work has been completed. The reviewer should be aware that timely review provides better progress and control of the quality of the audit work.

The reviewer should consider the following fundamental issues when reviewing an audit file:

- All required working papers and procedure steps have been adequately addressed, signed by preparer and reviewer, dated and cross-referenced. When a working paper or procedural steps is omitted, adequate reasons should be supplied;
- The audited financial statements (and other relevant information) have been identified and clearly linked to the audit;
- Acquired knowledge of business/the entity is adequate to support the auditors' decision relating to the audit approach;
- Conclusions were adequately drawn and supported by appropriate and sufficient audit evidence;
- Significant deviations from the overall audit plan and changes, if any, in the scope of the audit have been documented;
- Adequate level of audit coverage has been obtained for material areas;
- All significant professional judgments made have been documented and are supported by appropriate audit evidence;
- The audit was conducted in accordance with the relevant audit approach, guidelines and other directives;
- All significant audit matters have been resolved and/or appropriately reported to management in the management letter as well as in the audit report;
- The work performed and results obtained have been adequately documented;
- Based on the underlying audit work and findings the appropriate audit opinion has been expressed; and
- Reported findings are supported by adequate and sufficient audit evidence.

The scope of the reviewer's control should be increased if he/she identifies other possible risk areas or if there is any indication that the audit file does not meet the required technical standards.

For the purpose of quality control in OAGN, audit review can be divided into the following levels:

- First level – reviews by the responsible middle level audit manager e.g. Audit Director/Assistant Auditor General and
- Second level – review by higher level manager e.g. the Assistant Auditor General/Deputy Auditor General. This level of review includes the person who will finalize or sign off the audit report.

The Audit Director or Assistant Auditor General as a first level reviewer should focus on the reviews of working papers previously assessed by the audit team leader. He/she should focus on the adequacy of documentation and working papers, implementation of lead schedules, conclusion sheets and reviews of audit procedures. The Assistant Auditor General or Deputy Auditor General as a second level reviewer should review key working papers relating to critical audit objectives and records of audit conclusions.

The Auditor General is the final authority to exercise the audit quality control procedure. All audits should be conducted under his/her guidance to discharge the statutory audit mandate. If circumstances so require, he/she may ensure full compliance of audit process as required by relevant

laws, audit standards, guides, and manuals. The first and second level review process will include the following activities

First level Review (Director/Assistant Auditor General)

For the first level of review, some reliance can be placed on the field level review already performed. The first level reviewer will also review the work performed by the audit team leader. The experience and seniority of the field level team leader will influence the reliance placed on the field level works conducted. The first level reviewer will concentrate on the work performed by focusing on the documentation contained in key working papers:

- Engagement letter or Authorization letter;
- Overall audit plan, including significant risk areas and audit approach;
- Preliminary audit letter, confirming whether there is adequate audit evidence supporting the findings;
- Audit differences between audit plan / programme and actual work done; and
- Audit report with supporting audit evidence for the findings.

Second level Review (Assistant Auditor General/Deputy Auditor General)

The person who is responsible for finalizing/signing off the audit report should perform the second level review. In certain instances, more than one person, e.g. Assistant Auditor General and Deputy Auditor General, may perform this review. The second level reviewer should approve the overall audit strategy before any of the fieldwork is conducted. If this is not possible, the second-level reviewer should at least be consulted to obtain his or her inputs regarding the audit plan and audit scope. This is to ensure that the correct audit approach is followed and that the person who is responsible for this review is aware of the aspects covered in the audit plan. The second-level reviewer's control should focus on the following aspects:

- Work performed by the first-level reviewer;
- Appropriate and sufficient audit evidence exists to support the audit findings;
- Exceptions raised, Management letter and Draft audit report;
- Comparison of the work performed with the overall audit strategy to ensure that all risk areas have been addressed and deviations from the strategy have been documented;
- All reporting working papers including overall audit summary memorandum, deviations between audit plan/programmes and actual work done, events subsequent to balance sheet date/fiscal year etc.; and
- Financial statements and related disclosures.

Subject matters to be reviewed and commented by the first and second level reviewers are to be documented in the working paper *QC-1b Audit Quality Control Review Form* found in *Chapter 7 Appendices*.

7.4 Quality Assurance

Audit Quality assurance is the process that provides independent assurance to the Auditor General that the quality control systems and practices are working and his/her office is issuing appropriate reports.

7.4.1 Quality Assurance in an International parlance

Audits should be in line with best international practices as reflected in INTOSAI ISSAI and IFAC pronouncement on auditing. The twelfth Congress of the INTOSAI (Sydney 1986) recommended that the objective of quality assurance programmes of an audit institution is to satisfy its top management that: (extracted from existing FAOG)

- the audit work has been carried out to appropriate standards;
-

- the output has been presented in a satisfactory manner; and
- the work in general meets the legitimate needs and interests of the audited body and other users of output, including Parliamentary and supervisory authorities on the political level, the media and the public at large.

In addition, the ISSAIs state that the Supreme Audit Institutions (“SAI”) should establish systems and procedures to:

- confirm that integral quality assurance processes have operated satisfactorily;
- ensure the quality of audit report; and
- secure improvements and avoid repetition of weaknesses.

Quality Assurance is an assessment process focusing on the design and operation of the quality control system by persons independent of the system / audit under review. Based on the international audit practices, OAGN has developed and issued Government Auditing Standards, Code of ethics and manuals for carrying out audits. This assessment is designed to ensure that the system of quality control in audit is working effectively and the individual audits are carried out in compliance with auditing standards, rules, practices, procedures, and code of ethics issued by OAGN.

7.4.2 Ethical Values of Quality Assurance Review

OAGN management needs to consider how to instil the appropriate ethical values in the QA team. These values include the following:

Independence, objectivity and impartiality

The reviewer shall be independent from the auditees and the audit team. This implies that reviewers shall behave in a way that increases, or in no way diminishes, their independence. The following criteria can be considered in this regard:

- The reviewer shall not be a member of the audit team and shall not be selected by the audit team;
- A senior official shall be responsible for selection and appointment of the reviewers;
- It may be considered to appoint reviewers at the OAGN’s central level;
- The reviewer shall not otherwise participate in the audit during the period of review; and
- The reviewer shall not make decisions for the audit team.

Integrity

Integrity is the core value of a Code of Ethics. Reviewers have a duty to adhere to high standards of behaviour (e.g. honesty and candidness) in the course of their work and in their relationships with the audit team member. In order to sustain confidence, the conduct of reviewers shall be above suspicion and reproach. Reviewers shall not indulge in any corrupt practices.

Reviewers shall protect their independence and avoid any possible conflict of interest by refusing gifts or gratuities, which could influence or be perceived as influencing their independence and integrity.

Conflict of interest

Care should be taken that advice and consultation of the reviewer do not lead to a conflict of interest.

Professional secrecy

Reviewers shall not disclose information obtained in the reviewing process to third parties, neither orally nor in writing, except for the purposes of meeting the QAR objectives.

Professional competence and due care

Reviewers have a duty to conduct themselves in a professional manner at all times and to apply high professional standards in carrying out their work to enable them to perform their duties competently and with impartiality. Reviewers must not undertake work they are not competent to perform. Reviewers should know and follow applicable auditing, accounting and financial management standards, policies, procedures and practices including the Quality Assurance handbook. Likewise, they must possess a good understanding of the constitutional, legal and institutional principles and standards governing the operations of the Office.

Types of Quality Assurance Review

The main types of quality assurance review are described below:

7.4.3 Internal and External Quality Assurance review

Internal Quality Assurance Review is a periodic review performed within the OAGN by persons who have good knowledge of and are well acquainted with audit procedures, practices and standards. This could be conducted through an in-house peer review mechanism involving reviewers from different divisions/ directorates. The reviewers should follow all quality and technical standards issued by OAGN.

An organization external to the OAGN, such as another Supreme Audit Institution (a peer review), professional audit firm, management-consulting firm, academic experts, or regulatory body may also conduct the quality assurance review for the audits carried out by OAGN. It is performed to appraise the quality of the audit activity and provide independent assurance of the audit quality to management, parliamentary committee, and the external stakeholders, as well as those who rely on the work of the OAGN's audit activities. These reviews should be performed by qualified persons who are independent of the office and do not have any real or apparent conflict of interest.

7.4.4 Pre-report issuance and Post-audit review

A pre-report issuance review is a Quality Control review conducted before the audit report has been issued to ensure that the audit performance have been in compliance with the audit methodology and practices and other legal and regulatory requirements and that the report is appropriate in the circumstances. The review provides an objective evaluation of significant judgments made on accounting, auditing, and reporting matters.

The audit team may consult the pre-report issuance reviewer during the audit. Such consultation need not compromise the reviewer's eligibility to perform the role. Where the nature and extent of the consultations become significant, however, care should be taken by both the audit team and the reviewer to maintain the reviewer's objectivity.

Post audit Review is conducted after the audit reports have been issued. The preparation of an annual internal report on such reviews would be useful for an objective identification of shortcomings and improvements required for future audits of a similar nature.

7.4.5 Quality Assurance Policy and Process

OAGN has taken initiative in quality Assurance to assess and monitor the system of quality control, including a periodic inspection of audited files. To provide guidance to Quality Assurance reviewers, OAGN has developed and implemented "Quality Assurance Handbook 2009" for financial audit. The financial audits conducted by various audit directorates of OAGN are subject to quality assurance review as per the Quality Assurance Handbook⁶. The OAGN has constituted separate directorate to expedite the works of quality assurance.

Audit Quality Assurance process established by the OAGN to ensure that:

- a) Needed quality controls are in place;

⁶Refer to the Quality Assurance Handbook

- b) Quality controls are being properly implemented; and
- c) Potential ways of strengthening or otherwise improving quality controls are identified.

The quality assurance review process of financial audit, generally, involves the standard four phases of a project cycle as shown in the diagram below.



- A. In the first phase (**Planning**), the review team plan the review before it takes place. The inputs include the terms of reference, budgets and background information. The output of this phase will be a plan for conducting the review. This can be a long-term plan in case of an institutional level review and an annual plan in case of a financial audit level review.
- B. In the second phase (**Conducting**), the review team conducts the review using the quality assurance work programmes detailing the specific methods and checklists for getting evidence. The outputs of this phase are the *findings* and *observations*. These should be discussed with the senior management in the case of institutional level review and with the audit staff for individual level review to obtain feedback.
- C. In the third phase (**Reporting**), the review team uses the findings and observations of the conducting phase as inputs to prepare a report.
- D. The final (**Follow-up**) phase is where the review team uses the action plan prepared by the line functions as inputs and assess the extent of implementation of the action plan and reasons for non-implementation of any items in the action plan. Appropriate follow-up actions are taken to ensure that the agreed action plan is implemented or adequate steps are being taken to implement it.

Criteria for selecting files for Quality Assurance Review

As per the handbook, Quality Assurance Review team selects a sample of files for review and this depends on the number of quality assurance reviewers involved to complete the review within the allotted timeframe. A typical sample of audit files are selected on the basis of audit risks, public interest, resources mobilized, budget expenditures, representation of various audit directorates and auditors etc.

All audits determined as high risk from the selection criteria are reviewed on an annual basis. All other audits are reviewed on a 3 year rotation basis. At least one engagement of every Audit Director will be reviewed each year and the assignment of every Audit Officer will be reviewed at least every 3 years.

7.4.6 Formation of the Quality Assurance Committee

The OAGN generally constitute Quality Assurance committee under the chair of Deputy Auditor General. Director/AAG of Quality Assurance Directorate will be the member secretary of the committee and team manager of the Quality Assurance function. This committee will be responsible for carry out Quality Assurance function in the Office. The responsibilities of the Quality Assurance Committees are as follows:

- Prepare annual QA Operation plan for Institutional level as well as Financial Audit Level including follow up;
- Select appropriate audit criteria mentioned in the handbook;
- Recommend the name of staff to the Auditor General to constitute the review teams.
- Prepare the customized questionnaire/checklist for the review;
- Supervise and monitor the review assignments;
- train the selected personnel of the OAGN and create appropriate awareness program in the Office;
- Develop training course and materials;
- Determine the policy, procedure and areas for pre-issuance review;
- Monitor and provide suggestion for pre- issuance review.

7.4.7 Quality Assurance Review Team

Every year Auditor General constitutes the necessary numbers of review teams. The review teams may be constituted by deputing the members of the QA committee and other trained staffs from different Directorates of the OAGN. The reviewer should not be the same person who is involved in an audit of the same audit assignment. The quality assurance team generally will constitute at least two members - one team leader and one team member.

The review teams formed for the quality assurance review shall conduct reviews of the concerned audit files and works of audit departments using questionnaire and preparing review plans and procedures as specified by Quality Assurance Handbook. The reviewer should discuss about the review observations with the concerned auditors and audit supervisors prior to finalization of the review report.

At the end of review, each review team should prepare an overall summary report and provide the report to responsible audit directorate and quality assurance review committee. The report should also contain details of timing of the review and the names of review team members and a description of the scope of the review (general approach, extent of coverage of the general quality control aspects and the description of individual audit engagement). The reviewer may also highlight other pertinent issues that may be of interest to the other Audit Divisions and Directorates.

7.4.8 Quality Assurance Review Summary Report and follow up

Based on all reviews and additional information, a Quality Assurance Review Summary Report will be prepared and submitted to Auditor General on the quality of the audit works of different audit departments summing up general findings and recommendations. The report may entail the analysis of the audit work in the previous year, including information on audit work, information on training activity, a summary of issues arising from quality control systems; summaries of external reports evaluating the institutional activity and recommendations on how to improve audit works.

Audit teams and the departments reviewed should prepare action plans on how review findings and shortcomings are going to be corrected in future. These action plans should indicate what, who, where, when and how they are going to be corrected. The QA unit/committee may be consulted while drafting the action plans. The audit teams and different Directorate should report back on their progress with the implementation of the corrective actions.

The QA unit/committee should perform tests to confirm the effectiveness of the corrective actions. The OAGN will also use the results of the QA reviews to determine the training needs of its staff in general and compile training program to address these issues.

CHAPTER 8: FOLLOW-UP ACTIVITIES

8.1 Introduction

This chapter provides the concepts and procedures regarding follow-up audits and actions related to follow-up on audit observations and irregularities included in reports at different levels.

8.2 Follow-up audit

Conceptually, an audit that is designed to evaluate the effectiveness of corrective actions of audit observations is termed follow-up audit. Follow-up audit covers all required actions and processes to be undertaken by responsible persons of audited entity and auditors of the audit institution for the settlement of audit findings. It also denotes re-examination of the required documents and evidences produced after the issuance of preliminary and final audit report.

8.2.1 Follow-up audit process

The follow-up processes by OAGN are guided by the constitution, the audit law and other relevant laws. Auditors and supervising officers shall perform the prescribed procedures as specified by the Auditor General and his/her directives. Major processes for follow-up audit and activities are provided below:

- The Financial Procedure Act 1999 and Financial Procedure Regulation, 2007 require the audited entity to settle audit observations reported in the preliminary audit report within the period specified in the letter from the OAGN or within 35 days. An extended period can be granted by the OAGN in response to a written request from the audited entity.
 - Considering the appropriateness of the responses and evidences produced by the audited entity, the concerned audit directorate at OAGN may remove irregularities reported in the preliminary audit report. If the evidences and clarification submitted are not satisfactory, auditee is informed of the fact that on the basis of evidence submitted said audit observation cannot be settled or in some other circumstances asked for further clarification, evidences, or documents to settle the audit observation.
 - The concerned audit directorate at OAGN needs to issue a letter to the audited entity regarding the actions taken regarding the requests to the audited entity for settlement of audit observation.
 - Major audit irregularities that are not settled, within the appropriate period, are reported in the final draft audit report which is submitted to the Chief Accounting Officer, i.e., Secretary of the line ministries, and the concerned minister afterward for confirmation of and response to the audit findings.
 - The audit irregularities not settled after the response from the ministry are reported in the annual report which is submitted to the President.
 - Auditees are required to maintain records, settle irregularities, and obtain follow-up audits to settle irregularities before the next year's entity audit. The Board, committee and other entities of Government are required to maintain records of settle irregularities and to initiate follow-up audits to settle irregularities.
 - The follow-up audit processes involved are exhibited in the following diagrams and explained in detailed in the next sections.
-

