

Executive Summary

1. This assessment of public sector accounting and auditing is generally meant to help implement more effective Public Financial Management (PFM) through better quality accounting, reporting and public audit processes in Afghanistan, and to provide greater stimulus for more cost-effective outcomes of government spending. Annex A explains the methodology used for the assessment. Reporting is a major outcome of the public accounting process that provides an important basis for PFM accountability. More specific objectives are (a) to provide the country's accounting and audit authorities and other interested stakeholders with a common strongly founded knowledge as to where local practices stand against the internationally developed norms of accounting, financial reporting and auditing; (b) to assess the prevailing variances; (c) to chart paths for improving the accordance with international standards; and (d) to provide a continuing basis for measuring improvements. The adoption of a firmly based accounting, reporting, and auditing framework is a solid value proposition; the alternative is a gross wastage of public and donor funds. One of the foremost challenges facing the adoption of a clear-cut accounting, reporting, and auditing framework, is the lack of a program for ensuring sustainable national capacity development in Afghanistan. Unless this happens, Afghanistan will remain excessively dependent on foreign expertise indefinitely, and be highly vulnerable to reductions in aid flows and external technical assistance. Capacity development will also require wider public administration reforms (recruitment, pay, human resources); organizational restructuring and improvements; and training; these are not the specific topics of this assessment. Better management of the massive amounts of external technical assistance currently being injected into Afghanistan, is also needed to ensure that the technical assistance supports longer-term national capacity development. Adequate implementation of accounting and auditing, based on international standards is crucial to underpin these PFM systems. Response by the Treasury on the draft country report found that the accounting aspects of the Gap Analysis Report are accurate and useful, the options expressed are for the most part practical and can be implemented, and that in some cases the timing of implementation depends on further development of the environment in the country. The Auditor General responded that the audit aspects provided a valuable guide for setting the way forward and providing guidance on upgrading the operations of the CAO to comply appropriately with international practice.

2. The World Bank has developed a general PFM reform agenda; insofar as this covers accounting and audit, it is summarized in Annex E. This gap analysis report has taken note of the action plan agreed by the Government of Afghanistan. This is especially noted in the continuing severe capacity constraints in the field of accounting and auditing and the reliance placed on support from foreign consultants and advisors to sustain the existing PFM framework. The report also notes the urgent need for these consultants and advisors to work with Afghan counterparts, to build up their indigenous capacity to take over these functions eventually.

3. 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 the country should adopt a limited version of the standards, as the processes of developing the standards have already considered any acceptable options that can be incorporated into the text of the standards, but they do not override authoritative national standards issued by governments, regulatory or professional accounting bodies. Application of IPSAS by national authorities will support developments in public sector financial reporting directed at improving decision making, financial management, and accountability and 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. The traditional emphasis on cash 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. The desired actions indicated by the gap analysis assessment are summarized below.

5. Adopt International Public Sector Accounting Standards starting with the Cash Basis IPSAS as the basis for building in-country public sector financial management capacity expertise. With the adoption of International Public Sector Accounting Standards (IPSAS), the Cash Basis IPSAS should be applied first with a longer-term program for subsequent implementation of Accrual Basis IPSAS. The International Federation of Accountants (IFAC) issues IPSAS. Annex B gives a general description of IFAC and a listing of the IPSAS. At the present time, Afghanistan does not comply with the Cash Basis IPSAS, Part 1, in its annual accounts. The Government of Afghanistan should reformat the present cash basis of reporting to conform to the Cash Basis IPSAS. Annex C gives current Afghanistan auditing and accounting legislations. Benefits from eventually adopting accrual reporting are set out in Annex D. In its response to the draft country paper, the Treasury noted that that the PFEM law specifically requires the application of international accepted standards and principles but does not specify which standards are to be followed. The intentions of the Treasury as the organization given the responsibility for information and reporting, is to report Solar Year (SY)1385 (2006) and SY 1386 (2007) on a cash basis according to Cash Basis IPSAS with the required supplemental schedules as well as other schedules as needed. The PFEML also requires the Ministry to provide a full accounting (auditable) of all assets held by the State at the end of the fiscal year. At this stage, an accounting of identifiable assets with supportable values will be provided as a supplementary schedule. Considering the environment in Afghanistan, it will be several years before reliable information about State assets will be available.

