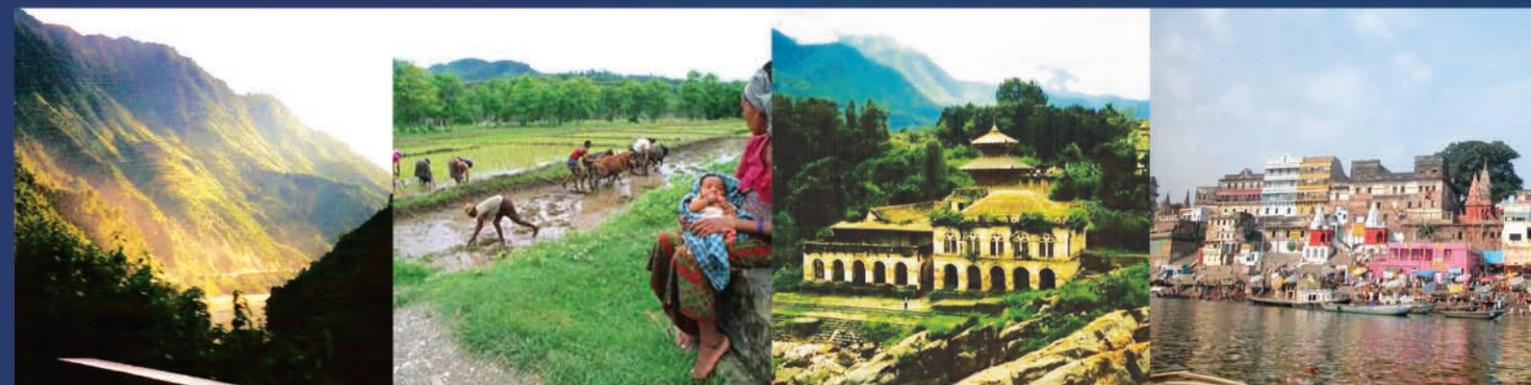


# Nepal

41430

## Public Sector Accounting and Auditing

A Comparison to International Standards



The World Bank



Government of Nepal

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The World Bank

South Asia Region Financial Management Unit  
May, 2007



Government of Nepal

Report No. : 39701-NP

**NEPAL**  
**PUBLIC SECTOR ACCOUNTING AND**  
**AUDITING**  
**A Comparison to International**  
**Standards**

**Country Report**



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# ABBREVIATIONS AND ACRONYMS

ASOSAI	Asian Organization of Supreme Audit Institutions
CAO	Chief Accounts Officer
CFAA	Country Financial Accountability Assessment
CFO	Chief Financial Officer
CIAA	Commission for the Investigation of Abuse of Authority
FCGO	Financial Comptroller General Office
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IDF	Institutional Development Fund
ICAN	Institute of Chartered Accountants of Nepal
IES	International Education Standards
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standard (of IFAC)
IPSASB	International Public Sector Accounting Standard Board
ISA	International Standards on Auditing
MoF	Ministry of Finance
MoGA	Ministry of General Administration
NAS	Nepal Accounting Standards
NASC	Nepal Administrative Staff College
NVC	National Vigilance Center
OAG	Office of the Auditor General
OIC	Officer in-Charge
PAC	Public Accounts Committee
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
RATC	Revenue Administration Training Center
SAI	Supreme Audit Institution
SOE	State-owned Enterprise





## ACKNOWLEDGMENTS

This assessment of accounting and auditing standards and practices in a public sector review was carried out in 2006 in active collaboration with the Government of Nepal and various stakeholders, particularly the Office of the Auditor General and the Financial Comptroller General Office. The review was conducted through a participatory process that involved these stakeholders whose responses to issues raised in the diagnostic questionnaires were especially useful, as were the reports and information available from the advising consultants, and recent World Bank assessments of public financial management. A draft report was circulated to the Government of Nepal in September 2006. A stakeholder workshop was held in Kathmandu on February 27, 2007 to discuss on the draft report and to review the results of the assessment and to discuss and agree on actions to be taken. The list of such actions has been included in this final report at Part IV. The team of advisors and development partners also contributed greatly to the early stages of the concept note and framework development, as well as drafting of earlier reports for this study, which, with companion studies, ultimately covers the countries of the South Asia Region: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

Discussions were held with senior officials of the Ministry of Finance, the President of the Institute of Chartered Accountants of Nepal, the Presidents of the Nepal Accounting Standards Board, and the Nepal Auditing Standards Board. In particular, the following officials provided their time and expertise to this assessment:

*Mr. Gehendra Nath Adhikari, Auditor General (now retired)*  
*Mr. Bachchu Ram Dahal, Deputy Auditor General (now Acting Auditor General)*  
*Mr. Ramesh Raj Satyal, Deputy Auditor General*  
*Mr. Dev B. Bohra, Assistant Auditor General*  
*Mr. Mahesh K Guragain, Director, Office of the Auditor General*  
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*Mr. Tirtha Raj Upadhaya, Past President, Nepal Accounting Standards Board*  
*Mr. K. K. Singh, Past President, Nepal Auditing Standards Board*  
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*Mr. Binod Bahadur Rajbhandary, President, Institute of Chartered Accountants of Nepal*  
*Mr. Madan Krishna Sharma, Chairman, Accounting Standards Board*  
*Mr. Prabhu Ram Bhandary, Chairman, Auditing Standards Board*

The responses to the diagnostic questionnaires by the chief executive officers and other concerned staff were helpful. The following state-owned enterprises participated in this process:

*Dairy Development Corporation*  
*Employees Provident Fund*  
*Nepal Electricity Authority*

*Nepal Oil Corporation  
Nepal Telecom Company Ltd.  
Nepal Water Supply Corporation  
Rastriya Banijya Bank  
Rastriya Beema Sansthan*

Three experienced national consultants were heavily involved in the assessment. Pradeep K. Shrestha (Lead National Consultant) is a Chartered Accountant and former President of the Institute of Chartered Accountants of Nepal with an extensive background of auditing and accounting in Nepal. Satish Chandra Lal, a Chartered Accountant and Council Member of the Institute of Chartered Accountants of Nepal, has a strong background of accounting and auditing; and Tanka Paneru, a Chartered Accountant and Council Member of the Institute of Chartered Accountants of Nepal, has experience in public sector audit.

The report also benefited from the comments of its peer reviewers within the World Bank: Manoj Jain (Senior Financial Management Specialist) and Stephane Guimbert (Senior Economist) in the South Asia Region. As the external peer reviewer, the Institute of Chartered Accountants of Nepal also provided valuable comments.

The World Bank Task Team has been responsible for finalizing this report.

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# EXECUTIVE SUMMARY

1. This assessment of public sector accounting and auditing in Nepal is intended to assist with the implementation of more effective public financial management (PFM) through better quality accounting and public audit processes. It is intended to provide greater stimulus for more cost-effective outcomes of government spending. The specific objectives are (a) to provide the country's accounting and audit authorities and other interested stakeholders with a common well-based knowledge as to where local practices stand in accordance with the internationally developed standards of financial reporting and audit; (b) to assess the prevailing variances; (c) to chart paths to reduce the variances; and (d) to provide a continuing basis for measuring improvements.
2. Adoption of international standards for accounting and auditing provides the basis for competent financial reporting and transparency. The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) has developed a core set of accrual-based International Public Sector Accounting Standards (IPSAS) and also a comprehensive IPSAS on the cash basis of accounting. These IPSAS establish an authoritative set of independent international financial reporting standards for governments and others in public sector organizations. The study has taken the international standards as axiomatic with any acceptable options incorporated in the standards. The study has not assessed whether Nepal should adopt a limited version of the standards as the processes of developing the standards have already considered any acceptable options.
3. Application of IPSAS will support developments in public sector financial reporting directed at improving decision-making, financial management and accountability; it will be an integral element of reforms directed at promoting social and economic development. The IPSASB has also developed guidance on the transition from cash- to accrual-based reporting.<sup>1</sup> The traditional emphasis on the cash basis of accounting has been found inadequate through failure to recognize true costs, and all assets and liabilities. Cash accounting can too easily neglect asset management, accumulating arrears, future liabilities (e.g., pensions), and contingent liabilities (e.g., guarantees).
4. Annex A explains the methodology used for the study. The first part of the diagnostic questionnaires compares the national standards to international standards and the latter parts deal with the implementation practices measured against the international standards, rather than the Nepal standards that are in use. The study is meant to assist with the adoption of international standards by Nepal. It

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<sup>1</sup> *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities, IFAC Public Sector Committee, December 2003.*



is not intended to assess how much of the weakness in the Nepali accounting and auditing is due to a problem of the standards that are in use, and how much is due to the manner of implementation. Proper implementation of the international standards will correct any implementation problems in the current Nepal standards and will be supported by international practices and guidance.

5. Annex B provides a summary of accounting and auditing standards referred to in this study. Annex C provides national accounting and auditing legislation. Annex D includes a description of the benefits of accrual accounting, and Annex E describes the accounting and auditing staffing arrangements in Nepal.

6. The desired actions indicated by this assessment are summarized in the following paragraphs and described in more detail in the main sections of the report.

7. **A more comprehensive plan is required for Nepal to adopt Cash Basis IPSAS as part of a longer-term program to adopt accrual-based reporting of expenditures for each government entity.** The Government of Nepal accounts have been maintained on a cash basis of accounting since 1962 but not in line with Cash Basis IPSAS. The accounts of the local autonomous bodies, Village Development Committees and District Development Committees, are maintained on the cash basis of accounting while the municipalities can maintain accounts either on the cash basis or accrual basis of accounting. The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSAS. All government departments should eventually use Cash Basis IPSAS in preparing financial statements, and then gradually move toward accrual-based IPSAS. The revenue is to be accounted on the cash basis of accounting. Programs for implementation should ensure effective action on the ground and should not just look good on paper, as indicated by the Country Financial Accountability Assessment (CFAA).

8. **Nepal accounting laws and regulations should specify adoption of International Public Sector Accounting Standards, Nepal Accounting Standards, and applicable International Accounting Standards and International Financial Reporting Standards.** Prevailing laws do not prescribe the adoption of IPSAS for the maintenance and compilation of the Government accounts. As part of progressive plan to enhance the public sector accounting system in compliance with IPSAS, the finance legislation should be amended to make mandatory requirements for the general budget sector to maintain accounts and prepare a consolidated financial statement as guided by IPSAS. With regard to state-owned enterprises (SOE), the Auditor General has already issued directives to these entities to adopt the guidelines stated in the Company Act for presentation of financial statements. The Company Act specifies the Nepal Accounting Standards (NAS), but other applicable International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) are not specified.<sup>2</sup> Relevant laws governing state-owned enterprises should be reviewed and amended for adoption of these accounting standards.

9. **More effective training requires curricula more attuned to international standards.** Current practices for selection of government accountants do not provide accounting staff with appropriate skills. Accounting staff recruitment should require special arrangements rather than the

<sup>2</sup> The International Accounting Standards Board issued IAS from 1973 to 2000. Since 2000, the IASB has issued IFRS.

standard general entry into the Nepal Civil Service. Current practices of government accountant and auditor training do not provide required skills commensurate to international standards. Orientation training provided for five weeks after recruitment and in-service training during continued service is not sufficient to understand the accounting and auditing system properly and enhance skills to required levels. In this respect, the Government of Nepal should prepare and implement a long-term vision/strategy in human resources development in developing the accounting and auditing sector. Assurance should be provided for adequate resources to implement the strategy.

10. **A code of conduct for accountants is needed.** There is no specific code of conduct for public sector accountants who are not members of the Institute of Chartered Accountants of Nepal (ICAN). A specific code should be created based on the codes of ethics of ICAN and IFAC. It is important to specify the code of conduct in the relevant laws.

11. **A chief financial officer should be designated and made accountable for specific functions and duties.** The Chief of Finance Administration Unit of each government office should be designated as chief financial officer, who should be responsible for maintenance of accounts preparation, submission of financial statements, and resolution of final audit irregularities; and made accountable both to the Financial Comptroller General and the Officer In-charge.

12. **The Government should empower the Accounting Standards Board to set IPSAS-based public sector accounting standards.** The Government of Nepal should empower the Accounting Standards Board through legal amendment or through appropriate decision, as required, to take a lead to introduce public sector accounting standards based on IPSAS. To facilitate the smooth functioning of the Board, to provide necessary resources and communicate the accounting requirement of the Government, a Steering Committee should be formed, chaired by the Finance Secretary and represented by the Financial Comptroller General Office (FCGO), Office of the Auditor General (OAG), ICAN and two standard setting Boards (Accounting and Auditing). The Auditor General should issue directives to state-owned enterprises specifying to adopt applicable IAS and IFRS, and relevant laws governing state-owned enterprises should be amended for adoption of these accounting standards. The Nepal Accounting Standards Board should prepare National Public Sector Accounting Standards on the basis of IPSAS.

13. **Corporate governance in the statutory authority sector needs to be improved through more effective audit review committees.** The SOE financial statements are not reported on time. Disclosures of the accounting policies are not adequate and transparent in accordance with International Accounting Standards. The Ministry of Finance should set up a Financial Review Committee to review the financial statements of the state-owned enterprises and ensure compliance with relevant laws and reporting standards (NAS, IAS and IFRS). Further, at the SOE level, it is recommended that an independent Audit Committee is set up for follow-up and monitoring of compliance with relevant laws and reporting standards. This has to be backed up by appropriate legislative amendment.

14. A Supplementary Table of Standards and Gaps at the end of this report provides a matrix detailing the current standards, the present position, and options for improvements, separately, for accounting and auditing. A summary of the accounting issues is shown in Table ES1, while Table ES2 covers those related to auditing.



**TABLE ES1. SUMMARY OF ACCOUNTING STANDARDS ISSUES**

<b>Standard</b>	<b>Current status</b>	<b>Activity required to adopt international standards</b>
1. Does the Public Sector Accounting Law adopt IPSAS?	No.	A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared using existing information. Some technical assistance will be needed.
2. Does the education and training of accountants accord with IES?	Not fully.	Accounting staff recruitment should require special arrangements rather than the standard general entry. For the existing cadre of accounts staff (up to the highest level), appropriate training should be designed and provided.
3. Does the Code of Ethics match - international standards?	No.	A code of conduct for accountants based on IFAC or ICAN codes is needed and should be incorporated in relevant laws.
4. Is there a body to prescribe public sector accounting standards?	No.	The Accounting Standards Board should be empowered through appropriate legal instrument to develop public sector accounting standards. The Auditor General should issue directives to SOEs to adopt NAS and other standards as necessary.
5. Are the financial statements in accordance with international standards?	No.	Government of Nepal should develop a plan for the medium-term to move toward improving the existing cash-based system to Cash Basis IPSAS with additional voluntary disclosure (e.g., undrawn borrowings, liabilities, outstanding advances and realization of assets and properties).
6. Is the statement of Cash Receipts and Payments in IPSAS form?	No.	For immediate implementation, the Government could learn from the experience of Sri Lanka in adopting Cash Basis IPSAS. For this, the Government could form a core team for a study visit to Sri Lanka and then apply possible changes in the existing accounting system.
7. Are accounting policies and explanatory notes required?	No.	
8. Are other disclosures in accord with IPSAS?	No.	
9. Does the government issue a consolidated financial statement which consolidates all controlled entities?	No.	This should be reviewed only after the general budget sector has been reported according to Cash Basis IPSAS.

**15. There is a need for the Office of the Auditor General to adopt the Nepal Standards on auditing for government audit, in addition to the INTOSAI Auditing Standards.** The accounts of the Government offices, Constitutional bodies, Nepal Army, Nepal Police, Supreme Court and other lower courts, corporate bodies fully owned by the Government, and other specific public organizations are audited and reported on by the Auditor General in the manner as determined by Law,

with due consideration given to the regularity, economy, efficiency, effectiveness, and the propriety thereof. The Office of the Auditor General developed its Government Auditing Standards in 1996 based on the INTOSAI Auditing Standards. These standards were updated in 2005 to accord with the revised INTOSAI Auditing Standards. These Government Auditing Standards are too general and do not describe in sufficient detail the audit procedures. The ICAN-developed Nepal Standards for Auditing are based on the IFAC-issued International Standards on Auditing (ISA). The Office of the Auditor General should also adopt the Nepal Standards for Auditing for government audits as recommended by the INTOSAI. The Office of the Auditor General should ensure that recently developed guidelines prepared as per the INTOSAI standards are implemented. Adequate resources need to be ensured to implement guidelines recently developed.

**16. The Audit Act should be revised to make provision for conducting any type of audit and to provide more effective independence.** Effective scrutiny by the legislature to ensure effective implementation of fiscal and expenditure policies needs comprehensive, competent, external audits. The Audit Act 1991 specifies matters to be audited but does not cover other specialized audit. The Act should be amended to authorize the Office of the Auditor General to conduct other specialized audits, such as environment and forensic audits. Revisions of the Law should be considered in reference to international standards.<sup>3</sup> While conducting other specialized audits, OAG may maintain a close coordination with other investigating agencies such as, the National Vigilance Center (NVC) and the Commission for the Investigation of Abuse of Authority (CIAA) to be informed about ongoing developments in the subject areas.

**17. Strengthened Public Accounts Committee and other departmental administrative processes are needed for following up on issues raised in audit reports.** Lack of a Parliament for some years has left a gap in the review process through Public Accounts Committees. In the context of recent restoration of the Parliament, the Public Accounts Committee (PAC) has recently been reconstituted, and is expected to play a significant role in the scrutiny of public accounts as raised in audit reports.<sup>4</sup> There is a need to strengthen the Public Accounts Committee through exposure to best practice examples, and by modernizing the functioning of the PAC.

**18. Audit appointments should include requirements for a degree with accounting or auditing content.** With a need to make a substantial investment in developing its human resources, the Office of Auditor General has prepared a medium-term Human Resources Development Plan and requires adequate resources to implement it. To minimize new requirements for training, future appointees should already be adequately qualified in basic accounting and audit. The Office of the Auditor General should work with other Supreme Audit Institutions or professional institutions to make arrangements to assist the continuing education program for audit staff. This Plan is needed to strengthen the technical and professional competence of the OAG staff to produce quality audit reports that meet international standards and serve the need of the stakeholders. The existing staff capacity to implement the new audit guidelines needs continuous enhancement.

**19. Auditing methods need to be updated.** The audit guidelines developed under the Public Audit Reform and Capacity Building Project are yet to be fully implemented. For this the Office of the Auditor General requires support with additional resources to continue to provide and update staff skills to

<sup>3</sup> *A Model National Audit Office Act, Association of Chartered Certified Accountants, UK, 2004.*

<sup>4</sup> *The World Bank has been developing guidance for Public Accounts Committees in the South Asia Region which may be helpful to the Parliament for Nepal.*



review internal control systems and assess audit risk appropriately. A more comprehensively structured audit planning and working paper system needs to be implemented to improve efficiency and reliability of the audits.

**20. The timeliness and precision of financial statement reporting needs to be improved.**

Coordination between the SOE auditees and the auditors is inadequate to ensure timely audit. Improvements in the consultative arrangements are needed, supported by appropriate penalties through legislation.

**21. An audit opinion needs to be provided on the consolidated government financial statement.**

The consolidated financial statements of the Government of Nepal need to be improved by providing a separate audit opinion. While implementing the Cash Basis IPSAS, it is recommended that a separate audit opinion is also provided to the consolidated government financial statements.

**22. There is a need for forensic audit training and improved reporting.**

The OAG Annual Audit Report concentrates on noncompliance with the prevailing Laws and also assesses performance of projects/sectors and relates to fraudulent transactions but not in a sufficiently systematic way to enable effective corrective actions. To address this issue, there is a need for forensic audit training. The Public Audit Reform and Capacity Building Project suggested that the OAG Audit Reports could be improved in terms of communicating clear objectives, addressing more relevant problems, making more effective recommendations, and involving more extensive audit work. There is potential to improve the effectiveness of the Audit Report by more efficient action on enforcement of corporate governance requirements through the Public Accounts Committee, Audit Committees, and the audit report review cells in ministries.

23. A summary of the auditing issues is shown in Table ES2.

**TABLE ES2. SUMMARY OF AUDITING STANDARDS ISSUES**

<i>Standard</i>	<i>Current status</i>	<i>Activity required to adopt international standards</i>
1. Is the SAI statutory framework in accordance with the needs of the INTOSAI Auditing Standards?	Broadly yes, but some deficiencies need to be corrected.	Deficiencies need to be addressed either through issuance of directives by the Auditor General, or by amendment of the Audit Act, whichever is appropriate.
2. Is there a body to prescribe public sector auditing standards?	The Auditor General does this.	The Nepal Auditing Standards Board should be empowered to set public sector auditing standards as per ISA and in keeping with the requirements of OAG.
3. Have INTOSAI and IFAC audit standards been adopted?	INTOSAI Auditing Standards have been adopted.	The plan needs to be developed to gradually adopt the NSA and ISA.
4. Has a code of ethics equivalent to the INTOSAI standards been adopted?	Yes.	Since the existing code of conduct is too rigid and unrealistic in implementation, this may deserve review.