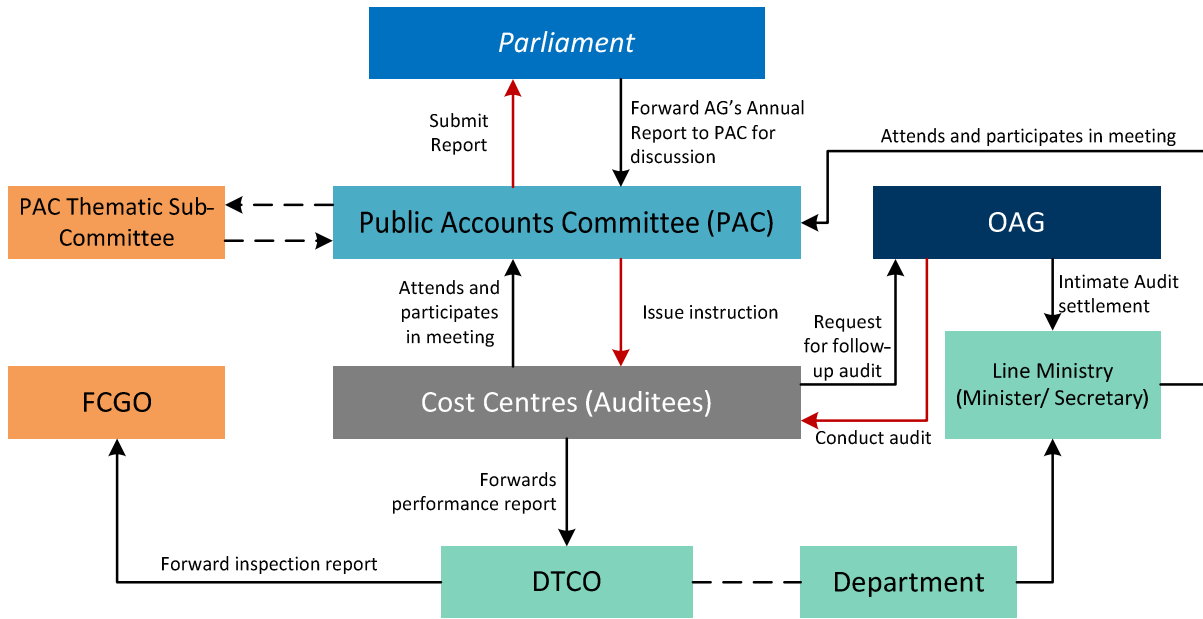


Figure 5: Follow-up Mechanism of Audit Recommendations

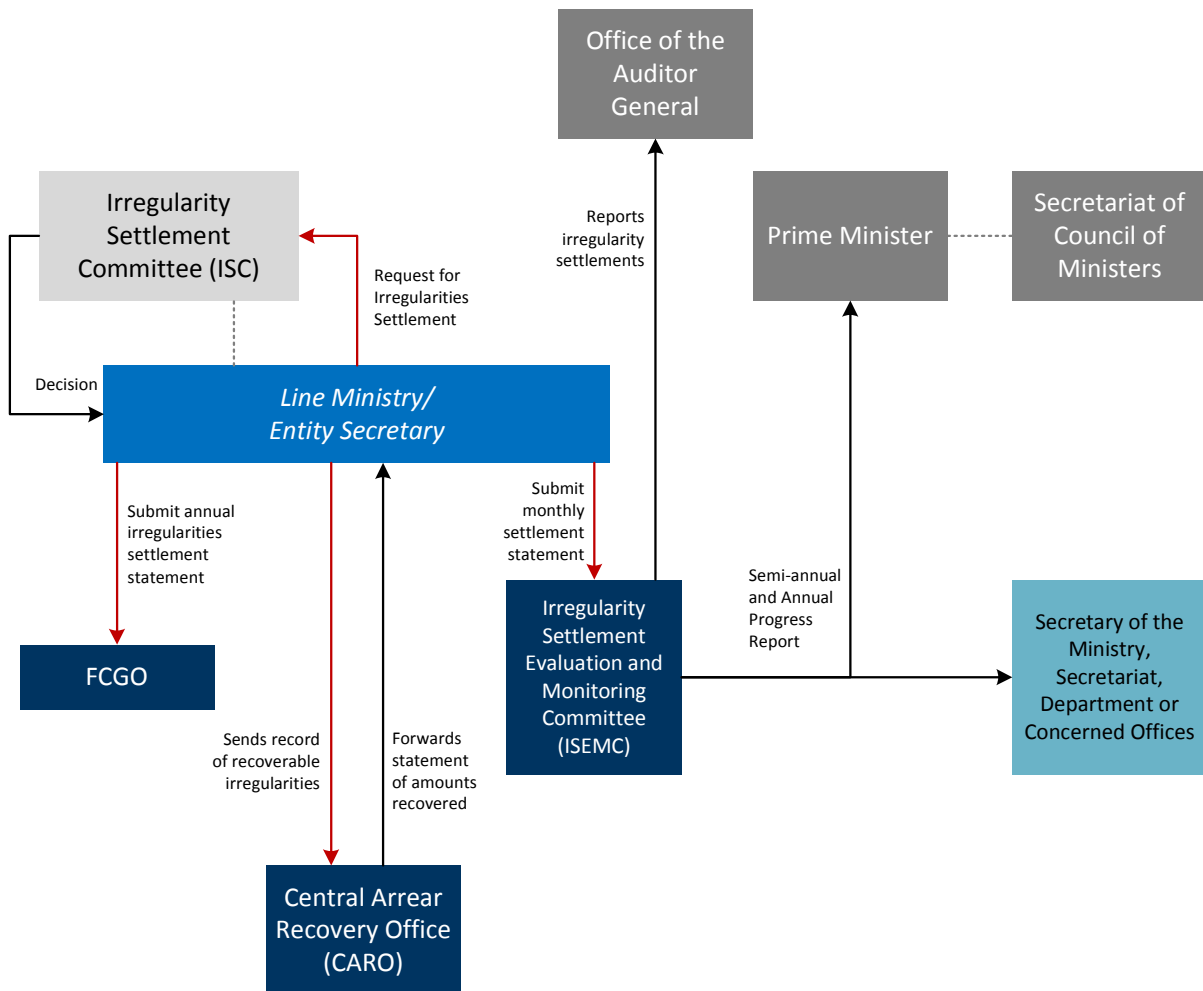


Figure 6: Follow-up Mechanism of Irregularity Settlements

8.2.2 Legal provisions on follow-up audit

The followings are the relevant major legal provisions made in the *Financial Procedure Act, 2055* and the *Financial Procedure Rules, 2064* relating to follow-up audit and settlement of irregular or recoverable amounts included in audit reports:

- The responsible person shall be accountable for the settlement of irregular amounts reported by the auditor by providing evidence/documents.
- The Chief Accounting Officer (i.e., secretary of ministry/ entity) shall be responsible for supervising whether irregular amounts have been settled or not.
- The concerned office shall settle irregular amounts reported by the Office of Auditor General in the course of an audit within thirty five days from the date of receipt of audit report.
- If there is a reasonable reason for being unable to settle the irregular amounts within the time-limit, the responsible person of the audited entity is required to make a request for extension of time-limit and the Office of Auditor General may grant a reasonable time-limit extension.
- The records of the irregular amounts and amounts recoverable reported in the audit report shall be maintained at the central and office levels.
- If the irregular amounts recoverable cannot be recovered from the regular procedures, the Chief accounting officer shall send such records to the Central Recovery Office.
- Irregular amounts other than those recoverable may be regularized by the Chief Accounting Officer accompanied by supporting documents and reason supporting the occurrence of no loss or damage in accordance with the prescribed procedures.
- It shall be the responsibility of the Chief Accounting Officer to give responses, in writing, to the public accounts committee of the Legislature-Parliament in relation to the irregular amounts indicated in the annual report of the Auditor General.
- It shall be the duty of the concerned Ministry to implement or ensure the implementation of the suggestions from the Public Accounts Committee on the Auditor General's Annual Report.
- The Government of Nepal may, on the advice of the public accounts committee and the Auditor General, form an Irregular Amounts Settlement Committee for the settlement of irregular amounts that could not be settled through normal procedures.

Note: Auditors are suggested to refer legal provisions contained in section 18 to 24 of *Financial Procedural Act, 2055* and Regulation 98 to 103 of *Financial Procedural Regulation, 2064*.

8.2.3 Recording and the settlement of Audit Findings by auditees

Audited entity and the controlling Department / Ministry are responsible for recording audit findings or irregularities mentioned in audit report. These entities are also responsible for timely settlement of reported irregularities. Recording and the settlement of audit findings or irregularities should be done by them in the prescribed format. AG form numbers stated below are to be used for the recording purposes by the controlling department/ ministry and audited office:

- Central Record of Audit irregularities (AG Form no. 205) available in Chapter 8: Appendix A
- Central record of irregularities raised (AG Form no. 206) available in Chapter 8: Appendix B
- Central record of settled irregularities (AG Form no. 207) available in Chapter 8: Appendix C

8.3 OAGN's role regarding Settlement of irregularities

For internal purpose and as a master record for the follow-up audit, each audit directorate maintain record of irregular amount. Responsibility for settlement of irregularities of audit report rests on the responsible person or chief accounting officer. Auditor's responsibility is to check/examine the status of the implementation or to assess compliance with the previous audits.

All audit findings, included in the preliminary audit report, are to be categorize and included in the follow-up database. The information in the database is to be updated for the amount settled based on the responses from the auditee. The responsible officer of OAGN shall ensure that the follow-up database is updated to identify the status of the irregularity.

Reports from the follow-up database are to be used to assist the OAGN in identifying the audit observations that were cleared within the allocated time frame and the ones that will be included in the Auditor General's Annual Report.

8.4 Follow-up audit processes by audit directorate/division

The follow-up of audit findings is to be carried out by the concerned audit directorate of the OAGN. The follow-up audit processes at audit directorate level vary as per the nature of the category of irregular item relating to:

- current year's audit findings/report
- previous years' Audit findings/report
- irregularities included in Auditor General's Annual Report
- Public Accounts Committee's decision/ recommendation on Audit General's Report
- Amounts settled by Irregularity Settlement Committee

8.5 Follow-up process of current year's audit findings/report

An auditee is responsible for providing responses with clarification and evidences to OAGN for clearance of irregularities included in preliminary audit report or management letter within the timeframe mentioned in the report or within 35 days as applicable. The auditees are requested to give their written responses by using the prescribed format as appended herewith in *Chapter 8: Appendix-D*.

In the cases where the responses to the preliminary audit report cannot be given by the auditee within the stipulated timeframe, the auditee may request OAGN for time extension as per Section 19 (2) of Financial Procedural Act, 2055 and an appropriate time extension shall be given by competent authority of OAGN as per the authority delegated by the AG.

After receiving response to the preliminary audit report, the responsible officer of the OAGN shall examine and take action on the documents and evidences provided by the auditee. The memorandum of follow-up audit shall be prepared by concerned officer and shall be approved by the competent authority within 15 days. In case where decision could not be made within the stipulated time frame, it shall be reported to the Deputy Auditor General along with the reasons for the additional time taken. The responsible officer with the decision of competent authority shall prepare the reply letter in the prescribed format found in *Chapter 8: Appendix E*. The responsible officer shall update the follow-up database to include the decision made by the competent authority.

When the decision for settlement of audit observations from a preliminary audit report is made, the settled audit finding or amount shall be removed from the record of the audit report and the auditee shall be informed using the prescribed letter found in *Chapter 8: Appendix F*. In case when the requested audit finding cannot be settled on the basis of auditee's response and evidences submitted, the auditee shall also be informed using the prescribed letter found in *Chapter 8: Appendix G* along with the reasons for non- settlement/clearance.

8.6 Follow-up of previous year's Audit findings/report

Audited entity shall follow the necessary procedures as directed by the Auditor General and shall request to the OAGN or audit team using a prescribed format for clearance of irregularities included in previous year's audit report.

After receiving the request letter, the responsible officer of OAGN or audit team member shall record the letter and verify the audit objections with master records of audit directorate within appropriate time frame. The responsible officer shall examine all documents produced by the audited entity along with the request letter and shall prepare a memorandum of follow-up action as per the prescribed format as shown in *Chapter 8 Appendix E*, and submit it to his/her supervisor for necessary decision.

Decision pertaining to requests for follow-up of previous audit findings shall generally be completed within 15 days of receipt of the letter. The authority limit in amounts or in other nature for granting

sanctions on settlement of irregularity should be adhered for the evidence or clarification submitted by auditee.

When the decision pertaining to the clearance or non-clearance of auditee's request is made, the audited entity shall be informed in writing in prescribed format. If any irregularity amount is settled, it shall be recorded in the master irregularity record of the concerned directorate at OAGN. The responsible officer shall update the follow-up database to identify any amounts that have been settled.

8.7 Follow-up of irregularities included in Auditor General's Annual Report

Irregularities and issues included in the Auditor General's annual report are deliberated at the Public Accounts Committee (PAC) of the Legislative-Parliament. The concerned DAG, AAG, and officials shall make necessary preparation for their participation to the PAC discussion during the committee meeting, to clarify and express the official view on the audit observations and recommendations included in the AG's annual report.

Each audit directorate shall maintain, on a yearly basis, a systematic record of relevant irregularities and issues reported in the annual report. This will include the responses from the concerned ministry and the result of the examination of how decisions of the public accounts committee have been followed-up.

The responsible person or Chief Accounting officer, after taking necessary actions or by providing evidences or commitments for future improvements to the PAC, may request OAGN in prescribed format for clearance of irregularities included in Auditor General's Annual report.

The Responsible officer of OAGN shall verify the items from the request letter with the master record of OAGN and the decisions by the Public Accounts Committee, and prepare a memorandum of follow-up and submit it to his/her supervisor. The memorandum of follow-up should be approved by the officer within the stipulated limit of 15 days from the receipt of a response. When the decision is made to clear irregularities, settled item shall be deleted from the record and responsible person/Chief Accounting Officer will be notified in writing in prescribed format.

8.8 Follow-up of Previous AG's Annual report recommendation

All responsible officers shall prepare the follow-up status of the major policy recommendations provided in previous years' Auditor General's report. Every audit directorate shall maintain the records of the major information relating to clearance and non-clearance of irregularity along with the mode of settlement and reasons for non-settlement. Major information and statistics pertaining to settlement of previous and current year irregularities and major causes of non-settlement shall be reported to the Auditor General. The responsible officer of OAGN shall ensure that the follow-up database is updated to identify the status of the irregularity.

8.9 Follow-up by Irregular Amounts settled by the Irregularity Settlement Committee

Pending irregularities for long time, except those identified as recoverable or misused, shall be put under purview of the Irregular Amounts Settlement Committee as specified in prevailing laws. The Irregular Amounts Settlement Committee can make decision on such irregularities and issue letters in respect to clearance. The Committee provides the statements of settled irregularities to Auditor General every year. The concerned audit directorate of OAGN shall include the fact and figure of irregularities settled by the Committee in the Auditor General's Annual report. The responsible officer of OAGN shall ensure that the follow-up database is updated to identify the status of such irregularity.

CHAPTER 9: AUDIT OF SMALL ENTITIES

This Chapter provides basic guidance for carrying out the audit of smaller entities for which the level of transactions are considered not appropriate for detailed auditing. The auditor is required to follow the audit procedures and matters stipulated in this chapter.

9.1 Introduction

All audits should fully comply with the International Standards of Supreme Audit Institutions [ISSAIs]. The objective of this chapter is to describe the characteristics commonly found in small entities and considers how these may affect the application of ISSAIs. The guidance mentioned below is aimed to supplement and not to substitute the guidance contained in the relevant section in this manual. It is therefore recommended that the relevant sections of this manual are to be considered together with this section.

Senior management of the OAGN and not by the audit team should decide, at the start of the audit if an audit is to follow the approach for a small entity. During the preparation of the ministry-level overall audit plan, smaller entities are to be identified and selected for auditing. In order to decide which are small entities, OAGN management needs to consider the following quantitative characteristics: the size of the entity, limited number of employees, volume of financial transactions such as limited: budget allocation, assets, revenue collection, deposit, or there was no significant prior audit findings. In addition to these, there are some other characteristics which may be considered during the audit planning.

9.2 Characteristics of Small Entity

A small entity refers to an entity which typically possesses these types of characteristics:

- Limited budget: revenue and deposit are; less than Rs.10 million of operating budget and less than Rs.7.5 million of capital budget, less than Rs.5 million of revenue collection and less than Rs.5 million of deposit or altogether Rs.30 million transaction.
- Small organization with limited number of employee[less than 30].
- Less sophisticated record or book keeping.
- Fewer types of goods and services provided to the people.
- Entities having effective internal control system and the internal audits are conducted regularly.
- No significant audit findings in prior year's internal and financial audit.
- The entities which have limited programs or activities to execute.
- Regular service provider to the people on behalf of the Government of Nepal.

These characteristics are not exhaustive. These may sometime also be found in larger entities. Also, all smaller entities may not display all or some of these characteristics and other characteristics may exist. Thus the decision whether a particular entity should be classified as a "Small Entity" need to be taken carefully by the senior management based on the recommendation of the concern audit division.

The Auditor General has approved a list of small entities which is provided in *Chapter 9: Appendix A*. This list is based on the recommendations of concern audit division. The list is to be updated annually while approving the annual plan of OAGN.

9.3 Objectives of audit

The main objectives of an audit of a small entity are as follows:

- Developing understanding about the characteristics of the small entity,
- Application of this manual for small entities detailing each stage of audit,
- To provide additional guidance on detail planning for small entities,

- To provide guidance on the preparation of checklist, management of working papers, documentation and reporting.

9.4 Audit consideration

Some characteristics of small public sector entities may affect the audit work to be performed and also the application of the standards. Auditors should keep in mind that audit standards may not be applicable for the engagement. In smaller entities auditors do not have to spend more time to develop an understanding of the entity due to the low volume of transactions.

In government normally the same audit mandate apply to the audit of small as well as large entities. Auditor should acquire understanding of legislative requirements applicable for the small entity and consider them throughout the audit. Auditor should be familiar with the legal requirements i.e. financial Acts, Rules and Regulations which are applicable for small and large entities.

9.4.1 Time Frame

Audits of small entities usually require fewer audit staff and strict time frames, yet all the guidelines introduced by the OAGN need to be considered and complied with where it is possible. Audit of small entities should be designed in the manner to save audit time. In order to save time, these audits should best be performed after the financial year end or the submission of the financial statements. During this audit, test of controls need not be performed normally. Some tests such as inventory counts, management of property may be considered and scheduled by the auditors where applicable.

9.4.2 Pre-engagement Activities

Pre-engagement activities are a vital part of planning the audits of small entities. There should be a qualified and efficient Audit team to take responsibility for the audit of small entity. Following points are taken into consideration before performing actual audit activities:

- Identification of actual time and audit budget for the audit of smaller entities is not always practical. When this is the case, budgeted and actual time may be monitored on an overall basis e.g. time and days for the major stages of the audit.
- Code of ethics and competency matrix should be completed for each team member and concluded on by the person responsible for the audit with working paper. Such format should be less time consuming and may be completed along with major audit assignment.
- Team arrangement should be completed with working paper. Usually when the work is divided between audit team members and over a short period of time there may not be need confirm the scope of work and deadlines in writing.
- Engagement letter should be completed for small entity audit using the same template included in the financial audit manual used by the OAGN. The procedures of completing audit should be communicated to the auditee.

9.4.3 Communication with management

As the audit should be finalized within a short period, the audit team leader should determine persons that are entrusted with the monitoring and supervision, control and direction of the small entity. This may be in the form of Department, Regional Directorate, Council, Board, Divisional offices, or other forms of offices. Timely response of management to audit queries should be emphasized. Meeting with management of the entity and those charged with governance are kept to the minimum during small audits and therefore require more planning from the auditors. Information to be obtained from management needs to be identified beforehand and similarly discussion points communicated to the management in advance.

9.4.4 Documentation

Audit documentation for small entities should facilitate supervision and review of the audit and should also provide evidence for the audit findings and audit report. However, the documentation for small entities may not be too extensive. The prescribed forms, templates and the identified and relevant working papers are to be completed and updated in the audit file of small entities. Where certain

working papers or some parts of the working papers are not applicable this should be clearly stated in the audit file along with references to related working papers.

9.5 Strategic Planning for entity audit

Auditing of public sector entities usually have mandate to audit the internal control of the auditing entities. Consequently, auditors have to evaluate the design and effective implementation of internal controls relating to the audit components. For this purpose, strategic audit plan should be prepared. Applicable working papers for the Engagement Strategic Planning for small entity are included in the table below.

| Working Papers | Purpose/outcomes | Mandatory working papers | To be completed by | To be reviewed by |
|----------------------|---|--------------------------------------|--------------------|-------------------|
| Planning materiality | Calculation of quantitative planning materiality considering factors which may influence materiality. | Mandatory to complete for each audit | Audit team leader | Audit Supervisor |
| Governance checklist | Identify risks relating to the entity's control environment | Mandatory to complete for each audit | Audit team leader | Audit Supervisor |
| | Assessment of the works performed by internal audit, and its report | Mandatory to complete for each audit | Audit team leader | Audit Supervisor |

Obtaining an understanding of the entities internal controls relevant to the audit is equally important in the audit of smaller public sector entities, there are often fewer employees, smaller budgets, small revenue and deposit which can limit the extent to which segregation of duties is practicable and documentation available. But internal control may be weak in such entities. The control environment will be very important to evaluate. This will involve assessment through a checklist.

9.6 Risk identification checklist

The risk identification checklist includes the consideration of aspects relating to weakness of the entity, identify the risks relating to provide service and identify the risks from prior years audit findings. Risk should be considered on a financial statement level (during strategic planning) and on a component level. On a financial statement level, the checklist mentioned in *Chapter 9: Appendix B* should be completed in order to identify risk indicator. Auditor should assess factor which indicate the entity is at risk of fully delivering services required by its mandate. The environment around the entity may impact on the operations of a smaller entities activities this should be evaluated.

Auditor should read prior year's audit report and management letter to identify the risk areas and linked to audited components identified for audit in the lead schedule. This is done in the risk of material misstatement working paper. Risk areas will be followed-up during detail planning and field work level.

9.7 Governance arrangement checklist

The governance arrangement checklist, found in *Chapter 9: Appendix C*, evaluates level of controls existing in the small entity, including the functioning and efficiency of internal audit. Level of internal controls of the entity is evaluated related to the following:

- Compliance with basic legal procedures
- Risk assessment process and control environment, and
- Effectiveness of internal audit.

Understand governance arrangements at the entity by looking at the work performed by internal audit. Audit team should be aware of any applicable legislative requirements relating to internal audit including the legislative (Law and Regulations) applicable for smaller entities and larger entities.

9.8 Risk of material misstatement on a financial statement

Summarize risks identified during strategic planning for each area and determine the overall level of risk of material misstatement on a financial statement.

9.9 Overall audit strategy

The overall audit strategy should summarize the conclusions drawn on working papers during the strategic planning phase. For Small entity audits the overall audit strategy may be kept brief deleting considerations if they are not applicable for small entity, it is more likely that:

- Internal audits will not normally be performed,
- Specialized audits and performance audit will not be performed,
- Formal meetings with management and those charged with governance will be kept to the minimum,
- Due to the short time frame of some audits queries may not be issued.

