



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 Framework⁶ by the Public Expenditure and Financial Accountability (PEFA) Program,⁷ 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

⁶ 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.

⁷ 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.