<b>Standard</b>	<b>Current status</b>	<b>Activity required to adopt international standards</b>
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	Yes.	
6. Does the SAI legal framework meet the INTOSAI standards for independence and powers?	Broadly.	The Audit Act needs to be amended to provide for, <i>inter alia</i> , more involvement of the legislature.
7. Does the education and training of auditors' accord with INTOSAI and IES standards?	Broadly, but there is room for improvement.	Recruitment and continuing professional education processes should be revised.
8. Is the SAI equipped with the audit methods and technologies to meet the INTOSAI Auditing Standards?	Broadly, but more resources are needed.	Computer-assisted audit technology and other technological audit techniques need to be applied within OAG for conducting the audit of entities having computer-based accounting systems.
9. Does the SAI have the quality assurance programs to meet international standards?	Yes, but implementation needs improvement.	Action is to be taken as per its recent peer review of its work.
10. Does the process to plan the audits meet international standards?	Partially.	The new methodologies recently developed need to be implemented through a training program.
11. Does the process to supervise the audits meet international standards?	Partially.	
12. Does the process to evaluate the reliability of internal control meet international standards?	Partially.	
13. Does the process used in audits to assess compliance with laws meet international standards?	Broadly.	
14. Does the audit process used to obtain evidence to support conclusions meet international standards?	Broadly.	
15. Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with?	Partially. Yes, in the case of SOEs and project financial statements being submitted to the MoF.	Audit opinions need to be more specific in accordance with INTOSAI standards.



<b>Standard</b>	<b>Current status</b>	<b>Activity required to adopt international standards</b>
16. Does the auditor prepare an audit opinion on the financial statements in a form that accords with international standards?	No, in case of AG's Annual Report. Partially, in case of specific audit report provided to SOEs and project financial statements being submitted to the MoF.	The OAG should issue audit reports giving reference to the financial reporting framework used to prepare the financial statements, and expressing an opinion on the complete set of financial statements of the Government budget sector and the fully owned SOEs.
17. Does the consideration of fraud and error in an audit of financial statements accord with international standards?	Broadly.	More systems-based auditing would be an improvement.
18. Are the Auditor General's reports made public?	Yes, but with delays.	Process and time allowed for publication should be laid down in the Law.
19. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?	No, in the absence of PAC for last four years.	Line ministries should form a separate cell or unit to take actions on and monitor actions taken to implement audit recommendations.

**24. Progressive implementation of the international standards will improve public financial management by providing a more ambitious and comprehensive reform program.** The consequences of the above variances from international standards for accounting and auditing are reflected in the quality of financial reporting. Public financial management relies on a comprehensive and timely accounting and financial reporting system. With assurance from a competent professional audit function, the system should work properly and provide reliable information. Current enforcement of adequate compliance with financial regulations in the general budget sector and corporate governance in the public enterprise sector falls short of satisfactory standards. Use of the PFM performance measurement framework developed by the Public Expenditure and Financial Accountability (PEFA) program is a good basis to develop and measure progress in the full cycle of PFM reform from budget formulation to legislative scrutiny and remedial action.<sup>5</sup> The performance indicators examined in the PEFA Program provide guidance for sequencing reforms that make logical sense to improve PFM in the Nepal context.

<sup>5</sup> The PEFA Program is a partnership among the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the Strategic Partnership with Africa, IMF, and the World Bank. A Steering Committee, comprising members of these agencies, manages the Program. A Secretariat is located in the World Bank in Washington, DC.



# INTRODUCTION

This assessment of public sector accounting and auditing in Nepal is generally meant to help implement more effective public financial management (PFM) through better quality accounting and public audit processes, and to provide greater stimulus for more cost-effective outcomes of government spending. More specific objectives are to (a) provide the country's accounting and audit authorities and other interested stakeholders with a common well-based knowledge as to where local practices stand in accordance with international standards of financial reporting and auditing; (b) assess the prevailing variances; (c) chart paths for improving compliance in accordance with international standards; and (d) provide a continuing basis for measuring improvements. The findings of this study will be a major input to the PFM work being undertaken by the Bank and country authorities.

1.1. As part of the general support program in South Asia for the assessment and improvement of public sector accounting and auditing, the World Bank, with the cooperation of member governments, is conducting a Review of Public Sector Accounting and Auditing Practices in member countries. In conducting this assessment, a diagnostic questionnaire, developed in the light of the PFM Performance Measurement Framework<sup>6</sup> by the Public Expenditure and Financial Accountability (PEFA) Program,<sup>7</sup> was used to gather substantial insight into country performance with regard to the external auditing and financial statement reporting PFM indicators. Annex A discusses the methodology used for conducting the assessment in this report and provides the context and limitations of this study.

1.2. The diagnostic questionnaire was used to gather information on national standards and practices for accounting, financial reporting, and auditing in the government budget sector and in the state-owned enterprise (SOE) sector. Conducted in cooperation with country authorities, the diagnostic questionnaires incorporate the principles contained in the public sector accounting and auditing standards promulgated by the International Organization of Supreme Audit Institutions (INTOSAI) and International Federation of Accountants (IFAC). Annex B summarizes the accounting and auditing standards referred to in this study. The responses to these questionnaires stimulated further discussions

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<sup>6</sup> The PFM Performance Measurement Framework has been developed as a contribution to the collective efforts of many stakeholders to assess and develop essential PFM systems, by providing a common pool of information for measurement and monitoring of PFM performance progress, and a common platform for dialogue.

<sup>7</sup> The PEFA Program is a partnership among the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund, and the Strategic Partnership with Africa. A Steering Committee, comprising members of these agencies, manages the Program. A Secretariat is located at the World Bank in Washington, DC.

among the World Bank team and country authorities. These discussions examined accounts and audit reports and working papers as a means to explore the quality of processes and products.

1.3. The system of maintenance of public accounts in Nepal began in 1768. Reforms to the accounting system were initiated in 1814 and 1880. Budget formulation was begun in 1952. The Government of Nepal enacted the Procedure Rule Relating to Governmental Expenditure in 1960, bringing uniformity in financial administration. Implementation of new accounting systems based on the double-entry system was developed with the help of the U.S. Agency for International Development and phased in over six years, starting in 1962 for expenditures. This accounting system was implemented to account for revenues from 1974. The Accounts Code was revised and updated in May 1997. The Office of the Corporation Coordination Council had recommended the financial accounting system for the state-owned enterprises in July 1977, and this continues more or less to be followed by the state-owned enterprises, except companies and banks. Audit was started in 1862. The Office of the Auditor General (OAG) was established in July 1959 in compliance with the Constitution of Nepal and the Audit Act that mandate a constitutional body to conduct audit.

1.4. The accounting and auditing capabilities were strengthened with the help of a project executed by the Asian Development Bank in 1988 and 1989. The main objectives of the project were to improve the government's central and district treasury office accounting systems to provide better control over the allocation and use of financial resources, better financial information for strengthening government accountability, and enhance the efficiency and effectiveness of existing financial audit procedures; identify the potential scope for performance auditing; develop performance audit methodology; train a small team of audit instructors; review the demand upto the year 2000 for accountants and auditors; review the capacity of existing institutions for accounting education; and make recommendations to correct imbalances. The World Bank provided the Institutional Development Fund (IDF) Grant in 1995 to assist in the strengthening of the internal audit system and to establish a system in the Financial Comptroller General Office (FCGO) to monitor the status of release of funds and donor reimbursements project-wise, and thereby to take timely corrective action to accelerate requests for reimbursement in various projects. The United Kingdom's Department for International Development funded projects which commenced around 1998, that helped the Government of Nepal to initiate computerization of government accounts in the Financial Comptroller General Office, which enabled this Office to prepare timely financial statements through direct access to information systems in 56 out of 75 District Treasury Comptroller Offices. The Financial Comptroller General Office obtains expenditure data from the remaining 19 District Treasury Comptroller Offices manually (including copying data onto floppy disks, faxing information, or delivering hard-copy statements).

1.5. The World Bank provided IDF grants from 1993 to 2005 for capacity-building and institutional development of the Office of the Auditor General. The projects implemented during 1993 to 1999 helped to improve the planning, organization, and operation of audits; develop government auditing standards; develop various audit guides in line with international best practices; develop a Performance Audit Guide; assist in implementation of revised auditing procedures; upgrade capacity in performance auditing; develop a specialized training program for staff; design a system of planning, monitoring and reporting; prepare a three-year development plan, and transfer technology, methodology and approaches. The latest Public Audit Reform and Capacity-building Project funded by the IDF grant was completed in

March 2006. The main objectives were to enhance the institutional capacity of the Office of the Auditor General to deliver quality public audit in the following ways:

- revising and consolidating the existing audit guidelines in conformity with Auditing Standards of the International Organization of Supreme Audit Institutions (INTOSAI), International Standards on Auditing (ISA) issued by the International Federation of Accountants, and the changes in the statutes, Acts, rules, and requirement in public audit areas (revenue audit, procurement and public works audit, project accounts audit, and an auditing procedures general guide);
- improving the Auditor General's reporting methodology commensurate with best international practices; and
- developing the Human Resources Development Plan, including strengthening of the training division to create a strong and fully equipped unit capable of providing quality training to OAG staff.





# PUBLIC SECTOR ACCOUNTING

## A. Institutional Framework for Public Sector Accounting

2.1. The institutional framework should include adherence to Nepal Accounting Standards (NAS), applicable International Accounting Standards (IAS), and International Financial Reporting Standards (IFRS);<sup>8</sup> the use of qualified accounting staff to provide timely, relevant, and reliable financial information that is needed to support all fiscal and budget-management, decision-making and reporting processes. The diagnostic questionnaires that were used in this assessment have collected information on the current arrangements and the apparent gaps in Nepal for accounting laws and regulations; education and training of public sector accountants; application of a code of conduct; and numbers and characteristics of public sector accountants.

### Accounting laws and regulations

2.2. **Nepal accounting laws and regulations should specify adoption of International Public Sector Accounting Standards.** Prevailing laws do not prescribe the adoption of International Public Sector Accounting Standards (IPSAS) for the maintenance and compilation of Government accounts. As part of a progressive plan to enhance the IPSAS-compliant public sector accounting system, there is a need to amend the finance legislation to make mandatory requirements for the general budget sector to maintain accounts and prepare a consolidated financial statement as guided by Cash Basis IPSAS. The Government of Nepal should then prepare a time-bound roadmap to gradually transit to full accrual basis of accounting in accordance with IPSAS, with due consideration of the government capacity to adopt accrual system. An extraction of the Financial Procedure Act is in Annex C, along with extracts from other Nepal auditing and accounting legislation.

2.3. **The Auditor General should issue directives to state-owned enterprises to adopt Nepal Accounting Standards and applicable International Accounting Standards and International Financial Reporting Standards; and relevant laws governing state-owned enterprises should be amended for adoption of these accounting standards.** Laws governing state-owned enterprises have made provision for maintenance of accounts on the basis of a double-entry book-keeping system, following generally accepted accounting principles in cases of state-owned enterprises, except companies and banks. The double-entry system does follow Nepal Accounting Standards in cases of companies, but there is no provision for mandatory compliance of International Accounting Standards, except for banks.

<sup>8</sup> The International Accounting Standards Board issued IAS from 1973 to 2000. Since 2000, the IASB has issued IFRS.



However, state-owned enterprises have been following the required IAS and NAS standards voluntarily. The Relevant Act of state-owned enterprises should be amended to prescribe for mandatory application of Nepal Accounting Standards, and applicable International Accounting Standards and International Financial Reporting Standards wherever Nepal Accounting Standards, have not been promulgated. The Auditor General has already issued directives to state-owned enterprises to adopt the guidelines stated in the Company Act for presentation of financial statements. The Company Act specifies the Nepal Accounting Standards, but other applicable International Accounting Standards and International Financial Reporting Standards are not specified. Relevant Laws governing state-owned enterprises are therefore required to be reviewed and amended for adoption of these accounting standards. Until the amendment of Relevant Acts of state-owned enterprises takes place, it is recommended that the Auditor General issue directives to state-owned enterprises, exercising the authority entrusted to his office by the Audit Act to comply with Nepal Accounting Standards and important applicable International Accounting Standards in addition to International Financial Reporting Standards.

**2.4. Nepal should adopt the Cash Basis IPSAS.** Nepal has been maintaining accounts on a cash basis but not in accordance with Cash Basis IPSAS. There is a need for improvements in the existing cash system to comply with IPSAS. For example, advance payments are treated as expenditures in the existing cash basis of accounting. The audited consolidated fund statement and annual revenue and expenditure statement do not include accounting policies and explanatory notes as required by IPSAS; whereas the consolidated financial statements issued by the Financial Comptroller General Office for government use include basic accounting principles and assumptions. According to the 2003 standard for financial reporting under the cash basis of accounting, the International Public Sector Accounting Standards Board (IPSASB) of the IFAC recognizes the right of governments and national standard-setters to establish guidelines and accounting standards for financial reporting. The IPSASB considers that the Cash Basis IPSAS is an important step forward in improving the consistency and comparability of financial reporting and encourages its adoption. For immediate implementation, the Government of Nepal could learn from the experience of Sri Lanka in adopting Cash Basis IPSAS. The Government of Nepal could form a core team to make a study visit to Sri Lanka and then apply possible changes in the existing accounting system. The Financial Comptroller General Office should take a lead in recommending and obtaining the approval of the Auditor General to base the format of consolidated financial statements on the Cash Basis IPSAS. Financial statements could be prepared on that basis for immediate implementation until the amendment of the Audit Act and the Financial Procedure Act. For the medium-term, the Government of Nepal should develop a plan to move toward improving the existing cash-based system of accounting to Cash Basis IPSAS with additional voluntary disclosure of, for example, un-drawn borrowings, liabilities, and outstanding advances.

**2.5. All government departments should eventually use the Cash Basis IPSAS in preparing financial statements, then gradually move toward the accrual IPSAS.** The Government budget sector accounts should be prepared first by improving the existing cash basis accounting system in accordance with the Cash Basis IPSAS. A program to gradually move toward the accrual-based IPSAS for accounting and reporting of expenditures should consider the government's accounting capacity to reach that stage. The cash basis of accounting would be continued for accounting revenue. This would provide sufficient time to the accountants to understand the Cash Basis and accrual IPSAS and eventually make the respective Government offices and Financial Comptroller General Office more accountable for

maintenance of accounts and preparation of financial statements. The transition from Cash Basis IPSAS to accrual-based IPSAS would depend on the capability of accountants and availability of information required for accrual-based IPSAS. Annex D describes the benefits of the accrual accounting.

**2.6. Establish timetables for the publication of audited annual accounts.** The Financial Procedure Act 1997 prescribes the timetable for submission of financial statements by the respective Government offices to the Financial Comptroller General Office and the Office of the Auditor General. The Act also prescribes the timetable for submission of financial statements of consolidated accounts for each financial year, and accounts of the appropriation, revenue, deposit, foreign aid, and loan, and investment, apart from consolidated funds, to the Office of the Auditor General by the Financial Comptroller General Office. But the laws do not prescribe the period within which the audited annual accounts have to be published. The Audit Act should mention the timetable for publication of audited annual accounts, and it should be published accordingly.<sup>9</sup>

**2.7.** The Government of Nepal can be assisted in moving from the Cash Basis IPSAS to the accrual-based IPSAS by utilizing an IFAC study on the transitional path to accrual IPSAS.<sup>10</sup> The study has four main parts:

- Introduction. Chapters 1-3 address general planning and project management issues.
- General Financial Reporting Issues. Chapters 4 and 5 deal with the selection, development and approval of accounting policies, and issues associated with the definition and identification of reporting entities.
- Financial Elements. Chapters 6-8 outline the broad steps required for the identification, recognition, measurement and disclosure of assets, liabilities, revenues, and expenses. The broad approaches discussed could be adapted and applied to particular items.
- Specific Topics. Chapters 9-15 highlight implementation issues associated with four specific accrual-based IPSAS, and provide guidance in relation to a selection of topics not addressed, or only partially addressed, by existing IPSAS.

## Education and training

**2.8. Current practices for selection of government accountants do not provide appropriate accounting skills.** Currently, accounts cadre staff are being recruited from candidates with educational qualifications in commerce, law, economics, statistics, mathematics and other academic disciplines, other than accounting. As a result, they are not adequately skilled to carry out accounting functions as per international standards. Recruitment should focus on accounting staff with academic qualifications only in commerce, specializing in accounting or audit. Recruitment of accounting staff should require special arrangements rather than the standard general entry into the Nepal Civil Service. Details of the selection processes are discussed in Annex E.

<sup>9</sup> *Quality and timeliness of annual financial statements is performance indicator No. 25 in the PFM performance measurement framework supported by the World Bank and other development agencies.*

<sup>10</sup> *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities, International Federation of Accountants Public Sector Committee Study 14, December 2003.*

2.9. **Current practices of training do not provide required skills to the government accountants and auditors.** Orientation training that is provided for five weeks after recruitment and continuing in-service training is not sufficient to understand the accounting and auditing system properly and enhance skill levels. Additional and continuing training is necessary to enhance the skills of the accountants and auditors, to aid in the implementation of all required accounting and auditing standards, easily and efficiently. The period of orientation training should be appropriately increased from five weeks to at least ten weeks, and the duration of training needs to be determined as per needs and work responsibilities. A continuing professional education strategy for new recruitment as well as the existing cadre of accounts staff, for short-term and long-term training, should be developed based on the academic qualifications and experience of various levels of the accountants. The continuing professional education training should be provided compulsorily to all the accountants and auditors according to their level, within five years of the start of the program. In this respect, the Government of Nepal should prepare and implement a long-term vision/strategy in human resource development in upgrading the accounting and auditing sector. Assurance should be provided for adequate resources to implement the strategy.

2.10. **More effective in-house training requires curricula more attuned to international standards.** The syllabi of the Nepal Administration Staff College (NASC), Revenue Administration Training Center (RATC), and the OAG Training Directorate do not cover all areas recommended by INTOSAI and IFAC. The training is meant to upgrade the skill levels to more productive working levels, as quickly as possible. Training curricula should be revised to include topics of IFAC-issued International Education Standards for Professional Accountants (IES) and, with the cooperation of the Institute of Chartered Accountants of Nepal (ICAN), to meet the professional accountancy needs of the public sector accountants and auditors based on the academic qualifications of professional accountants. The learning materials should be developed by accounting and auditing experts based on International Education Standards, and take into account international audit and accounting standards as required for adoption by public sector organizations. Details of training processes are discussed in Annex E.

2.11. **Introduction of International Education Standards and a professional education program is needed.** The local universities should include IAS, IFRS, NAS, IPSAS, and detailed IES-prescribed elements in the accounting degree curriculum. This basic knowledge would enable the trained staff to work independently. A professional education program should be offered to already working accountants and auditors who should be encouraged to join the program. The ICAN and its sister organization, the Nepal Accounting Technician Institute, can contribute significantly in providing training, by acting as resource providers and developing relevant materials. Further, a steering committee should be formed under the chairmanship of the Finance Secretary with representation from FCGO, ICAN, Accounting Standards Board, Auditing Standards Board, and Ministry of Education & Sports, to discuss on various options for a professional education program including developing a university education program.

## Code of conduct

2.12. **A code of conduct for accountants is needed.** There is no specific code of conduct for public sector accountants who are not members of the ICAN. Public sector accountants are guided by the Civil Service Act (Code) amended in 1992, Anti-corruption Act 2002, Financial Procedure Act 1999, and Financial Administration Rules 1999 (amended in 2003). Also in these above-mentioned laws for public servants, there are disciplinary rules and a general code of conduct under which disciplinary actions are

taken for non-compliance. Therefore, it is necessary to develop and enforce a Code of Conduct for public sector accountants who are not members of the ICAN. The new code, which should be incorporated into the relevant laws, should be based on the IFAC-issued Code of Ethics or ICAN-issued Code of Conduct for professional accountants. The arrangements should be made within the Financial Comptroller General Office to monitor and ensure that accountants are working in accordance with the code.

### Public sector accountant arrangements

2.13. **The Chief Financial Officer (CFO) is to be designated and made accountable to the Financial Comptroller General and the Chief Accounts Officer (CAO) through Officer-In-Charge (OIC) by assigning specific functions and duties.** For timeliness, relevance, and reliability, there should be a professionally qualified CFO function to be responsible to the Chief Accounts Officer for maintaining systems of internal financial controls that manage risks, and for preparing regular financial accounts for each government entity. The Chief Financial Officer should be responsible for the maintenance and management of the chart of accounts, ensure the most appropriate technological support for financial management practices, manage training and education needs for financial management, report on key performance indicators, and assist program managers to develop an effective financial approach to the delivery of expected outcomes. The chief of the Finance Administration Unit of each government office should be designated as the Chief Financial Officer of the office, and should be responsible for maintenance of accounts, preparation and submission of financial statements, and resolution of final audit irregularities. He should be made accountable both to the Financial Comptroller General and the Chief Accounts Officer (CAO) through Officer In-Charge (OIC). The duties and functions of the chief financial officer should be defined in the Financial Procedure Act and Financial Administration Rules. The CFO function should also include effective maintenance of prescribed internal financial control systems to minimize risks and resolution of final audit irregularities.

### Empowering Nepal Accounting Standards Board to set accounting standards for the public sector

2.14. **Empower the Nepal Accounting Standards Board to set public sector accounting standards based on IPSAS.** The Government of Nepal should empower the Accounting Standards Board through legal amendment or through appropriate decision, as required, to take a lead to set public sector accounting standards based on IPSAS. To facilitate the smooth functioning of the Board, to provide necessary resources and communicate the accounting requirements of the Government, a Steering Committee should be formed chaired by the Finance Secretary and represented by the Financial Comptroller General Office (FCGO), Office of the Auditor General (OAG), ICAN and two standard setting Boards (Accounting and Auditing). The National Public Sector Accounting Standards should be promulgated based on international public sector accounting standards for consistency with the IPSAS. The Office of the Auditor General should review and report on the compliance of the public sector accounting standards.