The working paper to be used to document the overall audit strategy can be found in *Chapter 9: Appendix D*

9.10 Setting of engagement team and discussion

Setting an engagement team and discussion should take place regarding the key areas and indicated in the working papers during the strategic planning stage.

9.11 Detailed Planning for audit of small entity

Auditing of public sector's small entities usually requires assessing the internal controls of the entities. Consequently, the auditor has to evaluate the system of internal control and its effectiveness in implementation relating to the audit components selected in the lead schedule. Auditor should evaluate the test of controls relating to areas significant risks, which include occurrence of expenditure, revenue and deposit and existence of assets.

Test of controls need to be considered as some controls have to be tested during the financial year such as, inventory counts. The working papers for detail planning for the audit of small entities are included in the table below.

| Working Papers | Purpose /Outcome | Mandatory working papers | Completed by | Reviewed by |
|---|--|--|--------------|-------------------|
| System description for audit components | Identification of audit components and risks to the component from inherent risk on a financial statement level. | Mandatory to be completed for each audited component. | Audit team | Audit Team Leader |
| Reliance on key controls for components | Link the risk identified in the system description to assertions and decide controls are going to be tested. | Mandatory to be completed for each component. | Audit team | Audit Team Leader |
| Audit programs | Risks identified in the system description need to be covered with test of controls and substantive tests. | Mandatory to be completed for each component. | Audit team | Audit Team Leader |
| Sampling | Samples should be included in the substantive procedures working papers. | Mandatory to be completed for each procedure or grouping of procedure. | Audit team | Audit Team Leader |

The detail audit plan and audit program working paper for small entities can be found in *Chapter 9: Appendix E*.

9.12 System description and reliance on key controls

Similar nature of transaction should be grouped and audit together. In order to ensure that the limited audit time and resources are concentrated on the risk areas there is also need to understand the main risk areas for each audited transaction. During detail planning the risks and controls should be identified accordance with identified in the lead schedule of strategic planning.

Audit team should understand the nature of transactions of each audit components identified in order to group such transactions into a system description. The total expenditure for an entity includes a variety of expenditure items, these items includes operating expenses, salary, supplies, consumables, capital expenses, consultancies, etc. Transactions under these components normally have similar processes, risk and subjected to the same internal controls. When this is the case, the audit team may group these components together for the purpose of detailed planning and field work.

The starting point of the system description is to understand the basic processes for each component of transactions. This represents the ideal situation based on the provision of the legal framework which should be understood by the audit team before completing the working paper. The legal framework will highlight the internal controls which need to be in place at the entity, where the legal framework do not cover or cover partially the main process of the audited components, audit team should use these points:

- Procedure adopted by the entity should confirm whether the entity has implemented necessary internal control to minimize the risks,
- Where there are exceptional circumstances, for example different forms used by the entity for an expenditure item, revenue and deposit – such instances should be noted.

9.13 Reliance on key controls for components

According to the nature of the transactions related risks and controls the financial operations of an entity can be grouped in to the following categories for reliance on key controls of the entity

| System description and control reliance | Considerations |
|---|--|
| Expenditure | Grouping the expenditure as operating expenditure, supplies, consumables, capital expenses, consultancies, other goods and services and inventory. |
| Salaries and Wages and other benefits | It has different processes risk and controls and need to be verified salaries, wages and other benefits of every personnel separately. It is also usually a large expenditure items in the smaller entities of government. |
| Procurement | The transaction made on procurement should be included as a separate audit component and evaluated separately where there is a statutory obligation to audit compliance for smaller entities, however there may not be larger contracts or too many contracts which makes sampling easier. |
| Revenue | Revenue normally received without any significant risks but the control system of revenue collection and deposit to the revenue account should be assured. |
| Deposit | Deposit normally received without any significant risks but the control system of deposit collection and withdrawal should be assured. For other income significant risk areas to be identified considered separately. |
| Fixed assets | Fix assets and non consumable goods and equipments are very important to cover where financial information are reported on cash basis. These types of assets should be identified as the significant risks are for the purpose of audit. |
| Cash and receivables [With Advance] | Should be covered separately where this type of transaction is found. |

9.14 Audit programs

Test of controls and substantive test should be cover acceptable assertions for each component. A minimum audit programs should be considered for major audit components.

9.15 Sampling

Sample size are identified through the usual considerations and working papers included in the financial audit manual. Where audit components are grouped together for the purpose of identifying control reliance, sample items may be calculated for the entire population of expenditure, revenue, deposit and other transactions. For example where audit components with similar nature were grouped together during planning, the entire expenditure will constitute the population used to calculate the sample size. Sample size calculated by using a larger account transaction and should cover all sub-components. Audit team should ensure that all components and items are selected from all sub components for audit.

9.16 Additional guidance for detail planning

The following guidance helps audit team to complete the system description and identify basic audit program for some of the main components. This guidance provides a starting point for the audit and aiming to be complete as far as audit work is concerned. Audit team should consider this guidance for each engagement.

9.17 Significant risk area due to risk

Occurrence of expenditure as invalid payments may be made by any entities. Test should that be performed for each type of transaction/payment. For example a transaction should be selected for goods and services, operating expenses, consultancy services, payment against civil works, withdrawal of deposit, payment of salary and other benefits, and other consumables, etc.

| Assertions | Audit objectives | Error statements |
|----------------|---|---|
| Occurrence | Transaction and events that have been recorded and disclosed have occurred and pertain to the entity | Fictitious transaction have been reflected and recorded in books of accounts and financial statements. |
| Accuracy | Accounts and other data relating to recorded transaction and events have been recorded appropriately. | Inaccurate recording due to human errors or misstatements. |
| Classification | Every transaction has been recorded in the proper books of accounts with budget head and revenue code. Financial information is appropriately presented on prescribed formats with disclosures and are clearly expressed. | Transaction posted to an incorrect books of account. The financial information's are incorrect, inappropriate, disclosures are not mentioned in the financial statement and the budget heads and revenue code are different . |
| Completeness | All transactions and events which should have been recorded all required disclosures have been included in the Financial Statements. | Transactions that have been effected are not recorded or disclosed. All required disclosures have not been included in the financial statements. |
| Compliance | Transactions have been effected in compliance with relevant laws, regulations, policies and programs. Compliances with prescribed standards in terms of disclosure of assets, inventory and liabilities. | Non compliance with relevant laws and regulations, policies and programs relating to the transactions Non compliance with prescribed standards in terms of disclosure of goods and services. |

FINANCIAL AUDIT MANUAL APPENDICES

Office of the Auditor General Nepal
Babarmahal, Kathmandu, Nepal

2015

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Annex 1 (Chapter 1)

Risk Based Audit Manual

Office of the Auditor General of Nepal
Babarmahal, Kathmandu
Falgun 2068 (March 2012)

INTRODUCTION TO RISK BASED AUDIT MANUAL

This Manual is solely intended for use by Office of Auditor General of Nepal. It is tailored to meet OAG-N 's demands in adequately discharging its constitutional responsibilities while auditing Government of Nepal funds, revenues and expenditures encompassing all government bodies, organizations, projects and investments. The Manual reflects international best practice in auditing and is tailored to the local environment and legislations in Nepal. The Risk Based Audit Manual comprises a two parts as follows:

PartI– RiskBasedAuditSelection

Designed for use by OAG-N in planning its audit activities by way of resource allocation and time management for achievement of the best audit results;

PartII– RiskBasedAuditExecution

Designed for use by the audit staff in planning and execution of the audits and for use by audit reviewer while reviewing audit results and conclusions;

PARTI RiskBasedAuditSelection

1.1 RiskBasedAuditSelectionRationale

Risk Based Audit Selection at OAG-N has been essential due to the following reasons

1.1.1 ToAllocateScarceResources

- **LimitationofManpower atOAG-N**

OAG-N has staff strength of less than 450 out of which less than 250 actually engage in the field audit works. With this limited resources OAG-N has to carry out audit exercise of the entire government units.

- **LargeNumber ofAuditUnits**

The audit units within the purview and scope of OAG-N are approximately 4,000 and increasing. OAG-N has to carry out 100% audit of the audit units, which makes approximately 32 audits for a team of two members to complete within a period of six months.

- **ExpediencyforAuditReports**

OAG-N has been completing its audit activities and reporting to the President within 9 months from the end of the financial reporting period. There is a pressure on OAG-N to make the report more relevant by making it timelier by reducing the reporting period to 6 months from the end of the financial period. This has to be achieved on the backdrop that many government agencies do not finalise the accounts and reports on timely manner for audit to be commences as soon as the financial period ends. Above that there are two festivities, with extended government holidays, immediately after two months of the financial yearend.

This has put immense pressure on the audit staff to complete the audit work in haste, which sometime might result in compromise of the audit quality and thus creating risk of achieving the set objectives of ensuring accountability and transparency in public financial management system. Therefore with the limited workforce, increasing number of audit units and pressure to finalise the audit reports within 6 months from the financial yearend has necessitated OAG-N to adopt Risk based Audit selection method in its audit procedures.

1.1.2 ToTargetHighImpactAreas (forqualityofauditresults) ValueofRiskBasedAudit

1. Fosters dedicatedauditcoverage tohigh-risk areas

Traditional Audit focuses on the audit universe, audit cycle, statutes, regulations and other requirements, auditor’s experience and expertise. This may result in high risk areas being either neglected or less focused. With Risk Based Audit resources are dedicated to high-risk areas.

2. Yieldsdisciplinedanalyticalapproach toevaluatingtheaudituniverse

In RBA, audit universe is segregated into categories based on risks. While identifying risks audit team analysis various risk factors and risk situations, which provides strong basis for audit planning and execution. Further the risk identification process makes the audit team more aware of the audit environment and team gets in depth knowledge of the entity to b audited.

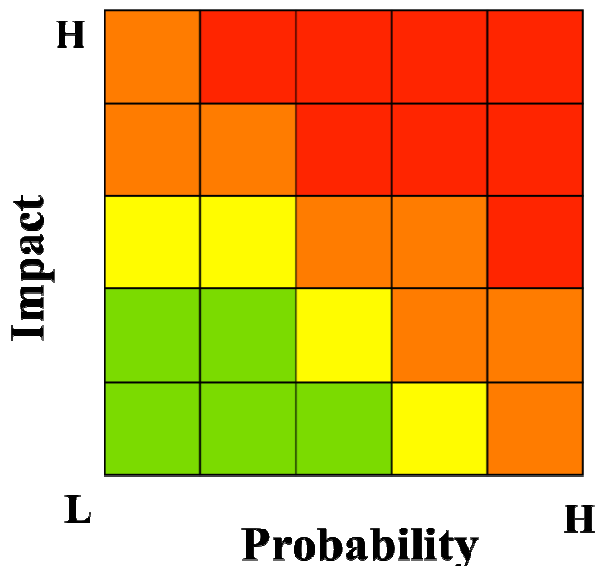
3. Highlightspotentialrisks inorganisationthatmightotherwise beunknown Following traditionalmodel of audit where risks are not analysed prior to the audit important and areas of risk might have been overlooked or under-looked. Risk Based Audit practices creates an environment where potential risks associated with the organisation to be audited are highlighted for the purpose of the audit and for the management.

4. Allocatesresourceswhere pay-backisgreatest

In traditional audit practice scarce resource may have been deployed for areas, which yields insignificant results. Whereas in RBA planning is done in such a way that best available resources (both HR and Time) is deployed to risky areas where best audit result is expected and where there is highest audit risks. This is even more imperative in the situation where there is limited resource at OAG-N and there is a time boundary within which to make the final report.

5. Provides atoolformanagementtogaugeorassessenterprise risk

RBA practice in OAG-N tool to gauge risk associated with the audit units and with the public sector financial management system. This provides better information to report the weaknesses, misstatements in the reports.



Target audit resources where risk is greatest!

1.2 Managing Audits

The OAG-N is responsible for ensuring that Public Financial management system is transparent, accountable, efficient, effective and economic. Therefore OAG-N is a key supervisory watchdog of public funds. Good management of the OAG-N relies on

- a) thorough planning of the audit
- b) effective execution of the plan via the good allocation, and efficient use, of resources,
- c) effective staff monitoring, mentoring and appraisal
- d) technical development and capacity building of professional staff
- e) Identify number of units to be audited (Assess risk associated with each of those units)
- f) Segregate the audit units for Detailed Audit or Desk Review
- g) Identify number of audit staff available at the directorate
- h) Allocate staff to the audits in terms of the expertise and reporting requirement

1.3 Proposed Audit Selection

OAG-N does not have adequate resources to do a 100% audit of every audit units. Therefore the AG has to decide how best to determine audit priorities, and where to allocate his relatively scarce resources.

The method of determining audit priorities is to carry out an assessment of relative risk of loss or error in each audit area, of each audit entity, and to assess the possible value and impact of the loss/error. Those areas which are considered high risk / high value must receive high priority and an appropriate allocation of the department's resources. This is called the risk-based approach to the audit of financial transactions.

Each audit directorate at OAG should at the planning stage should assess and analyse the audit units in the specific directorate and decide on the units to be selected for (1) Detailed Audited or for (2) Desk Review. This selection should be based on the risk analysis criteria set for individual directorate.

1.3.1 Selection for Detailed Audits

OAG-N will select audit audits for detailed field audit on the basis of Risk Analysis or selected risk criteria.

Compulsory Selection

Cases, which fulfil one or more specified criteria, decided for the year e.g. cases of a particular trade (expense / revenue) above a threshold, e.g "x" amount are selected compulsorily for field audits under this process if the laid down parameters exist.

Indicative compulsory selection for OAG-N

If the following parameters agree with any government entities, they are to be selected for audit compulsorily irrespective of any other condition:

- Those entities that are constitutionally or statutorily required to be audited (e.g. - The financial statement of Special Entities namely; The accounts of the Supreme Court, the Legislature-Parliament, the Constituent Assembly, Constitutional Bodies, the Nepal Army, the Armed Police or Nepal Police) compulsorily by AG.
- Revenue receipts exceeding "X" amount
- Expenditure exceeding "X" amount, non routine expenditure exceeding "X" amount
- Large interest payments exceeding "X" amount
- Purchase of property / capital expenditure exceeding "X" amount
- Entities having contract / construction volume exceeding "X" amount
- Entities having procurement of goods &/or services exceeding "X" amount
- Advances (receivables) / Payables exceeding "X" amount or "X" % of total revenue.
- Entities not selected for last 3 years or more for field audits

NOTE:These parameters may be different from directorate to directorate depending upon the nature of the business, assessed risks and the significance to the OAG-N report and public sensibility. These parameters will be set at AG's discretion and may be revisited and revised as circumstances demand. (Refer Annexure 3 for Sample)

1.4 Score (Risk) Based Selection

Statistical score based selection the audit units are selected on the basis of risk weight. The steps involved in the risk score based approach to auditing can be summarized as follows:

- (a) Identify key risks and controls – what could go wrong
- (b) Prioritize the risks and controls by assessing the importance of each risk focusing on their likelihood
- (c) Assess the effectiveness of the identified controls in addressing risks – assess control coverage

Risk Analysis

Risk analysis enables the auditor to evaluate the vulnerability of a particular system or group of systems. It is based on subjective judgment but various techniques can be used to make the analysis more systematic and, in part, more objective. Use of them will strongly support the auditor's judgment on the priority and frequency of audit. They can also help identify areas of high exposure, which might not have otherwise been identified. The auditor should document fully all the stages of the risk assessment exercise.

In planning an audit the AG will carry out an assessment of Audit Risk that exists in the Government Offices being audited. High-risk areas will be subject to audit at least quarterly, whilst low risk areas may be subject to audit annually. The main factors which increase risk in any single area of an audit include:

- (a) The Volume of transactions - the higher the volume, the higher the risk
- (b) The value of sums of money involved -the higher the value, the higher the risk
- (c) The relative complexity [and strength or weakness] of the Systems, Internal Controls, and Segregation of Duties. Complex or weaker systems give rise to higher risk
- (d) The sensitivity of systems which includes:
 - i. Systems that are particularly susceptible to maladministration such as Salaries, Allowances etc. These are high risk
 - ii. The likelihood of collusion amongst employees. This raises risk
 - iii. Systems where the capacity of staff is known to be weak [or there has been high incidence of new key staff,]. This raises risk
- (e) The relative strength or weakness of the overall control environment within the Audit Entity particularly with regard to financial management and analysis of financial performance. A weak control environment raises risk.

Risk Factors: Indicative

| Materiality | Points |
|--|--------|
| Audit Area over NRs 100 million | 8-10 |
| Audit Area NRs 10 million to NRs 100 million | 4-7 |
| Audit Area less than NRs 10 million | 1-3 |

| Impact on Operations | Points |
|--|---------------|
| Significant impact on core business | 8-10 |
| Significant impact on specific program moderate impact on core | 4-7 |
| Negligible impact on specific program or core business | 1-3 |

| Public Sensitivity | Points |
|--|---------------|
| Likely to result in public or parliamentary interest | 8-10 |
| May result in public or parliamentary interest | 4-7 |
| Unlikely to result in public or parliamentary interest | 1-3 |

Probability Factors - Indicative

| Probability of Risk | Points |
|---|---------------|
| High probability of significant issues | 0.8-1.0 |
| Moderate probability of significant issues and high probability of improvement needed | 0.4-0.7 |
| Low probability of significant issues & moderate to low probability of improvement needed | 0.1-0.3 |

As decided by AG from year to year. These criteria and parameters may be revisited, reviewed and revised by AG from year to year

Example of Risk Assessment

| Potential Audit Segment (to be determined by each directorate) | Material | Impact | Visibility/ Sensitivity | Subtotal of Risk Consequence | Probability | Risk Score |
|---|-----------------|---------------|------------------------------------|---|--------------------|-----------------------|
| Security of Office Equipment | 4 | 7 | 5 | 16 | 0. | 8.0 |
| Revenue Management | 7 | 7 | 8 | 22 | 0. | 13. |
| Contract Execution/ Procurement | 3 | 5 | 9 | 17 | 0. | 5.1 |
| Total Risk Score | | | | | | 24. |

RiskAssessmentAction

- Similar assessment will be done for the audit units in the directorate other than those categorised in Compulsory Selection.
- Units with high Total Risk score will be selected for detailed field audits

Alternatively

The AG may assess the risk attached to each audit area or accounting system, in accordance with the table below:

| | Element (indicative) | Scale of Measurement (indicative) | Risk Rati | Weightin g | Risk Score |
|---|---------------------------------|--|----------------------|-----------------------|-----------------------|
| | (i) | (ii) | (iii) | (iv) | (v)= (iii) X |
| a | Volume of Transactions | 0 - 300 301 - 1000 Over 1000 | 1 2 3 | 1, 2 or 3 | |

| | | | | | |
|----------------|------------------------|-------------------------|---|-----------|--|
| b | Value of Transactions | 0 – 10million | 1 | 1, 2 or 3 | |
| | | 10 – 100 million | 2 | | |
| | | Over 100 million | 3 | | |
| c | Complexity of Systems | Degree of Complexity | 1 | 1, 2 or 3 | |
| | | Low=1 Medium=2 High=3 | 2 | | |
| | | | 3 | | |
| d | Sensitivity of Systems | Degree of Sensitivity | 1 | 1, 2 or 3 | |
| | | Low=1 Medium=2 High=3 | 2 | | |
| | | | 3 | | |
| e | Control Environment | Quality of Control | 1 | 1, 2 or 3 | |
| | | Environment | 2 | | |
| | | Low=3, Medium=2, High=1 | 3 | | |
| Total Risk (R) | | | | | |

Notes:

- (a) Risk rating represents the possible impact an element will have on the risk assessment process.
- (b) Weighting factor represents the importance the Auditor attaches to the particular element of risk. The low risk element being assigned 1 while the high risk area is assigned 3.
- (c) The Auditor will be expected to use his/her professional judgement in the process of assigning the weighting factor to the elements of risk.
- (d) Weighting – After giving a risk rating for each factor, it is necessary to determine an appropriate weighting for each of the factors. The weighting given indicates the relative importance/potential impact of each of the risk factors. For example Sensitivity of Systems (4) may be given a weighting of 3, while Volume of Transactions (1) may be given 1. This indicates that the factor of Sensitivity is considered to be 3 times more important than the factor of Volume.

