



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.¹ 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

¹ *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.² 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

² 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

Standard	Current status	Activity required to adopt international standards
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.³ 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.⁴ 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

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

⁴ *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.

Standard	Current status	Activity required to adopt international standards
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.



Standard	Current status	Activity required to adopt international standards
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.⁵ The performance indicators examined in the PEFA Program provide guidance for sequencing reforms that make logical sense to improve PFM in the Nepal context.

⁵ 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.