## B. Accounting Standards as Practiced

2.15. The diagnostic questionnaires collected information on current arrangements and apparent gaps with IPSAS in the maintenance of accounts and presentation of financial reports. This exercise helped to recommend activities that will help bring local standards in line with international standards

2.16. **More formalized arrangements are needed before setting accounting standards for the public sector.** The Accounts Code sets out the detailed rules for the cash-based system of accounts. It is issued and amended by the Financial Comptroller General Office, with the approval of the Auditor General who has the responsibility under the Constitution to prescribe the format of accounts and the authority to issue accounting directives to the public sector under the Audit Act. It would be appropriate to adopt IPSAS as the standards for the public sector.

2.17. Table I identifies the current position and the steps required if the Cash Basis IPSAS are to be adopted in practice as well as on paper in the regulations.

**TABLE I. REQUIRED STEPS FOR ADOPTING CASH BASIS IPSAS**

<b>Requirements</b>	<b>Current deficiencies</b>	<b>Activity required to adopt Cash Basis IPSAS</b>
Financial statements presented in the IPSAS	The reporting structure focuses on consolidated fund and public accounts and the Cash Basis IPSAS for financial statements is not followed.	A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared using existing information from the accounting records. Also, for each entity (i.e., ministry and department), an additional statement in accord with the Cash Basis IPSAS can be prepared.
Information to IPSAS in statement of cash receipts and payments	The financial statements do not present all the information in the format required by the Cash Basis IPSAS. All this information is available on the government reporting system, but is in formats that are inconsistent with IPSAS.	This work requires restructuring of the FCGO computerized reporting formats. Technical advice is required to extract the information in the required form and present the consolidated financial statements in the format prescribed by the IPSAS.
Accounting policies and explanatory notes	The audited consolidated fund statement and annual revenue and expenditure statement do not include accounting policies and explanatory notes, whereas the FCGO-issued consolidated financial statements for government use include basic accounting principles and assumptions.	There is a need to state the accounting policies and explanatory notes, and the basis on which the accounts are prepared.



<b>Requirements</b>	<b>Current deficiencies</b>	<b>Activity required to adopt Cash Basis IPSAS</b>
<p>General considerations</p> <ul style="list-style-type: none"> <li>■ Reporting period</li> <li>■ Adequacy of information about the entity</li> <li>■ Presentation of comparative information</li> </ul>	<p>Audited financial statements are not available within 6 months of the reporting period. Cash balances that are available for use and cash balances that are subject to external restrictions and un-drawn borrowing facilities are not disclosed. The presentation does not meet certain transparency requirements of IPSAS.</p>	<p>It would be necessary to reduce the reporting lag and to disclose further information required by Cash Basis IPSAS, for example, to disclose un-drawn borrowing facilities, liabilities of the Government, and outstanding advances.</p>
<p>Correction of errors disclosed</p> <ul style="list-style-type: none"> <li>■ Nature of error</li> <li>■ Amount of correction</li> <li>■ Comparative information restated</li> </ul>	<p>The nature of errors, the amount of the correction, and the fact that comparative information has been restated, or that it is impracticable to do so, is not done.</p>	<p>Further training and better supervision of accounts officer would be needed to correctly classify expenditures and disclosure of errors, and restatement of comparative information where practicable.</p>
<p>Consolidated financial statements</p>	<p>Consolidated financial statements of consolidated funds, the appropriation, revenue, deposit, foreign aid and loan, and investment are prepared.</p>	<p>A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared. Further steps will be needed to include controlled entities as per IPSAS.</p>
<p>Treatment of foreign currency cash receipts, payments, and balances treated in compliance with IPSAS</p>	<p>The cash receipts, payments, and cash balance are accounted as per IPSAS, but financial statements are prepared using even closing rates. The exchange difference of loan liability during project period is not accounted to expenses.</p>	<p>Need to comply with the treatment of foreign currency and disclosure aspects as per IPSAS.</p>
<p>Effective date of Part I and transitional provision compliance.</p>	<p>The government has not formulated a migration path and timeline for achieving Cash Basis IPSAS, Part I, compliance.</p>	<p>Need for the OAG and FCGO to formally adopt IPSAS and for the FCGO to prepare an implementation plan and timeline setting out specific steps to be taken, including disclosure, if necessary, of application of the transitional provision (i.e., full compliance achieved within 5 years) for reporting periods beginning on a date within 5 years of first adoption of IPSAS.</p>

## C. Assessment of Accounting and Auditing in State-owned Enterprises

2.18. Audit reports from a sample of state-owned enterprises were examined for purposes of this assessment. Those state-owned enterprises whose accounts were examined are listed in Table 2. The examination revealed that two enterprises (Nepal Oil Corporation and Rastriya Banijya Bank) had qualified audit opinions.

2.19. Corporate governance in the statutory authority sector needs to be improved through a more effective audit committee. The financial statements of state-owned enterprises are not reported on time. Disclosures of the accounting policies are not adequate and transparent in accordance with International Accounting Standards. The provision of an audit committee should be made in the Relevant Acts of the state-owned enterprises. Audit committees are to be made active and effective so as to ensure corporate governance in reporting and resolve audit irregularities reported by the Auditor General.

**TABLE 2. STATE-OWNED ENTERPRISES EXAMINED**

<i>State-owned enterprise</i>	<i>Year- end for independent audit</i>
Rastriya Banijya Bank (RBB)	2004/05
Nepal Electricity Authority (NEA)	2004/05
Employees Provident Fund (EPF)	2004/05
Dairy Development Corporation (DDC)	2004/05
Nepal Telecom Company Ltd. (NTC)	2003/04
Nepal Water Supply Corporation (NWSC)	2003/04
Nepal Oil Corporation (NOC)	2001/02
Rastriya Beema Sansthan (RBS)	1997/98

2.20. **The Financial Review Committee should be set up to check the financial statements for compliance with the adopted standards.** The financial statements of the state-owned enterprises are audited and reported upon by OAG-appointed independent professional auditors. These auditors are then reviewed by the Office of the Auditor General. The appointed auditors issue audit reports to the Auditor General expressing their opinions on the financial statements of the state-owned enterprises. The Auditor General reviews the report and submits his reports to the management of state-owned enterprises in the prescribed format. Except for the financial statements of state-owned enterprises required by donor agencies, the Auditor General, ordinarily, does not express his opinion on the consolidated financial statements presented in his Annual Report, as required by Section 4 (C) of the Audit Act. The Auditor General's Annual Audit Report, however, mentions the qualification as a comment. Action is needed to require state-owned enterprises to amend their accounts in accordance with audit findings so that true and fair accounts may be issued for general public scrutiny within a stipulated period consistent with that of listed enterprises. The Financial Review Committee in the Ministry of Finance should be set up to review the financial statements of the state-owned enterprises and ensure compliance with relevant laws, Nepal Accounting Standards, International Accounting Standards and International Financial Reporting Standards.



# PUBLIC SECTOR AUDITING

## A. Statutory Framework for Public Sector Auditing

3.1. Effective scrutiny by the legislature to ensure effective implementation of fiscal and expenditure policies needs comprehensive, competent, external audits that are underpinned by International Standards on Auditing.<sup>11</sup> The environment for an effective Supreme Audit Institution (SAI) requires a comprehensive approach to public financial management. Supreme Audit Institutions are not stand-alone institutions. They are part of a PFM architecture that includes budgeting, accounting, internal control, audit and legislative oversight, and government response. Improving the way the supreme audit institution functions is integral to providing information for improving the overall PFM system. But the action must be within the executive branch, yet under the watchful eyes of the legislature and the public. A strong demand for good public sector external auditing is necessary for the Supreme Audit Institution to have any impact. This requires the willingness of the executive branch to accept and respond to external scrutiny over its management of funds and to ensure that reform action is taken. It also requires public presentation of the audit reports to ensure public support for effective action. All of these requirements are covered by the INTOSAI and IFAC Auditing Standards. These should be adopted by the Auditor General.

3.2. The diagnostic questionnaires collected information describing current arrangements and the apparent gaps in the country for the following areas:

- Institutional framework for the Supreme Audit Institution,
- Process for setting auditing standards,
- Use of code of ethics or conduct,
- Arrangements to ensure accountability in the Supreme Audit Institution,
- Arrangements to ensure independence,
- Arrangements to ensure adequate skills and qualifications for the auditors,
- Arrangements for providing training,
- Arrangements to ensure auditor competence, and
- Arrangements for quality assurance.

Those areas with significant scope for improvement are discussed below.

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<sup>11</sup> *Scope, quality, and follow-up of external audit is performance indicator No. 26 in the PFM performance measurement framework supported by the Bank and other development agencies.*



## Statutory framework

3.3. **The Audit Act should make provision for conducting other specialized audits.** The Constitution establishes the Auditor General. Annex C gives the relevant extracts from Part XII of the Interim Constitution and from the Audit Act 2048 (1991) relating to the Auditor General. The Interim Constitution authorizes the Auditor General to audit and certify accounts of the Legislative-Parliament, Constituency Assembly, Commission for Investigation of Abuse of Authority, Office of the Auditor General, Public Service Commission, Election Commission, National Human Rights Commission, Government offices, Constitutional bodies, Nepal Army, Nepal Police, Nepal Armed Police, Supreme Court and other lower courts, corporate bodies fully owned by the Government of Nepal, and other public organizations required by law to be audited by the Auditor General. The Audit Act 1991 specifies that the Auditor General-with due regard to the regularity, economy, efficiency, effectiveness and propriety-shall audit a specified set of matters but does not generalize the authority, so that it covers all types of audits (see Annex C). The Audit Act should be amended to authorize the Office of the Auditor General to conduct other specialized audits, such as environment audit and forensic audit.

3.4. **The Financial Procedure Act should contain an adequate Offences clause.** Full cooperation by auditees and ethical behavior by auditors are essential for effective audit. Current legislation is inadequate in responding to significant lack of cooperation by the auditee. A culture of impunity must be strictly guarded against, and the auditee should be punished for non-cooperation by amending the Financial Procedure Act.

## Setting auditing standards

3.5. **The Audit Act should adopt Nepal Standards on Auditing (NSA) and International Standards on Auditing.** The Office of the Auditor General developed Government Auditing Standards in 1996 based on the INTOSAI Auditing Standards. These Government Auditing Standards were updated in 2005 to accord with the revised INTOSAI Auditing Standards. These Government Auditing Standards are too general and do not describe in sufficient detail the audit procedures. The ICAN-developed Nepal Standards for Auditing are based on the IFAC-issued International Standards on Auditing (ISA). The Office of the Auditor General should also adopt the Nepal Standards for Auditing for government audits. The Office of the Auditor General should ensure that recently developed guidelines prepared as per the INTOSAI standards are implemented. Adequate resources need to be ensured to implement guidelines recently developed. The International Audit and Assurance Standards Board is progressively rolling out International Standards on Auditing. The INTOSAI is moving from maintaining its own auditing standards toward supporting the IAASB in order that the IAASB Auditing Standards appropriately reflect the interests of the international public sector audit community.

3.6. International Standards on Auditing and Nepal Standards on Auditing represent best international practices for the auditing profession, particularly in the areas of fundamental auditing practice such as:

- audit evidence,
- documentation,
- audit materiality,
- fraud,
- audit errors,
- audit opinions,
- audit planning,



- environment assessments, and
- supervising the work of audit staff.

**3.7. The Auditor General has already adopted the INTOSAI Auditing Standards as the core of its own auditing standards.** INTOSAI Auditing Standards are internationally recognized, credible, and readily available. However, it is generally recognized that INTOSAI Auditing Standards need the underpinning support of the more detailed International Standards on Auditing. With the decision by INTOSAI to adopt International Standards on Auditing and to prepare public sector practice notes, where necessary, to support each of these Standards, the way is open for Nepal to use the more comprehensive International Standards on Auditing and Nepal Standards on Auditing. This is quite appropriate as Nepal is a member of INTOSAI and its regional group, the Asian Organization of Supreme Audit Institutions (ASOSAI).

**3.8. The audit opinion needs to be provided on the consolidated government financial statement.** Currently, the consolidated financial statements of the Government of Nepal do not contain an audit opinion. While implementing the Cash Basis IPSAS, it is recommended that the audit opinion is also provided to the consolidated government financial statements.

### Code of ethics

**3.9. An effective monitoring system should be put in place.** The Office of the Auditor General adopted the INTOSAI Code of Ethics in 1996 and also developed its own INTOSAI-based Code of Ethics for its staff in 1999, incorporating provisions of various acts. The Office of the Auditor General needs to revisit its Code of Ethics to ensure that it is practical and realistic, and then set up a more rigorous monitoring system to ensure compliance.

### Accountability in the Supreme Audit Institution

**3.10. The Office of the Auditor General needs to prepare a five-year corporate plan and adopt the system of peer review.** The Office of the Auditor General is basically functioning without a long-term plan. It should prepare and implement a five-year corporate plan. The Office of the Auditor General recently requested the Malaysian National Audit Department to review OAG work; such a practice should continue on a regular basis by inviting peer reviewers from other supreme audit institutions to review the quality of the audit and offer guidance to enhance the capability of the OAG staff.

### Ensuring independence

**3.11. The Audit Act needs to be amended to provide effective independence.** Core principles of SAI independence were set out by the INTOSAI. Some of these principles were only partially, if at all, met by the current legislative and administrative framework:

- financial and managerial autonomy and the availability of appropriate human, material, and monetary resources;
- independence of the SAI Heads, including security of tenure and legal immunity in the normal discharge of their duties;
- sufficiently broad mandate and full discretion in the discharge of SAI functions; and the freedom to decide on the content and timing of their reports and to publish and disseminate them; and
- existence of effective follow-up mechanisms on SAI recommendations.

**3.12. More statutorily independent arrangements for establishing the budget should be put in place by legislation.** The Auditor General should be vested with more financial powers. The

annual OAG budget needs to be placed and approved by the Ministry of Finance, unlike other ministries, and passed by the Parliament without voting. The best international practice is for the Public Accounts Committee to discuss the OAG budget and then submit it to the Parliament without specific need for the approval of the Ministry of Finance, but usually with some comment by the Ministry of Finance.

3.13. **Legislation should mention the period within which the Annual Audit Report is to be submitted and require the Report to be made public.** The Law should fix the period within which the Auditor General should submit the Annual Audit Report to the Parliament through the Prime Minister. The Law should provide that immediately after submission to the Prime Minister, the Report is presented to the Parliament for discussion and concurrent publication. Submission and publication within six months of the end of the financial year is generally considered best practice.

3.14. **Improved Public Accounts Committee and departmental administrative processes are needed for following up audit reports.**<sup>12</sup> There is an enormous backlog by the Public Accounts Committee in hearing audit observations. Due to political instability and dissolution of the Parliament in 2002, there were no arrangements for public scrutiny of the Auditor General's Audit Reports. The Public Accounts Committee was not in existence for almost four years. Recently, Parliament has been reinstated as a result of major political movements. A Public Accounts Committee has been constituted. Since its constitution, PAC has begun to play an active role instigating public debate on outstanding irregularities as reported by the Annual Audit Reports, and reiterating the need for financial discipline for effective public financial management. Due to this four-year gap, there would obviously be a need for major institutional strengthening of the Public Accounts Committee. No doubt, under a democratic system, the Public Accounts Committee should be made more effective to complete hearing of the Audit Reports within the period specified by Parliament. The respective Secretariat of the Ministry should form a separate cell to resolve audit irregularities in coordination with the respective auditee, Financial Comptroller General Office, and the Office of the Auditor General.

### Qualifications and skills for the auditors

3.15. **Basic qualifications should include an accounting or auditing specialization for all appointees.** The current OAG recruitment criteria for financial auditors require a candidate to have graduated in commerce/management for officer level and 10+2 for non-officer. The criteria do not require specialization in accounting or auditing. As a result, the staff do not possess the necessary skills to conduct quality audits. In order to bring the existing staff up to mainstream levels of competency, extensive training for longer durations will be needed. New recruitment at all levels should require an academic degree specializing either in accounting or auditing. Emphasis should move toward providing more professional training and encouraging staff to acquire professional diplomas or degrees. The Office of the Auditor General would be required to make a substantial investment in developing its human resources. Through its last IDF grant, the Office of the Auditor General prepared a medium-term Human Resource Development Plan. The success of the Plan will be seen only when it is judiciously implemented; for this to happen, additional resources for implementation are needed.

### Training

3.16. **The Office of the Auditor General should provide extensive orientation training on recruitment and operate a continuing professional development program for its staff.** Newly recruited staff should be provided with at least 10 weeks of extensive training on IES-recommended topics

<sup>12</sup> *Legislative scrutiny of external audit reports is performance indicator No. 28 in the PFM performance measurement framework supported by the Bank and other development agencies.*

and Government Auditing Standards as well as audit guidelines. In-service training should be provided on regular basis under a continuing education program, as per the Human Resources Development Plan, to enhance and update the audit skills for conducting specialized audits in accordance with the internationally accepted best practices. The Office of the Auditor General could work with other supreme audit institutions or professional organizations to arrange for OAG staff to participate in other established, continuing education programs.

### Auditor competence

3.17. **It is necessary to strengthen the technical and professional competence of the OAG staff to produce quality audit reports that meet international standards and serve the need of the stakeholders.** The Office of the Auditor General has developed various audit guidelines; a separate directorate is working within the Office on policy-making, maintenance and updating of guidelines. The existing capacity of OAG personnel to implement these guidelines has not reached the desired level, thus requiring more training and practical experience. The adoption of the Nepal and international auditing standards will help staff to understand audit methodologies. The Office of the Auditor General concentrates on regularity and performance audits, but now needs to improve implementation through training so as to build its in-house capacities to focus more on performance audits to assess the results. These will need to measure development outputs and outcomes, and in a progressive prioritized manner, introduce forensic, environmental, and information technology audits. The Office of the Auditor General needs to create a few core groups of specialized professional accountants to conduct these specialized audits. Technology software support is needed for the audits of entities with information technology-based accounting. All these would require Government's commitment for significant reform of the Office of the Auditor General, by providing scaled-up resources, both financial and human resources, to comply with focus on new requirements.

### Quality assurance

3.18. **Improved structures and indexing of more comprehensive audit working papers is required to help audit supervisors to ensure specified quality standards.** The Government Auditing Standards, consisting of policy standards and operational guidelines, provide guidance on supervision, audit planning, compliance with laws, internal control, audit evidence, review and interpretation of audit findings, materiality, report and presentation, peer review, and debriefing for quality control. The quality of the audit is assured through direction in the form of audit plan and program, close supervision, discussion on accounting and auditing issues with appropriate authority, and a review process. Moreover, the supervisor and higher-level personnel review the work of assistants and finalize the audit findings, conclusions, and recommendations, taking into consideration the materiality and significance of the audit findings. But due to lack of trained personnel, the audit standards cannot be suitably implemented and audit working papers are not maintained properly as specified, in some cases. A robust quality assurance regime needs to be put in place and operate effectively. Working papers should be properly organized and maintained; they should be indexed for easy cross-reference, quality control review, and recording quality supervision. There is a practice of internal post-audit quality review (peer review) to some extent. Such a review system can be further enhanced through the use of external reviewers.

## B. Auditing Standards as Practiced

3.19. The diagnostics questionnaires have collected information about the current arrangements for the audit methodology and the apparent gaps in the country in the following areas:

- audit planning,
- audit supervision,
- reviewing internal controls,
- reviewing compliance with laws,
- ensuring that adequate audit evidence is collected,
- analyzing whether the financial statements accord with accounting standards,
- preparing audit opinions,
- reporting on fraud, and
- reporting on compliance.

Out of this exercise came recommended activities that will help bring local standards in line with international standards.

### Audit planning

3.20. **More comprehensive auditing requirements based on specific objectives of the audits should be planned.** The Office of the Auditor General is under-resourced with respect to personnel having knowledge to conduct all types of audit that meet the quality of its statutory obligations and experience to report within six months from the financial statement reporting date. Resource problems will be exacerbated as the Office of the Auditor General endeavors to audit all of the entities under its mandate, and to appropriately respond to the challenges of improved financial reporting over coming years. More efficient auditing processes can alleviate the problem. The Auditor General's Annual Reports should provide recommendations and advice to Parliament for improvement of the PFM system. The current introduction of comprehensive audit planning process under the Public Audit Reform and Capacity Building Project has not yet been implemented in all audits. Risk assessment, determination of materiality level, review of the internal audit work program and its preliminary assessment to identify both their strengths and weaknesses, and audit approach based on assessment of internal audit have to be specified in all audit plans. The existing system gives attention to planning timetable and human resources for the audits, but not sufficiently with risk and materiality issues. The OAG staff need to be trained in a more forward-looking and modern audit planning process.

### Audit supervision

3.21. **A more comprehensively structured working paper system is needed for all audits to attain the normal audit objectives regarding the validity of transactions.** Working papers are not filed in a systematic way. Working papers should be more structured and cross-referenced to substantiate the audit conclusion and opinion. The OAG staff need more guidance on various techniques of audit testing and process of supervision.

### Reviewing internal control

3.22. Implement internal control review process to identify audit risk recommended in the Operating Guidelines. Under the Public Audit Reform and Capacity Building Project, the Office of the Auditor General has already developed Audit Guidelines for Government audit. However, the Guidelines have not been fully implemented due to lack of sufficient technical knowledge to review internal control systems and assess audit risk appropriately. The control risk is not properly assessed and substantiated with appropriate working papers, to the desired extent. Training on Audit Guidelines and various ISA-recommended audit methodologies should be provided to the OAG staff for learning how to implement guidelines and the International Standards on Auditing, and to review internal controls for assessment



of audit risk, in addition to upgrading overall audit skills. An audit methodology should clearly outline the following points:

- audit confidence level;
- requirements for audit planning, audit work papers, and audit reporting;
- how audit materiality is determined and what is an acceptable level of audit risk and confidence;
- how to develop an appropriate mix of audit work to address audit risks.