The auditor should calculate the risk inherent in each audit area by applying the following formulae:

$$\text{RiskIndex(R)} = \text{Ra} + \text{Rb} + \text{Rc} + \text{Rd} + \text{Re}$$

Where a to e are the elements of risk

Ra (Risk of element a) = Risk rating of element a X Weighting Factor of element a

Re (Risk of element e) = Risk rating of element e X Weighting Factor of element e

Applying the above formula to each system/audit area will result in a ranking of risks, i.e. the higher the resulting number, the higher the relative risk. In allocating scarce resources to each audit area [and in deciding on sample sizes or coverage in each area] priority and emphasis should be given to the high risk areas.

RiskAssessmentAction

- Similar assessment will be done for the audit units in the directorate other than those categorised in Compulsory Selection.
- Units with high Total Risk score will be selected for detailed field audits

Example:

Directorate responsible for Local Government Bodies has been assigned to carry out audit of DDCs. Aware that the directorate is required to use a risk-based approach to the audit it will have to evaluate number of risk elements and below are the findings of one DDC:

- (a) There were 1250 payment transactions during the audit period.
- (b) The total value of all the transactions during the period is NRs. 50 million.
- (c) The payment system being used is semi-automated and is not very complex. She considers it to be of medium complexity. The Auditor is of the view that a complex system would increase the risk tremendously and has decided to attach the highest weight to this element.
- (d) The Auditor considers that the payments area is a highly sensitive area. She is also of the view that sensitivity of the system would increase the risk tremendously and has decided to attach the highest weight to this element.
- (e) The auditor's assessment is that the Control Environment is weak. This would imply that the audit risk is likely to be high. From her experience, however, she knows that the Accounting Officer and the Head of Accounts are very reliable and honest Officers who have served the Local Government for over two decades without any mismanagement of public funds. She therefore considers that this element is not likely to have a big impact on the overall risk of this audit area.

The risk assessment for the expenditure audit area would result in a score as shown in the table below:

| | Element (indicative) | Scale of Measurement (indicative) | Risk Rating | Weight ing Factor | Risk Score |
|---|---------------------------------|---|------------------------|----------------------------------|------------------------------|
| | (i) | (ii) | (iii) | (iv) | (v)= (iii) X (iv) |
| a | Volume of Transactions | 0 - 300 301 - 1000 Over 1000 | 3 | 1 | 3 |
| b | Value of Transactions | 0 – 10million 10 – 100 million Over 100 million | 2 | 2 | 4 |
| c | Complexity of Systems | Degree of Complexity Low=1 Medium=2 High=3 | 2 | 3 | 6 |
| d | Sensitivity of Systems | Degree of Sensitivity Low=1 Medium=2 High=3 | 3 | 3 | 9 |

| | | | | | |
|---|---------------------|---|---|---|----|
| e | Control Environment | Quality of Control Environment Low=3, Medium=2, High=1 | 3 | 1 | 3 |
| | Total Risk (R) | | | | 25 |

The Risk score of 25 obtained for the DDC in the above table is then compared with that of other DDCs. These DDCs are then ranked according to the total risk scores by the directorate setting a cut off Risk Score for detailed audit and those scoring less than the cut off point are designated for desk review.

Defining Selection Basket

Each selection basket represents a set of financial data and non-financial information on which criteria for selection of audit entity is processed.

Selection baskets can be configured according to

- Categories and nature of the entity
- Territorial jurisdictions
- Legal and regulatory requirements
- All or some of these

Selection of entity for field audit through Computer Assisted Selection System

Risk Based Audit Selection (statistical selection) is enhanced by the use of computer based selection with the relevant risk data and parameters being set in the computer programme and computer selects the audit units in terms of the risk grading. For sophisticated audit selection using Risk Based Model it is recommendatory that such CASS be developed and implemented at OAG-N.

1.5 Discretionary Selection

Audit units are selected on discretion among those not selected by the Compulsory Selection or Risk (Score) Based Selection, but the directorate / auditors feels that such units possess audit risk and needs to be audited (filed audits). Each directorate should set a number or % of audit units to be selected by discretion whether they have been left out of risk based selection process but still pose audit risk and needs to be audited (filed audits). Each discretionary selection needs to be approved by Deputy AG / Assistant AG as appropriate.

1.6 Selection for Desk Review

There is a constitutional mandate for AG to audit the GoN agencies and bodies. However the method and the process of the audit can be determined by the AG himself/herself.

OAG-N will conduct 'Detailed Field Audits' for the units selected through the compulsory selection or risk (score) based selection or discretionary selection. For remaining audit audits (which are of low risk) OAG-N will employ less rigorous audit procedure (named Desk Review). Nature, Extent and Timing of the Desk Reviews will be determined by the AG. Typical Desk Review will be conducted by

- Reviewing the basic documents
 - Bank & cash book
 - Progress reports

- Bank reconciliation
- Advance ledgers
- Conducting Analytical Procedures on the financial statements
- Reviewing Internal Audit Reports

PART II RISK BASED AUDIT EXECUTION

2.1 Audit Risk Conceptual Framework

Audit Risk is the risk that the auditor gives inappropriate opinion.

An audit in accordance with ISA / INTOSAI standards is designed to provide reasonable assurance that the financial statement taken as a whole are free from material statements. The concept of reasonable assurance implies that there is a risk that the audit opinion will be inappropriate (e.g. unqualified opinion when the financial statements are materially misstated).

Audit risk is controlled and determined solely by the Auditor. The risk may be reduced to an acceptable level by designing and performing audit procedures to obtain sufficient and appropriate audit evidence to be able to draw reasonable conclusion on which to base the audit opinion.

Audit Risk therefore considers two base risks

- Financial Statements may be materially stated prior to the audit (financial statement risk)
- And that auditor may not detect such risks (detection risks)

Financial Statement Risks

| | | |
|---|--|---|
| Audit Risk = Inherent Risk (AR) x Control Risk (IR) x Detection Risk (DR) | | |
| | IR and CR - Auditor Assesses (Independent of audit) | DR - Auditor Manages (Manipulates to achieve acceptable level of audit risk) |

Inherent Risks

The susceptibility of an account balance (or class of transactions) to misstatement, that could be material (individually or in aggregate), assuming no related internal controls. Inherent Risk is the risk inherent in the nature of the organization, its type of transactions.

Some indicative examples of inherent risks are

- Doubts about the integrity of management
- Management inexperience in the preparation of the financial statements
- Accounts, which involve a high degree of estimation
- Entity lacks sufficient capital to continue operations
- Potential for technological obsolescence of products and services
- Complex underlying transactions and events, which might require using the work of an expert
- Complex capital structure
- Highly desirable and movable assets (e.g. cash) susceptible to loss or misappropriation

- Unusual and complex transactions completed at or near the period end
- Numerous locations and geographical spread of production facilities
- Changes in consumer demand
- Transactions not subject to ordinary processing

Control Risks

The risk that a misstatement that could occur (at assertion level) & be material will not be

- prevented; or
- detected and corrected on a timely basis; by the accounting and internal control system.

Some indicative examples of Control Risks are

- History of errors found by auditor
- Management attitude/dominance
- Inexperienced/incompetent staff
- Lack of segregation of duties/inadequate supervision
- Size of entity/accounting systems
- Non Compliance of management policies
- Weaknesses in safeguard of assets
- Inability to produce financial information and financial statements on timely basis
- Inaccuracy of financial information
- Disorderly conduct of businesses

Control Risk is assumed to be high (i.e risk of material misstatement) UNLESS

- internal controls which are likely to prevent / detect / correct material misstatements relevant to the assertions are identified, and
- test of operating effectiveness (of controls) are planned to be performed to support the assessment

Control risks will be assessed as high

- internal controls are not assessed to be effective or
- evaluating the operating effectiveness of the controls would not be an efficient audit approach or
- sufficient audit evidence can purely be achieved from substantive testing

Detection Risks

It is the risk that the auditor will not detect a misstatement that exists (in the financial statements at assertion level) and that could be material (both individually or in aggregate)

Factors to be taken into account for detection risks are

- possible selection of inappropriate audit procedures at the planning stage (AT PLANNINGSTAGE)
- misapplication of audit procedures (AT EXECUTION STAGE)

- misinterpretation of test results (AT REVIEW STAGE)

Because of the nature of the audit process (inherent limitation of audit) some detection risk will always be present even when 100% examination of account balances are undertaken. But the aim is to reduce this risk at an acceptable level.

Substantive Procedures are those procedures that are performed in order to detect material misstatements in financial statements audits, it includes

- test of details of transactions
- test of details of account balances
- test of details on disclosures and
- analytical reviews

Auditor assesses inherent and control risk and manages audit risk by manipulating the detection risks. Low detection risks means higher level of substantive testing

METHODS OF VARYING DETECTION RISKS

| Audit Action | Examples |
|---------------------------------|---|
| Change NATURE of the audit work | <ul style="list-style-type: none"> • Direct confirmation from independent parties rather than relying on documentation within the entity <ul style="list-style-type: none"> • Physical verification • Use extensive test of details in addition to analytical |
| Change EXTENT of the audit work | <ul style="list-style-type: none"> • Use larger sample size |
| Change TIMING of the audit work | <ul style="list-style-type: none"> • Perform audit procedures at the period end rather than at interim visit or much later than the end of the reporting period. |

2.1 Risk Based Audit Procedures

2.1.1 Risk Identification

Each directorate is responsible to identify risks associated with the audit entity. Each dire is responsible for the maintenance and updating of the Risk Register.

How to find Risks?

- Initial identification
 - o Questionnaires to relevant audit units/sub-units prepared on the basis of the knowledge of the processes and interviews with the audit entity personnel
 - o Past Audit reports
 - o Investigation Reports
 - o Discussion with the audit entity personnel
 - o Reviewing relevant documents
- Risk Register
 - o Maintained and updated by each directorate

- Transactions and Process Testing
 - o Traditional audit testing's
 - o Internal control reviews
- Investigation reports
 - o In-house investigations
 - o Performance audits
 - o Investigations carried out by regulators

2.1.2 Risk Analysis

A Assess Likelihood of Risks

B Assess Consequence of Risks

C. Assign Scoring to Risk

| CONSEQUENCE Impact of the risk when it occurs e.g. | LIKELIHOOD (Likelihood of risk occurrence) | RISK DEFINITION | SCORE |
|--|--|------------------------|--------------|
| Risks results in wrong opinion being given on the financial statement | Almost certain | Very High | 5 |
| Misses out major misstatement in the financial statement | Probable | High | 4 |
| Audit fails to look into major risk area that requires detailed verification | Possible | Medium | 3 |
| Audit process fails to document routine evidences | Unlikely | Low | 2 |
| Auditor fails to perform audit procedures on low value item | Rare | Very Low | 1 |

Qualitative Risk Analysis

The risk management plan is the key input to qualitative risk analysis. The plan will dictate the process, the methodologies to be used, and the scoring model for identified risks. In addition to the risk management plan, the identified risks from the risk register, obviously, will be needed to perform an analysis. These are the risks that will be scored and ranked based on their probability and impact.

Not all risks are worth responding to while others demand attention. Qualitative analysis is a subjective approach to organising and prioritising risks. Through a methodical and logical approach, the identified risks are rated according to probability and potential impact.

The outcome of the ranking determines four things:

- It identifies risks that require additional analysis through quantitative risk analysis.
- It identifies the risks that may proceed directly to risk response planning.
- It identifies risks that are not critical, process-stopping risks, but requires documentation
- It prioritizes risks.

A qualitative analysis of risks and conditions is done to prioritize their affects on objectives.

Creating a Probability-Impact Matrix

Each identified risk is fed into a probability-impact matrix, as seen in Figure below. The matrix maps out the risk, its probability, and its possible impact. The risks with higher probability and impact are a more serious threat to the project objectives than the risks with lower impact and consequences. The risks that are threats to the project require quantitative analysis to determine the root of the risks, the methods to control the risks, and effective risk management.

- **What are risks?**

Risks are the set of circumstances that hinder achievement of objectives. The three components of risk:

o Risk Event

o Probability of Risk Event

o Impact of Risk Event (Risk Event Value)

- Risk Event is a discrete occurrence that may affect the project for better or for worse.

Mathematically $R = P * I$

| | | | | | | |
|---------------------------------|----------------------|--------------------------------|-------------------------|-------------------|-------------------|-------------------------|
| Consequence (of risk) | catastrophic [5] | [5] Issue | [10] Issue | [15] Unacceptable | [20] Unacceptable | [25] Unacceptable |
| | major [4] | [4] Acceptable | [8] Supplementary Issue | [12] Issue | [16] Unacceptable | [20] Unacceptable |
| | moderate [3] | [3] Acceptable | [6] Supplementary Issue | [9] Issue | [12] Issue | [15] Unacceptable |
| | minor | [2] Acceptable | [4] Acceptable | [6] Supplementary | [8] Supplementary | [10] Issue |
| | insignificant [1] | [1] Acceptable | [2] Acceptable | [3] Acceptable | [4] Acceptable | [5] Supplementary Issue |
| | | rare [1] | unlikely [2] | possible [3] | probable [4] | almost certain [5] |
| | | Likelihood (of risk) | | | | |

- Unacceptable : Immediate action required to control the risk
- Issue : Action required to control the risk
- Supplementary issue : Action is advisable if it is cost-effective
- Acceptable : No action required

QuantitativeRiskAnalysis

Quantitative risk analysis attempts to numerically assess the probability and impact of the identified risks. Quantitative risk analysis also creates an overall risk score for the unit's process and activity. This method is more in-depth than qualitative risk analysis and relies on several different tools to accomplish its goal.

Qualitative risk analysis typically precedes quantitative analysis. All or a portion of the identified risks in qualitative risk analysis can be examined in the quantitative analysis. The performing organization may have policies on the risk scores in qualitative analysis, which require the risks to advance to the quantitative analysis. The availability of time and budget may also be a factor in the determination of which risks should pass through quantitative analysis. Quantitative analysis is a more time-consuming process, and is therefore also more expensive. There are several goals of quantitative risk analysis:

- To ascertain the likelihood of reaching the organization/unit's success
- To ascertain the likelihood of reaching a particular objective
- To determine the risk exposure for the process or activity
- To determine the likely amount of the contingency reserve needed
- To determine the risks with the largest impact
- To determine realistic time, cost, and scope targets

ToolsofQuantitativeanalysis

- 1 **InterviewingStakeholdersandExperts**
- 2 **ApplyingSensitivityAnalysis**
- 3 **FindingtheExpectedMonetaryValue**
- 4 **UsingaDecisionTree**
- 5 **UsingaProcessSimulation**

2.1.3 Risk Management (Risk Response)

| | | Likelihood | |
|--------------|------|---|---|
| | | Low | High |
| Consequences | High | Transference <i>(risksharing)</i> | Avoidance <i>(termination)</i> |
| | Low | Acceptance <i>(riskretention)</i> | Mitigation <i>(contingency planning, reduction)</i> |

- **Avoidance**

Avoidance is simply avoiding the risk. This can be accomplished many different ways and generally happens early in the planning phase when any change will result in fewer consequences than later in the audit execution. Examples of avoidance include the following:

- o Changing the plans to eliminate the risk
- o Clarifying audit programmes to avoid discrepancies
- o Hiring additional team members that have experience with the required technology and system
- o Using a proven audit methodology rather than a new approach
- o Eliminate a specific threat, usually by eliminating the cause.
- o Examples: Don't do the activity that has risk or do the activity in a different way such that the risk is no longer a risk

- **Mitigation**

Mitigating risks is an effort to reduce the probability and/or impact of an identified risk. Mitigation is done—based on the logic—before the risk happens. The cost and time to reduce or eliminate the risks is more cost effective than repairing the damage caused by the risk. The risk event may still happen, but hopefully the cost and impact of the risk will both be very low.

Mitigation plans can be created so they are implemented should an identified risk cross a given threshold. Reduce the risk factor by reducing the probability of occurrence or reducing the risk event value (impact of the risk) Examples of mitigation include:

- o Adding activities to reduce the risk probability or impact
- o Simplifying the processes so that audit processes are understood by all involved
- o Completing more tests on the activity before implementation
- o Developing prototypes, simulations, and limited releases

- **Acceptance**

Risk acceptance is the process of simply accepting the risks because no other action is feasible; or the risks are deemed to be of small probability, impact, or both and that a formal response is not warranted. Passive acceptance requires no action; the process or activity team deals with the risks as they happen. Active acceptance entails developing a contingency plan should the risk occur. Acceptance may be used for both positive and negative risks.

A contingency plan is a predefined set of actions the team will take should certain events occur. Events that trigger the contingency plan should be tracked. A fallback plan is a reaction to a risk that has occurred when the primary response proves to be inadequate.

Most risk acceptance policies rely on a contingency allowance. A contingency allowance is the amount of money the unit will likely need in the contingency reserve based on the impact, probability, and expected monetary value of a risk event.

- o Accepting the consequences of the risk.
- o Acceptance can be active: Developing a contingency plan should the risk occur
- o Acceptance can be passive: Accepting a lower profit is some activities overrun

- **Transference**

Transference is the process of transferring the risk (and the ownership of the risk) to a third party. The risk doesn't disappear, it's just someone else's problem. Transference of a risk usually costs a premium for the third party to own and manage that risk. Transference is usually done for negative risks. Common way of transferring risk include

- o Engaging experts to such risk areas

Preparing for Risk Response

To successfully prepare for risk response, the project manager, project team, and appropriate stakeholders rely on several inputs—many of which stem from qualitative and quantitative risk analysis. The risk management plan is needed during the risk response planning, but the risk register is also needed to provide the following:

- A list of prioritized risks
- A risk ranking
- A prioritized list of quantified risk
- A probabilistic analysis of the activity
- The probability of the organization/unit meeting the cost and schedule goals
- The list of potential responses decided upon when risks were first identified
- Any risk owners that have been identified
- A list of risks with common causal factors
- Trends from qualitative and quantitative analysis

Following management actions has to be taken to in dealing with the risks in terms of their risk ranking

| Consequences | | | |
|---------------------|---------------------------------------|--------------------------------------|--------------------------------|
| Significant | Considerable management Required | Must manage and monitor Risks | Extensive management essential |
| Moderate | Risks worth accepting with monitoring | Management effort worthwhile | Management effort required |
| Low | Accept Risk | Accept Risk, but continue monitoring | Manage and monitor Risks |
| | Low | Moderate | Significant |
| Likelihood | | | |

2.1.4 Risk Monitoring and Control

Risk monitoring and control is an active process that requires participation from the manager, activity team members, key stakeholders, and, in particular, risk owners within the process. As the process progresses or activities are carried out, risk conditions may change and require new responses, additional planning, or the implementation of a contingency plan.

