AUDIT OF PUBLIC ENTERPRISES

Office of the Auditor General of Nepal

Auditor General of Nepal

Babar Mahal
PO Box 13328
Kathmandu
NEPAL

Office of the Auditor General
Nepal
2016

Foreword

As per the Audit Act, 2048, Office of the Auditor General of Nepal, (OAGN) is empowered to conduct audit of public enterprises where government has hundred percent ownership. This Guideline for Audit of Public Enterprises is prepared to provide guidance to the auditors engaged in conducting audit of such public enterprises.

The Audit Act provides that Auditor General may appoint practicing accountant to work as his assistant in case where office of the auditor General has not enough resources to conduct audits of fully owned public enterprises. Public Enterprises are being audited mostly by practicing accountants (Chartered Accountants and Registered Auditors) and some of the public enterprises by OAGN's own staffs. It is hoped that this Guidelines will be applicable for both of them; appointed auditors or OAGN's own staffs.

This Guideline has been developed considering the requirements of applicable standards in public sectors. OAGN believes that this Guideline will help to ensure quality audit bringing more professionalism in auditing. This guideline is designed to provide guidance to OAGN staffs and the professional Accountants appointed to audit on behalf of OAGN in conducting audits in accordance with applicable legislative requirements, professional standards and OAGN's policies.

Utmost care has been done to make this guideline error free. However, we will be grateful if the user could inform any suggestions on this guideline to the concerned Directorate of the OAGN.

At last, I would like to appreciate team of OAG Nepal, SOAGP and stakeholders who gave their efforts in the preparation and development of this guideline.

(Sukudev Kharty)

Acting Auditor General

Table of Content

GUIDELINES FOR THE AUDIT OF PUBLIC ENTERPRISES

1. Introduction

The quality of the audits depends on having strong methodology and guidance. The policies, procedures and guidance outlined in this audit guideline is designed to provide reasonable assurance that the OAGN and the professional auditors appointed to audit on behalf of OAGN conduct high-quality audits in accordance with applicable legislative requirements, professional standards and the office's policies. The policies and procedures contained in this Guideline are based on Financial Audit Manual 2015 approved by OAGN, current standards of the audit profession and good practices in public sector auditing. This is an important tool to be used in all audit work relating to public sector undertakings. The purpose for this guide is to establish audit procedures and provide guidance on the objective and general principles governing the audit of financial statements of public enterprises (PEs) including other statutory organizations in Nepal. The Office expects auditors of such PEs to comply with this guideline and the relevant professional standards.

2. Use of This Audit Guide-line

There is an expectation that the framework described in this guideline will be followed by the professional auditors appointed by OAGN and the OAGN staffs when conducting audits of PEs. This Audit Guideline is the major reference source for the audit approach and the supporting working practices. It has been designed for use by all members of the engagement team. This Audit Guideline does not include detailed guidance on materiality, risk identification and risk response, audit sampling and other matters. So, the users of this guideline are suggested to refer the Financial Audit Manual 2016 approved by OAGN, respective auditing standards; NSAs or ISSAIs for specific audit procedures.

3. Legal Mandate and laws relating to conduct audit of PSUs

The Legislature-Parliament is fully empowered to exercise the highest level supervisory control over public resources including public finance made use by the executive in conformity with legislative provisions made by Parliament through the Annual Appropriation Act and all other applicable statutes in order to make sure that such resources are being made use economically and effectively. The authority for the Auditor General to audit of accounts of public funds is primarily derived from Article 241 of the Constitution of the Federal Democratic Republic of Nepal.

Further, Audit Act, 2048 (1991) through section 6 empowers auditor general to conduct audits of fully owned PEs.

Audit Act, 2048 (1991)

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/she may appoint license holder auditors under the prevailing laws an assistant. While appointing auditor as such, he/she shall give priority to the Nepali citizen.

(3) The auditor 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 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 fixed 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.

4. Auditing Standards

4.1 **IFAC Standards**: The accounting bodies of various countries established the International Federation of Accountants (IFAC) in 1977, to develop and enhance a coordinated worldwide accountancy profession. The International Auditing Practices Committee (IAPC) is a standing committee of the Council of IFAC and has been assigned the specific responsibility and authority to issue standards on auditing and related services. The IFAC has issued a number of International Standards on Auditing (ISAs). The ISAs do not override the statutory, regulatory or professional regulations in a country. Though the ISAs are, by themselves, not binding on the auditors in a particular country, they nevertheless provide an authoritative view of what are internationally recognized as generally accepted auditing practices. Some countries have adopted the ISAs without any changes while some others have adopted them with such modifications as are considered appropriate in the context of the local conditions.