The audit should be completed by a process that encompasses how audit errors are summarized and evaluated against audit materiality.

## Compliance with laws

3.23. **Obtain management representation letter from all government offices.** The written management representations should be obtained as required by the auditing standards from all the auditees with respect to compliance with all prevailing laws.

## Audit evidence

3.24. **The supporting documents obtained for audit evidence should be more systematically maintained.** The supporting documents obtained for audit evidence are critical in substantiating the audit findings and comments made in the audit report. Audit evidence should be properly documented, filed, and cross-referenced in the working paper file.

3.25. **Inventory and investment should be valued.** At year-end, the Office of the Auditor General should attend physical verification of inventory to obtain evidence of any impairment at some Government projects having considerable amounts of inventory. Similarly, the Government investment should be valued on the basis of share market price of shares of the entities listed in the share market and suitable valuation methods of shares of the entities not listed in the share market. Any impairment of inventory and loss on investment are to be considered for reporting in the Annual Audit Report.

## Analyzing financial statements

3.26. **Audit testing needs to be more directed toward forming an audit opinion.** Testing should be expanded to undertake full financial attest audits covering all financial assertions. A financial audit should be conducted to provide an audit opinion on the complete set of financial statements instead of commenting on the deficiencies found in the scrutinized transactions. The Audit Report is heavily compliance-based, identifying regulatory breaches in the transaction, and focuses on discrepancies found. The financial statements of the government budget sector and the state-owned enterprises published in the Audit Report should present the disclosures about various elements of the financial statements.

## Reporting on financial statements

3.27. **State-owned enterprises need to submit financial statements on time and have audits completed within a specified period.** At present, the state-owned enterprises do not prepare financial statements on time for submission to the auditors. The audit takes longer than the expected time because of delays in responding to the audit queries and lack of adequate cooperation from some auditees. The state-owned enterprises also do not respond to the preliminary audit within prescribed periods. This has caused substantial delays in completion of the audits and subsequent reporting on the financial statements. The state-owned enterprises should be strictly instructed to submit the financial

statements on time and help to complete audit within prescribed period. Failing to meet the deadline, the responsible officers should be held liable for any penalty as warranted through legislation.

**3.28. The requirements of ISA 700. The Auditor's Reports on Financial Statements, to form the audit opinion should be adopted in full.** The Audit Report contains the scope of audit, purpose of audit, audit standards, and methodologies used, but does not contain reference to the financial reporting framework used to prepare the financial statements and the degree of detail set by ISA 700 (in paragraphs 12 to 15). This leaves some uncertainties as to the standards used for the work. It is uncertain whether the audit provides a reasonable basis for the opinion, and if the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Office of the Auditor General should issue Audit Reports giving reference to the financial reporting framework and expressing an opinion on the complete set of financial statements of the government budget sector and the fully state-owned enterprises.

### Reporting on fraud

**3.29. There is a need for forensic audit training.** The Audit Report concentrates on non-compliance with the prevailing laws and covers fraudulent transactions. The Office of the Auditor General focuses on fraudulent transactions but not in a sufficiently systematic way. International Standards on Auditing (ISA) 240, The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements, requires the auditor to perform procedures to obtain information that is used to identify the risks of material misstatement due to fraud. In addition, it requires the auditor to evaluate the design of the entity's related controls, including relevant control activities; and to determine whether they have been implemented. The ISA 240 also requires the auditor to inform the auditee's management and its board of any fraud and of the failure in its internal control that led to the fraud. The Audit Report should mention the reasons that led to the fraud and actions taken by the auditee to avoid recurrence of the fraud.

### Reporting on compliance

**3.30. Improve the effectiveness of the Audit Report by more efficient action on enforcement of corporate governance requirements through the Public Accounts Committee, Audit Committees, and Audit Report Review Cell.** Under the present process, a preliminary audit report is prepared on completion of the audit and provided to the entity for comment, which is then considered in preparing the report that is sent to the Responsible Account Officer/Minister for final comment. Final observations on audit irregularities are included in the Annual Audit Report that is submitted to the Prime Minister. A follow-up on actions to resolve the irregularities is carried out during the next years' audit. The Public Accounts Committee of the Parliament calls the auditee/ministry for response to unresolved audit findings. The Public Audit Reform and Capacity Building Project found that OAG Annual Audit Reports could be improved in communicating clear objectives, addressing more relevant problems, making more effective recommendations, and involving more extensive audit work. To reduce the number of unresolved audit objections to be included in the Annual Audit Report, minor irregularities are to be reported in management letters addressed to the Secretary of the respective Ministry and the Finance Ministry. The Annual Audit Report should be concise and include only major irregularities that have system wide implications. In coordination with the respective auditee, Financial Comptroller General Office, and the Office of the Auditor General, a separate Audit Report Review Cell is to be formed in each Secretariat of the Ministry to resolve audit irregularities. This will also assist in reducing the number of irregularities to be reported to the Parliament for examination by the Public Accounts Committee.

# 4

## ACTION PLANS

<b>Accounting Standard Issues</b>	<b>Current status</b>	<b>Action required to be taken to move towards international standards</b>
<b>STATUTORY FRAMEWORK FOR ACCOUNTING</b>		
1. Does the Public Sector Accounting Law adopt IPSAS?	A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared using existing information. Some technical assistance will be needed.	OAG should approve the implementation of IPSAS on recommendation of FCGO under existing Law.
<b>EDUCATION AND TRAINING FOR ACCOUNTANT COMPETENCE</b>		
2. Does the education and training of accountants conform to IFAC International Education Standards?	No. Accounting staff recruitment should require special arrangements rather than the standard general entry.  Existing accounts cadre staff are not exposed to IPSAS.	A steering committee to be formed under the chairmanship of the Finance Secretary and having representation from FCGO, Ministry of Education & Sports, ICAN, Accounting Standards Board, and Auditing Standards Board to discuss training and education issues and recommend appropriate strategies to comply with IFAC standards. Discussion should also focus on capacity building of the existing accounts cadre.
<b>CODE OF ETHICS</b>		
3. Does the Code of Ethics match international standards?	A code of conduct for accountants based on IFAC or ICAN codes is needed and should be incorporated in relevant laws.	FCGO and MoGA in coordination with ICAN should take lead role to draft code of ethics.
<b>SETTING ACCOUNTING STANDARDS</b>		
4. Is there a body to prescribe public-sector accounting standards?	The Nepal Accounting Standards Board should be empowered to set up standards for the public sector. The Auditor General should issue directives to SOEs to adopt NAS and other international standards as necessary.	A Steering Committee, as referred above, will also facilitate and coordinate resources to the Nepal Accounting Standards Board for formulation and implementation of Public Sector Accounting Standards. The existing Law is to be amended to empower the Nepal Accounting Standards Board to formulate Public Sector Accounting Standards.



<b>Accounting Standard Issues</b>	<b>Current status</b>	<b>Action required to be taken to move towards international standards</b>
<b>FINANCIAL REPORTING</b>		
5. Are the financial statements in accord with the IPSAS standard?	No. The Government of Nepal should develop a plan for the medium-term to move toward improving the existing cash-based system to Cash Basis IPSAS with additional voluntary disclosure (e.g., un-drawn borrowings, liabilities, and outstanding advances).	
6. Is the statement of cash receipts and payments in IPSAS form?	For immediate implementation, the Government could learn from the experience of Sri Lanka in adopting Cash Basis IPSAS. For this, the Government could form a core team for a study visit to Sri Lanka and then apply possible changes in the existing accounting system. Disclosures are not in line with IPSAS.	For the remaining actions the Nepal Accounting Standard Board will assist the MoF to take the necessary steps to implement the proposed activities.
7. Are accounting policies and explanatory notes required?		
8. Are other disclosures in accord with IPSAS?		
9. Does the government issue a consolidated financial statement which consolidates all controlled entities?	This should be reviewed only after the general budget sector has been reported according to Cash Basis IPSAS.	

<b>Auditing Standard Issue</b>	<b>Current status</b>	<b>Action required to be taken to move towards international standards</b>
<b>STATUTORY FRAMEWORK FOR AUDITING</b>		
1. Is the SAI statutory framework in accord with the needs of the INTOSAI Auditing Standards?	Broadly yes, but some deficiencies need to be corrected.	The Audit Act needs to be amended in accordance with the model laws described in this report.
<b>SETTING AUDITING STANDARDS</b>		
2. Is there a body to prescribe public sector auditing standards?	The Auditor General does this.	The Nepal Auditing Standards Board should be empowered to set public sector auditing standards.

<b>Auditing Standard Issue</b>	<b>Current status</b>	<b>Action required to be taken to move towards international standards</b>
3. Have INTOSAI and IFAC audit standards been adopted?	INTOSAI Auditing Standards have been adopted.	A plan needs to be developed to gradually adopt the NSA/ISA.
4. Has a code of ethics equivalent to the INTOSAI standards been adopted?	Yes.	There is some concern that the existing code of conduct is too rigid and unrealistic in implementation, this may deserve review. OAG needs to take action on this.
<b>ENSURING INDEPENDENCE OF THE AUDITOR</b>		
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	Yes.	No action needed.
6. Does the SAI legal framework meet the INTOSAI standards for independence and powers?	Broadly.	The Audit Act needs to be considered for amendment to provide for, inter alia, more involvement of the legislature as regards arrangements for the appointment of the Auditor General and audit reporting, as set out in the model legislation referred to in this report.
<b>TRAINING AND AUDITOR COMPETENCE</b>		
7. Does the education and training of auditors conform to INTOSAI and IES standards?	Broadly, but there is room for improvement.	Recruitment and continuing professional education processes should be revised by the OAG.
8. Is the SAI equipped with the audit methods and technologies to meet the INTOSAI Auditing Standards?	Broadly, but more resources are needed.	Computer-assisted audit technology and other technological audit techniques need to be applied within OAG for conducting the audit of entities having computer-based accounting systems.
<b>QUALITY ASSURANCE</b>		
9. Does the SAI have the quality assurance programs to meet the international standards?	Yes, but implementation needs improvement.	Action is to be taken by the OAG as per the recent peer review of its work.

<b>Auditing Standard Issue</b>	<b>Current status</b>	<b>Action required to be taken to move towards international standards</b>
<b>AUDIT PLANNING AND CONDUCT</b>		
10. Do the processes for planning, supervision, evaluation of internal control, assessment of compliance with laws and collection of audit evidence for the audits meet international standards?	Partially.	The new methodologies recently developed need to be implemented through a training program.
<b>AUDIT REPORTING</b>		
11. Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are being complied with?	Yes, in the case of SOEs and project financial statements being submitted to the MoF.	Audit opinions need to be more specific in accordance with INTOSAI standards.
12. Does the auditor prepare an audit opinion on the financial statements in a form that accord with international standards?	Not in the case of the AG's Annual Report. Partially, in the case of specific audit reports provided to SOEs and project financial statements being submitted to the MoF.	The OAG should issue an audit report giving reference to the financial reporting framework used to prepare the financial statements and expressing an opinion on the complete set of financial statements of the Government budget sector and the fully owned SOEs.
13. Does the consideration of fraud and error in an audit of financial statements accord with international standards?	Broadly Yes.	More systems-based auditing would be an improvement.
14. Are the Auditor-General's reports made public?	Yes, but with delays.	Process and time allowed for publications should be laid down in the Law, as per the proposals in the model audit legislation.
<b>RESPONSE TO AUDIT REPORTS</b>		
15. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?	No. In the absence of PAC for four years, it was not possible.	Line ministries should form a separate cell or unit to monitor take actions taken to resolve on audit recommendations.



# Annex - A

## METHODOLOGY OF THE ASSESSMENT

As part of the general support program in South Asia for assessment and improvement of public sector accounting and auditing against international standards, the World Bank with the cooperation of member governments is conducting the Review of Public Sector Accounting and Auditing Practices in member countries. The development of the PFM Performance Measurement Framework<sup>13</sup> by the Public Expenditure and Financial Accountability (PEFA) Program<sup>14</sup> has opened the way for a diagnostic tool to be developed, that is referenced to the accounting and auditing standards of International Federation of Accountants (IFAC), the International Organization of Supreme Audit Institutions (INTOSAI), and other relevant international benchmarks. This exercise provides substantial insight into country performance with regard to the external auditing and financial statement reporting FM indicators.

A set of 6 questionnaires are used to collect relevant information on country practices:

1. **The public sector accounting environment** -- collecting basic information about financial laws and standards-setting arrangements, educational requirements for accountants compared with IFAC International Education Standards, ethical requirements compared with the IFAC Code of Ethics for Professional Accountants.
2. **Public sector accounting practices for the general budget sector if using the cash basis of accounting** -- compared with the requirements of the Cash Basis International Public Sector Accounting Standards (IPSAS).
3. **Public sector accounting practices for the general budget sector if using the accrual basis of accounting** -- compared with the IPSAS requirements that govern accrual reporting for the public sector.
4. **Public sector auditing environment** -- compared with the provisions of the INTOSAI Code of Ethics and the INTOSAI general standards.

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<sup>13</sup> The PFM Performance Measurement Framework has been developed as a contribution to the collective efforts of many stakeholders to assess and develop essential PFM systems, by providing a common pool of information for measurement and monitoring of PFM performance progress, and a common platform for dialogue.

<sup>14</sup> The PEFA Program is a partnership among the World Bank, the European Commission, the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa. A Steering Committee, comprising members of these agencies, manages the Program. A Secretariat is located in the World Bank in Washington, DC.

5. **Public sector auditing practices** -- compared with the requirements of the INTOSAI field standards and reporting standards, and the IFAC International Standards on Auditing (ISA).
6. **Accounting and auditing practices for state-owned enterprises** - compared with the requirements of the International Financial Reporting Standards (IFRS) and International Standards on Auditing that govern commercial reporting.

The responses to the diagnostic questionnaires, prepared by the relevant country authorities with the help of in-country experts retained by the World Bank, are supplemented by a due diligence review conducted by members of a World Bank task team.

Various documents are examined as part of the review, including relevant laws, codes of conduct, national accounting and auditing standards, accountant selection and promotion processes, training needs assessments, accountancy training course outlines, curricula and accreditation methods, sample accounts, sample audit reports and working paper sets.

A country report on the assessment is prepared for each country and reviewed by an expert panel of advisors before examination by the World Bank country team. The draft is then shared with the Government for response before finalization. Discussions will also be held with the relevant stakeholders to devise an implementation plan to address the way forward, with a view to minimize variances from international standards.



# Annex - B

## ACCOUNTING AND AUDITING STANDARDS

This Annex contains a summary of the frameworks that have been used for the public sector accounting and auditing assessment.

The International Accounting Standards Board (IASB), the International Federation of Accountants (IFAC), and the International Organization of Supreme Audit Institutions (INTOSAI) are cooperating in setting international standards for accounting and auditing.

The IASB is an independent, privately funded accounting standard-setter based in London, England. The IASB members come from nine countries and have a variety of functional backgrounds. In the public interest, IASB is committed to developing a set of high-quality, understandable, and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world. The IASB issued International Accounting Standards (IAS) from 1973 to 2000. Since 2000, it has issued International Financial Reporting Standards (IFRS).

The IFAC has its headquarters in New York, USA, and comprises 163 member bodies, mainly the national professional accountancy bodies of most countries around the world. The IFAC Board established the International Public Sector Accounting Standards Board (IPSASB) to develop high-quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements. These are the International Public Sector Accounting Standards (IPSAS). The full text of Standards and Exposure Drafts currently on issue is available at <http://www.ifac.org/publicsector>. The first 20 IPSAS are based on IAS to the extent appropriate for the public sector. The IFAC also has established the International Auditing and Assurance Standards Board (IAASB) to prepare and promulgate International Standards on Auditing (ISA) and is now working in cooperation with INTOSAI on preparing public sector guidance on the use of ISA.

INTOSAI includes the Auditors General from almost all national government audit departments around the world and has its Secretariat in the Vienna offices of the Auditor General of Austria. Its Auditing Standards Committee, chaired by the Auditor General of Sweden, produces the INTOSAI Code of Ethics and Auditing Standards, a set of standards of a higher and more generic level than the IFAC-issued ISA. The Auditing Standards Committee is working with the IAASB to prepare practice notes explaining the application of each ISA in the public sector.<sup>15</sup>

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<sup>15</sup> Working Group on Financial Audit Guidelines, INTOSAI Auditing Standards Committee, Swedish National Audit Office, 2004.

The various standards are listed on the following pages.

## **IFAC-issued International Public Sector Accounting Standards (IPSAS)**

- IPSAS 1, *Presentation of Financial Statements (May 2000)*
- IPSAS 2, *Cash Flow Statements (May 2000)*
- IPSAS 3, *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies (May 2000)*
- IPSAS 4, *The Effects of Changes in Foreign Exchange Rates (May 2000)*
- IPSAS 5, *Borrowing Costs (May 2000)*
- IPSAS 6, *Consolidated Financial Statements and Accounting for Controlled Entities (May 2000)*
- IPSAS 7, *Accounting for Investments in Associates (May 2000)*
- IPSAS 8, *Financial Reporting of Interests in Joint Ventures (May 2000)*
- IPSAS 9, *Revenue from Exchange Transactions (June 2001)*
- IPSAS 10, *Financial Reporting in Hyperinflationary Economies (June 2001)*
- IPSAS 11, *Construction Contracts (June 2001)*
- IPSAS 12, *Inventories (June 2001)*
- IPSAS 13, *Leases (December 2001)*
- IPSAS 14, *Events after the Reporting Date (December 2001)*
- IPSAS 15, *Financial Instruments: Disclosure and Presentation (December 2001)*
- IPSAS 16, *Investment Property (December 2001)*
- IPSAS 17, *Property, Plant and Equipment (December 2001)*
- IPSAS 18, *Segment Reporting (June 2002)*
- IPSAS 19, *Provisions, Contingent Liabilities and Assets*
- IPSAS 20, *Related Party Disclosures*
- IPSAS 21, *Impairment of Non-cash Generating Assets*
- Cash Basis IPSAS, *Financial Reporting under the Cash Basis of Accounting*

## **International Education Standards (IES)**

- IES 1, *Entry requirements to a program of professional accounting education*
- IES 2, *Content of professional accounting education programs*
- IES 3, *Professional skills*
- IES 4, *Professional values ethics and attitudes*
- IES 5, *Practical experience requirements*
- IES 6, *Assessment of professional capabilities and competence*
- IES 7, *Continuing professional development*
- IES 8, *Competence requirements for audit professionals*



## International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS)

IFRS 1,	<i>First-time Adoption of International Financial Reporting Standards</i>
IFRS 2,	<i>Share-based Payment</i>
IFRS 3,	<i>Business Combinations</i>
IFRS 4,	<i>Insurance Contracts</i>
IFRS 5,	<i>Non-current Assets Held for Sale and Discontinued Operations</i>
IFRS 6,	<i>Exploration for, and Evaluation of, Mineral Resources</i>
IAS 1,	<i>Presentation of Financial Statements</i>
IAS 2,	<i>Inventories</i>
IAS 7,	<i>Cash Flow Statements</i>
IAS 8,	<i>Accounting Policies, Changes in Accounting Estimates and Errors</i>
IAS 10,	<i>Events after the Balance Sheet Date</i>
IAS 11,	<i>Construction Contracts</i>
IAS 12,	<i>Income Taxes</i>
IAS 14,	<i>Segment Reporting</i>
IAS 16,	<i>Property, Plant and Equipment</i>
IAS 17,	<i>Leases</i>
IAS 18,	<i>Revenue</i>
IAS 19,	<i>Employee Benefits</i>
IAS 20,	<i>Accounting for Government Grants and Disclosure of Government Assistance</i>
IAS 21,	<i>The Effects of Changes in Foreign Exchange Rates</i>
IAS 23,	<i>Borrowing Costs</i>
IAS 24,	<i>Related Party Disclosures</i>
IAS 26,	<i>Accounting and Reporting by Retirement Benefit Plans</i>
IAS 27,	<i>Consolidated and Separate Financial Statements</i>
IAS 28,	<i>Investments in Associates</i>
IAS 29,	<i>Financial Reporting in Hyperinflationary Economies</i>
IAS 30,	<i>Disclosures in the Financial Statements of Banks and Similar Financial Institutions</i>
IAS 31,	<i>Interests in Joint Ventures</i>
IAS 32,	<i>Financial Instruments: Disclosure and Presentation see also; See also Financial Instruments - other issues</i>
IAS 33,	<i>Earnings per Share</i>
IAS 34,	<i>Interim Financial Reporting</i>
IAS 36,	<i>Impairment of Assets</i>
IAS 37,	<i>Provisions, Contingent Liabilities and Contingent Assets</i>

- IAS 38, *Intangible Assets*  
 IAS 39, *Financial Instruments: Recognition and Measurement see also; See also Financial Instruments - other issues*  
 IAS 40, *Investment Property*  
 IAS 41, *Agriculture*

## INTOSAI Code of Ethics and Auditing Standards

### Code of ethics

**Integrity.** Auditors have a duty to adhere to high standards of behavior (e.g. honesty and candidness) in the course of their work and in their relationships with the staff of audited entities.

**Independence,** objectivity and impartiality. The independence of auditors should not be impaired by personal or external interests. There is a need for objectivity and impartiality in the work and the reports, which should be accurate and objective. Conclusions in opinions and reports should be based exclusively on evidence obtained and assembled in accordance with the SAI's auditing standards.