There are several goals to risk monitoring and control:

- To confirm risk responses are implemented as planned

- To determine if risk responses are effective or if new responses are needed
- To determine the validity of the project assumptions
- To determine if risk exposure has changed, evolved, or declined due to trends in the project progression
- To monitor risk triggers
- To confirm policies and procedures happen as planned
- To monitor the project for new risks

CHAPTER 2 APPENDICES

PE-1 Format for Audit Authorisation Letter

To
Auditee

- OAGN will commence the audit from xx/xx/xxxx
- Following will be the audit team member
- Request for providing required documents for smooth completion of the audit

Regards

AAG / Director / DAG

PE-2 Code of Ethics Declaration

| | |
|---|--|
| Name of Audited Entity: _____ | |
| Fiscal Year: _____ | |
| For the purpose of the audit of <i>[Insert the name of audited entity]</i> , I confirm that: | |
| <ol style="list-style-type: none"> 1. Ourselves, or any members of our immediate family do not have a financial interest in the audited entity. 2. We do not have any business or financial relationship with the audited entity or any of its officers and employees. 3. We are not, and have not been in the last two financial years, an employee of the audited entity. 4. We have not received or due to receive any gifts, donations, or any other benefits from the audited entity. 5. We do not have any family or other relationship with any director, officer, and employee of the entity under audit that may impair my independence. 6. We understand the requirements in the OAG-Nepal Code of Ethics as far as: <ul style="list-style-type: none"> • We shall exercise due care and perform the audit in a professional manner and to the best of our abilities. • We shall perform the audit with honesty, integrity, impartiality, prudence, and political neutrality. • We shall keep full confidentiality of information obtained during the audit process and shall not disclose such information to third parties. | |
| Circumstances, which may impair my compliance with the above statements for the applicable. | |
| <i>Name of team member</i> | <i>List circumstances where applicable</i> |
| | |
| | |
| | |
| | |
| DECLARATION | |
| We, the undersigned fully understand the requirements and responsibilities contained in the Code of Ethics. Where applicable, we have documented the circumstances, which may impair compliance. | |
| <i>Name and designation of team member</i> | <i>Signature</i> |
| | |
| | |
| | |
| | |
| AUTHORIZATION | |
| After consideration of the declarations by the audit team members, I conclude that all the requirements contained in the Code of Ethics are understood and met for the audit engagement. Any threat to the audit team's independence have been eliminated or reduced to an acceptable level. | |
| Name and designation _____ Signature _____ | |

PE-3 Record of Audit Activities

Name and address of audited entity: _____

Fiscal year: _____

Audit period: from 20../.../..... To 20../.../...../...

| Audit activities | Programmed date/ days | Actual date/ days | Variance | Causes for Variance |
|--|------------------------------|--------------------------|-----------------|----------------------------|
| Declaration of code of ethics | | | | |
| Audit Engagement letter | | | | |
| Understand auditee's business | | | | |
| Identification and assessment of audit risks | | | | |
| Preparing and approving audit plan and program | | | | |
| Entrance Meeting | | | | |
| Execute audit works | | | | |
| Exit meeting or discussion on audit findings | | | | |
| Issue of preliminary audit report | | | | |
| Issue of final audit report | | | | |
| Preparing drafts for AG's report | | | | |

I/we, the undersigned fully understand my/our responsibilities for this audit engagement / work division. I/we have disclosed audit information correctly and accurately.

Name and Designation of audit team leader _____

Signature _____

| Opinions/ suggestions of audit supervisors |
|--|
| 1) Immediate supervisor: _____ _____ Name and Designation: _____ Signature _____ |
| 2) Reviewer: _____ _____ Name and Designation: _____ Signature _____ |

PE-4 Competency Matrix

| Name/Position | Academic Qualification | Years Experience |
|-----------------------|------------------------|------------------|
| Audit Supervisor | | |
| Audit Team Leader | | |
| Audit Subordinate (1) | | |
| Audit Subordinate (2) | | |
| Etc. | | |

Prepared by: _____

Title: _____

PE-5 Audit Engagement Letter

Date:

Name and address of audited entity _____

Addressee: _____ [Insert Designation of Officer in charge]

Subject: Audit Engagement

Dear Sir/madam,

The financial statements of [*Insert the name of the audited entity*] for the year ended 20../.. are subject to audit by the Auditor General in terms of the Interim Constitution, 2063 (2007) and the Audit Act, 2048 (1991). The purpose of this letter is to outline:

1. The terms of the audit engagement and the nature, and limitations of the audit.
2. The respective responsibilities of the auditor and your management.
3. The terms of the audit engagement are set out below. This letter will remain effective until a new audit engagement letter is issued.

Objective of the audit

The objective of the audit is to express an independent opinion and observation on the examination of financial statement as well as the compliance with relevant laws and regulations applicable to financial matters.

[*Insert any additional objectives e.g. the evaluation of compliance with authorities or internal controls, where applicable*]

Responsibilities of the auditor

1. Our audit will be conducted in accordance with International Auditing Standard of SAI (Supreme Audit Institution) and the Office of the Auditor General's Government Auditing Standards (GAS), 2061 (2005). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.
2. The procedures selected depend on the auditor's judgment, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating whether the accounts maintained and overall financial statements presented by management are based on Government of Nepal accounting policies.
3. We do not examine every transaction, nor do we guarantee complete accuracy of the financial statements or compliance with all applicable legislation.
4. Because of the inherent limitations of an audit, together with the inherent limitations of internal control and accounting system, there is unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with the International Standards of Supreme Audit Institutions (ISSAIs).
5. Though we are not directly aimed to report on management deficiencies and internal control, we will report or communicate to you any significant deficiencies in the internal control, non-effective performance of operations, instances of non-compliance with authorities, waste, instances of abuse and the like that come to our notice in course of the audit.

Responsibilities of your management

Management has the following responsibility:

1. to prepare financial statements in accordance with Government of Nepal accounting policies in the manner required by law;
2. to establish and maintain internal controls necessary to:

APPENDIX F.

- enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - provide reasonable assurance that adopted policies and prescribed procedures are adhered to and that errors and irregularities, including fraud and illegal acts, are prevented or detected,
 - safeguard the office assets and properties
3. to provide auditors with unrestricted access to:
- all information which is relevant to the presentation of the financial statements such as accounts, records, documentation and other matters;
 - any additional information that we may request from management for the purpose of the audit; and
 - any persons within the entity from whom we consider it necessary to obtain audit evidence.

Agreement to terms

This letter will remain effective unless it is amended, suspended, or replaced. We shall be grateful if you confirm your acceptance to the terms of this letter by signing and returning the enclosed copy.

We look forward to full cooperation from your office during our audit.

On behalf of Office of Auditor General

On behalf of Audited entity

Name: _____

Name: _____

Designation: _____

Designation: _____

Date: _____

Date: _____

CHAPTER 3 APPENDICES

SP 1 Understanding the Entity and its Environment

| | | | |
|-----------------------------------|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: (Level 1) | | | |
| Reviewed By: (Level 2) | | | |

A General Information

| | |
|------------------------------------|--|
| Name of the audited entity | |
| Address | |
| Telephone: | |
| Fax numbers: | |
| Email / Website | |
| Banking details: | |
| <u>Attorney details: (for PSU)</u> | |

B Management

| Name | Rank | Telephone | e-mail address |
|------|------|-----------|----------------|
| | | | |
| | | | |
| | | | |

C Audit objective & scope (ISA 1200)

| | |
|---|--|
| Audit file no./ Audit project code | |
| Auditing standards | |
| Purpose and objective of the entity audited | |
| Specific Audit objective& scope | |

D Category and size of the entity

| | Comments/notes | WP Ref |
|--|----------------|--------|
| Major Account Headings | | |
| Total no. staff | | |
| Total Receipts (Appropriation) | | |
| Total Expenditure | | |
| Total Revenue (<i>in case of revenue agencies –e.g. customs, inland revenue etc</i>) | | |
| Head office location | | |
| Departments or other units or agencies controlled by the entity | | |
| Locations and cost centres | | |
| Structure of the entity (<i>Organogram</i>) | | |

E Understanding of the entity and its environment (ISA 1315) ¹

| | Particulars | Comments/notes | Risks (<i>inherent</i>) to be considered in SP-7 | WP-ref |
|----------|---|----------------|--|--------|
| A | <i>Auditee and its Legal environment</i> | | | |
| 1 | <i>Applicable reporting (and accounting) framework. ?</i> | | | |
| 2 | <i>Legal and regulatory framework applicable to the auditee ?</i> | | | |
| 3 | <i>Any other specific legislation, regulation, government policies that affect auditee's operation.</i> | | | |
| B | <i>Nature</i> | | | |

¹Note: SP 1 should be used to understand the entity and its environment and various documents collected from the audited entity should contribute to complete the permanent audit file.

| | | | | |
|----------|--|--|--|--|
| 4 | <i>Major areas of operations? (e.g. projects and/or services, regulation)</i> | | | |
| 5 | <i>Auditee's long term, medium term and annual plan</i> | | | |
| 6 | <i>Nature of income sources (appropriation, donor etc),</i> | | | |
| C | Selection & Application of Accounting Policies | | | |
| 7 | <i>Are there any changes in the auditee's accounting policies during the period under audit?</i> | | | |
| 8 | <i>Any specific accounting policies and practices applied by the auditee that will have being on the financial statements?</i> | | | |
| D | Objectives and Strategies and Related Business Risks | | | |
| 9 | <i>Are there any new areas of operations during the period under audit(Product and services) to consider for operational risks including new accounting, regulatory, current & prospective financing requirement (only those risks that may give rise to material misstatement, as auditors are not required to asses entire business risks)</i> | | | |

SP-2 Materiality and Planning Lead Schedule

| | | | |
|-----------------------------------|--|--------------|--|
| Entity: | | | |
| Period: | | | |
| Prepared by: | | Date: | |
| Reviewed By: (Level 1) | | Date: | |
| Reviewed By: (Level 2) | | Date: | |

A. Planning Materiality
 A1. Quantitative Materiality

| Materiality basis | Guideline % | % Used | Amounts NRs from financial statements | Materiality amounts |
|--------------------------------|--------------------|---------------|--|----------------------------|
| Gross receipts (appropriation) | 1-3 | | | |
| Gross expenditure | 1-3 | | | |
| Deposits | 1-3 | | | |
| Advances | 2-3 | | | |
| Revenue | 1-3 | | | |

A2. Qualitative Materiality: Factors to Consider

| |
|--|
| <p>Examples:</p> <p>Compliance with Laws and Regulations a – Compliance of Audit Act (2048) Matters to be Audited (Sec 4) Matters to be audited in terms of propriety (Sec 5) b – Compliance with relevant acts and rules Public Procurement Act (2063) and Rules (2064) Act and laws specifically relevant to the entity Adequacy of disclosures a – Disclosures as required NAPSAS (to the extent applicable) b – OAGN Form Implementation Directive</p> <p>Application of accounting policies a – Compliance of Financial Procedure Act 2055 and Rules (2064) b – DTCO Directives</p> |
|--|

APPENDIX B.

B. Planning Lead Schedule

| | Budget Sub heading (e.g.) | Initial Appropriated amount | Final Budget | Disbursements | Expenditure | Balance | Advance | Quantitative Significance (from Materiality above) | Qualitative materiality (auditor to use judgement) | Indicate Audit Strategy |
|---|---------------------------|-----------------------------|----------------------|---------------|----------------|------------------------------|---------------|--|--|---|
| | 3370143 | | xx | xx | xx | xx | xx | YES/No | YES/No | If yes in either of these two then audit strategy will be Detailed substantive procedure, link to DP1 |
| 1 | 6010163 | | xx | xx | xx | xx | xx | YES/No | YES/No | If No in both then audit strategy will be Analytical procedure and/or some Substantive Procedure |
| 2 | 6010143 | | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 3 | 3373024 | | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 4 | 3371074 | | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 5 | 3371234 | | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 6 | 3371484 | | xx | xx | xx | xx | xx | YES/No | YES/No | |
| | | | - | - | - | - | - | | | |
| | Revenue | | | | | | | | | |
| | Heading | Recognised Revenue (lagat) | Collected | Deposited | Remaining Cash | Remaining Recognised (lagat) | | | | |
| | | | | | | | | YES/No | YES/No | |
| | Deposit | | | | | Remaining | | | | |
| | P/Y Brought Forward | This year's recognised | Forfieted / Adjsuted | Returned | Total | As per Bank | As per ledger | | | |
| | | | | | | | | YES/No | YES/No | |

Note:

1. The significance of the amounts are to be judged on the basis of the materiality (qualitative and quantitative) and impact on Audit Risk
2. If 'YES' - If item is significant the audit approach could be Test of Detail / Substantive Procedures (and indicate alternatives if any)
3. If 'NO' - If item is not significant then the audit approach could be Analytical Procedures and some SP (also indicate alternatives if any)

This working paper should be completed using the excel version.

SP-3 Preliminary Analytical Review

| | | | |
|-------------------------------|--|-------------|--|
| Auditee: | | | |
| Period: | | | |
| Prepared By: | | Date | |
| Reviewed By: (Level 1) | | Date | |
| Reviewed By: (Level 2) | | Date | |

Same data as in SP2 imported

NRs '000

| Budget Sub heading (e.g. 3370143) | Initial Appropriated amount | Final Budget | Disbursements | Expenditure | Balance | Advance | Previous Year Figure | CY (Actual) Vs Budget | | CY Vs PY | | Notes / Leads for audit |
|-----------------------------------|-----------------------------|----------------------|---------------|----------------|------------------------------|---------------|----------------------|-----------------------|-------|----------|-------|--|
| | | | | | | | | Amount | % | Amount | % | |
| 1 | 6010163 | | | | | | | - | 0.00% | - | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| 2 | 6010143 | | | | | | | - | 0.00% | - | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| 3 | 3373024 | | | | | | | - | 0.00% | - | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| 4 | 3371074 | | | | | | | - | 0.00% | - | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| 5 | 3371234 | | | | | | | - | 0.00% | - | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| 6 | 3371484 | | | | | | | - | 0.00% | - | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| Revenue | | | | | | | | | | | | |
| Heading | Recognised Revenue (lagat) | Collected | Deposited | Remaining Cash | Remaining Recognised (lagat) | | | | | | | |
| | | | | | | | | #VALUE! | 0.00% | #VALUE! | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| Deposit | | | | | | | | | | | | |
| P/Y Brought Forward | This year's recognised | Forfieted / Adjstute | Returned | Total | As per Bank | As per ledger | | | | | | |
| | | | | | | | | #VALUE! | 0.00% | #VALUE! | 0.00% | Auditor to input (if any) - if there is any lead then link to SP 7 |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |

Automatic excel calculates

This working paper should be completed using the excel version

SP-4 Understanding the entity's control environment

| | | | |
|-----------------------------------|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: (Level 1) | | | |
| Reviewed By: (Level 2) | | | |

| S.N. | Particulars | Comments / Notes | Risks to be considered (Yes / No) | WP Ref |
|----------|---|------------------|-----------------------------------|--------|
| A | Segregation of duties | | | |
| 1 | Is there appropriate level of segregation of duties ? (<i>May not be applicable in smaller entities</i>) | | | |
| 2 | Does the executive exercise oversight through a reporting process to compensate for the lack of segregation of duties ? (In case of small auditees) | | | |
| B | Accounting System and Records maintenance | | | |
| 3 | Is the system manual or automated ? | | | |
| 4 | Is back up of accounting and other data kept regularly and in a safe location? | | | |
| 5 | Is manual control in place for large, unusual and non-recurring transactions? | | | |
| 6 | Are all mandatory records being maintained up-to date? | | | |
| C | Supervision and Oversight | | | |
| 7 | Are all positions filled? | | | |
| 8 | What is the auditee's perception of span of control? | | | |
| 9 | Is supervision (both internal and external) sufficient and functioning? | | | |
| 10 | Are deficiencies observed documented and acted upon? | | | |
| 11 | Is there a Job Description available for each employee | | | |
| D | Asset control | | | |
| 12 | Are logs and similar controls being | | | |

APPENDIX D.

| S.N. | Particulars | Comments / Notes | Risks to be considered (Yes / No) | WP Ref |
|----------|--|------------------|-----------------------------------|--------|
| | maintained to ensure that assets or not used for other than official purpose ? | | | |
| 13 | Are the disposition of assets properly authorised ? | | | |
| 14 | Is the custody of assets properly maintained ? | | | |
| 15 | Is there a system of periodic physical verification of assets? | | | |
| E | Reporting | | | |
| 16 | Are all external reports prepared or not? (State % of preparation) | | | |
| 17 | Are all reports prepared and reported on timely manner? (State % of delay observed) | | | |
| 18 | Are there any past cases of inaccuracy in reporting | | | |
| F | Complaint management system | | | |
| 19 | Is there a compliant management system for both internal and external complaints? | | | |
| 20 | Are the complaints actioned upon? | | | |
| 21 | What are the nature of complaints? (Does it provide any audit lead?) | | | |
| G | Internal Audit | | | |
| 22 | Is there an internal audit system? <i>(Please fill in the assessment of internal audit in SP 6)</i> | | | |

Use Appendix D-2 Typical Control Activities to assist in the identification and assessment of internal controls

SP 5 Identifying Risk of Material Misstatement

| | | | |
|-----------------------------------|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: (Level 1) | | | |
| Reviewed By: (Level 2) | | | |

| | Particulars | Comments/notes | Risks (to be considered in SP-7) Yes / No | WP-ref |
|-----------|--|----------------|--|--------|
| A. | Risk of Material Misstatement at Financial Statement level | | | |
| 1. | List risks due to deficient control environment? (refer ICQ and SP 4 for details) | | | |
| 2. | Are there any concern about the integrity of the auditee's management? (Refer: PE 2, SP 1 and other possible information sources such as Media, CIAA investigation, court cases etc) | | | |
| 3. | Are there any risks that give rise to the condition where sufficient & appropriate audit evidences may not be available? <ul style="list-style-type: none"> • Record Management • Availability and willingness to supply records to audit team | | | |
| B. | Risk of Material Misstatement at Assertion Level | | | |

| | | | | |
|--|---|--|--|--|
| 4 | <p>Whether there is risk at</p> <ul style="list-style-type: none"> ▪ Completeness: (that all transactions, events & disclosures are recorded) ▪ Occurrence: (all transactions events pertain to the auditee) ▪ Measurement: (elements included in the financial statement are valued/ allocated at appropriate amount) ▪ Presentation: (information is appropriately presented, described and disclosed) ▪ Accuracy: (financial and other information are disclosed fairly and at appropriate amount) ▪ Right and Obligations: (auditee holds/controls the right to assets and liabilities are auditee's obligations) ▪ Existence: (Assets Liabilities and Equity Interest exists) <p>(understand the risks that needs to be tested and included in Detailed Planning</p> | | | |
| C. Risk of Material Misstatement due to Fraud | | | | |
| 5. | Does the auditee have Fraud Reporting mechanism? | | | |
| 6. | Have there been any reported frauds during the period? If Yes, then what is the magnitude of the fraud and which all areas of operation and reporting does the fraud have any bearing? | | | |
| 7. | Are there any fraud reported concerning the auditee in the media and other available sources? | | | |
| 8. | Any other possible risk of fraud (including arising from inherent risks (also refer SP1) ? | | | |

SP-6 Using the Work of Others

| | | | |
|-----------------------------------|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: (Level 1) | | | |
| Reviewed By: (Level 2) | | | |

A. - Using the work performed by another Auditor**Applicable or not?**

If **yes** fill the table below and state the conclusion

If **no** then skip this

| Assessment Criteria | Assess | Remarks / Notes |
|----------------------------|--|------------------------|
| Organisational Status | <ul style="list-style-type: none"> ▪ Free from operating responsibility (independence) ▪ Free to communicate with the external auditor | |
| Scope | <ul style="list-style-type: none"> ▪ Nature and extent of the assignment (extent, direction and timing of the tests) ▪ Evidence that recommendation have been actioned by the management | |
| Technical Competence | <ul style="list-style-type: none"> ▪ Technical training and proficiency ▪ Recruitment procedure ▪ Professional qualification | |
| Due care | <ul style="list-style-type: none"> ▪ Planning, supervision, review and documentation procedures applied ▪ Existence of manuals, work programmes and work papers | |