6. Take steps to more effectively, involve local staff in the accounting and reporting processes, modernize reporting, and strengthen legislation. Computerization is proceeding under the broad Public Administration and Capacity Building Program. The accounting advising consultant, Bearing Point, is preparing most of the financial reports and annual financial statements, but localization is needed for sustainability. The Public Finance and Expenditure Management (PFEM) Law needs strong accountability arrangements, including the implementation of a chief financial officer function. There is a severe human resource constraint in accounting in Afghanistan. The Government needs to lead in developing a government accounting cadre from a critical mass of professional accountants in Afghanistan.

7. Increase efforts for bringing in professional accounting and auditing training to Afghanistan. As part of the Public Administration and Capacity-Building Program, a training facility is being created for accountants and auditors from the Ministry of Finance and the Control and Audit Office under the Auditor General. These accountants and auditors are expected to undergo dedicated full-time basic accounting and auditing training followed by examination and certification. The Ministry of Finance and the Auditor General should establish staff qualification requirements and make use of these facilities by developing separate professionally qualified accountancy and auditing cadres. In response to the draft report, the Treasury advised that it is planning to put into place in SY1386 (2007) an extensive staff and hiring program with educational and training standards for government accountants, and that the UK Association of Chartered Certified Accountants program will be a valuable asset in training accountants who would be able to serve in the government as well as in private industry. The Treasury also advised that it is essential that a professional accounting organization be formed by members of the profession and supported by the Ministry of Finance. This is a longer term responsibility that should be coordinated with academic, professional and governmental individuals and supported by professional dues, governments and private enterprises.

8. Monitor more adequately the reporting for state-owned enterprises. Only a few state-owned enterprises produce annual accounts for audit. Regulation arrangements are needed for reporting for all firms with some public ownership.

9. The Supplementary Table of Standards and Gaps at the end of this report provides a matrix detailing the accounting standards, the present position, and options for improvement. A summary of the key accounting standards issues is shown in Table ES1.

Table ES1.
Summary of Key Accounting Standards Issues

<i>Standard</i>	<i>Current status</i>	<i>Action needed to move towards international standards</i>
1. Does the Public Sector Accounting Law adopt IPSAS?	Yes.	
2. Does accounting education and training accord with IES?	No.	The assistance from a professional distance-learning institution may be taken to build local training
3. Does the Code of Ethics match	No.	Relevant parts of the IFAC Code

<i>Standard</i>	<i>Current status</i>	<i>Action needed to move towards international standards</i>
international standards?		should be adopted.
4. Is there a body to prescribe public sector accounting standards?	Law specifies international standards.	
5. Are the financial statements in accord with the IPSAS standard?	No.	Use the IPSAS reporting format.
6. Is the statement of cash receipts and payments in IPSAS form?	No.	Use the IPSAS reporting format.
7. Are accounting policies and explanatory notes required?	No.	Use the IPSAS reporting format.
8. Are other disclosures in accord with IPSAS?	No.	Use the IPSAS reporting format.
9. Does the government issue a consolidated financial statement which consolidates all controlled entities?	No.	Not feasible in the short term.

10. Adopt the IFAC-issued International Standards on Auditing (ISA) and the International Organization of Supreme Audit Institutions (INTOSAI) Auditing Standards. The Control and Audit Office (CAO) of Afghanistan has planned to adopt auditing standards that are developed on the basis of the INTOSAI Auditing Standards. Implementation of the CAO standards needs improvement. The application of international standards on auditing would be improved by the preparation of a more modern audit manual. This manual, which will be based on INTOSAI Auditing Standards, is in the CAO development program. The application of these standards requires adequate professional competence, organizational independence, and adequate resources and systems. The weak areas need the investment of financial and human resources if staff skills are to meet the required standards. (See Annex B for a general description of INTOSAI and IFAC and a listing of their respective auditing standards).