**Professional secrecy.** Auditors should not disclose information obtained in the auditing process to third parties except for the purposes of meeting the SAI's statutory responsibilities.

**Competence.** Auditors must not undertake work for which they are not competent to perform.

### Basic postulates for the auditing standards

- (a) The SAI should consider compliance with the INTOSAI auditing standards in all matters that are deemed material. Certain standards may not be applicable to some of the work done by SAIs, including those organized as Courts of Account, nor to the non-audit work conducted by the SAI. The SAI should determine the applicable standards for such work to ensure that it is of consistently high quality.
- (b) The SAI should apply its own judgment to the diverse situations that arise in the course of government auditing.
- (c) With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a need for the accountability process to be in place and operating effectively.
- (d) Development of adequate information, control, evaluation and reporting systems within the government will facilitate the accountability process. Management is responsible for correctness and sufficiency of the form and content of the financial reports and other information.
- (e) Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the government, and audited entities should develop specific and measurable objectives and performance targets.
- (f) Consistent application of acceptable accounting standards should result in the fair presentation of the financial position and the results of operations.
- (g) The existence of an adequate system of internal control minimizes the risk of errors and irregularities. It is the responsibility of the audited entity to develop adequate internal control systems to protect

its resources. It is also the obligation of the audited entity to ensure that controls are in place and functioning to help ensure that applicable statutes and regulations are complied with, and that probity and propriety are observed in decision making. The auditor should submit proposals and recommendations where controls are found to be inadequate or missing.

- (h) Legislative enactments would facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit.
- (i) All audit activities should be within the SAI's audit mandate.\*
- (j) SAIs should work towards improving techniques for auditing the validity of performance measures.
- (k) SAIs should avoid conflict of interest between the auditor and the audited entity.

\* The full scope of government auditing includes regularity and performance audit.

#### **Regularity audit embraces:**

- Attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements;
- Attestation of financial accountability of the government administration as a whole;
- Audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;
- Audit of internal control and internal audit functions;
- Audit of the probity and propriety of administrative decisions taken within the audited entity; and
- Reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed.

#### **Performance audit is concerned with the audit of economy, efficiency and effectiveness, and embraces:**

- Audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- Audit of the efficiency of utilization of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies; and
- Audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of activities compared with the intended impact.

#### **General auditing standards**

- (a) The auditor and the SAI must be independent.
- (b) The auditor and the SAI must possess the required competence.
- (c) The auditor and the SAI must exercise due care and concern in complying with the INTOSAI auditing standards. This embraces due care in planning, specifying, gathering and evaluating evidence, and in reporting findings, conclusions and recommendations.

- (d) The SAI should adopt policies and procedures to recruit personnel with suitable qualifications.
- (e) The SAI should adopt policies and procedures to develop and train SAI employees to enable them to perform their tasks effectively, and to define the basis for the advancement of auditors and other staff.
- (f) The SAI should adopt policies and procedures to prepare manuals and other written guidance and instructions concerning the conduct of audits.
- (g) The SAI should adopt policies and procedures to support the skills and experience available within the SAI and identify the skills which are absent; provide a good distribution of skills to auditing tasks and assign a sufficient number of persons for the audit; and have proper planning and supervision to achieve its goals at the required level of due care and concern.
- (h) The SAI should adopt policies and procedures to review the efficiency and effectiveness of the SAI's internal standards and procedures.

### **Field standards**

- (a) The auditor should plan the audit in a manner that ensures that an audit of high quality is carried out in an economic, efficient and effective way, and in a timely manner.
- (b) The work of the audit staff at each level and audit phase should be properly supervised during the audit; and documented work should be reviewed by a senior member of the audit staff.
- (c) The auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control.
- (d) In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits.

### **Reporting standards**

- (a) At the end of each audit the auditor should prepare a written opinion or report, as appropriate, setting out the findings in a n appropriate form; its content should be easy to understand and free from vagueness or ambiguity, include only information which is supported by competent and relevant audit evidence, and be independent, objective, fair and constructive.
- (b) It is for the Auditor General to decide finally on the action to be taken in relation to fraudulent practices or serious irregularities discovered by the auditors.



## IFAC-issued International Standards on Auditing (ISA)

### Framework:

- Introductory matters
- 100 *Assurance Engagements*
- 110 *Glossary of Terms*
- 120 *Framework of ISAs*

### Responsibilities

- 200 *Objective and General Principles Governing an Audit of Financial Statements*
- 210 *Terms of Audit Engagements*
- 220 *Quality Control for Audit Work*
- 230 *Documentation*
- 240 *The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements*
- 240 *A Fraud and Error*
- 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*
- 260 *Communications of Audit Matters with Those Charged with Governance*

### Planning

- 300 *Planning*
- 310 *Knowledge of the Business*
- 320 *Audit Materiality*

### Internal control

- 400 *Risk Assessments and Internal Control*
- 401 *Auditing in a Computer Information Systems Environment*
- 402 *Audit Considerations Relating to Entities Using Service Organizations*

### Audit evidence

- 500 *Audit Evidence*
- 501 *Audit Evidence - Additional Considerations for Specific Items*
- 505 *External Confirmations*
- 510 *Initial Engagements - Opening Balances*
- 520 *Analytical Procedures*
- 530 *Audit Sampling*
- 540 *Audit of Accounting Estimates*
- 550 *Related Parties*
- 560 *Subsequent Events*
- 570 *Going Concern*
- 580 *Management Representations*

### Using the work of others

- 600 *Using the Work of Another Auditor*
- 610 *Considering the Work of Internal Auditing*
- 620 *Using the Work of an Expert*

### Audit conclusions and reporting

- 700 *The Auditor's Reports on Financial Statements*
- 710 *Comparatives*
- 720 *Other Information in Documents Containing Audited Financial Statements*

### Specialized areas

- 800 *The Auditor's Report on Special Purpose Audit Engagements*
- 810 *The Examination of Prospective Financial Information*

### Related services

- 910 *Engagements to Review Financial Statements*
- 920 *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*
- 930 *Engagements to Compile Financial Information*

# ANNEX C.

## NEPAL AUDITING AND ACCOUNTING LEGISLATION

### (A) Auditing Legislation

**Extracts from Part 12 of the Interim Constitution of Nepal 2007, relating to the Auditor General**

#### **Article 122. Establishment and Term of Office of Auditor-General**

- (1) There shall be one Auditor-General in Nepal.
- (2) The Prime Minister shall appoint the Auditor General on the recommendation of the Constitutional Council.
- (3) The term of the Auditor General shall be six years within the restrictive Clause (7) from the date of appointment. Provided that:
  - (a) if before the expiry of his term, the Auditor General attains the age of sixty five, he shall retire.
  - (b) he may be removed from his office on the same grounds and in the same manner as has been set forth for the removal of a Judge of the Supreme Court.
- (4) The position of the Auditor General shall be deemed vacant in the following circumstances:
  - (a) if his resignation is submitted to the Prime Minister in writing;
  - (b) if pursuant to clause (3) his term expires or he is removed from his office, or
  - (c) if he dies.
- (5) No person shall be eligible to be appointed as the Auditor General without having the following qualification and he:
  - (a) holds a graduate degree in management, commerce or account from a university recognized by Government of Nepal, or has worked in special class of the Nepal Government passing chartered accountancy examination, or has experience at least for twenty years;
  - (b) is not a member of any political party during appointment;
  - (c) attained the age of forty five, and
  - (d) has maintained high moral character.



- (6) The remuneration and other conditions of service of the Auditor General shall be as determined by law. The remuneration and other conditions of service of the Auditor General shall not, so long as he holds office, be altered to his disadvantage.
- (7) A person once appointed to the office of the Auditor General shall not be eligible for appointment in other Government Service.

Provided that nothing in this Clause shall be a bar to appointment to any position of a political nature, or to any position which has the responsibility of making investigations, inquiries or findings on any subject, or to any position which has the responsibility of submitting advice, opinions or recommendations after carrying out studies or research on any subject.

### **Article 123. Functions, Duties and Powers of the Auditor General**

- (1) The accounts of the Supreme Court, the legislative-Parliament, the Constituency Assembly, the Commission for the Investigation of Abuse of Authority, the Auditor General, the Public Service Commission, the Election Commission, the National Human Right Commission, the Office of the Attorney General, other offices of the Constitutional Bodies, the Nepal Army, the Nepal Armed Police and Nepal Police, and all other government offices and courts shall be audited by the Auditor General in the manner as determined by law, with due consideration given to the regularity, economy, efficiency, effectiveness and the propriety thereof.
- (2) The Auditor General shall be consulted in the matter of appointment of auditors for carrying out the audit of any corporate body of which Government of Nepal owns more than fifty percent of the shares or the assets. The Auditor General may also issue necessary directives setting forth the principles for carrying out the audit of such corporate bodies.
- (3) The Auditor General and his assistants shall, at all times, have access to documents concerning the accounts for the purpose of carrying out the functions stipulated in clause (1) above. It shall be the duty of the concerned office to provide all such documents or information, which may be demanded by the Auditor General or his assistants.
- (5) In addition to the accounts of the offices referred to in clause (1) above, the law may also require that the accounts of any other office or institution be audited by the Auditor General.

### **Article 124. Reports of Auditor-General to be laid before Parliament**

- (1) The Auditor General shall submit an annual report to the Prime Minister on the works he has performed. The Prime Minister shall cause such report to be laid before Parliament.
- (2) In addition to the submission of the report as mentioned in the clause (1) above, the Auditor General shall provide details of the statements of the entities audited, status of the irregularities, efforts made to resolve irregularities and progress achieved in clearing the irregularities and suggestions for improvements.

### **Extracts from Audit Act 2048 (1991) (Audit Act 2018 was repealed)**

#### **Section 3 (1). Methods of Audit**

The Auditor General may conduct final audit of the financial activities and other activities relating thereto, of the offices, bodies or organizations under its jurisdiction, either in detail or sporadically or

in samples, prescribe scope, methodology and timing of audit and present the facts obtained therefrom, make critical comments thereon and submit its reports.

#### Section 4. Matters to be audited

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 sub-heads by the Appropriation Act for respective services and tasks have been expended for the specified purposes of designated services or tasks 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 they 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 preservation 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;



## Section 6. Audit of Corporate Bodies Wholly Owned by Government of Nepal

- (1) Notwithstanding anything contained in the existing laws, the audit of the corporate bodies wholly owned by Government of Nepal shall be audited by the Auditor General, pursuant to this Act.
- (2) If the Auditor General is constrained by time and resources to audit the corporate bodies wholly owned by Government of Nepal pursuant to Sub-section (1), he may appoint professional auditors according to the existing laws, as his assistants. While appointing auditor as such, he shall give priority to Nepali citizens.
- (3) The auditors appointed pursuant to Sub-section (2) shall act under the direction, supervision and control of the Auditor General.
- (4) The powers, functions, duties and responsibilities of the auditors appointed pursuant to Sub-section (2), and the procedures to be followed by them in course of audit and provisions relating to their report shall be as prescribed by the Auditor General.
- (5) The remuneration to be paid by the concerned **organization** to the auditors appointed pursuant to Sub-section (2) shall be prescribed by the Auditor General, keeping in view the volume of financial transactions, status of accounts, number of branches and sub-branches, work load and work progress of the concerned **organization**.

## Section 7. Audit of Corporate Bodies Substantially Owned by Government of Nepal

- (1) The audit of the corporate bodies substantially owned by Government of Nepal shall be done in accordance with the existing laws relating to such body.
- (2) Notwithstanding anything contained in Sub-section (1), the Auditor General shall be consulted while appointing an auditor for auditing of the corporate bodies substantially owned by Government of Nepal.
- (3) The procedures to be followed while consulting the Auditor General for appointing auditors pursuant to Sub-section (2) and on matters of principles of audit to be followed by the auditors during their audit, shall be as prescribed by the Auditor General.
- (4) The concerned **organization** shall deliver at the Office of the Auditor General a copy of the report submitted by the auditor appointed in consultation with the Auditor General, pursuant to Sub-section (2).
- (5) The Auditor General may issue directives to the concerned **organization** in respect of the irregularities observed in the report received pursuant to Sub-section (4) and it shall be the duty of concerned **organization** to abide by such directives.

## Section 8. Annual Report of the Auditor General

The Auditor General shall submit its annual audit report, including his critical comments and recommendations thereon, to The Prime Minister on the final audit of Government Offices and other offices and **organization** prescribed by existing laws, which are subject to audit by the Auditor General.

Provided that the Auditor General may submit at any time, a report to The Prime Minister if he deems necessary to take immediate action against any loss or damage already happened or impending upon the fixed and current national assets.

### **Section 9. Recruitment of Officers and Employees and Condition of Services**

- (1) There shall be officers and employees as approved from time to time by Government of Nepal in order to assist the Auditor General in the performance of his duties. The number of such employees shall not be reduced without the approval of the Auditor General.
- (2) A separate cadre of officers and employees in the Office of the Auditor General shall be constituted. The recruitment and other conditions of services of the officers and employees within the cadre shall be as prescribed in the Rules to be framed under this Act.

### **Section 11. Powers to Frame Rules**

The Government of Nepal may, in consultation with the Auditor General, frame Rules for the implementation of this Act.

### **Section 12. Action to be taken Against Irregularities**

Necessary legal action shall be taken in respect of the faults and irregularities observed during the audit of income and expenditure and other financial matters of Government of Nepal, according to the existing laws.

## **(B) Accounting Legislation**

### **Extracts from Part 13 of the Interim Constitution of Nepal 2007 relating to the Auditor General**

#### **Article 123 (4). Form and manner of keeping public accounts**

The accounts to be audited pursuant to clause (1) above shall, subject to the relevant law, be maintained in such form as prescribed by the Auditor General.

### **Extracts from Audit Act 2048 (1991)**

#### **Section 10. Powers to issue Directives by the Auditor General**

The Auditor General may, subject to the Constitution of Nepal and the existing laws, issue **directives** to the concerned Government Offices, and Corporate Bodies wholly or substantially owned by Government of Nepal, from time to time to make proper arrangements on matters of accounts and to maintain regularity therein. It shall be the duty of the concerned offices or **organizations** to abide by such directives.

### **Extracts from Financial Procedure Act 2055 (1997)**

#### **Section 4. Responsibility to keep accounts of consolidated fund**

- (1) Maintenance of up to date accounts of consolidated fund and preparation of its annual statement shall be the duty and responsibility of the Financial Comptroller General Office and for that and



other function including submission of accounts, Financial Comptroller General Office may fix responsibility to Government office, Nepal Rastra Bank and other banks.

- (2) It will be the duty of all respective offices and bank to take and execute the responsibility as prescribed in the Sub-section (1).
- (3) Other procedures relating to operation of consolidated fund, maintenance of central accounts and preparation of financial statement shall be as prescribed.

### **Section 10. Keeping of accounts of transactions**

- (1) Accounting system of transaction shall be as prescribed by the Government of Nepal. Unless prescribed, accounts of the transactions shall be maintained as per current prevailing accounting system till such system is not prescribed
- (2) Accounts of the transaction shall be maintained in the format approved by the Office of the Auditor General.
- (3) It will be the duty of the Financial Comptroller General office to get approval of the format as per sub-section (4) and for its implementation. Auditor General, if deemed necessary to improve in the prevailing accounts format, may issue directives mentioning the improved format to the Financial Comptroller General office after obtaining suggestion of the Financial Comptroller General.
- (4) Financial Comptroller General Office shall be responsible for maintaining accounts of other two kinds of transactions except foreign aid, loan grant, investment, appropriation, revenue apart from consolidated fund and to submit consolidated financial statement to the Auditor General. Respective office shall maintain accounts of expenditures from any kind of grant or sources not included in the budget and submit its statement to the Financial Comptroller General Office within fifteen days from the end of fiscal year.
- (5) Responsible Accounts Officer shall get the consolidated accounts prepared after obtaining all the financial statements of appropriation, revenue and deposit from subordinate offices.
- (6) Responsible Accounts Officer shall arrange for keeping statement of other types of assistance received as per Sub-section (3) of Section (5) in the Subordinate office and be responsible for keeping its consolidated statement.

### **Section 11. Responsible person shall be accountable**

- (1) Responsible person shall clearly keep or arrange to keep accounts of each transaction following the procedures prescribed by the prevailing Laws.

### **Section 12. Maintenance of accounts of revenue, submission of its statements and its audit**

- (1) Chief of office shall be responsible for submission of records, statement and accounts of revenue, maintenance of its accounts and audit conducted.

### **Section 13. Deposit and accounting of cash and stock**

- (1) The responsible person shall deposit the cash in the same day or the next day & goods in the appropriate place within 7 days of the receipt and maintain the records of the same.

### **Section 14. Submission of accounts**

- (1) Financial Comptroller General Office shall submit financial statement of consolidated accounts of each financial year and accounts of the appropriation, revenue, deposit, foreign aid and loan and investment apart from consolidated fund within the period specified by the Auditor General to the Office of the Auditor General.
- (2) The Responsible Accounts Officer shall prepare and submit the consolidated financial statement of all revenue and expenditures of each fiscal year along with subordinate office to the Financial Comptroller General Office and Office of the Auditor General.
- (3) The responsible person shall submit the accounts of transactions and related documents to the concerned office or Auditor as prescribed.

### **Section 16. Audit**

- (1) Financial Comptroller General Office shall conduct or get conducted the internal audit as prescribed.
- (2) Each office shall get audit conducted from the Office of the Auditor General submitting prescribed accounts and financial statements of all kinds of income and expenditure.

### **Section 18. Responsibility for settlement of findings**

- (1) The responsible person shall be accountable for settlement of irregularities reported by the auditor by providing evidence/ documents or regularizing the legibility of the transaction or recovering.
- (2) The Responsible Accounts Officer shall be accountable to settle or get settled the audit irregularities as per prevailing laws supervising whether irregularities were settled or not as per Sub-section (1).

### **Section 19. Audit and settlement of irregularities**

- (1) The respective office shall get audit conducted of the settlement of the irregularities within 35 days from the date of receipt of irregularities reported by the Office of the Auditor General.
- (2) An application may be submitted to the Office of the Auditor General mentioning reasons if available for not able to settle the irregularities within the time limit as prescribed in Sub-section (1). Office of the Auditor General shall extend the reasonable time on receipt of such request.
- (3) The Office of the Auditor General shall intimate the responsible account officer if irregularities are not settled and audit of the same is not get conducted within the time limit as prescribed in sub-section (2) and Responsible Accounts Officer shall be accountable to initiate actions according to information received. The Auditor General shall intimate to the minister or state minister if the Responsible Accounts Officer does not take action.

### **Section 36. Making of rules**

The Government of Nepal may enact necessary rules to implement the objectives of this Act.



# ANNEX D.

## BENEFITS OF ACCRUAL ACCOUNTING

### **Extract from Study No. 14, “Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities,” IFAC Public Sector Committee, December 2003**

- I.18 The PSC has commented extensively on the benefits of accrual accounting for governments and individual public sector entities in previous Studies (Studies 5, 6, 8, 9, 10 and 11) and Occasional Papers (Papers 1, 3, 5, 6 and 7). In order to provide some context for readers who are not familiar with the PSC’s other publications, this section contains a summary of the benefits of reporting on the accrual basis.
- I.19 The information contained in reports prepared on an accrual basis is useful both for accountability and decision-making. Financial reports prepared on an accrual basis allow users to:
- assess the accountability for all resources the entity controls and the deployment of those resources;
  - assess the performance, financial position and cash flows of the entity; and
  - make decisions about providing resources to, or doing business with, the entity.
- I.20 At a more detailed level, reporting on an accrual basis:
- shows how a government financed its activities and met its cash requirements;
  - allows users to evaluate a government’s ongoing ability to finance its activities and to meet its liabilities and commitments;
  - shows the financial position of a government and changes in financial position;
  - provides a government with the opportunity to demonstrate successful management of its resources; and
  - is useful in evaluating a government’s performance in terms of its service costs, efficiency and accomplishments.

### **Financial Position**

- I.21 Accrual accounting provides information on an entity’s overall financial position and current stock of assets and liabilities. Governments need this information to:
- make decisions about the feasibility of financing the services they wish to provide;



- demonstrate accountability to the public for their management of assets and liabilities recognized in the financial statements;
  - plan for future funding requirements of asset maintenance and replacement;
  - plan for the repayment of, or satisfaction of, existing liabilities; and
  - manage their cash position and financing requirements.
- I.22 Accrual accounting requires organizations to maintain complete records of assets and liabilities. It facilitates better management of assets, including better maintenance, more appropriate replacement policies, identification and disposal of surplus assets, and better management of risks such as loss due to theft or damage. The identification of assets and the recognition of depreciation help managers to understand the impact of using fixed assets in the delivery of services, and encourage managers to consider alternative ways of managing costs and delivering services.
- I.23 Accrual accounting provides a consistent framework for the identification of existing liabilities, and potential or contingent liabilities. The recognition of obligations meeting the definition of a liability and the criteria for recognition:
- compels governments to acknowledge and plan for the payment of all recognized liabilities, not just borrowings;
  - provides information on the impact of existing liabilities on future resources;
  - means that it is possible to allocate responsibility for the management of all liabilities; and
  - provides necessary input for governments to assess whether they can continue to provide current services and the extent to which they can afford new programs and services.
- I.24 Accrual accounting highlights the impact of financing decisions on net assets/equity and may lead governments to take a longer term view when making financing decisions than is generally possible when relying on cash or modified cash reports. Information on net assets/equity also means that governments may be held accountable for the financial impact of their decisions on both current and future net assets/equity. Changes in an entity's net assets/equity between two reporting dates reflect the increase or decrease in its wealth during the period, under the particular measurement principles adopted and disclosed in the financial statements. Under the accrual basis of accounting, the financial statements will include a Statement of Financial Position which discloses information about assets and liabilities. Where assets and liabilities are not equal, a residual figure for net assets/equity will be reported. Where this figure is positive it can be interpreted as the net resources that may be applied for the provision of goods or services in the future, and therefore the community's investment in the reporting entity. Where the figure is negative, it may be viewed as the amount of future taxation or other revenues which are already committed to paying off debt and other liabilities. Net assets/equity can comprise some or all of the following components:
- contributed capital;
  - accumulated surpluses and deficits; and
  - reserves (for example revaluation reserve; foreign currency translation reserve).