Conclusion: State to what extent reliance will be placed on the work of the other auditor

Auditor to write the conclusion of extent of reliance

B. - Using the work of an Expert**Applicable or not?**

If **yes** fill the table below and state the conclusion

If **no** then skip this

| Assessment Criteria | Assess | Remarks / Notes |
|----------------------------|--|------------------------|
| Independence | <ul style="list-style-type: none"> ▪ Free from operating responsibility ▪ Free to communicate with the external auditor ▪ Independence ▪ Who has hired (client or auditor) | |
| Scope | <ul style="list-style-type: none"> ▪ Nature and extent of the assignment (extent, direction and timing of the tests) | |
| Technical Competence | <ul style="list-style-type: none"> ▪ Technical training and proficiency ▪ Recruitment procedure ▪ Professional qualification | |
| Due care | <ul style="list-style-type: none"> ▪ Planning, supervision, review and documentation procedures applied ▪ Existence of manuals, work programmes and work papers | |
| Work results | <ul style="list-style-type: none"> ▪ Experts work is consistent with other evidences and auditor's knowledge | |

Conclusion: State to what extent reliance will be placed on the work of the expert

Auditor to write the conclusion of extent of reliance

C. – Using work of the internal auditor**Applicable or not?**

If **yes** fill the table below and state the conclusion

If **no** then skip this

| Assessment Criteria | Assess | Remarks / Notes |
|----------------------------|---|------------------------|
| Independence | <ul style="list-style-type: none"> ▪ Independent ▪ Free to communicate with the external auditor | |
| Scope | <ul style="list-style-type: none"> ▪ Nature and extent of the assignment (extent, direction and timing of the tests) ▪ Evidence that recommendation have been actioned by the management ▪ Whether opinion is qualified or not | |
| Technical Competence | <ul style="list-style-type: none"> ▪ Technical training and proficiency ▪ Recruitment procedure ▪ Professional qualification | |
| Due care | <ul style="list-style-type: none"> ▪ Planning, supervision, review and documentation procedures applied ▪ Existence of manuals, work programmes and work papers | |

Conclusion: State to what extent reliance will be placed on the work of the internal auditor

Auditor to write the conclusion of extent of reliance

SP-7 Risk Analysis and Audit Approach

| | | | |
|---------------------|--|-------------|--|
| Auditee: | | | |
| Period: | | | |
| Prepared By: | | Date | |
| Reviewed By: | | Date | |

| | Risks (collate form SP 1 to SP 6) | Impact / Consequen | Likelihood / Probability | Risk Score | Audit Approach for Risks identified |
|---|--|-------------------------------|-------------------------------------|-------------------|--|
| | | 1 - 5 | 1 - 5 | 1 - 25 | |
| | Accounting Risks | | | | |
| 1 | | score | score | #VALUE! | Auditor to input |
| 2 | | score | score | #VALUE! | Auditor to input |
| 3 | | score | score | #VALUE! | Auditor to input |
| 4 | | score | score | #VALUE! | Auditor to input |
| | Inherest Risks | | | | |
| 1 | | score | score | #VALUE! | Auditor to input |
| 2 | | score | score | #VALUE! | Auditor to input |
| 3 | | score | score | #VALUE! | Auditor to input |
| 4 | | score | score | #VALUE! | Auditor to input |
| | Control Risks | | | | |
| 1 | | score | score | #VALUE! | Auditor to input |
| 2 | | score | score | #VALUE! | Auditor to input |
| 3 | | score | score | #VALUE! | Auditor to input |
| 4 | | score | score | #VALUE! | Auditor to input |
| | Other Risks (Auditor feels there are risks in areas but not identified in SP1 - SP6 or from the Risk register at the directorate, past experience) | | | | |
| 1 | | score | score | #VALUE! | Auditor to input |
| 2 | | score | score | #VALUE! | Auditor to input |
| 3 | | score | score | #VALUE! | Auditor to input |
| 4 | | score | score | #VALUE! | Auditor to input |

This working paper should be completed using the excel version

SP-8 Audit Planning Memorandum

| | | | |
|---|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: <i>(Level 1)</i> | | | |
| Reviewed By: <i>(Level 2)</i> | | | |

**Office of the Auditor General
Audit Directorate**

Name and address of the Entity:.....

Fiscal Year:-----

- 1. Auditee
 - a. About Auditee
 - b. Nature of Business
 - c. Auditee's summary financial information

- 2. Applicable laws and regulation
- 3. Audit Scope and Objective
- 4. Summary of Critical Risk Areas and Audit Approach
- 5. Audit Team
- 6. Audit Time Table
 - a. Planning
 - b. Field Work
 - c. Reporting

DP-1 Audit Programme

| | | | |
|-----------------------------------|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: (Level 1) | | | |
| Reviewed By: (Level 2) | | | |

| Audit Area / Risk Area | Assertion(s) Tested | Control Environment | Substantive Procedure (Test of Detail and Analytical Procedure) | WP Ref |
|--|------------------------|----------------------|---|--------|
| | | | (Nature, Extent and Timing) | |
| | | What is the control? | What would be the Substantive procedure (test of detail) | |
| Audit risk as assessed in SP 7 | | | | |
| | | | | |
| | | | | |
| Other Audit Areas as per auditor's judgment that will be necessary | | | | |
| | | | | |
| | | | | |
| Random test (Analytical Procedure and / or some (few) substantive procedure for non significant items) | | | | |
| Auditor to identify from the non- significant items | | | | |

CHAPTER 4 APPENDICES

AE-1 Entrance Conference

Objective: An Entrance Conference is to:

-

| | |
|--|--|
| DATE OF MEETING: | |
| LOCATION OF MEETING: | |
| APPROXIMATE START AND END TIMES: | |
| MEMBERS OF THE AUDIT TEAM: | |
| NAMES AND POSITIONS OF THE AUDITEE: | |

SUMMARY POINTS:

- Questions asked and the answers to them – Minutes attached.)

CONCERNS RAISED BY MANAGEMENT AT THE MEETING:

- Timing of the audit
- Resources to be provided to the auditor
- Making available data from IT systems

| | |
|--|--------------------|
| <u>SIGNATURE OF THE SENIOR ENTITY REPRESENTATIVE:</u> | <u>Date</u> |
| • | |

| | |
|---|--------------------|
| <u>SIGNATURE OF THE TEAM LEADER:</u> | <u>Date</u> |
| • | |
| • | |

AE-2 Materiality and Planning Lead Schedule

| | | | | |
|---------------------|--|---------------------|-------------|-------------|
| Auditee: | | Name | Rank | Date |
| Period: | | Reviewed by: | | |
| Prepared by: | | Level 1 | | |
| Rank: | | Level 2 | | |
| Date: | | Level 3 | | |

A Planning Materiality

A1 Quantitative Materiality

| Materiality basis | Guideline % | % used | Amounts NRS from financial statements | Materiality Amounts |
|-----------------------------------|--|---|---------------------------------------|---------------------|
| Gross receipts (appropriation) | 1 - 3 | Auditor to use judgement (enter % to be used) | - | |
| Basis Used for Materiality | Auditor to use judgement (enter basis used i.e. tick one of the 4 items above) | | | |
| Materiality Amount (NRs) | | | | |

A2 Qualitative Materiality: factors to consider Auditor to enter qualitative materiality characteristics

Compliance with Laws and regulations

- a. - Compliance of Audit Act (2048)
 - Matters to be audited (Sec 4)
 - Matters to be audited in terms of propriety (Sec 5)
- b. - Compliance with relevant acts and rules
 - Public Procurement Act (2063) and Rules (2064)
 - Act and laws specifically relevant to the entity

Adequacy of disclosures

- a. - Disclosures as required NAPSAS (to the extent applicable)
- b. - OAGN Form Implementation Directive

Application of accounting policies

- a. - Compliance of Financial Procedure Act 2055 and Rules (2064)
- b. - DTCO Directives

B Performance Lead Schedule: To be prepared for each budget sub head e.g. 3370143

NRS '000

| | Budget Sub heading (e.g.) | Initial Appropriated amount | Final Budget | Disbursements | Expenditure | Balance | Advance | Quantitative Significance (from Materiality above) | Qualitative materiality (auditor to use judgement) | Indicate Audit Strategy |
|---|---------------------------|-----------------------------|--------------|---------------|-------------|---------|---------|--|--|---|
| | 21111 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | If yes in either of these two then audit strategy will be Detailed substantive procedure, link to DP1 |
| 1 | 21112 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | If No in both then audit strategy will be Analytical procedure and/or some Substantive Procedure |
| 2 | 22112 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 3 | 22211 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 4 | 22212 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 5 | 22311 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | |
| 6 | 22411 | xx | xx | xx | xx | xx | xx | YES/No | YES/No | |
| | | | - | - | - | - | - | | | |

Note:

- 1 The significance of the amounts are to be judged on the basis of the materiality (qualitative and quantitative) and impact on Audit Risk
 - 2 If 'YES' - If item is significant the audit approach could be Test of Detail / Substantive Procedure (also indicate alternatives if any)
 - 3 If 'NO' - If item is not significant the audit approach could be Analytical Procedures and some SP (also indicate alternatives if any)
- AE-2 Should be completed using the excel version of this document

AE-3 Test of Control

| | | | | |
|-----------------------------------|-------------|-------------|------------------|--|
| Auditee: | | | | |
| Period: | | | | |
| | Name | Date | Signature | |
| Prepared by: | | | | |
| Reviewed By: (Level 1) | | | | |
| Reviewed By: (Level 2) | | | | |

| Control being Tested | Voucher no. / other documents | Date | Amount | Observation | Reliability of Control (High / Medium / Low) | Notes for sampling | WP ref |
|---|---|--|----------------------|--|---|--|---------------|
| <i>Please bring in controls identified during the SP and DP</i> | <i>Refer to the voucher number or the document reviewed</i> | <i>Date of the voucher / document (if any)</i> | <i>Amount tested</i> | <i>Specific audit observation. (the controls may be functioning or partly functioning)</i> | <i>Auditor judgement on to what extent the control can be relied upon</i> | <i>If control reliability is high the sampling size will be low and vice versa</i> | |
| | | | | | | | |

Approved by _____ Rank _____ Date _____

AE-4 Sampling for Substantive Procedures

| | | | | |
|-----------------------------------|-------------|-------------|------------------|--|
| Auditee: | | | | |
| Period: | | | | |
| | Name | Date | Signature | |
| Prepared by: | | | | |
| Reviewed By: (Level 1) | | | | |
| Reviewed By: (Level 2) | | | | |

| Selection | No of Items | Amount Covered | <i>Note for audit team</i> |
|---|--------------------|-----------------------|---|
| High Value Items | | | <i>Use materiality as the guidance for identifying high value items</i> |
| Key Items | | | <i>Key items are selected on judgemental basis by the auditor</i> |
| Sampling (from the rest i.e. after high value and key items) | | | <i>Sample from the rest (after high value and key items) – note that the relation from AE 2 should be evident that is if control reliability is high then small sample and vice versa</i> |
| Total | | | |
| Total Population Size | | | |
| Percentage covered | % | % | |

| | Audit Notes | Reporting Remarks |
|--|--------------------|--------------------------|
| | | |
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| | Audit Notes | Reporting Remarks |
|--|--------------------|--------------------------|
| | | |
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| | | |
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| | | |
| | | |
| | | |
| | | |

| | | |
|--|--|---|
| Total Errors Identified | | |
| Projection of Error | | <i>(please exclude anomalous (one off) errors for projection)</i> |
| Total Projected in the population | | |
| Conclusion of the population tested | | <i>Indicate auditor's opinion on the population</i> |

Approved by _____ Rank _____ Date _____

Notes for team auditors

- *The statistical sampling as identified in the original AE 4 may be tried out, or else this has been devised for simplicity*
- *Please refer to planning where you have identified as items for which (i) Substantive Procedures needs to be done or (ii) Analytical Procedure and some SP needs to be done. This sampling needs to be done for each accounting heading where you have identified as “requires substantive procedures”*

| | | |
|--|--|--|
| Total Errors Identified | | |
| Projection of Error | | (please exclude anomalous (one off) errors for projection) |
| Total Projected in the population | | |
| Conclusion of the population tested | | Indicate auditor’s opinion on the population |

Approved by _____ Rank _____ Date _____

Notes for team auditors:

- The statistical sampling as identified in the original AE – 4 may be tried out, or else this has been devised for simplicity
- Please refer to planning where you have identified as items for which (1) Substantive Procedures needs to be done or (2) Analytical Procedure and some SP needs to be done. This sampling needs to be done for each accounting heading where you have identified as “requires substantive procedures.”
- Error projection in GoN audit may not be relevant as all the issues identified will be reported in Preliminary Report and OAGN will not report unqualified opinion.

AE-5 Substantive Analytical Procedures**1. Identify the amount and audit objective for the test**

[e.g. completeness of the school fees]

2. Develop an expectation

[e.g. school fees is expected to be XXX]

3. Determine the threshold

[e.g. variance between more or less than 10% is acceptable]

4. Identify significant differences for investigation

[e.g. variances 10%]

5. Investigate differences

[Discuss with management and obtain explanations for significant differences]

6. Evaluate findings

Note:

Use this WP only if Analytical Procedure has been used as a substantive procedure

AE-6 Audit Differences and Issue Log

| | | | | |
|---------------------|--|---------------------|-------------|-------------|
| Auditee: | | Name | Rank | Date |
| Period: | | Reviewed by: | | |
| Prepared by: | | Level 1 | | |
| Rank: | | Level 2 | | |
| Date: | | Level 3 | | |

| Preliminary Report Ref | Audit Issue | | | Issue nature | Category | Responsible Person / Agency | Category Code | Settled during 35 days (Y/N) |
|------------------------|---|-------|--------------|--------------|----------|-----------------------------|---------------|------------------------------|
| | Qualitative | | Quantitative | | | | | |
| | Issue | Issue | Amount (NRs) | | | | | |
| 1 | Statement of Fact | | | NA | | | | |
| 2 | 8 months delay in receipt of expenditure and programme authorisation (Fin Procedure Act) | | | Compliance | | | | |
| 3 | Statement of Fact | | | NA | | | | |
| 4 | Most programme expenditures (82.97%) were spent in the third trimester of the year that too 66.63 was spent in the final month of the year | | | Regularity | | | | |
| 5 | Urban and privileged area's demand has been considered to identify projects | | | Regularity | | | | |
| 6 | Two separate packages have been made with the same party to remain within the limit allowed for Users' Committee contracts (Public Procurement Reg) | | | Compliance | | | | |

APPENDIX F.

| | | | | | | | | |
|----|--|---|--------------|------------|--|--|--|--|
| 7 | Circumvention of Procurement Rule, project bifurcated into packages and given to the same party (Procurement Act) | | | Compliance | | | | |
| 8 | | VAT paid to the suppliers on purchases not reported to the Inland Revenue (VAT Act) | 1,661,222.01 | Compliance | | | | |
| 9 | Insurance not done for construction worth more than NRs 1 M (Public Procurement Act) | | | Compliance | | | | |
| 10 | Discussion with the beneficiary group not undertaken (if undertaken not documented) before signing the programme contracts (Procurement Reg) | | | Compliance | | | | |
| 11 | Drawing Designs of the proposed projects not prepared (Public Procurement Reg) | | | Compliance | | | | |
| 12 | Users Group, from among the beneficiaries, should submit required documents to the concerned entity, the details of expenses should be shown publicly at the project site (Public Procurement Reg) | | | Compliance | | | | |
| 13 | | Tax invoice not obtained | 109,756.81 | Compliance | | | | |
| 14 | Ministry norms not followed for conducting River Study Works (Procurement Act) | | | Compliance | | | | |

APPENDIX F.

| | | | | | | | | |
|------|--|--|-------|------------|--|--|--|--|
| 14.1 | Payment made on receipt of Final Reprot, no inception report and draft report was presented as required by contract. | | | Regularity | | | | |
| 14.2 | Circumvention of Procurement Rule, project bifurcated into small packages (Procurement Act) | | | Regularity | | | | |
| 14.3 | Consultant's work not reviewed whether they are in compliance with agreed ToR | | | Regularity | | | | |
| 15 | Documentation not proper for travel expenses (Travel Expense Reg) | | | Compliance | | | | |
| 16 | Regular expense (office security and sanitation expense) budgeted and expended from Capital Expense heading | | | Regularity | | | | |
| 17 | Field Visit - quality of work is less than satisfactory | | | Regularity | | | | |
| 18 | Salary report not approved as required by (Public Service Act) | | | Compliance | | | | |
| 19 | Deposit to be recognised as Income NRs 1 M | | | Regularity | | | | |
| 20 | Inventory not management in accordance with - Fin Procedure Act | | | Compliance | | | | |
| 21 | Statement of Fact - Assessment of Internal Audit | | | Compliance | | | | |
| 22 | Statement of Fact - settlement of questioned costs | | | Compliance | | | | |
| | | | ##### | | | | | |

AE-7Model Representation Letter

To
Date: _____
The Audit Team leader/Auditor
Office of the Auditor General
Address.....

Subject: Written Representation Letter

Dear Sir/Madam,

We acknowledge that you have been assigned for the audit and express an audit opinion on the financial transactions of this (Insert name of entity) for the fiscal year 20../20.. In connection to this audit, we hereby submit you this Management Representation Letter related to financial transaction of our Ministry/Department/Office/entity. We acknowledge that we as management is responsible for the accuracy of the accounting records and the fair presentation financial statements in accordance with prevailing statutes and accounting standards and the auditor's responsibility is to express an opinion on these financial statements based on audit examination.

We confirm, to the best of our knowledge and belief, the following representations given to you in connection with the financial statements submitted to you with our letter dated.....

1. There have been no irregularities, fraud and illegal acts involving any member of management or employees who have significant roles in the operation of financial transactions and management of internal control;
2. We have made available to you all books of account and relevant documents along with the supporting evidences, executive orders, decisions and minutes of meetings and no such information or document has been withheld without producing you;
3. We have not operated any other financial transactions except those presented in the attached financial statements;
4. We have compiled all relevant statutes in connection with operation of financial transactions;
5. Our organization has satisfactory title to all owned assets and they are free from any liens or encumbrances, except those disclosed in the separate Notes to the financial statements;
6. We confirm that our financial statements are fairly presented on the basis of true and factual matters in accordance with relevant statutes and are free from material misstatements including omission;
7. For the subsequent events affecting the financial statements, that occurred after the date of financial statements, we have prepared and attached herewith separate statements of (Statement of advance settlement, unpaid checks, Cash in transits, Recovery of excess paid amounts etc.) without revising the financial statements;
8. We express our commitment for the maintaining fair financial transactions by taking necessary actions in connection to the audit observations;
9. In connection to financial transactions, no litigation or legal proceedings has taken place and no document or account has been taken to any entity;
10. We express our responsibility for implementing effective internal controls to prevent and detect error, misstatements, and frauds.

We will further acknowledge you if any information comes to our notice against the above mentioned representation.