4.2 **ICAN Standards**: Auditing Standards Board develops the Audit Standards in Nepal which is pronounced by the Institute of Chartered Accountants of Nepal (ICAN). ICAN has issued a number of Auditing Standards (NSAs) which are generally based on the corresponding ISAs issued by IFAC, taking into consideration the applicable laws, customs, usages and business environment in Nepal. Since, under the Companies Act, companies in Nepal are required to be audited by the members of ICAN holding appropriate Certificate of Practice (COP) or by OAGN in case of the government companies owned by Government, these Standards have a significant effect on the way audit of companies is conducted in Nepal.

4.3 **INTOSAI Standards**: The Auditing Standards Committee of the International Organization of Supreme Audit Institutions (INTOSAI) issued the Auditing Standards at the XIV Congress of INTOSAI in 1992 in Washington, D.C. as amended by the XV Congress of INTOSAI in 1995 in Cairo, Egypt. The Auditing Standards Committee of the International Organization of Supreme Audit Institutions (INTOSAI) issued Code of Ethics for auditors in the public sector in 1998. While they do not have mandatory application, they reflect a "best practices" consensus among the Supreme Audit Institutions (SAIs) and each SAI is required to judge the extent to which the Standards are compatible with the achievement of its mandate.

The INTOSAI auditing standards consist of four parts- Basic principles, General standards, Field standards and Reporting standards. The *basic principles* for auditing standards are basic assumptions, consistent premises, logical principles and requirements, which help in developing auditing standards and serve the auditors in forming their opinions and reports, particularly in cases where no specific standards apply. The *general standards* describe the qualifications of the auditor and/or the auditing institution so that they may carry out the tasks related to field and reporting standards in a competent and effective manner. The *Field Standards* regulate the audit activity by establishing the framework for conducting and managing audit work. The *Reporting standards* relate to the forming audit opinion after completing the audit works.

4.4 **Bridging Document**: INTOSAI has issued a INTOSAI Auditing Standards Bridging Document to provide a link between INTOSAI Auditing Standards and International Standards on Auditing (ISAs) issued by IFAC's IAASB. INTOSAI Standards will continue to provide the necessary framework and overriding principles for financial audit by SAIs. INTOSAI plans development of its own implementation guidelines or '**Practice Notes'** by building on the more detailed value of the additional guidance contained in ISAs, in so far as it is relevant to the work of SAIs. While the Bridging Document and Practice Notes aim to support INTOSAI members in the application of ISAs, it will the responsibility of each SAI to consider the relevance of each ISA to its own particular circumstances.

ISSAI = ISA + Practice Notes

4.5 Auditing Standards of the Office of the Auditor General-Nepal:

The Office of the Auditor General of Nepal (OAGN), as a member of INTOSAI, has adopted the auditing standards, practices and procedures of INTOSAI. The mission of the office is to providetrustworthy, effective and independent audit for the efficient management and utilization of public resources.

4.6 ISSAI Framework:

The INTOSAI has taken initiative to provide an up-to-date framework of professional standards to its members and to adopt the basic framework of ISAs. The International Standards of Supreme Audit Institutions (ISSAI) consist of all documents endorsed by the Congress of INTOSAI with the purpose of guiding the professional standards of SAIs. The ISSAIs provide a framework for auditors, which include the International Standards on Auditing, and additional practice notes for the application of ISAs in the public sector. This includes recommendations on the legal, organizational, and professional prerequisites as well as on the conduct of the auditing and any other tasks with which SAIs may be entrusted. The ISSAI documents include descriptions or examples of good auditing practices.

The ISSAIs documents are codified in 1-4 digit numbers adding one more number before ISA number. The last three positions in the ISSAI number indicate the corresponding number of the ISA (for example, ISSAI 1800 includes ISA 800 and Practice Note for ISA 800). The hierarchical level of ISSAI number is mentioned below:

Level 1: *Founding Principles*- contains the founding principles of INTOSAI i.e. The Lima Declaration.