## Financial Performance

- I.25 Accrual accounting provides information on revenues and expenses, including the impact of transactions where cash has not yet been received or paid. Accurate information on revenues is essential for assessing the impact of taxation and other revenues on the government's fiscal position, and in assessing the need for borrowing in the long term. Information on revenues helps both users and governments themselves to assess whether current revenues are sufficient to cover the costs of current programs and services.
- I.26 Governments need information about expenses in order to assess their revenue requirements, the sustainability of existing programs, and the likely cost of proposed activities and services. Accrual accounting provides governments with information on the full costs of their activities so that they can:
- consider the cost consequences of particular policy objectives and the cost of alternative mechanisms for meeting these objectives;
  - decide whether to fund the production of services within government sub-entities, or whether to purchase goods and services directly from non-government organizations;
  - decide whether user fees should cover the costs associated with a service; and
  - allocate responsibility for managing particular costs.
- I.27 Accrual accounting can provide financial information on whether sub-entities are delivering specified services, and delivering them within agreed budgets. The same information, at a more detailed level, can also be used within sub-entities for the management of activity and program costs.
- I.28 Accrual accounting allows an individual entity to:
- record the total costs, including depreciation of physical assets and amortization of intangible assets, of carrying out specific activities;
  - recognize all employee-related costs and to compare the cost of various types of employment or remuneration options;
  - assess the most efficient way of producing their goods and services and of managing the resources over which they have been delegated authority;
  - determine the appropriateness of cost-recovery policies; and
  - monitor actual costs against budgeted costs.

## Cash Flows

- I.29 Accrual accounting provides comprehensive information on current cash flows and certain projected cash flows, including the cash flows associated with debtors and creditors. It can therefore lead to better cash management and may assist in the preparation of more accurate cash budgets.

# ANNEX E.

## SELECTION AND TRAINING FOR ACCOUNTANTS AND AUDITORS

1. There are two separate cadres of accounts and audit staff in the Government: (a) a cadre of audit staff in the Office of the Auditor General, and (b) a cadre of accounts staff in the Financial Comptroller General Office.

### **Accounts Cadre Staff**

2. Accounts cadre staff are required to have educational qualifications in commerce, law, economics, statistics, and mathematics for gazetted officers and any academic subject for non-gazetted second class appointments (non-officers); and are recruited by the Public Service Commission for assignment in the Nepal Civil Service to work under the Financial Comptroller General Office. These staff are under the administrative control of the Financial Comptroller General Office, which controls their assignment, transfer, promotion, and disciplinary action. They work as accountants in the government offices or as internal auditors to conduct internal audit of the government offices on behalf of the Financial Comptroller General Office.

3. Accounts cadre staff of officer level are trained in the Nepal Administration Staff College and Revenue Administration Training Center for five weeks in a foundation course after appointment. The accounts cadre staff remains probationary for one year. They are then posted to the Financial Comptroller General Office. Advanced training is provided to the officer-level staff, once during their service at each officer level, for five weeks. Training to the non-officer staff is not compulsory during their service period; however, training is provided to some non-officer staff on a needs basis. Officer-level staff may also receive advanced training abroad.

4. The accounts cadre staff of officer level in the NASC and RATC go through the following courses:
- (a) Accountancy, elementary;
  - (b) Government accounting;
  - (c) Loan disbursement and accounting;
  - (d) Project accounting;
  - (e) Financial Procedure Act, Financial Administration Rules, Audit Act and other relevant Laws of the government;
  - (f) Budgeting and reporting;
  - (g) Regularity and performance auditing;
  - (h) Internal audit;



- (i) Financial management;
- (j) Procurement procedure.
- (k) General understanding of NAS and IAS

### **Audit Cadre Staff**

5. Audit cadre staff are required to have a minimum educational qualification of graduation in commerce or management for officer level and school grade 10+2 for non-officers. They are recruited by the Public Service Commission in consultation with the OAG, according to the OAG Employees Service Rules. The Auditor General can also hire the services of any expert required for audit work, under contract with reasonable remuneration.

6. The OAG's training directorate provides training to the newly recruited staff on accounting, auditing and relevant laws. It also provides training under a continuing education program on a needs basis. Training materials and curricula, and the skills of trainers need to be improved. The OAG's syllabus does not cover the whole syllabus recommended by the IES. Training in more specialized areas and in IT is outsourced to professional training institutions. Some staff are also provided with scholarships to study Chartered Accountancy courses. At present there are five Chartered Accountants in the OAG. The Human Resources Development plan developed in 2005 requires a minimum of 18 hours attendance in the continuing education program (CEP) annually and a minimum of 54 hours of CEP over a rolling 3 years period. The plan is in the process of being implemented.

7. The audit cadre officers are provided training on the following courses:

- (a) OAG's organization and management structure;
- (b) Government accounting, project accounting;
- (c) Auditing;
- (d) Government auditing standards;
- (e) Nepal Accounting Standards and its legal relevance;
- (f) Internal audit;
- (g) Audit provision made in the Company Act, Audit Act and various Acts;
- (h) Audit plan, program, supervision, follow up and maintenance of audit file;
- (i) Audit of state-owned enterprises and autonomous bodies;
- (j) Regularity, performance, revenue, procurement, and foreign-aided project audit;
- (k) Audit of construction projects;
- (l) Audit report writing;
- (l) Functions, duties and authorities of the Public Accounts Committee;
- (m) Functions, duties and authorities of the OAG;
- (n) Financial Procedure Act, Financial Administration Rules, and other relevant Laws governing audit; and
- (o) Civil Service Act and Regulation and OAG Employees Regulation.

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## I. PUBLIC SECTOR ACCOUNTING

### A. Assessment of the National Public Sector Accounting Environment

Timely, relevant, and reliable financial information is required to support all fiscal and budget- management, decision-making, and reporting processes.

The Accounting Law		
STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>I. For reliability, the requirements for public sector accounting and reporting should be specified by Law, cover all government-owned enterprises, specify the methods by which accounting and auditing standards are to be set for the public sector, specify the reporting requirements and lay down timetables for the publication of audited annual accounts.</p>	<p>Public sector accounting and reporting are governed by the parts 9 and 12 of the Interim Constitution of Nepal 2007, and the following laws:</p> <ul style="list-style-type: none"> <li>■ Audit Act 1991 (repealing Audit Act 1961),</li> <li>■ Financial Procedure Act 1999,</li> <li>■ Financial Administration Rules 1999 (amended in 2003),</li> <li>■ Operating Fund Act 1986,</li> <li>■ Company Act 2007,</li> <li>■ Bank and Financial Institution Act 2006,</li> <li>■ Nepal Rastra Bank Directives,</li> <li>■ Public Enterprises Act 1972,</li> <li>■ Relevant Acts of State-Owned Enterprises,</li> <li>■ Relevant Acts of Autonomous Bodies,</li> <li>■ Appropriation Act (enacted every year),</li> <li>■ Finance Act (enacted every year),</li> <li>■ Loan and Guarantee Act (enacted every year),</li> <li>■ National Loan Act (enacted every year).</li> </ul> <p>The Law covers government offices, Constitutional bodies, autonomous bodies, and government-owned enterprises.</p> <p>Subject to the relevant law, the accounts of government offices, constitutional bodies, and autonomous bodies are maintained in the form recommended by the Financial Comptroller General Office and as prescribed by the Auditor General. The government accounts have been maintained on a cash</p>	<p>The Auditor General has already issued directives to state-owned enterprises (SOE) to adopt guidelines stated in the Company Act for presentation of financial statements but has not specified the adoption of NAS and IAS. The relevant laws governing state-owned enterprises should be amended to prescribe for mandatory application of NAS, and applicable IAS and IFRS for those accounting standards where NAS has not been promulgated. Until the amendment of the relevant laws, it is recommended that the Auditor General issues directives to state-owned enterprises exercising authority entrusted by the Audit Act to comply with NAS and important applicable IAS and IFRS.</p> <p>The Audit Act and Financial Procedure Act should be amended for maintenance of government accounts on Cash Basis IPSAS and publication of a consolidated financial statement in accordance with Cash Basis IPSAS financial reporting. Once the Cash Basis IPSAS is adopted for at least five years, the accrual basis of accounting should be adopted for the general budget sector.</p> <p>The Government of Nepal should empower the Nepal Accounting Standards Board to set public sector accounting standards based on IPSAS. The auditing</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	<p>basis of accounting since 1962 but not as per the Cash Basis IPSAS. The accounts of the local autonomous bodies, Village Development Committees and District Development Committees, are to be maintained on the cash basis of accounting while the municipalities can maintain accounts either on the cash basis or accrual basis of accounting.</p> <p>Laws governing state-owned enterprises have made provision for maintenance of accounts on the basis of a double-entry book-keeping system following generally accepted accounting principles for state-owned enterprises, except companies and banks; and Nepal Accounting Standards (NAS) in case of companies; but there is no provision for mandatory compliance of International Accounting Standards (IAS), except for banks.</p> <p>The Audit Act has entrusted authority to the Auditor General— subject to the Interim Constitution of Nepal 2007 and the existing laws—to issue directives to the concerned government offices and corporate bodies, wholly or substantially owned by Government of Nepal, from time to time, to make proper arrangements on matters of accounts and to maintain regularity therein.</p> <p>There is no accounting standard-setting authority for the public sector. The Nepal Accounting Standard Board formed under the Nepal Chartered Accountant Act 1997 has promulgated 19 accounting standards applicable to companies. In the absence of legal provision to comply with these standards, except companies and banks, state-owned enterprises have been following the required IAS and NAS.</p>	<p>standards, which are based on the International Standards on Auditing, and promulgated by the Nepal Accounting Standard Board, should be adopted by the OAG for auditing the general budget sector.</p> <p>The timetable for publication of audited annual accounts should be specified in the Audit Act. Provision for appropriate actions should be made in the Relevant Acts of state-owned enterprises for late submission of the annual accounts for audit.</p>



STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	<p>Similarly, the Nepal Auditing Standard Board formed under the Nepal Chartered Accountant Act 1997 has promulgated 30 auditing standards.</p> <p>Section 14 of the Financial Procedure Act requires submission to the Office of the Auditor General of financial statements of consolidated accounts of each financial year and accounts of the appropriation, revenue, deposit, foreign aid, and loan and investment, apart from consolidated funds within the period specified by the Auditor General.</p> <p>The Auditor General conducts audits, with due regard to the regularity, economy, efficiency, effectiveness and propriety, to ascertain whether financial transactions comply with existing laws and accounts have been maintained in the prescribed forms, and such accounts fairly represent the position of the transactions.</p> <p>The laws have not prescribed timetables for the submission of audit reports and publication of audited annual accounts of the government account and the state-owned enterprises, except companies and banks. However, the Auditor General had submitted annual audit reports within the next financial year. The companies and banks should publish their annual accounts within five months from the end of fiscal year; but in most cases it is not followed. Audit of many state-owned enterprises are substantially delayed due to late preparation of accounting records and financial statements, and delay in responding to the preliminary management report. Even if the audit of state-owned enterprises is completed on time, the publication of SOE audited annual accounts is delayed due to late submission of the audit report by the Auditor General.</p>	

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>2. Compliance with IPSAS for noncommercial bodies and IAS for commercial bodies is needed for consistent transparency.</p>	<p>There are no specific requirements regarding compliance with IPSAS in the government sector accounting. The Government is maintaining accounts on the cash basis of accounting, but the annual financial statements are not prepared in this format or on Cash Basis IPSAS. For example, advance payments are treated as expenditures in the existing cash basis of accounting. The audited consolidated fund statement and annual revenue and expenditure statement do not include accounting policies and explanatory notes; however, the consolidated financial statements issued by the FCGO for government use does include basic accounting principles and assumptions.</p> <p>The Law does not require compliance with IFRS (including IAS) for the state-owned enterprises, except companies and banks. The state-owned enterprises are required to maintain accounts on the basis of double-entry systems following generally accepted accounting principles. The Law does not prohibit state-owned enterprises from compliance with the standards, and accordingly state-owned enterprises are maintaining some IAS- and NAS-based accounts.</p>	<p>The Financial Comptroller General should recommend and obtain approval of the Auditor General for the format of consolidated financial statements based on the Cash Basis IPSAS and prepare the financial statement on that basis for immediate implementation. Until amendment of the Audit Act and Financial Procedure Act, the information required for Cash Basis IPSAS is available in the current cash basis of accounting under the Financial Procedure Act for immediate implementation, the Government of Nepal could learn from the experience of Sri Lanka in adopting Cash Basis IPSAS.</p> <p>Transition from Cash Basis IPSAS to Accrual Basis IPSAS for accounting and reporting of expenditure of general budget sector (noncommercial bodies) should be adopted with consideration of the capability of the accountants and accounting systems. Cash basis of accounting is to be followed to account revenue.</p> <p>The Auditor General can issue directives exercising authority entrusted by the Audit Act to the state-owned enterprises for maintenance of accounts based on NAS and applicable IAS, and for immediate implementation of NAS and applicable IAS and IFRS. Subsequently, the Relevant laws of state-owned enterprises should be amended to prescribe for mandatory application of NAS and applicable IAS and IFRS.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<b>Education and Training of Public Sector Accountants</b>		
<p>3. For reliability, the curriculum requirements for the accounting qualifications of public sector accountants should accord with internationally recognized standards of accounting training as established in the International Education Standards for Professional Accountants (IES).</p>	<p>The qualifications of public sector accountants do not require training in internationally recognized standards of accounting as established by the International Education Standards for Professional Accountants.</p> <p>Educational qualifications, generally in commerce, law, economics, statistics, or mathematics are required for public sector accountants. The curriculum of the commerce discipline is not adequate for requirements of public sector professional accountants.</p> <p>The majority of public sector accountants are not qualified professional accountants (members of a professional accounting body). A few qualified professional accountants are working in some state-owned enterprises. Many accountants are from non-commercial backgrounds and are working on the basis of experience.</p> <p>The Nepal Administrative Staff College (NASC) and Revenue Administration Center (RATC) provide one-month intensive orientation training to newly recruited government officer-level accountants. This training, given after recruitment but before deputation, covers the government accounting system, financial management, relevant laws, and a general understanding of IAS. Upon request, the Revenue Training Center also provides training on revenue accounting to the government accountants. Training is not provided to the newly recruited non-officer staff. Some public sector enterprises, including Nepal Rastra Bank (Central Bank) have their own training institutions and provide training on subjects related to their own accounting system and IAS.</p>	<p>Degrees with significant accounting content should be made compulsory for the accountants of the government and all state-owned enterprises. The Government and state-owned enterprises should try to recruit more qualified professional accountants so that IPSAS, IAS, IFRS, and NAS can be more easily implemented within a short period of time.</p> <p>The Government should assist local universities to include topics of IPSAS, IAS, IFRS, NAS, and IES-prescribed courses in the curriculum of the accounting degree.</p> <p>The training curricula should meet the professional accountancy needs of public sector accountants, based on the academic qualifications of the accountants, and impart basic knowledge and encourage independent work.</p> <p>The period of orientation training should be increased to at least 10 weeks (from 5 weeks).</p> <p>The NASC and RATC, which lack well-trained instructors in internationally recognized standards of accounting, should hire or train instructors to provide IES-based training for professional accountants. The Government and state-owned enterprises may also enter into agreement with the ICAN or private centers to provide the necessary training.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	Some private training centers use qualified professional accountants to provide training on IAS and NAS to the SOE staff and persons seeking new SOE jobs.	
4. For reliability, public sector accountants should be provided with continuing professional training requirements that accord with internationally recognized standards of accounting training.	<p>There are 4,523 staff members involved in accounts. Their academic qualifications vary depending on their level of designation, but for the most part, they lack professional accounting training.</p> <p>Five-week training is provided to officer-level staff, once during service at each level. Training to non-officer staff is not compulsory during their service period. Training is provided to some non-officer staff on a needs basis. There is a general need to provide public sector accountants with comprehensive training in line with the IES for Professional Accountants. Training curricula should include IPSAS, IAS, IFRS, internal control system, audit, financial data analysis, macroeconomic analysis, and other relevant subjects.</p>	<p>Training is necessary to enhance the accounting skills of the accountants and to implement IPSAS, IAS, IFRS, and NAS, easily and smoothly. The extent of continuing education depends on the academic qualifications and training already provided to the individuals.</p> <p>The Government should conduct a study to establish the status of various levels of accountants and understand their comprehensive training needs. A continuing professional education strategy for short-term and long-term training of five years that accords with internationally recognized standards of accounting training should be developed based on the study. Compulsory continuing professional education training should be provided to all the accountants according to their level within five years or a specified period.</p> <p>Professional training may be provided with the help of the ICAN and its sister organization, the Nepal Accounting Technician Institute, for immediate implementation of IPSAS.</p>

### Code of Ethics for Public Sector Accountants

*The INTOSAI code covers integrity, independence, objectivity and impartiality; professional secrecy and competence.*

5. For reliability, public sector accountants should be required to adhere to	There is no specific code of ethics for public sector accountants. Public sector accountants are guided by	It is necessary to develop and enforce a code of ethics based on IFAC or ICAN codes for the
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STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>the principles laid down in a code of ethics that are at least in accordance with the internationally recognized standards for professional accountants. This may be based on IFAC or INTOSAI codes.</p>	<p>the Civil Service Act (Code) amended in 1992, Anti-corruption Act 2002, Financial Procedure Act 1999, and Financial Administration Rules 1999 (amended in 2003). The Civil Service Code is not in accord with the IFAC or INTOSAI Codes of Ethics.</p> <p>The OAG adopted the INTOSAI Code of Ethics in 1996. In 1999, the OAG also developed its own staff code of ethics, which is compatible with INTOSAI Code of Ethics.</p> <p>Since 2004, ICAN has enforced a code of ethics in line with the IFAC Code of Ethics for Professional Accountants.</p> <p>If found negligent by the courts, government accountants can be penalized for noncompliance of acts and financial rules as per provisions of the respective laws. Similarly, ICAN takes action for breach of the code of ethics by public sector accountants who are ICAN members.</p>	<p>public sector accountants who are not members of ICAN and OAG staff by incorporating it in relevant laws. The arrangement should be made within FCGO to ensure compliance with the code.</p>

### Public Sector Accountant Arrangements

<p>6. For timeliness, relevance and reliability, there should be a professionally qualified CFO function to be responsible to the chief accounts officer for maintaining systems of internal financial controls that manage risks, and for preparing regular financial accounts for each government entity.</p> <p>7. The CFO should also be responsible for the maintenance and management of the chart of accounts, to ensure the most appropriate</p>	<p>The Financial Procedure Act makes provision for a Responsible Accounts Officer and Responsible Person. Responsible Accounts Officer means the secretary responsible for the ministry and the subordinate offices of the ministry to maintain accounts, prepare consolidated financial statements, submit statements of accounts, arrange for the audit to be conducted, respond to the report of the Auditor General, and take or cause to be taken actions to settle irregularities by taking part in the discussions held at the Public Accounts Committee. Responsible Person means the Officer in-charge or other person responsible to carry out the financial activities</p>	<p>The roles of Responsible Accounts Officer (i.e., Secretary) or Responsible Person (i.e., Officer in-charge) and Chief of Finance Administration Unit should be clearly divided between financial administration function and accounting function.</p> <p>The Chief of Finance Administration Unit should be designated as chief financial officer and should be responsible for maintenance of accounts, preparation and submission of financial statements, and resolution of final audit irregularities; and accountable both to the FCG and the Chief Accounts Officer (CAO)</p>
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STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>technological support for financial management practices, manage training and education needs for financial management, report on key performance indicators, and assist program managers develop an effective financial approach to the delivery of expected outcomes.</p>	<p>as delegated by the Responsible Accounts Officer. Functions and duties of the Responsible Accounts Officer and Responsible Person are similar to the chief financial officer in the Financial Procedure Act and Financial Administration Rule.</p> <p>The Chief of Finance Administration Unit of each office under the accountability of the Officer in-charge maintains accounts of expenditures, prepares statements of expenses and financial statements, maintains records of the audit irregularities and submits evidence to resolve irregularities. He/she carries out financial transactions assigned by the Officer in-charge, gives opinion on financial transactions to the Officer in-Charge, and bears responsibility for decisions taken on the basis of such opinion.</p> <p>The Financial Comptroller General acts like the chief accounts officer but with duties and functions not specified in acts and rules. The FCGO is responsible to maintain the central level accounts and prepare annual financial statements of the appropriation, revenue, deposit, assistance, grant, loan, interest, dividend, investment, consolidated fund, contingency fund, and other government funds; give necessary instructions after inspecting offices; resolve giving opinion on disputes arisen in respect of implementation of Financial Administration Rules; maintain records of central irregularities based on annual statements of irregularities received from the constitutional bodies and ministries; and carry out such functions as specified by Government of Nepal for implementation of financial rules.</p>	<p>through the Officer in-charge (OIC).</p> <p>The Responsible Account Officer or Responsible Person should be made responsible for the administration of the office, implementation of the program, and financial administration and jointly accountable with chief financial officer for maintenance of accounts and preparation and submission of the financial statements.</p> <p>The duties and functions of the FCG and chief financial officer should be defined in the Financial Procedure Act and Financial Administration Rules. It should be specified to whom they are accountable.</p> <p>Initiate reforms in the existing internal audit system which should include a separate Internal Audit Division in the FCGO. Further, a separate cadre of internal auditors should be formed. Accounting function should be kept separate from internal audit function, and there should be no inter-transfer between these two disciplines.</p> <p>Special training to conduct internal audit should be provided to the Internal Audit Division. Report of internal audit should be submitted to the FCG and to the concerned office through FCGO.</p> <p>The Internal Audit Manual, developed in 1995, later revised in 2006, should be revised to reflect recent changes in the concept of internal audit, auditing standards, and various laws.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	<p>The positions of chief financial officer and chief accounts officer are not specifically provisioned in the act and rules that would define their duties, functions, and accountability.</p> <p>The Responsible Accounts Officer maintains accounts and prepares financial statements and submits them to the FCGO and OAG. The Chief of Finance Administration Unit, although an accountant, is not directly responsible for accounting. The Chief of Finance Administration Unit is responsible to the Officer in-charge for maintenance of accounts and financial administration, while responsible to the FCGO for only personnel administration and not for maintenance of accounts. As a result, accountants are not held responsible and accountable to FCGO for maintenance of accounts and preparation of financial statements even though FCGO administers the Government accountants.</p> <p>Appointment for chief financial officer and chief accounts officer does not require specific professional accounting qualifications in the Government of Nepal</p> <p>FCGO is responsible for maintaining systems of internal financial controls, maintenance and management of the chart of accounts to ensure the most appropriate financial management practices, and manage training and education needs for financial management. The Chief of Finance Administration Unit assists program managers to develop an effective financial approach to the delivery of expected outcomes and report on key performance indicators.</p> <p>There is no written Internal Control Manual.</p>	<p>FCGO must develop an Internal Control Manual to guide the staff to apply and ensure best practices of internal control system in financial management.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	<p>One accountant works as both an accountant and internal auditor depending on deputation. The accountants are not trained to conduct internal audit. An Internal Audit Manual needs to be prepared and implemented. As a result internal audit is not effective.</p> <p>The final audit irregularities are not resolved on time since the Chief of Finance Administration Unit is not accountable for resolution of irregularities.</p>	