Chief of Financial Administration Division
Name: _____

Chief of the Entity/Office
Name _____

AE-8Exit Conference

| | | | | |
|---------------------|--|---------------------|-------------|-------------|
| Auditee: | | Name | Rank | Date |
| Period: | | Reviewed by: | | |
| Prepared by: | | Level 1 | | |
| Rank: | | Level 2 | | |
| Date: | | Level 3 | | |

| | |
|--|------------|
| DATE OF MEETING: | 15.02.2013 |
| LOCATION OF MEETING: | |
| APPROXIMATE START AND END TIMES: | |
| MEMBERS OF THE AUDIT TEAM: | |
| NAMES AND POSITIONS OF THE AUDITEE: | |

SUMMARY POINTS:

CONCERNS RAISED BY MANAGEMENT AT THE MEETING:

| | |
|--|--------------------|
| <u>SIGNATURE OF THE SENIOR ENTITY REPRESENTATIVE:</u> | <u>Date</u> |
| | |

| | |
|---|--------------------|
| <u>SIGNATURE OF THE TEAM LEADER:</u> | <u>Date</u> |
| | |
| | |

Annex: Issue log signed by the management
(this is to ensure that all the issues were shared with the management)

CHAPTER 5 APPENDICES

AR-1 Final Analytical Review

| | | | | |
|---------------------|--|---------------------|-------------|-------------|
| Auditee: | | Name | Rank | Date |
| Period: | | Reviewed by: | | |
| Prepared by: | | Level 1 | | |
| Rank: | | Level 2 | | |
| Date: | | Level 3 | | |

| | | Yes / No / Partially | Remarks |
|---|--|----------------------|--|
| 1 | Are the results/ conclusions drawn from the Audit consistent with the Reviewer's (DDG/AAG) knowledge of business | | Elaborate if there is any inconsistency |
| 2 | Are fluctuations or relationship of elements of financial statement consistent with other information available with the Reviewer's (DDG/AAG) | | |
| 3 | If any inconsistency with the other information, have those been investigated by enquiry with the management and performing other audit procedures | | |

AR-2Draft Management Letter (Preliminary Audit Report)

| | | | | |
|---------------------|--|---------------------|-------------|-------------|
| Auditee: | | Name | Rank | Date |
| Period: | | Reviewed by: | | |
| Prepared by: | | Level 1 | | |
| Rank: | | Level 2 | | |
| Date: | | Level 3 | | |

For sharing with the management

AR-3 Final Management Letter (Preliminary Audit Report)

| | | | |
|-----------------------------------|-------------|-------------|------------------|
| Auditee: | | | |
| Period: | | | |
| | Name | Date | Signature |
| Prepared By: | | | |
| Reviewed By: (Level 1) | | | |
| Reviewed By: (Level 2) | | | |

Along with the management comments after deletion / modification of issues reported in the draft (document an annexure of justification for deletion / modification)

AR-4 Matters for Attention During Next Year's Audit

AR 5- Formats of final audit report with audit Opinion**A. UNQUALIFIED OPINION****Subject: Audit report**

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying financial statements of(Name of Office), which comprise the (Consolidated Financial Statements, Balance sheet as at Ashad 31, 20XX, and the income statement, Statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.)

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with (Name of Law or Nepal Public Sector Accounting Standards (NPSAS) International Public Sector Accounting Standards, IPSAS or Nepal Accounting Standards (NAS) or International Financial Reporting Standards, IFRSs), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards of INTOSAI (International Organization of Supreme Audit Institution) - from 2010 issued as ISSAIs (International Standards of Supreme Audit Institutions), which are aligned with the ISAs/International Standards on Auditing) ; or Nepal Standards on Auditing/NSA Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of(Name of Auditee) as at Asad 31, 20XX, and (of) its financial performance and its cash flows for the year then ended in accordance with (Nepal Public Sector Accounting Standards or Nepal Accounting Standards or International Public Sector Accounting Standards or International Financial Reporting Standards).

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

B. QUALIFIED OPINION**Subject: Audit report**

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying financial statements of(Name of Office), which comprise the (Consolidated Financial Statements, Balance sheet as at Ashad 31, 20XX, and the income statement, Statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.)

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with..... (Name of Law or Nepal Public Sector Accounting Standards (NPSAS) International Public Sector Accounting Standards, IPSAS or Nepal Accounting Standards (NAS) or International Financial Reporting Standards, (IFRSs), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with (International Organization of Supreme Audit Institution (INTOSAI) Standards or International Standards of Supreme Audit Institution (ISSAI) Standards or Nepal Standards on Auditing, NSA or International Standards on Auditing, ISA). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

Insert paragraph

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of (Name of Auditee) as at Asad 31, 20XX, and (of) its financial performance and its cash flows for the year then ended in accordance with (Nepal Public Sector Accounting Standards or Nepal Accounting Standards or International Public Sector Accounting Standards or International Financial Reporting Standards).

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

C. ADVERSE OPINION**Subject: Audit report**

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying financial statements of(Name of Office), which comprise the (Consolidated Financial Statements, Balance sheet as at Ashad 31, 20XX, and the income statement, Statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.)

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with (Name of Law or Nepal Public Sector Accounting Standards (NPSAS) International Public Sector Accounting Standards, IPSAS or Nepal Accounting Standards (NAS) or International Financial Reporting Standards, IFRSs), and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with (International Organization of Supreme Audit Institution (INTOSAI) Standards, International Standards of Supreme Audit Institution (ISSAI) Standards or Nepal Standards on Auditing, NSA or International Standards on Auditing, ISA). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Basis for Adverse Opinion

Insert paragraph

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for

Adverse Opinion paragraph, the financial statements do not present fairly (or *do not give a true and fair view of*) the financial position of (Name of Auditee) and its subsidiaries as at Asad 31, 20XX, and (of) their financial performance and their cash flows for the year then ended in accordance with (Nepal Public Sector Accounting Standards or Nepal Accounting Standards or International Public Sector Accounting Standards or International Financial Reporting Standards).

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

D. DISCLAIMER OPINION**Subject: Audit report**

[Appropriate Addressee i.e. Auditee]

Report on the Financial Statements

We have audited the accompanying financial statements of(Name of Office), which comprise the (Consolidated Financial Statements, Balance sheet as at Ashad 31, 20XX, and the income statement, Statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.)

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with (Name of Law or Nepal Public Sector Accounting Standards (NPSAS) International Public Sector Accounting Standards, IPSAS or Nepal Accounting Standards (NAS) or International Financial Reporting Standards, IFRSs), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with (International Organization of Supreme Audit Institution (INTOSAI) Standards or International Standards of Supreme Audit Institution, ISSAI or Nepal Standards on Auditing, NSA or International Standards on Auditing, ISA).

Because of the matter described in the paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Insert paragraph

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report] [Auditor's address]

AR-4 Matters for Attention During Next Year's Audit

| | | | | | |
|---------------------|--|---------------------|-------------|-------------|-------------|
| Auditee: | | Reviewed by: | Name | Rank | Date |
| Period end: | | Level 1: | | | |
| Prepared by: | | Level 2: | | | |
| Rank: | | Level 3: | | | |
| Date: | | | | | |

| No. | Matters for attention | Comments | WP ref. |
|------------|------------------------------|-----------------|----------------|
| | | | |
| | | | |
| | | | |
| | | | |

CHAPTER 6 APPENDICES

Audit Examination Note

| |
|---|
| Serial No..... |
| <p>Office of the Auditor General</p> <p>Audit Examination Note</p> |
| Name of Entity audited..... Address:..... Fiscal year..... Name of authorized/responsible person for operation: Name of Accounting Head: Budget/Revenue/Deposit head: Annual Budget/revenue/transaction: Rs..... Budget Released/Revenues received: Rs..... Budget Expended/ Deposited: Rs----- Budget/ Cash Balance Rs ----- Name of Auditor performing examination (Mr/Ms)----- Examined period From.....to..... No. of total Vouchers----- No. of Vouchers Examined----- |
| Matters/Issues to be examined as per audit plan----- ----- ----- ----- ----- Audit Methods /Techniques(detailed or selective)to be used----- ----- |
| Matters/Issues examined (Actual)----- ----- ----- ----- ----- Audit Methods/Techniques(detailed or selective)being used----- ----- |

Audit Writing Paper

| Office of the Auditor General Audit Writing Paper | | | Serial No..... |
|---|---|----------------------|-----------------------------------|
| Name of Entity audited..... Address:..... Fiscal year..... Examined period..... Budget/Revenue/Deposit head:..... | | | |
| Audit Programme Reference no | Details about transactions examined and audit Observations <i>{Please give reference to the transaction i.e. voucher no, date, and other information on the top}</i> | Reference document | Remarks |
| 12 | <i>Example- Transaction details</i> Voucher no 25 dated 2068-9-3 Payment of ABC contractor interim bill | Interim bill no 4 | |
| Audit Observations | | | |
| | -Contractor's bill is not duly checked by the engineer and not approved by the Project Chief as per Financial procedure Rule no | | |
| | -No recovery from the bill is at the rate of xx percent amounting to Rs. 2,00,000/- made for the mobilization advance provided to the contractor as per Contract Agreement clause no..... | | To be checked in subsequent bills |
| | | | |
| | | | |
| Name of Auditor | | Reviewer's Name..... | |
| Signature..... | | Date..... | |

CHAPTER 7 APPENDICES

QC-1a Audit Quality Control – Field Level

| Office of the Auditor General Nepal Audit Quality Control Review Form (To be filled up by Audit Team Leader) | | | | | |
|--|--|-----------|------------------------|--------------------------|---------|
| Name of Auditee: | | | Fiscal Year: | | |
| Audit works performed by..... | | | Designation | | |
| S. N | Particulars | Yes/No/NA | Team Leader's Comments | Action taken for comment | Remarks |
| 1 | Have all material balances in the financial statements been identified for audit and included in the lead schedule? | | | | |
| 2 | Have the audit examinations covered significant areas as per audit plan & programme? | | | | |
| 3 | Have prior years' issues been identified and analysed as continued audit risks? | | | | |
| 4 | Have the audits evaluated the internal control system of the entity and internal audit's report and included unsettled findings of internal audit in preliminary audit report? | | | | |
| 5 | Have the audits assessed significant areas of audit risks, test of control and substantive tests as per OAGN strategy? | | | | |
| 6 | Were fraud risk factors considered and identified? | | | | |
| 7 | Whether Have adequate and appropriate supporting evidences been received to support major audit findings and are they documented systematically in the audit file? | | | | |
| 8 | Whether Have the bases for the draft of audit findings or observations been appropriately disclosed as per working papers and audit notes? | | | | |
| 9 | Were significant matters resulting from the audits incorporated in preliminary audit report? | | | | |
| 10 | Have basic documents pertaining to audit e.g. authorization letter, management representation letter and meeting with auditees etc. been properly enclosed in the file? | | | | |
| 11 | Have appropriate actions been taken for responding to the auditee's requests on observations of previous year's follow up audit? | | | | |
| Certification and overall comments by Audit Team Leader: | | | | | |
| Signature:----- | | | Designation:----- | | |
| Name :----- | | | Date:----- | | |

Note: The Audit Team Leader may write down questions, instructions and suggestions in the comment column to facilitate follow-up. The concerned auditor should write down follow up actions taken in the concerned column and the audit team leader needs to give final comments in remarks column.

QC-1b Audit Quality Control Review Form

| Office of the Auditor General Nepal Audit Quality Control Review Form (To be filled up by First and Second level Reviewers) | | | | | |
|---|--|--------------|----------------------|--------------|---------|
| Name of Auditee: | | Fiscal Year: | | | |
| S. N | Particulars | Yes/No/NA | Comments of reviewer | Action taken | Remarks |
| 1 | Whether the audit Authorization and Engagement letter is attached? | | | | |
| 2 | Whether declarations on Code of Ethics compliance and conflict of interest are attached? | | | | |
| 3 | Whether the audited financial statements (and other relevant audited information) have been attested by the audit team? | | | | |
| 4 | Whether the Knowledge of business was obtained adequately to support/form the auditors' decision relating to the audit approach? | | | | |
| 5 | Whether the risk assessment procedures were followed to focus on critical risk areas and risk assessment form is attached? | | | | |
| 6 | Whether the sampling methods or basis of sampling/techniques were clearly defined to ensure that adequate level of audit coverage has been obtained for material or risky areas? | | | | |
| 7 | Whether a detailed audit programme showing the segregation of duties of audit team members was prepared and approved? | | | | |
| 8 | Whether an audit plan and audit programmes have been approved by competent authority? | | | | |
| 9 | Whether a revised audit plan and programme have been prepared in case of inability to perform audit works as per approved plan and programme or in the situation requiring additional tests or examinations. | | | | |
| 10 | Whether adequate correspondences have been undertaken for the non-submission of documents/ statements prior to reporting the matters? | | | | |
| 11 | Whether the audit has followed the required procedures and instructions (as per audit guide, manual and directives) while performing the audit assignment? | | | | |
| 12 | Where the audit found cases of misappropriation of assets or fraudulent financial reporting or material misstatements, were the matters immediately reported to supervisors? | | | | |
| 13 | Whether the discussions were held on the drafts of major audit findings with audited entity's management and the discussion minutes | | | | |

APPENDIX B

| | | | | | |
|----|---|--|--|--|--|
| | attached? | | | | |
| 14 | Whether preliminary audit report has been timely issued? | | | | |
| 15 | Whether the audit team has maintained systematic records of the receipts and issuance of letters in connection to the audit. | | | | |
| 16 | Whether follow up audits have been conducted in case of Auditee's request for it? | | | | |
| 17 | Whether all required working papers and procedures/ steps have been adequately completed and duly signed by the preparer and reviewer with dates? | | | | |
| 18 | Whether entity level audit plan was prepared on the basis of approved overall annual plan and strategy and significant deviations from the overall audit plan have been documented? | | | | |
| 19 | Whether audit files were submitted to supervisor in stipulated time? | | | | |
| 20 | Whether all documents of audit files are placed in prescribed order and the files have been systematically cross-referenced with index? | | | | |
| 21 | Whether audit opinions and recommendations have been expressed based on the underlying audit work and findings? | | | | |

Certification by the Reviewers

Overall impression/comment of the Supervising (First level) reviewer:

.....

Audit Quality:

Excellent/Good/Satisfactory/Improvement to be made.....

Signature: -----

Designation:-----

Name of reviewer: -----

Date:-----

Overall impression/comment of the Final (Second level) reviewer:

.....

Signature: -----

Designation:-----

Name of reviewer: -----

Date:-----

Notes:

1. *This checklist is designed for the general purpose of the audit. Additional matters can be added to the checklist as per the requirements of audit.*
2. *Out of the matters stipulated in above checklist, the first level reviewer should focus on No. 1 to 15 and second level reviewer on No 16 to 21.*
3. *Audit Directorate may develop separate type of checklists for conducting quality controls of specific audit?*
4. *The reviewer should comment on the comment column for the audit works considering the compliance and the quality of works performed.*
5. *The Audit team leader should write down the required actions taken in the concerned column for the reviewer's comment and the reviewer should make final comment in remarks column and make certification on the review form.*
6. *The first reviewer should grade or rank the audit quality of the reviewed file on the basis of the compliance and quality of audit works performed. The audit file should be graded on the basis of the compliance to the matters of checklist as per the criteria given below:
 Excellent= above 80%, Good= 65-80 %, Satisfactory= 50-64%, Improvement to be made= below 50%.*

CHAPTER 8 APPENDICES

Central Record of Audit irregularities (office wise) (AG Form no. 205)

Government of Nepal

..... Ministry/Secretariat/Commission

Central Record of Irregularities (office wise)

Fiscal Year:

| S.N | Name of Office | Office account folio no | Irregularities of Appropriations | Irregularities of Revenues | Irregularities of deposits (Retentions) | Other irregularities | Total irregularities | Settled irregularities | Remaining irregularities | Remarks |
|-----|----------------|-------------------------|----------------------------------|----------------------------|---|----------------------|----------------------|------------------------|--------------------------|---------|
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |

Prepared by: _____

Approved by: _____

Office-wise central record of irregularities (AG Form no. 206)
Government of Nepal

..... Ministry/Secretariat/Commission

Office wise Central record of irregularities raised (reported) by OAG

Fiscal year:

Name of Office:

Revenue/Current/Capital/Deposit

| Para no | Central folio no | Balance Irregularity | | | Settled amount | | | | | Outstanding Irregularities | | | | Remarks |
|---------|------------------|----------------------|---------|-------|-----------------|-------------|----------|-----------------|-------|----------------------------|-----------------|---------|-------|---------|
| | | Irregularity | Advance | Total | Ledger folio no | Regularized | Recovery | Advance settled | Total | To be regularized | To be recovered | Advance | Total | |
| | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | |
| | Total | | | | | | | | | | | | | |

Prepared by: _____ **Approved by:** _____

Office wise central record of settled irregularities (AG Form no. 207)

Government of Nepal

..... Ministry/Secretariat/Commission

Fiscal year:

| S.N. | Name of Office | Budget code no | Office ledger folio no | Irregularity Para no. | Request for Follow-up | | Follow-up and settled Amount | | | Remark |
|------|----------------|----------------|------------------------|-----------------------|-----------------------|--------|------------------------------|------|--------|--------|
| | | | | | Date | Amount | Letter no. | Date | Amount | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | Total | | | | | | | | | |

Prepared by: _____ Approved by: _____

Letter format for request of follow-up (samparichhan)

Date:

Subject: Follow-up Audit

Office of the Auditor General

..... Directorate or Field Audit Team

We have settled the irregularities (reported) raised by the Office of the Auditor General related to (Name of Office) of budget code _____ for the fiscal year _____ as per the provision of the Financial Procedure Act, 2055 section 18 which was included in _____ annual report. We request information on the follow-up action for the following irregularities as per the provision of the Financial Procedure Act, 2055 section 19.

| S.N. | Para no. | Irregularities | | Settled | | Responsible person for settlement |
|------|----------|----------------|--------|-------------|--------|-----------------------------------|
| | | particulars | Amount | Particulars | Amount | |
| | | | | | | |
| | | | | | | |

For: (Name of Audited entity) _____

Memorandum format for follow-up action (Samparichhan ko tippani & Adesh)

Date:

Office of the Auditor General

..... Division

..... Directorate

Subject: Memorandum of follow-up

We have received a request on (Date of request) to settle down audit irregularities related to budget code (Appropriations, Revenues, Deposits/ other transactions) included in the Auditor General's report (Date) of (Name of Auditee) related to fiscal year We examined the related documents for the following irregularities and we are providing you with the proposed decision to settle them down:

| S.N. | Irregularities para no. | Statements of irregularities | Amount requested for settlement | Findings of follow-up audit and proposed decision | Settled amount | Name and Designation of auditor conducting the follow-up |
|------|-------------------------|------------------------------|---------------------------------|---|----------------|--|
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

**Letter format for follow-up of settled irregularity
(Samparichhan Bhayako Letter)**

Date:

(Addressee or Name of Auditee)

Subject: Information regarding settled irregularity

We have examined the documents related to budget code no. (Appropriation, Revenue, Deposit, Other transaction) of fiscal year submitted to us on (Date of letter) included in Auditor General's report The following irregularities are cleared as per the decision of (Level of decision maker) on (Date of decision):

| S.N. | Irregularities para no. | Statements of Irregularities and basis of decision | Settled/ cleared amount | Remarks |
|------|-------------------------|--|-------------------------|---------|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

CC

..... Ministry

..... Department

Sincerely yours

.....

For Office of the Auditor General

**Letter format for acknowledging non-settlement of irregularities
(No samparichhan letter)**

Date:

(Addressee or Name of Auditee)

Subject: Non –Settlement of requested irregularities

We have examined the documents related to budget code no. (Appropriation, Revenue, Retention, Other transaction) of fiscal year submitted to us on (Date of letter) included in Auditor General's report The following irregularities are not settled down due to reason mentioned below as per the decision of (Level of decision maker) on (Date of decision):

| S.N. | Irregularities para no. | Statements of Irregularities and basis of decision | Reason for non-settlement | Remark |
|------|-------------------------|--|---------------------------|--------|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

CC

..... Ministry

..... Department

Sincerely yours

.....