***Level 2*:** *Prerequisites for the functioning of SAIs*- state and explain the basic prerequisites for the proper functioning and professional conduct of SAIs.

Level 3*: Fundamental Auditing Principles*- contains the fundamental principles in carrying out auditing of public entities.

Level 4*: Auditing Guidelines*- translate the fundamental auditing principles into more specific, detailed and operational guidelines that can be used on a daily basis for auditing tasks.

The INTOSAI Financial Audit Guidelines (ISSAI 1000- 2999) represent the fourth level of the ISSAI Framework. They provide guidance for conducting financial audits of public sector entities. The INTOSAI Financial Audit Guidelines include the ISAs issued by the International Auditing and Assurance Standards Board (IAASB). Practice Notes, which are included in the guidelines, provide relevant guidance on applying each ISA in financial audit of public sector entities.

In applying the INTOSAI Financial Audit Guidelines, SAIs should recognize that the ISAs and Practice Notes together form the guidance.

5. Fundamental Requirements

5.1. The audit of PEs and other statutory organization shall be conducted in accordance with auditing standards as prescribed in relevant laws governing the incorporation of the PEs or such statutory organization. In the absence of prescription of specific auditing standard in relevant law, audit shall be conducted in accordance with International Standards of Supreme Audit Organizations (ISSAIs) issued by the Professional Standards Committee ofInternational Organization of Supreme Audit Institutions (INTOSAI) as well as applicable Nepal Standards on Auditing (NSA).

5.2. The auditor should comply with ethical principles governing professional responsibilities as outlined in Code of Ethics issued by the OAGN and ICAN Code of Ethics.

6. Objectives of the Financial Audit

The objectives of the financial audit are:

a) Express an opinion on whether the financial statements of the audited organization as a whole present fairly, in all material respects the financial position of the organization at year end, the results of its operations and cash flows for the year then ended, etc., in conformity with applicable accounting principles;

b) Audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;

c) To provide particular assurance statement, if any, as required by law or by the regulating bodies of the respective sector.

7. Scope of Financial Audit

7.1 The financial audit should be organized to cover adequately all aspects of the enterprise as far as these are relevant to the financial statements being audited as per applicable auditing standards.

7.2 The audit should cover all required functional and operational matters as required by the relevant law, applicable financial reporting framework, this guideline and other directives and instructions issued by the Auditor General.

7.3 As to years to audit, it should be, normally, the financial year for which auditor has been appointed or the immediately expired financial year, if not otherwise required or mentioned by/in law, appointment letter or guideline and instructions.

8. Financial Audit Methodology

8.1 Auditor should apply all procedures as required by the auditing standards as applicable for the engagement. Such standards as per legal provisions and other guidelines may be International Standards on Auditing- ISAs (e.g.as required by Nepal Rastra Bank Act, 2058 for audit of Nepal Rastra Bank), Nepal Standards on Auditing (NSAs), International Standards of Supreme Audit Institutions (ISSAIs).

8.2 Auditors should use procedures and working paper template as provided in Financial Audit Manual prepared by the OAGN to the extent applicable to the audit of PEs.

8.3 Auditors should use other methodologies as prescribed in Terms and Conditions of appointment letter/ or in Authorization Letter.

8.4 Audit Process Flow: The Audit team has to complete a set of sequential audit processes. An auditor must obtain a clear understanding of the audit process flow from planning right through to reporting. A brief description about the audit process is given below:

- ***Pre-engagement activities-*** This includes activities required prior to the start of the audit work including auditors' understanding of and compliance with the established code of ethics, identifying competent audit team and arranging for other resource requirements and clarifying audit objectives, scope and terms to the client through engagement letter, etc.
- ***Strategic Planning-*** Strategic plan ensures that the auditor has considered all relevant factors surrounding the environment within which the auditee or client operates and assists in establishing overall audit strategy and developing audit plan.
- ***Detailed Planning*** **-**Detailed plan determines the audit responses to assessed risks by defining the nature and audit tests. It consists of detailed audit program to address the identified risks.
- ***Audit Execution or Fieldworks-*** This includes the actual execution of the audit works by undertaking the procedures like tests of controls, substantive audit procedures, analytical procedures, getting representation from the management of auditee, etc.
- ***Reviews, Conclusions and Reporting*** **-** Issuing preliminary and final audit report, audit opinions, and management letter after evaluating audit evidence

and observation.

