



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);⁸ 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.

⁸ 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.⁹

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.¹⁰ 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.

⁹ *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.*

¹⁰ *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

Requirements	Current deficiencies	Activity required to adopt Cash Basis IPSAS
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.



Requirements	Current deficiencies	Activity required to adopt Cash Basis IPSAS
General considerations <ul style="list-style-type: none"> ■ Reporting period ■ Adequacy of information about the entity ■ Presentation of comparative information 	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.	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.
Correction of errors disclosed <ul style="list-style-type: none"> ■ Nature of error ■ Amount of correction ■ Comparative information restated 	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.	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.
Consolidated financial statements	Consolidated financial statements of consolidated funds, the appropriation, revenue, deposit, foreign aid and loan, and investment are prepared.	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.
Treatment of foreign currency cash receipts, payments, and balances treated in compliance with IPSAS	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.	Need to comply with the treatment of foreign currency and disclosure aspects as per IPSAS.
Effective date of Part I and transitional provision compliance.	The government has not formulated a migration path and timeline for achieving Cash Basis IPSAS, Part I, compliance.	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.

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.