## B. Assessment of National Public Sector Accounting Standards

*Financial reporting must be adequate to meet the accountability demands of stakeholders.*

### Framework for the Preparation and Presentation of Financial Statements

<p>8. National accounting standards should accord with international standards to provide consistency.</p> <p>The responsibility for establishing national accounting standards for the public sector should be well defined to provide reliability.</p>	<p>The Government has not adopted IPSAS. There is no public sector accounting standard-setting board. However, the Auditor General is authorized to prescribe the format of accounts on the recommendation of the FCGO under the Constitution and issue accounting directives to the public sector under the Audit Act.</p>	<p>The Nepal Accounting Standards Board should be empowered to set public sector accounting standards based on IPSAS. The national public sector accounting standards should be promulgated based on international public sector accounting standards, for consistency with the IPSAS.</p> <p>The Government should adopt the IPSAS until national accounting standards are promulgated. The OAG should review and report whether the financial statements have been prepared in compliance with the public sector accounting standards.</p>
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### Preparation and Presentation of Financial Statements on the Cash Basis

<p>9. Financial statements should be presented using IPSAS.</p>	<p>Nepal has not adopted the Cash Basis IPSAS and financial statements do not present all the information in the format required by Cash Basis IPSAS.</p> <p>The FCGO has all the information required for presenting consolidated</p>	<p>The consolidated financial statements should be presented in the IPSAS. The FCGO is capable and willing to report on the Cash Basis IPSAS. However, technical advice is required to extract the information in the required form and present the consolidated</p>
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STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	financial statements in the format of IPSAS (as per discussions held with FCGO).	financial statements in the format prescribed by the IPSAS.  Forms of the financial statements are required to be designed to meet the requirements of the IPSAS.

## C. Assessment of Accounting and Auditing in State-owned Enterprises

### Financial Statements should comply with IAS and IFRS

10. The financial statements should include (a) balance sheet, (b) income statement, (c) statement of changes in equity, or a statement of recognized gains and losses, and (d) cash flow statement. [IAS 1.8]

The financial statements should present fairly (or give a true and fair view of) the financial position, financial performance, and cash flows of the entity. [IAS 1.13]

The financial statements should be prepared on the accrual basis of accounting. [IAS 1.25]

The financial statements should be prepared using the accounting policies established by the International Accounting Standards. [IAS 1]

The financial statements of the state-owned enterprises established under the Company Act, Corporation Act, and special Acts (Nepal Electricity Act, Employees Provident Fund Act) include (a) balance sheet, (b) income statement, and (c) cash flow statement but does not include the statement of changes in equity. The Company Act does not require preparation of statement of changes in equity. Other acts have not made the preparation of cash flow and statement of changes in equity mandatory. However, all state-owned enterprises prepare cash flow statements. The OAG annual report includes the balance sheet and the income statements of the state-owned enterprises.

State-owned enterprises established under the Company Act have to follow NAS while banks are required to follow IAS. But laws governing the state-owned enterprises, except companies and banks, have made provision for maintenance of accounts on the basis of double-entry book-keeping system following generally accepted accounting principles. There is no provision for mandatory compliance of NAS and IAS. State-owned enterprises follow some IAS. The financial statements are not prepared using the accounting policies of all IAS and

Relevant Acts of the state-owned enterprises, except companies and banks, have to be amended to prescribe for mandatory application of NAS and applicable IAS, and IFRS for those accounting standards where NAS has not been promulgated. Until the amendment of the relevant laws, the Auditor General should issue directives to state-owned enterprises exercising authority entrusted by the Audit Act, to comply with NAS and important applicable IAS and IFRS.

Provision for audit committees should be made in the relevant acts of the state-owned enterprises. Audit committees should be made active and effective to ensure corporate governance and resolve audit irregularities reported by the Auditor General.

The Financial Review Committee should be constituted in the Ministry of Finance under the Economic Affairs and Policy Analysis Division, to review the SOE financial statements and ensure their compliance with the relevant laws, NAS, and IAS.

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	<p>disclosures in the SOE accounts are not adequate to meet IAS.</p> <p>The SOE financial statements are prepared on the accrual basis of accounting, except interest income of the bank. The bank must account for income on cash basis as per Directives of the Central Bank. Some state-owned enterprises do not account for full liability of staff retirement benefits and do not follow IAS.</p> <p>The independent professional auditor, who is appointed by the Auditor General as an assistant, issues the audit report expressing his opinion on the financial statements in the format prescribed by the NSA. The Auditor General reviews the report and submits reports to SOE management in the format prescribed by the NSA. The Auditor General however does not express opinion in the format on the consolidated financial statements presented in his Annual Report, as required by the Section 4 (C) of the Audit Act. However, the OAG audit report mentions the qualification as a comment. Out of the sample of eight annual reports examined by the World Bank assessment, two audit reports (Rastriya Banijya Bank and Nepal Oil Corporation) are qualified.</p>	

**II. PUBLIC SECTOR AUDITING**

**A. Assessment of the Public Sector Auditing Environment**

Effective scrutiny by the legislature through comprehensive, competent, external audit enables accountability for the implementation of fiscal and expenditure policies.

The environment for an effective SAI requires a comprehensive approach to Public Financial Management (PFM). SAIs are not stand-alone institutions; they are part of a PFM architecture that also includes budgeting, accounting, internal control, audit and legislative oversight, and government response. Improving the way the SAI functions is integral to providing information for improving the overall PFM system, but the action must be within the executive under the watchful eyes of the legislature and the public. A strong demand for good public sector external auditing



STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
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is necessary for the SAI to have any impact. This requires willingness of the executive branch to accept and respond to external scrutiny over its management of funds and to ensure that action is taken for reform. It also requires public presentation of the audit reports to ensure public support for effective action.

### Statutory Framework

11. Statutory auditing requirements should be established by legislation.	Statutory auditing requirements are given in the Interim Constitution, Part XII; and Audit Act 1991 (repealing Audit Act 1961).	
12. The SAI should have authority to conduct a full range of audits for all government owned or controlled entities including regularity, financial, and performance audits. (INTOSAI Lima Declaration Sections 18-19)	<p>The accounts of the Supreme Court, the legislative-Parliament, the Constituency Assembly, the Commission for the Investigation of Abuse of Authority, the Office of the Auditor General, the Public Service Commission, the Election Commission, the National Human Rights Commission, the Office of the Attorney General, other offices of the Constitutional Bodies, the Nepal Army, the Nepal Armed Police and Nepal Police, and all other government offices and courts shall be audited by the Auditor General in the manner as determined by Law, with due consideration given to the regularity, economy, efficiency, effectiveness and the propriety thereof.</p> <p>The Auditor General's consultation and recommendation is needed when appointing an auditor of corporate bodies for which the Government of Nepal owns more than 50 percent shares or assets. The Auditor General is authorized to issue necessary directives setting forth the principles for carrying out the audit of such corporate bodies.</p> <p>The Audit Act does not specify the types of audits to be conducted by the auditor General; it specifies the matters to be audited. The Auditor General is authorized to conduct audits giving due consideration to the regularity, economy, efficiency,</p>	<p>The Audit Act specifies the matters to be audited. This Act does not give the degree of discretion needed or the range of audit types that should be allowed.</p> <p>The OAG is currently under-resourced in personnel having the knowledge to conduct the level and extent of auditing of all types to meet its statutory obligations and report within six months from the reporting date.</p> <p>The Auditor General should provide recommendations and advice to Parliament for improvement to the financial management system.</p> <p>The Audit Act should be amended to authorize the OAG to conduct specialized audits, such as forensic, environment, anti-corruption and fraud, for all government-owned or -controlled bodies.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>13. The legislation should set out penalties in the event of noncompliance with the auditing requirements, and these penalties should be applied appropriately.</p>	<p>effectiveness and the propriety of the transactions. This authority implies financial and performance audits other than environment, forensic, anti-corruption, and fraud audit.</p> <p>Under the Audit Act, the Employees' Regulations of OAG, and the Anti Corruption Act, disciplinary action can be taken against staff for noncompliance with auditing requirements.</p> <p>The Financial Procedures Act and the Financial Administration Rules have set out the imposition of penalty and departmental actions to the auditee for noncompliance of certain auditing requirements.</p> <p>The Audit Act and the Financial Procedure Act do not specify any penalty to the auditee if the auditee obstructs the conduct of an audit or provides wrong information.</p>	<p>The Financial Procedure Act should be amended to contain an offence clause for the following activities committed by the auditee without lawful justification or excuse, and be liable to be penalized for such an offence that:</p> <ul style="list-style-type: none"> <li>■ intentionally obstructs, hinders or resists the Auditor General,</li> <li>■ intentionally refuses or fails to comply with any lawful requirement of the Auditor General,</li> <li>■ makes a statement or gives information to the Auditor-General knowing, or reckless to the fact that the statement or information is false or misleading,</li> <li>■ willfully suppresses any information required by the Auditor-General in the performance of his/her duties, or</li> <li>■ represents directly or indirectly that the person holds any authority under this act when the person knowingly does not hold that authority.</li> </ul>
<b>Setting Auditing Standards</b>		
<p>14. The Government should adopt the INTOSAI Auditing Standards and the IAASB International Standards for Auditing for public sector entities. (ISA 200.5</p>	<p>The OAG developed Government Auditing Standards in 1996 based on INTOSAI Auditing Standards. These standards were updated in 2005 to accord with the revised INTOSAI Auditing Standards.</p>	<p>Through legislation, the OAG should also adopt ISA and NSA for conducting the SOE and government audits.</p>



STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
and INTOSAI Auditing Standards I.0.14)	<p>These Government Auditing Standards are too general and do not describe in sufficient detail the audit procedures. IFAC-issued ISA are not made mandatory to conduct government audits.</p> <p>As ICAN members, the professional auditors of fully state-owned enterprises appointed to act as an assistant of the OAG and auditors of substantially state-owned enterprises are required to follow Nepal Standards on Auditing (NSA) adopted by the ICAN. These standards are in accord with the International Standards on Auditing.</p>	
<b>Code of Ethics</b>		
15. The INTOSAI Code of Ethics should have been fully adopted by the SAI (IFAC ISA 200.4 and INTOSAI Code of Ethics 4), communicated to all staff, and applied.	The OAG adopted the INTOSAI Code of Ethics in 1996. Also, in 1999, OAG developed its own code of ethics based on INTOSAI and incorporated provisions of various acts. Some of the requirements of the OAG Code of Ethics are not realistic and practical. The OAG Code of Ethics has been distributed and communicated to all staff.	The OAG needs to revisit their Code of Ethics to make it more realistic and then follow up rigorously with an effective monitoring system to ensure compliance.
<b>Accountability in the SAI</b>		
16. There should be an accountability process in the SAI. (INTOSAI Auditing Standards I.0.20)	The OAG does not operate a management board, but responsibilities, rights, and duties are clearly laid down in the Constitution. The Auditor General must prepare an annual audit report to be laid before the Parliament.	
17. There should be clear responsibility in the SAI for (i) advising on internal finance, keeping proper financial records and accounts, and maintaining systems of internal control; (ii) for ensuring compliance with laws and regulations	Financial Procedure Act and Financial Administration Rules apply.	

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>18. The SAI should prepare an annual report on its operations and performance that is separate to its reports on its audits. It should provide an objective, balanced and understandable account of activities and achievements, and details of financial position and performance.</p>	<p>OAG does not prepare an annual report on its operation and performances. However, the Annual Audit Report includes a chapter of OAG activities undertaken during the year. The Annual Audit Report includes the number of audits conducted and financial statements (the budgets received and expenditures incurred).</p>	
<p>19. The SAI should prepare a corporate plan or equivalent.</p>	<p>The OAG does not prepare a corporate plan. It prepares an annual operational program for the audit before beginning the fiscal year (July 15) and provides it to government entities. This covers the submission of financial statements and schedules for field audit and reporting.</p>	<p>The OAG should prepare a corporate plan for a period of at least five years and implement it to enhance the capability of the OAG.</p>
<p>20. The SAI should undergo peer review or independent performance audit.</p>	<p>An internal OAG peer review is in place. The National Audit Department of Malaysia conducted a peer review during the OAG Public Audit Reform and Capacity-building Project in 2005 as a part of institutional strengthening. An independent professional Chartered Accountant is being appointed to conduct internal audit of the OAG accounts.</p>	<p>Some audits (approximately 20 every year) conducted by the OAG should undergo peer review by other SAI or external qualified professional auditors to review the quality of the audit and enhance capability of the OAG staff.</p>

**Independence provided by the Legislation**

Legislation needs to be adequate for the following core principles of SAI independence if the SAI is to provide effective external scrutiny:

- (1) Existence and de facto application of an appropriate and effective constitutional and legal framework;
- (2) Independence of the SAI Heads, including security of tenure and legal immunity in the normal discharge of their duties;
- (3) Sufficiently broad mandate and full discretion in the discharge of SAI functions;
- (4) Unrestricted access to information;
- (5) Obligation to report on their work;
- (6) Freedom to decide on the content and timing of their reports and to publish and disseminate them;
- (7) Existence of effective follow-up mechanisms on SAI recommendations;
- (8) Financial and managerial autonomy and the availability of appropriate human, material, and monetary resources.

(Core Principles of SAI Independence, INTOSAI Sub-committee on SAI Independence, 2004)

<p>21. The legislation should spell out in detail the extent</p>	<p>The Interim Constitution and Audit Act have guaranteed the</p>	<p>The Audit Act needs to be amended to provide the full range</p>
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STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>of the SAI independence. (INTOSAI Lima Declaration Section 5)</p> <p>22. The legislation should assure the independence of the SAI Heads and “Members” (in collegial organizations) and that there is security of tenure and legal immunity in the normal discharge of their duties. (INTOSAI Lima Declaration Section 6)</p>	<p>independence of the OAG. The Prime Minister appoints the Auditor General on the recommendation of the Constitutional Council. The Auditor General and his assistants shall at all times have access to information necessary for the audit.</p> <p>The Auditor General is appointed for six years and eligible for reappointment subject to 65 years of age limit. The Auditor General can be removed from office on the same grounds and in the same manner as has been set forth for the removal of a judge of the Supreme Court.</p>	<p>of effective independence set out in the Core Principles of SAI Independence.</p>
<p>23. The SAI’s constitutional/statutory/legal framework should ensure that it has available sufficient human, material and monetary resources. (INTOSAI Lima Declaration Section 7)</p>	<p>According to Section 9 of the Audit Act 1991, the OAG can have a prescribed number of separate cadre officers and employees as approved from time to time by the Government of Nepal. The number of such employees cannot be reduced without the approval of the Auditor General. The recruitment and other conditions of services of the OAG staff shall be as prescribed in the rules framed under the Audit Act.</p> <p>The budget of the OAG, after discussion with the Ministry of Finance, is submitted to the Parliament, which passes it without voting. There is no budget constraint to OAG.</p>	<p>The best international practice is to discuss OAG budget in the Public Accounts Committee and then submit to the Parliament without discussion with and approval of the Ministry of Finance.</p>
<p>24. A fixed term must be long enough to survive changes of government and avoid pressures concerning re-appointment impinging too early in the term of office of the SAI office holder. A single non-renewable appointment is preferable to avoid those pressures. (INTOSAI Working Group on SAI Independence, 2004)</p>	<p>The Prime Minister appoints the Auditor General for the period of 6 years on the recommendation of the Constitutional Council. A person to meet eligibility for appointment as Auditor General must hold post graduate degree in management, commerce or account from a university recognized by Government of Nepal or has worked in special class of the Nepal Government passing chartered accountancy examination or has</p>	

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
	<p>experience in auditing of at least twenty years, is not a member of any political party during appointment, has attained the age of forty five, and has maintained high moral character.</p>	
<p>25. The legislation should ensure that the Head of the SAI is free to determine the organization of the audit office, including personnel and contract management systems and material acquisition/disposal policies and procedures. The SAI should be able to determine personnel policies, including the selection, recruitment, training, remuneration, promotion, discipline, and dismissal of staff and contract personnel. (INTOSAI Lima Declaration Section 6)</p>	<p>The Office of the Auditor General is free to determine the structure of its organization with the approval of Government of Nepal.</p> <p>The Employees Service Rules enacted under the Audit Act provides the criteria of recruitment, training, promotion, discipline, dismissal, and other conditions of service of the OAG officers and employees. The Public Service Commission recruits the staff in consultation with the OAG as per these Rules. The Auditor General can hire the services of any expert required for the task of audit under contract with reasonable remuneration.</p> <p>The OAG follows the Financial Administration Rules for procurement of materials and services and disposal. Remuneration and other benefits of the OAG staff are as per the Government.</p>	
<p>26. There should be unrestricted access to information. (INTOSAI Lima Declaration Section 10)</p>	<p>The Article 123 (3) of the Interim Constitution provides unrestricted access to information. Under the Audit Act, the Auditor General may examine documents relating to accounts of the program and project being operated under the grants of Government of Nepal. And if deemed necessary in the course of audit, the Auditor General may require the contractor of government contracts to produce relevant documents or other evidence relating to the contract.</p>	<p>The penalty clause should be included in the Financial Procedure Act for restricting the auditor to obtain information required for the audit.</p>
<p>27. The legislation should give the SAI the right and obligation to report on their work. (INTOSAI Lima Declaration Section 16)</p>	<p>The Auditor General is required to submit reports, which are to be tabled in the Parliament.</p>	<p>Legislation should fix the time within which the OAG should submit the audit report to the Prime Minister, and make provision for publishing the report</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>The legislation should give the SAI the right and obligation to report effectively on its work, and the freedom to decide on the content and timing of its reports and to publish and disseminate them expeditiously. (INTOSAI Lima Declaration Section 17)</p>	<p>The Auditor General is free to decide on the content and timing of its reports. However, the Auditor General may submit a report at any time to the Prime Minister, if deemed necessary to take immediate action against any loss or damage already incurred or impending upon the fixed and current national assets. There is no legal provision for publishing the report. However, the Auditor General publishes and disseminates the report after submission of annual audit report to the Parliament.</p>	<p>to the public after submission to the Prime Minister, preferably, at the same time, presenting it to the Parliament if in session.</p>
<p>28. To the extent the findings of the Supreme Audit Institution are not delivered as legally valid and enforceable judgments, the Supreme Audit Institution shall be empowered to approach the authority, which is responsible for taking the necessary measures and require the accountable party to accept responsibility. (Lima Declaration Section 11.2)</p>	<p>The audit findings are discussed with the auditees during the audit. The preliminary audit reports are forwarded to the auditees for their comments with copy to the ministry's secretariat. Upon receipt of the comments, the final draft audit report is prepared and issued to the concerned auditee and copied to the secretariat of the respective ministry. The audit report is finalized on receipt of the response from the auditee or on expiry of the time granted for response.</p> <p>The audit reports have been disseminated to the public by putting on the OAG website after submission of the reports to the Prime Minister. The audit reports of the last four years were not tabled in the Parliament due to dissolution of the Parliament. However, after the reconstitution of the Parliament this has been tabled. There is an enormous backlog in hearing the audit objections by the Public Accounts Committee.</p>	<p>The Public Accounts Committee should be made more effective to complete hearing of the audit reports within the period specified by the Parliament.</p> <p>The secretariat of the respective ministry should form a separate cell to resolve audit irregularities in coordination with the respective auditee, FCGO, and the OAG.</p> <p>A yearly progress report of the follow up action taken by the concerned office is required to be issued.</p>