- ***Quality Assurance and Controls-*** Throughout the whole audit process, quality control of the audit work performed and conclusions reached is undertaken by audit supervisors. Quality assurance may be undertaken for individual audit assignments by the experienced and qualified reviewer and for institutional level review by a group of auditors or by peer reviews by another Supreme audit institutions

The following table provides a picture of the complete audit process to be followed by each audit team while carrying out the financial audit. The audit team has to document in the prescribed working paper (template) to evidence that each stage of the audit process is completed adequately with full compliance to the audit standards, guide, and this manual. Included in each working paper are the relevant review requirements and the references to working papers where applicable. It also shows the purpose/ outcome of each audit activity and responsibilities of audit team and auditors for documenting the evidences to ensure that every audit activity is completed during the audit:

PRE-ENGAGEMENT ACTIVITIES				
SN	**Documentation on audit activity**		**Purpose / Outcome**	**Completed by**
1	PE-1	Programmed vs. actual days	Establish the programmed days for the audit and actual days spent on the audit	Audit Supervisor: Director/ AAG
2	PE-2	Code of ethics	Conclude on the audit team's independence	Audit team members
3	PE-3	Audit Engagement letter	Common understanding and agreement about the terms of the engagement and management's responsibility	Audit team leader
4	PE-4	Competency Matrix	Identifies the academic qualifications and service experience (years) for each team member.	Team Leader
5	PE-5	Audit Engagement Letter	Common understanding and agreement about the terms of the engagement and management's responsibility.	Audit Team Leader (EL to be signed by AAG or DAG)
STRATEGIC PLANNING				
6	SP-1	Understanding the entity and its environment	Compiles basic information on the auditee, its business and its environment.	Audit Team Leader

7	SP-2	Materiality and Planning Lead Schedule	Assess materiality for planning purpose.	Auditor
8	SP-3	Analytical Procedures for Planning	Review the current financials with the budget and previous period for risk identification. (also could use ratios and trends for analysis).	Auditor
9	SP-4	Understanding the entity's control environment	Assess the control environment of the entity for risk of material misstaement due to inadequacy or ineffectiveness of controls.	Audit Team
10	SP-5	Identifying Risks of Material Misstatement	Identify risks of material misstatements through frauds or deficient or weak internal controls.	Audit Team
11	SP-6	Using the work of others	Assess whether reliance can be placed on work of others.	Audit Team
12	SP-7	Risk Analysis and Audit Approach	Identifies risks of material misstatement and develops audit approaches to address risks.	Audit Team Leader
13	SP-8	Audit Planning Memorandum	Formalize audit planning summary for review/approval.	Audit Team Leader
DETAILED PLANNING				
14	DP-1	Audit program	Design appropriate audit procedures for the risks identified through risk assessment indicating nature, extent, and timing of the audit.	Auditor
AUDIT EXECUTION or FIELD WORKS				
15	AE-1	Entrance conference	Format for recording results of entrance conference	Audit Team
16	AE-2	Performance, Materiality and Execution Lead Schedule	Identify performance level materiality.	Auditor
17	AE-3	Test of Controls	Document the performance of tests of control (existence, operation, and effectiveness), to place the extent of reliance on controls.	Auditor

18	AE-4	Sampling for Substantive Procedures	Use sampling in performing audit procedures and document the performance of substantive procedures.	Auditor
19	AE-5	Analytical procedures as substantive procedures	Documenting use of analytical procedures as a tool of substantive procedure for obtaining audit conclusions.	Audit Team Leader
20	AE-6	Audit Difference and Issue Log	Summarize the audit differences and audit issues (to be discussed in the exit conference and to include in Draft Management Letter)	Auditor
21	AE-7	Written Representations	Obtain written representations in accordance with ISSAI 1580 for matters where normal audit procedures could not generate sufficient audit eveidences.	Auditor
22	AE-8	Exit Conference	Format for recording results of exit conference (including audit issues discussed and concerns raised by management).	Auditor
REVIEWS, REPORTING and CONCLUDING				
23	AR-1	Final Analytical Review	Review the audit work carried out to assess whether the audit resuts are in line with the audit reviewer's knowledge of the auditee. Reviewer to use ratios and trends.	Reviewer (DDG/AAG)
24	AR-2	Draft Management Letter	Present preliminary audit issues to the management in the form of a draft management letter for the management to provide its comments.	Audit Team Leader
25	AR-2a	Final Management Letter	Issue final management letter including management's response to the issues identified.	Audit Team Leader
26	AR-3	Format for Audit Report (based on type of opinion)	Form and audit opinion on the financial statements.	Audit Team Leader