11. Institute a new National Audit Act. A new National Audit Act supported by the Constitution is needed to support an independent audit office. A new National Audit Act is needed to provide greater discretion to the Control and Audit Office in the areas of financing and personnel policies. There is a need to improve audit impact. Audit recommendations and observations go unheeded in too many instances. The application of audit findings needs to be greatly improved through a mix of strategies. Greater transparency through more interaction with the media, along with more focused and effective report writing and report follow-up processes would increase the incentives for auditees to take action on audit findings. The long-standing Control and Audit Law provides for an Audit and Control Department (more generally called the Control and Audit Office) to organize the audit and control affairs of public properties. An adequate audit law should remove the control elements of the current laws as they are inconsistent with the role of a modern audit office. This would mean properly establishing the position of Auditor General and its office thus allowing it to carry out a full range of audits, including the audit of the performance of the budget and the annual accounts of all

levels of government and state-owned enterprises. A change to the Constitution should include establishing the Auditor General as a constitutional office.¹

12. Implement the 2004-2009 Strategic Development Plan. The Strategic Development Plan provides an effective development path and an in-house method of monitoring progress. The Auditor General has been allocated an advisor who should be entrusted with developing an appropriate program for implementing the Auditor General's Strategic Development Plan and fulfill further development needs. For example, the Control and Audit Office should contract with private sector auditors who could concentrate on conducting the audits of World Bank projects and funds, which would improve government audits.

13. The Supplementary Table of Standards and Gaps at the end of this report shows the present position for each component of the standards, and the options for improvements that would bring Afghanistan into closer conformance with the international standards. A summary of auditing standards issues is shown in Table ES2 below.

14. Monitor accounting and audit impact under current programs. The use of PFM-indicators surveys, suitably extended in detail, would provide a comprehensive basis for monitoring progress in adopting and applying international standards in accounting and auditing. In the absence of, or the delay in preparing, such a survey, improvements in accounting and audit impact should be measured over the next few years by monitoring the progress of strengthening current programs for the Ministry of Finance and the Office of the Auditor General.

Table ES2.
Summary of Auditing Standards Issues

<i>Standard</i>	<i>Current status</i>	<i>Action needed to move towards international standards</i>
1. Is the SAI statutory framework in accord with the needs of the INTOSAI Auditing Standards?	No.	A new Audit Act is needed.
2. Is there a body to prescribe public sector auditing standards?	No.	The new Audit Act should adopt IFAC ISA.
3. Have INTOSAI and IFAC audit standards been adopted?	CAO has adopted INTOSAI Auditing Standards.	An audit manual should follow IFAC ISA.
4. Has a code of ethics equivalent to the INTOSAI standards been adopted?	Yes.	
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	No.	The Strategic Development Plan will introduce the process.
6. Does the SAI legal framework meet the INTOSAI Auditing Standards for independence and powers?	No.	A new Audit Law is needed.
7. Does the education and training of	No.	The assistance from a professional

¹ Guidance is provided by two model laws: (1) a general prescription of a Model Law developed by the UNDP Program for Accountability and Transparency (PACT) and (2) A Model National Audit Office Act, The Association of Chartered Certified Accountants, UK, 2004

<i>Standard</i>	<i>Current status</i>	<i>Action needed to move towards international standards</i>
auditors conform to INTOSAI and IES?		distance-learning institution may be taken to build local training.
8. Is the SAI equipped with the audit methods and technologies to meet the INTOSAI standards?	No.	The Strategic Development Plan will be of assistance, but additional resources will be needed.
9. Does the SAI have the quality assurance programs to meet international standards?	No.	The Strategic Development Plan will introduce the process.
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?	No.	A new manual of audit procedures and training is needed.
11 Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with?	Yes.	
12 Does the auditor prepare an audit opinion on the financial statements in a form that matches international standards?	Yes.	
13. Does the consideration of fraud and error in an audit of financial statements accord with international standards?	Yes.	
14. Are the Auditor General's reports made public?	No.	The Audit Law should arrange for reports to be tabled and made public when tabled.
15. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?	Follow up is inadequate.	Stronger scrutiny processes are needed.