### Qualifications and Skills of the Auditor

*Qualified accountants are needed to sign audit opinions, and auditors must have adequate professional expertise and technical knowledge to carry out audits.*

29. The government and the SAI accounting schools

Government has its own training institutions, Nepal Administrative

The syllabus provided to the auditors by the OAG and

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>syllabus should cover all areas recommended by International Federation of Accountants' educational standards. (IES)</p>	<p>Staff College (NASC) and Revenue Training Center (RTC), which have specialized and qualified trainers, training materials, and curricula. Training is carried out for periods of 5 weeks to 3 months.</p> <p>OAG has its own training directorate to provide training to newly recruited staff and continuing staff on an 'as needed' basis. Training materials, curricula, and skilled tutors are not up to the desired standard. In the case of training in specialized areas and computer technology, training is outsourced to other professional trainers and institutions.</p> <p>The syllabi of the NASC and RTC do not cover all areas recommended by the IES. The OAG syllabus to some extent covers the IES-recommended syllabus.</p>	<p>NASC should cover all IES-recommended areas of training.</p> <p>The period of orientation training should be increased to at least 10 weeks for newly recruited staff.</p>
<p>30. There should be adequate professional criteria for recruitment and promotion of auditors. (INTOSAI Lima Declaration Section 14 and INTOSAI Auditing Standards 2.1.4)</p>	<p>Minimum education qualification for recruiting officer level is graduate degree in commerce or management and education level 10+2 for non-officer. The criteria do not require specialization in accounting or auditing. The OAG Employees Regulations provide criteria for promotion, such as seniority, education, training, etc. Staffs are also provided with some scholarships to study chartered accountancy. At present there are 5 professional qualified auditors in the OAG.</p>	<p>Recruitment of all level should require a degree specializing either in accounting or auditing.</p> <p>Emphasis should be to move toward providing more professional training and encouraging staff to acquire professional memberships, diplomas, or degrees.</p>
<h3>Training</h3>		
<p>31. The SAI should operate a continuing professional development program for its professional personnel. (INTOSAI Lima Declaration Section 14 and INTOSAI Auditing Standards 2.1.5-2.1.12)</p>	<p>The Human Resources Development Plan developed in 2005 requires 18 hours minimum of continuing education annually and of 54 hours minimum of continuing education over a rolling 3-years period. The plan is in process of implementation. Training facilities are modernized for this purpose.</p>	<p>The Human Resources Development Plan is to be strictly implemented.</p> <p>The OAG should work with other SAIs or professional institutions to make arrangements to provide a continuing education program for audit staff.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<b>Audit Competence</b>		
<p>32. The SAI should equip itself with the full range of up-to-date audit methodologies, including systems-based techniques, analytical review methods, statistical sampling, and audit of automated information systems. (INTOSAI Auditing Standards 2.2.37)</p>	<p>Audit guidelines have been developed. A separate directorate is working within the OAG for policy making, maintenance, and updating of the manuals, etc. However, the existing capacity of the OAG personnel to implement these manuals is not up to the desired level, and there is a need for more training and development in practical use of the manuals.</p> <p>Computer hardware and software are used for report writing purpose on a limited basis. Computer-assisted audit techniques and other audit-enhanced technologies need to be applied within OAG for conducting the audit of entities having computer-based accounting systems.</p>	<p>The OAG-developed Operating Guidelines contain the main standards of the audit methodologies but lack detailed procedures. The adoption of the NSA and ISA will help to provide the detail for the audit methodologies, including systems-based techniques, analytical review methods, statistical sampling, and audit of automated information systems. OAG staff should be trained to conduct all types of audit effectively.</p>
<b>Quality of the Audit</b>		
<p>33. The SAI should have quality assurance programs in place to ensure audit performance and results. Written quality control policies and procedures should be communicated to the audit personnel in a manner that provides reasonable assurance that the policies and procedures are understood and implemented. (ISA 220.7)</p>	<p>Government Auditing Standards, consisting of policy standards and operational guidelines, provide guidance on quality control. The staffs are being trained to understand and follow these standards and guidelines.</p>	<p>Working papers should be properly maintained in an organized way and should be indexed for easy cross-reference, quality control review, and recording quality supervision.</p>
<p>34. Quality control procedures should cover:</p> <ul style="list-style-type: none"> <li>■ Direction: Assistants to whom work is delegated need appropriate direction.</li> <li>■ Supervision: covering the following functions during the audit: (a) monitor the progress of the audit, (b) become informed of</li> </ul>	<p>The quality control procedures cover direction, supervision, and review. The audit assistants are given clear instructions through audit plans and programs. The audit work is closely monitored. The supervisor is to be immediately informed about accounting and auditing issues, and appropriate authority is to be consulted on such issues. The supervisor and higher personnel</p>	

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>and address significant accounting and auditing issues, and (c) resolve any differences of professional judgment between personnel and consider the level of consultation that is appropriate.</p> <p>■ Review: The work performed by each assistant needs to be reviewed by personnel of at least equal competence. (ISA 220.11, 220.14 &amp; 220.15)</p>	<p>review the work of assistants. There is a practice of post-audit quality review system (peer review) to some extent.</p> <p>The working papers have not been maintained properly in some cases.</p>	

## B. Assessment of Public Sector Auditing Standards and Practices

*Results from the audits should hold the executive to account for its fiscal and expenditure policies and their implementation.*

Planning		
<p>35. The planning process should collect information about the audited entity and its organization in order to identify important aspects of the environment in which the audited entity operates, develop an understanding of the accountability relationships, determine whether appropriate action has been taken on previously reported audit findings and recommendations, assess risk, and determine materiality. (IFAC ISA 300.6-300.9)</p> <p>The planning process should identify the scope of the audit, and specify the audit objectives and the tests necessary to meet them. (ISA 300.10-300.12)</p> <p>The planning process should review the internal audit of the audited entity and its work program, identify</p>	<p>The OAG follows the Government Auditing Standards and INTOSAI Auditing Standards. Information about the audited entity is collected. Follow up is done to review whether appropriate action has been taken to resolve previous year’s audit findings and implement recommendations. But the risk is not always assessed and materiality is not determined in all audits.</p> <p>The planning process identifies the scope and objectives of the audit and necessary tests required to conduct an audit.</p> <p>The planning process reviews the internal audit report of the audited entity, identifies key management systems and controls, and determines</p>	<p>The planning process of all audits should include more comprehensive planning based on the specific objectives of the audits. The auditors should be trained to implement all planning processes. They should visit other SAI for on-the-job training.</p> <p>Emphasis should be given on review of the internal audit work program and assessment of internal auditors’ strengths and weaknesses.</p>



STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>key management systems and controls, and carry out a preliminary assessment to identify both their strengths and weaknesses, and determine the approach to be adopted in the audit. (ISA 300.9)</p> <p>The planning process should highlight special problems foreseen when planning the audit. (ISA 300.10)</p> <p>The planning process should prepare a budget and a schedule for the audit, and provide for appropriate documentation of the audit plan and for the proposed fieldwork. (ISA 300.10)</p> <p>The planning process should identify staff requirements and a team for the audit. (ISA 300.11)</p> <p>The planning process should familiarize the audited entity about the scope, objectives and the assessment criteria of the audit and discuss with them as necessary. (ISA 300.7)</p>	<p>the approach to be adopted in the audit. It does not review the internal audit work program or carry out a preliminary assessment to identify both strengths and weaknesses.</p> <p>The planning process highlights special problems foreseen when planning the audit.</p> <p>In the case of some audits, the budget covers audit expenses, excluding personnel cost and office overhead cost, and the audit schedule mentions various stages of audit.</p> <p>The planning process identifies staff requirements for the audit.</p> <p>The auditors familiarize the audited entity with the scope, objectives, and assessment criteria of the audit at the time of entrance conference and during the audit.</p>	
<b>Supervision</b>		
<p>36. The process of supervision should ensure that the members of the audit team have a clear and consistent understanding of the audit plan. (INTOSAI Auditing Standards 3.2.3a)</p>	<p>The audit team gets a clear understanding about the audit plan because they are involved in the audit planning process and are guided during supervision of the audit</p>	<p>There is a need for more guidance on the audit testing to be undertaken and the functions of supervision, and the forms of audit opinion to be given.</p>
<p>37. The process of supervision should ensure that the audit is carried out in accordance with the auditing standards and practices of the SAI.</p>	<p>Senior-level officers supervise the field-level audit, review documents, and discuss the issues identified at a higher level. Audit files are reviewed at three levels of officers to ensure</p>	<p>Working papers are to be more structured and cross-referenced to substantiate the audit conclusion and opinion.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
(INTOSAI Auditing Standards 3.2.3b)	that audit is done as per auditing standards. Supervision at field level is in practice.	
38. The process of supervision should ensure that the audit plan and action steps specified in that plan are followed unless a variation is authorized. (INTOSAI Auditing Standards 3.2.3c)	Checklists are used and reviewed to ensure that audit actions and steps specified in audit plan are followed.	
39. The process of supervision should ensure that working papers contain evidence adequately supporting all conclusions, recommendations and opinions. (INTOSAI Auditing Standards 3.2.3d)	Working papers contain competent, relevant, and reasonable audit evidence to support audit conclusions, recommendations, and results.	
40. The process of supervision should ensure that the auditor achieves the stated audit objectives. (INTOSAI Auditing Standards 3.2.3e)	The supervising officer ensures it.	
41. The process of supervision should ensure that the audit report includes the audit conclusions, recommendations and opinions, as appropriate. (INTOSAI Auditing Standards 3.2.3f)	The process of supervision ensures that the audit report includes the audit conclusions and recommendations. Audit opinions in the case of state-owned enterprises are expressed in the annual Auditor General's Report but not in the standard format. Audit opinions are not expressed in the case of budget sector audits.	
<b>Internal Controls</b>		
42. The auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and sufficient to	Yes, but not in writing in all cases as per the idea given by previous audit experiences. The risk is not assessed. The OAG staff lack sufficient technical knowledge to assess audit risk appropriately.	Training on operational guidelines developed for the Government audit and various ISA-recommended audit methodologies should be provided to OAG staff. In addition to upgrading their audit skills in implementing guidelines and ISA, staff should also be provided with materials for on-the-job training

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>design and perform further audit procedures. (ISA 315.2)</p>		<p>to understand how to use audit methodologies in other SAls.</p>
<p>After obtaining an understanding of the accounting and internal control procedures, the auditor should obtain a sufficient understanding of control activities to assess the risks of material misstatement at the assertion level and to design further audit procedures responsive to assessed risks. (ISA 315.90)</p>	<p>Yes, in material cases, it is done</p>	
<p>The auditor should document in the audit working papers: (a) conclusions reached about susceptibility to material misstatement due to error or fraud; (b) the understanding obtained of the entity's accounting and internal control procedures; and (c) the assessment of control risk. (ISA 315.122-123)</p>	<p>Yes, but in case of control risk it is not properly assessed and substantiated with appropriate working papers to the desired extent.</p>	
<p>The auditor should perform tests of controls to obtain sufficient appropriate audit evidence that the controls were operating effectively at relevant times during the period under audit. (ISA 330.23)</p>	<p>Yes, tests of controls are carried out to check the operation of internal control system during the period under audit.</p>	
<p>When the auditor cannot obtain sufficient appropriate audit evidence as to a material financial statement assertion, the auditor should express a qualified opinion or a disclaimer of opinion. (ISA 330.72)</p>	<p>No, but in the case of certification of project account, the OAG expresses a qualified or a disclaimer of opinion as the case may be.</p>	
<p>The auditor should make management aware</p>	<p>Yes, a preliminary audit report is issued to the auditee to inform in writing</p>	

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>in writing, as soon as practical and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control procedures, which have come to the auditor's attention. (ISA 315.120)</p>	<p>about material irregularities caused due to weaknesses in the operation of the accounting and internal control procedures and to obtain written responses for confirmation of irregularities.</p>	
<p><b>Compliance with Laws</b></p>		
<p>43. The auditor should obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry and how the entity is complying with that framework. (ISA 250.15)</p> <p>The auditor should perform testing and other procedures to help identify instances of noncompliance with those laws and regulations where noncompliance should be considered when preparing financial statements. (ISA 250.18)</p> <p>The auditor should obtain sufficient appropriate audit evidence about compliance with those laws and regulations generally recognized by the auditor to have an effect on the determination of material amounts and disclosures in financial statements. (ISA 250.19)</p> <p>Generally, management is responsible for establishing an effective system of internal controls to ensure compliance with laws and</p>	<p>They are obtained.</p> <p>Substantive testing, including analytical testing, is performed to identify instances of noncompliance with laws and regulations.</p> <p>Audit evidence of noncompliance is obtained to substantiate the determination of material amounts and disclosures in financial statements.</p> <p>The legal framework, mandate, policies, and procedures of the entity are verified. The entity's internal control is evaluated, and risk is assessed but not in detail in case of</p>	



STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>regulations. In designing steps and procedures to test or assess compliance, the auditor should evaluate the entity's internal controls and assess the risk that the control structure might not prevent or detect non-compliance. These evaluations should be used to report to management on defects in the system of internal controls and the steps that should be taken to improve the system. (ISA 250.17)</p> <p>The auditor should obtain written representations that management has disclosed to the auditor all known actual or possible noncompliance with laws and regulations whose effects should be considered when preparing financial statements. (ISA 250.23)</p> <p>The SAI should use regularity audit to make sure that the State budget and accounts are complete and valid. The audit procedure may result, in the absence of irregularity, in the granting of a "discharge". If not, other processes are needed to resolve irregularities.</p>	<p>audit of Government offices. In case of weakness/noncompliance, corrective measures are recommended.</p> <p>Written representations are obtained from state-owned enterprises and Government offices for audit of project financial statements but not from all the Government offices.</p> <p>It is confirmed that state budget and accounts are complete and valid as per the requirement prescribed in the Audit Act by verifying budget authorizations, over-run of budget, approval of budget transfer, and proper allocation of expenditures. Mistakes in the financial statements are corrected for final reporting.</p>	<p>Written representations from the management of all Government offices should be obtained.</p>
<b>Evidence</b>		
<p>44. When obtaining audit evidence from tests of control, the auditor should consider the sufficiency and appropriateness of the audit evidence to support the assessed level of control risk. (ISA 500.10)</p>	<p>The sufficiency and appropriateness of the audit evidence are considered to support the assessed level of control risk and financial statement assertions.</p>	<p>Audit evidences should be properly documented, filed, and cross-referenced in the working paper file.</p>

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>When obtaining audit evidence from substantive procedures, the auditor should consider the sufficiency and appropriateness of audit evidence from such procedures together with any evidence from tests of control to support financial statement assertions. (ISA 500.12)</p>		
<p>45. When inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting. (ISA 500.Part A.5)</p> <p>When in substantial doubt as to a material financial statement assertion, the auditor should express a qualified opinion or a disclaimer of opinion. (ISA 500.18)</p>	<p>The auditors do not attend the physical verification conducted at the end of the fiscal year, but they carry out physical verification during the audit on material basis.</p> <p>Inventories are not shown in the financial statements of the Government.</p> <p>Qualified audit opinions or disclaimers of audit opinions are issued as necessary to the donor agencies in the case of financial statements of the Government projects and to the OAG by the auditor appointed as assistant in case of financial statements of fully state-owned enterprises.</p>	<p>The OAG should attend physical verification of inventory at the end of the year of some of the Government projects having a considerable amount of inventory.</p> <p>The OAG should also start reporting on impairment of inventory.</p>
<p>46. When long-term investments are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure? (ISA 500.38)</p>	<p>All investments are accounted by FCGO showing opening, addition/adjustment, and cumulative figures of each fiscal year. A summary of investments is reported in the Auditor General's Annual Report.</p> <p>There is no practice of valuation of Government investment.</p>	<p>The Government investment should be valued on the basis of share market price of shares of entities listed in the share market, and suitable valuation methods of shares of entities not listed in the share market. Any loss on investment should be reported in the Annual Audit Report.</p>
<b>Analysis of Financial Statements</b>		
<p>47. In regularity (financial) audit and in other types of audit when applicable, the auditor should analyze the financial</p>		<p>The financial statements of the Government budget sector and the state-owned enterprises published in the Audit Report should present the disclosures</p>

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<p>statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. (INTOSAI Auditing Standards 3.6.1) Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on the financial statements. The auditor should ascertain whether:</p> <p>(a) financial statements are prepared in accordance with acceptable accounting standards;</p> <p>(b) financial statements are presented with due consideration to the circumstances of the audited entity;</p> <p>(c) sufficient disclosures are presented about various elements of financial statements; and</p> <p>(d) various elements of financial statements are properly evaluated, measured, and presented. (ISA 200.2-200.12)</p>	<p>(a) The financial statements of the Government budget sector are prepared in prescribed forms based on government accounting systems. The financial statements of the state-owned enterprises are prepared based on NAS, IAS, or GAAP prescribed in the relevant laws.</p> <p>(b) Yes. Financial statements are presented with due consideration to the circumstances of the audited entity.</p> <p>(c) Sufficient disclosures are presented in the audited financial statements of fully state-owned enterprises submitted to the OAG. But the disclosures are not presented in the financial statements published in the Annual Audit Report. The Government does not have practice of disclosing various elements of the financial statements.</p> <p>(d) Yes, various elements of financial statements are properly evaluated, measured, and presented.</p>	<p>about various elements of the financial statements.</p>

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<b>Reporting on Financial Statements.</b>		
<p>48. The auditor should provide an opinion paragraph in the audit report. (ISA 700.4)</p> <p>There should be a reference to the financial reporting framework used to prepare the financial statements (including identifying the country of origin of the financial reporting framework when the framework used is not International Accounting Standards). (ISA 700.12-15)</p> <p>The opinion paragraph should contain an expression of opinion on the financial statements stating the auditor's opinion as to whether the financial statements give a true and fair view (or are presented fairly) in all material respects. (ISA 700.17)</p>	<p>Normally, OAG provides an audit opinion on project financial statements to the donor agencies. The OAG Annual Audit Report does not contain a separate opinion paragraph in the prescribed format.</p> <p>The OAG Annual Audit Report does not contain reference to the financial reporting framework.</p> <p>Such opinion is given in the Annual Audit Report of the financial statements of the Government projects submitted to the donor agencies. The audit report of fully state-owned enterprises submitted to the OAG by the professional auditor appointed as assistants are issued in the format and language prescribed by the national and international standards on auditing.</p>	<p>The OAG should issue audit reports giving reference to the financial reporting framework used to prepare the financial statements and expressing an opinion on the complete set of financial statements of the Government budget sector and the fully state-owned enterprises.</p>
<p>49. The SAI should provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion. Reports should be made where weaknesses exist in systems of financial control or accounting. (ISA 700.17)</p>	<p>The OAG does not issue a qualified opinion in the prescribed format but mentions the audit observations/irregularities in the Annual Audit Report. The OAG provides the final draft Audit Report before finalization for comment to the audited entities. The final audit observations presented in the Annual Audit Report are made available to the audited entities.</p>	<p>The OAG should issue any qualified opinions or disclaimers of opinion in the prescribed format</p>
<b>Reporting on Fraud</b>		
<p>50. The SAI should report fraudulent practices or serious irregularities</p>	<p>Auditors are responsible for following the applicable standards when considering fraud and error</p>	<p>The Audit Report should mention the reasons that led to the fraud, and the actions taken by the</p>

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<p>discovered by the auditors. (INTOSAI Auditing Standards 4.0.7) ISA 240 establishes standards and provides guidance on the auditor's responsibility to consider fraud and error in an audit of financial statements. The standard requires that – when planning and performing audit procedures and evaluating and reporting the results thereof – the auditor consider the risk of material misstatements in the financial statements resulting from fraud or error.</p>	<p>during audit of financial statements. If any cases of fraud and error are reported during the course of audit, they are brought to the notice of the accountable officers/ministers. Such fraud and error are reported in the draft audit report, which is forwarded to the auditee/minister for comment and incorporated after review of the response of the auditee in the Annual Audit Report.</p>	<p>auditee to avoid recurrence of the fraud.</p> <p>The OAG staff should be trained in forensic audit to conduct audits in a systematic way to find fraud and error</p>
<h3>Reporting on Compliance</h3>		
<p>51. With regard to regularity audits, does the auditor prepare a written report, which may either be a part of the report on the financial statements or a separate report, on the tests of compliance with applicable laws and regulations? (INTOSAI Auditing Standards 4.0.7)</p>	<p>A preliminary Audit Report is prepared on completion of the audit and provided to the entity for their response. And then, considering their responses and evidences submitted subsequently the final Audit Report is sent to the Responsible Account Officer/Minister for their final comment. After obtaining their comments and responses, the final observations and audit irregularities are included in the Annual Audit Report.</p> <p>A follow-up audit is also carried out during the next years' audit on resolving such irregularities.</p>	<p>The Annual Audit Report should be concise and include only major irregularities. The minor irregularities are to be reported in the separate management letter addressed to the secretary of the respective ministry and the Finance Ministry.</p> <p>A separate audit report review cell is to be formed in each secretariat of the ministry to resolve audit irregularities in coordination with the respective auditee, FCGO, and the OAG. This will reduce the number of irregularities to be reported to the Parliament and workload of the Public Accounts Committee and help to resolve the irregularities on time. In addition, it may be useful to explore other alternative approaches following reviewing of similar systems in other countries.</p>