For Office of the Auditor General

Legal provisions on follow-up audit

A. Financial Procedure Act, 2055

Section 18-Responsibility for settlement of irregular amount:

- (1) The responsible person shall be accountable for the settlement of irregularities reported by the auditor, by providing evidence/documents thereon or regularizing the legibility of the transaction or recovering the same.
- (2) The Chief Accounting officer shall be responsible for supervising whether irregular amounts have been settled or not pursuant to Sub-section (1) and settling, or causing to be settled, the irregular amounts in accordance with the prevailing laws.

Section 19- Verification and settlement of irregular amounts:

- (1) The concerned office shall, in relation to irregular amounts as reported by the Office of Auditor General in the course of audit, have settlement and verification hereof as prescribed, within Thirty Five days from the date of receipt of such irregular amounts.
- (2) If there is a reasonable reason for being unable to have verification and settlement of irregular amounts within the time-limit as referred to in Sub-section (1), a request, accompanied by the reason, may be made to the Office of Auditor General for the extension of time-limit, and if such a request is made, the Office of Auditor General may extend the reasonable time-limit.
- (3) If the settlement and verification of irregular amounts is not made even within the time-limit extended pursuant to Sub-section (2), the Auditor General shall give information thereof to the Chief Accounting Officer, and it shall be the responsibility of the accounts responsible officer to take action as set forth in the information so received. If accounts responsible officer fails to take action, the Auditor General shall give information thereof to the departmental minister or minister of state.

Section 20- To maintain records of irregular amounts:

- (1) There shall be maintained the records of the irregular amounts indicated in, and amounts found recoverable and payable as mentioned in, the audit report at the central and office levels.
- (2) The recovery of embezzled and misappropriated amounts as found from the audit or irregular amounts that could not be regularized in pursuance of the prescribed procedures shall be recovered from the responsible person.
- (3) If the irregular amount held to be recoverable pursuant to Subsection (2) cannot be recovered from the regular procedures, the accounts responsible officer shall send such records to the Central Recovery Office in such manner as prescribed.
- (4) Monitoring related to settlement of irregular amounts shall be carried out as prescribed.

Section 21- Recovery, settlement, and regularization of irregular amounts:

- (1) The procedures for the recovery, settlement, and regularization of irregular amounts as indicated in the audit report and verification thereof shall be as prescribed.
- (2) If, in the case of irregular amounts other than those found to be recoverable and payable, there are supporting documents and reasonable reasons that the procedures required to be fulfilled pursuant to the prevailing law but no loss or damage has occurred to the governmental cash and inventories, the settlement of such irregular amounts may

be made by regularizing such amount in accordance with the prescribed procedures and verifying the same.

- (3) It shall be the responsibility of the Chief Accounting Officer to give responses in writing in the public accounts committee of the Legislature-Parliament in relation to the irregular amounts indicated in the annual report of the Auditor General, to appear at the meeting of the committee, take part in the discussions and express his or her comments thereon at the meeting and take, or cause to be take, acts and actions on the settlement of irregular amounts.
- (4) After the suggestions submitted to the Legislature-Parliament following discussions at the public accounts committee of the Legislature- Parliament pursuant to Sub-section (3) have been approved by the Legislature-Parliament, it shall be the duty of the concerned Ministry to implement or cause to be implemented the suggestions set forth in the report.
- (5) The procedures relating to the settlement of irregular amounts shall be as prescribed.

Section 22- Recovery of irregular amounts from assets:

The irregular amounts of which records have been established pursuant to Sub-section (2) of Section 20 shall be recovered as prescribed. If recovery cannot be so made, the central recovery office shall recover the irregular amounts to be recovered as a governmental due.

Section 23-Formation of irregular amounts settlement committee:

- (1) The Government of Nepal may, on the advice of the public accounts committee and the Auditor General, form an Irregular Amounts Settlement Committee consisting of the following persons as its members, from time to time, by a Notification in the Nepal Gazette for the settlement of irregular amounts that could not be settled through normal procedures.

Section 24- Functions, duties and powers of Irregularity Settlement Committee:

The functions, duties, and powers of the Irregularity Settlement Committee formed pursuant to Section 23 shall be as follows:

- (a) If, in respect of such irregular amounts under any constitutional organ or body, ministry, secretariat, department, court or office as could not be settled and verified through regular procedures, other than the irregular amounts found to have been misappropriated, embezzled and to be recoverable as found from audit, a recommendation is made by the concerned constitutional organ or body, ministry or secretariat for the settlement of such irregular amounts, such irregular amounts shall be regularizes or remitted on the basis of propriety and records of such irregular amounts shall be obliterated.
- (b) If the settlement of the irregular amounts recommended for settlement pursuant to Clause (a) cannot be settled, the concerned constitutional body or organ, ministry, secretariat, department, court or office shall be written to regularize or recover the irregular amounts.

B. The Financial Procedure Rules, 2064

Rule 98 - Responsibility for Settlement of Figure of Unlawful Amount:

- (1) It shall be the obligation of the Accounts Responsible Officer to see whether the Office In-charge or the responsible person has settled the irregularities or not, and get the same settled pursuant to the prevailing law, if they have not been settled.
- (2) It shall be the obligation of the responsible person or the Office In-charge to settle the irregularities set from the audit by submitting evidence or by regularizing or recovering the same.

- (3) Where the responsible person or the Office In-charge or employee with the obligation to settle the irregularities has to leave the Office by being transferred, promoted or retired, he shall hand over the details of the irregularities yet to be settled and all the details on the action relating to the transactions to the successor, and the successor shall also take over the inventory of the irregularities yet to be settled and all the details on the action relating to the transactions, and settle, and cause to be settled, the irregularities on the priority basis.

Rule 99 - To Make Reply by Taking Action on Settlement of Figure of Unlawful Amount;

- (1) After a letter has been received from the concerned auditor or the Office carrying out the audit in respect of the irregularities detected from the internal audit or the final audit, the irregularities shall be settled within the time-limit, if any, specified in that letter and within thirty-five days if no such time-limit is specified in that letter, by regularizing the irregularities if they have to be regularized, by submitting necessary evidence, if any evidence has to be submitted or by recovering them, if they have to be recovered or by giving clear reply if they have to be made clear through such reply; and a reply to that letter shall be given to the auditor or the Office carrying out audit within thirty-five days. If anything needs to be made clear in respect of the transactions and evidence, the auditor may immediately get reply through a letter rogatory.
- (2) If the irregularities cannot be settled pursuant to Sub-rule (1) a requisition, accompanied by the reasons therefore, shall be made to the body having written the letter on irregularities for time extension and the irregularities shall be settled by completing that act within the time-limit extended by that body.
- (3) A reference copy of the action and reply, as referred to in Sub-rule (1) or (2), shall be given to the pertinent superior office.
- (4) The Chief of pertinent superior office may pursuant to Section 33 of the Act, impose a fine on, or may pursuant to the prevailing law relating to the service, take departmental action against, or may take both actions against, the person who does not take action on settlement of irregularities pursuant to Sub-rules (1) and (2) and whose reply even if made is not satisfactory.
- (5) The Accounts Responsible Officer shall submit the irregularities remained to be verified within the time mentioned in sub-section (1) of Section 19 of the Act to the irregularity settlement committee as referred to in Section 23 of the Act, and get them settled and cross off their records from the Department of the Auditor General.
- (6) The information on the irregularities, which the irregularity settlement committee under Section 23 of the Act has decided to settle and which has been recovered and settled by the Central Revenue Collection Office, shall be given to the Office of the Auditor General and the records shall be cleared off.

Rule 100 - Provisions Relating to Settlement of Figure of Unlawful Amount:

- (1) The Accounts Responsible Officer shall himself regularize those irregularities which he may regularize pursuant to the prevailing law.
- (2) The Accounts Responsible Officer shall, in the case of those irregularities which he himself cannot directly regularize but he may regularize by inquiring any Office or authority or the concerned person or employee, regularize such irregularities by so holding inquiry.
- (3) The Accounts Responsible Officer of the concerned Ministry, Secretariat or constitutional body and organ may, on the recommendation of the Office In charge and the

Departmental Head, regularize such irregularities as seemed to have been irregular merely because of failure to meet the requirements to be met pursuant to the prevailing law but no governmental loss and damage has been caused thereof. In so regularizing the irregularities, the reasons for not causing such loss and damage shall be made clear as far as possible.

- (4) In cases where the Accounts Responsible Officer has a reasonable reason for regularizing the irregularities other than those mentioned in Sub-rules (1), (2) and (3) and remission has to be granted to regularize the same, it shall be remitted under Rule 106.

Rule 101 - Irregularity Settlement Evaluation and Monitoring Committee:

- (1) The Government of Nepal may form an irregularity settlement evaluation and monitoring committee to bring about effectiveness in the acts and actions relating to the settlement of irregularities by monitoring the settlement of irregularities carried out by the Office.

Rule 102 - Duty of Accounts Responsible Officer:

It shall be the responsibility of the Accounts Responsible Officer to maintain accounts and submit account statements and see and inspect whether audit has been performed or not pursuant to these Rules, to make comments on the annual report of the Auditor General and to carry out, or cause to be carried out, actions relating to the settlement of irregularities by taking part in the discussion held at the Public Accounts Committee of the Legislature Parliament.

Rule 103 - To Forward Statement of Irregularities:

- (1) The concerned Office shall recover such amounts as held to be recovered. If the concerned Office fails to recover it within one year, it shall submit it, accompanied by the reasons for failure to recover such amount despite its frequent actions, to the Accounts Responsible Officer. The Accounts Responsible Officer shall forward to the Central Revenue Collection Office record, accompanied by the details so submitted, and filled in the format referred to in Schedule-15.
- (2) The Central Revenue Collection Office shall examine the details received pursuant to Sub-rule (1) and maintain records thereof within seven days if it is found to meet the requirements and give information thereof to the concerned body. The concerned body shall, on the basis thereof, have to cross off, or cause to be crossed off, the inventory of its irregularities.
- (3) If, in examining the details received pursuant to Sub-rule (2), there appears a mathematical error, the Central Revenue Collection Office shall write to the Accounts Responsible Officer for review.

CHAPTER 9 APPENDICES

List of small entities (Examples)

| S.N | Name of Entities |
|-----|--|
| | District co-operative offices, |
| | District Post offices, |
| | Primary health canthers |
| | Area Police offices |
| | Area administration offices |
| | Land reform offices |
| | District survey office |
| | Regional administration office |
| | Regional post office |
| | Revenue courts |
| | Administrative court |
| | Metrological Basin offices |
| | Boarder administration offices |
| | District advocate offices |
| | Appeal advocate offices |
| | Regional quality control offices |
| | Metrological offices |
| | Commerce offices |
| | Ayurved hospitals |
| | District level medicine management offices |
| | Plant quarantine offices |
| | Animal quarantine offices |
| | Taxpayers service office |
| | District offices of national investigation |
| | Public service commission zonal offices |
| | District election offices |
| | Seismographic measurement centers |
| | District statistics offices |
| | Woman development offices |
| | Tourism offices |
| | Small and cottage industries offices |
| | Small and cottage industries committees |
| | Small custom offices[Chhoti Bhansar] |
| | Constitutional bodies |

Internal Control Checklist/Risk identification check-list

Name of the Entity: _____ Fiscal year: _____

| S. No | Description | Yes | No | Partially complied | Not applicable | Remarks |
|-------|---|-----|----|--------------------|----------------|---------|
| 1 | Every goods purchased or received from anywhere are accounted in inventory with price | | | | | |
| 2 | Supervision of inventory is being and reporting regularly | | | | | |
| 3 | Inventory account is updated | | | | | |
| 4 | Price of durable goods are coated properly | | | | | |
| 5 | Prescribe accounting formats are used for book keeping and reporting | | | | | |
| 6 | Public Building and land's record is updated | | | | | |
| 7 | Annual procurement plan is prepared | | | | | |
| 8 | Procurement unit is established | | | | | |
| 9 | Time frame for completion of work is mentioned in the cost estimates | | | | | |
| 10 | Main Deposit ledger and personal deposit ledger are updated | | | | | |
| 11 | The balance of deposit in books of account and the bank account is the same | | | | | |
| 12 | Revenue receipt control register is mentioned properly | | | | | |
| 13 | Revenue account and bank account shows the same amount of deposit in revenue head | | | | | |
| 14 | General voucher has been prepared when the revenue income is posted on the books of accounts | | | | | |
| 15 | Revenue accounts mentioned properly and reporting is being regularly | | | | | |
| 16 | Supervision from upper authority is being regularly | | | | | |
| 17 | All properties are used in office purpose | | | | | |
| 18 | Advance is cleared in timely basis | | | | | |
| 19 | Job description of all employees is given and the responsibility of every employees is clear | | | | | |
| 20 | Ongoing projects and programs are monitored timely | | | | | |
| 21 | Annual progress report, financial report is prepared and submitted to concern authority in timely basis | | | | | |

Governance Arrangement Checklist

Name of the Entity: _____ Fiscal Year: _____

| S. No | Description | Yes | No | Partial | Not applicable |
|-------|--|-----|----|---------|----------------|
| 1 | Accuracy of financial statement | | | | |
| 2 | Financial statements are certified by district treasury and account control office[DTCO] | | | | |
| 3 | Over expenditure is made than approved budget in line items | | | | |
| 4 | Advance amount is same with advance ledger | | | | |
| 5 | Internal audit is completed in a timely manner | | | | |
| 6 | Internal audit findings are cleared in time | | | | |
| 7 | Salary report is approved by competent authority | | | | |
| 8 | Bank reconcile statement is prepared timely | | | | |
| 9 | Record of audit findings are updated and clear regularly | | | | |
| 10 | Cash revenue is deposited within stipulated time | | | | |
| 11 | Last year cash balance is deposited within stipulated time | | | | |
| 12 | Last year's balance is carry forwarded in current year' account[revenue arrears, cash and deposit balance] | | | | |
| 13 | Expenditure made on other purpose from deposit account | | | | |
| 14 | At the end of fiscal year, bank statement is received and the reconcile statement is prepared | | | | |
| 15 | Organizational structure of the entity is clear and jobs are defined accordingly | | | | |
| 16 | Internal control system is adopted and functioning effectively | | | | |
| 17 | Overall progress is satisfactory | | | | |
| 18 | Periodic reporting are being regularly | | | | |

Office of the Auditor General
..... Directorate
.....Ministry/Commission/ Secretariat/ Office

Strategic Audit Planning Format

Part 1

Introduction of Ministry/Commission/secretariat/ Office.

1.1. Scope

1.2. Sectoral policies

1.3. Main points from sectoral planning and annual budget

1.4. Set policies and programs from budget statement

1.5. Legal provisions[Act, regulations, by laws, procedures and norms]

1.6. Organizational structure

1.7. Overall risk assessment [based on prior year's findings]

Part 2

2.1. Budgetary description to be audited and follow up audit
Fiscal year: 20XX/XX

| S.No | Description | Budget Code [upasirshak] | Budgeted Amount | |
|------|-------------------|-----------------------------|-----------------|---------|
| | | | Govt. of Nepal | Foreign |
| 1 | Operating | | | |
| 2 | Capital | | | |
| 3 | Other transaction | | | |
| | Total: | | | |

2.2. Revenue estimate for the year 20XX/XX

| S.No | Revenue head | Description | Amount | Estimate/Actual |
|------|--------------|-------------|--------|-----------------|
| 1 | | | | |
| 2 | | | | |
| 3 | | | | |

2.3. Deposit Transaction

| | |
|-------------------|----------------------------------|
| Number of offices | outstanding balance from 20XX/XX |
| | |

2.4. Audit backlog

| S.No | description | Units | Amount |
|------|-------------|-------|--------|
| 1 | | | |
| 2 | | | |
| 3 | | | |

2.5. Name of offices to be audited

| S.No | Description of offices | Number of offices |
|------|--|-------------------|
| 1 | Ministry/commission/secretariat/office | |
| 2 | Regional offices | |
| 3 | Division offices | |
| 4 | District offices | |
| 5 | Other | |

APPENDIX D

2.6. Name of public Enterprises and other public statutory organizations to be audited

| S.No | Name of the PES | Audit completed year | Fiscal year's to be audited | Amount of audit completed year |
|------|-----------------|----------------------|-----------------------------|--------------------------------|
| 1 | | | | |
| 2 | | | | |
| 3 | | | | |

2.7. Description of project account to be certified

| S.No | Project/ Program | Office Located area and district | Donor agency | Date to be provided audit report |
|------|------------------|----------------------------------|--------------|----------------------------------|
| 1 | | | | |
| 2 | | | | |
| 3 | | | | |

2.8. Technical Assistance

| S.No | Programs | Donor Agency | Agreed Amount | |
|------|----------|--------------|------------------|-----------------|
| | | | Foreign currency | Nepalese Rupees |
| 1 | | | | |
| 2 | | | | |

2.9. Other Assistance out of budget estimates and technical assistance

| S.No | Programs | Donor Agency | Agreed Amount | |
|------|----------|--------------|------------------|-----------------|
| | | | Foreign currency | Nepalese Rupees |
| 1 | | | | |
| 2 | | | | |

2.10. Audit work plan with manpower

Part 3

Audit objective, Scope and process

3.1. Audit objective

3.2. Scope of audit

3.3. Audit process

3.4. Description of the offices to be audited through simple audit planning and program as a small entity including public enterprises, committees, boards, funds and other statutory organizations.

| S.No | Name of the Office | District |
|-------------|---------------------------|-----------------|
| | | |
| | | |
| | | |

Part 4

Identified risk areas in operating expenses, capital expenses, deposit, revenue, other income for auditing of small entities including public enterprises and other statutory organizations

| S.No | Risk areas and identified risks and topics [to be identified separately for operating expenses ,capital expenses, revenue, deposit, other income and expenditure] for auditing of small entities including public enterprises and other statutory organizations |
|------|---|
| | |
| | |
| | |
| | |
| | |

Prepared by
Audit officer

Recommended by
Director

Approved by
Assistant Auditor General

Office of the Auditor General

..... Directorate

.....Ministry/Commission/ Secretariat/ Office

Detail audit planning and audit program for small entities

(Including small public enterprises, committees, boards, funds and other statutory organizations)

1. Financial Transaction[For government offices]

| Budget category with sub head | Annual budget | Release | Expenditure | Balance amount of advance | |
|-------------------------------|---------------|---------|-------------|---------------------------|---------------|
| | | | | Personnel advance | Other advance |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

2. Revenue

| Revenue sub head | Arrears | Collected | | Deposited | Outstanding | |
|------------------|---------|-----------|---------|-----------|-------------|------|
| | | Arrears | Current | | Arrears | Cash |
| | | | | | | |
| | | | | | | |
| | | | | | | |

3. Deposit

| carry forward from last year | Income of this year | Expenditure | | Balance | |
|------------------------------|---------------------|-------------|----------------------|--------------------------------|----------------------------|
| | | Withdrawal | Deposited to revenue | According to books of accounts | according to bank accounts |
| | | | | | |
| | | | | | |

4. Other Transactions and income and expenditure details

| Opening balance | This year's income | Total income | Expenditure | Balance |
|-----------------|--------------------|--------------|-------------|---------|
| | | | | |
| | | | | |

5. For small public enterprises, other statutory organizations [Including committees, boards, and other funds]

Financial Transactions

| Opening balance | This year's income | Total income | Expenditure | Balance |
|-----------------|--------------------|--------------|-------------|---------|
| | | | | |
| | | | | |

6. Objectives of Audit

7. Scope of Audit

8. Process and limitations of audit

9. Audit period

10. Audit team

11. Budget

12. Audit program

| S.No | Topics/subjects to be audited | Audit process and selection of sample size | Auditor | Cross reference number of working papers |
|------|-------------------------------|--|---------|--|
| | | | | |

13. Supervision:- Supervised by director

Prepared by
Audit officer

Recommended by
Director

Approved by
Assistant Auditor General