27	AR-4	Matters for Attention (next year)	Identify issues that will be relevant for next year's audit as a follow-up and/or for next year's risk assessment.	Audit Team
QUALITY CONTROL and ASSURANCE				
28	QC-1	Audit Quality Control Review Form	Ensure that audit was conducted in accordance with ISSAIs and complies with OAG audit policies and procedures.	Director / AAG

9. Responsibility of Preparation of Financial Statements

The financial statements subject to audit are those of the entity, prepared by management of the entity with oversight from those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. So, the management is responsible for the preparation and fair presentation of financial statements in accordance with applicable Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

10. Initial Engagement Activities

Before establishing the overall audit strategy and developing the detailed audit plan, the auditor shall carry out initial key tasks in relation to the engagement. The auditors are required carry out the initial engagement activities set out in NSA/ or any other guidance document issued by the OAGN. Following are the some of the activities auditors should consider:

- ✓ Confirming and declaring to the OAGN that auditor being appointed is eligible to work as a auditor of the entity as per prevailing laws.
- ✓ Considering independence requirements, including the rotation of engagement team members
- ✓ Building the engagement team, understanding the respective roles of the Engagement Leader, Engagement Manager , team members, and assigning responsibilities
- ✓ Planning for the effective review of audit work and documentation
- ✓ Using an auditor's expert on the audit engagement

- ✓ Assigning specialists in accounting or auditing to the engagement team
- ✓ Considerations where the entity uses the work of a management's expert in the preparation of the financial statements

11. Planning an Audit

11.1. The auditor should plan the audit in a manner which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner

11.2 In planning the audit, the auditor should:

a. Identify important aspects of the environment in which the audited entity operates;

b. Develop an understanding of the accountability relationships;

c. Consider the form, content and users of audit opinions, conclusions or reports;

d. Specify the audit objectives and the tests necessary to meet them;

e. Identify key management systems and controls and carry out a preliminary assessment to identify both their strengths and weaknesses;

f. Determine the materiality of matters to be considered;

g. Assess the extent of reliance that might be placed on other auditors, for example, internal audit;

h. Identify, assess the risks and develop appropriate responses to the risks so assessed;

i. Review the internal audit of the audited entity and its work program;

j. Determine the most efficient and effective audit approach;

k. Provide for a review to determine whether appropriate action has been taken on previously reported audit findings and recommendations; and

l. Provide for appropriate documentation of the audit plan and for the proposed fieldwork.

The following planning steps are normally included in an audit:

a. Collect information about the audited entity and its organization in order to assess risk and to determine materiality;

b. Define the objective and scope of the audit;

c. Undertake preliminary analysis to determine the approach to be adopted and the nature and extent of enquiries to be made later;

d. Highlight special problems foreseen when planning the audit;

e. Prepare a budget and a schedule for the audit;

f. Identify staff requirements and a team for the audit; and

g. Familiarize the audited entity about the scope, objectives and the assessment criteria of the audit and discuss with them as necessary.

10.3 Identification and Assessment of Risk - Risk Indicators: It is not be possible to give the details of the factors affecting the risk across the board for all entities in view of the fact that there are varieties of PEs. Some of the risk indicators are indicated in the following table:

SN	Risk Indicators
1	Previous Audit Observations not yet settled
2	Number and amount of accounting adjustments made in last 3 years
3	Nature of transactions--their mix and size
4	Number and location of field formations/branch offices, etc.
5	Any formation of new offices, branches, locations, etc. during the period under audit
6	Any new activities undertaken during the period under audit
7	Any re-organization of the office / department during the period under audit
8	Any financial problems facing the entity like shortage of funds, liquidity crunch, huge debts, default in repayment of borrowings/payments to suppliers, etc.
9	Effectiveness of internal controls and management's response to any weaknesses in internal controls
10	Complexity of accounting principles and calculations

11	Complexity of operations and underlying regulations/ regulatory environment
12	Susceptibility of assets to material fraud/misappropriation
13	Staffing of Accounts personnel--number and competence
14	Whether any judgment is involved in accounting process
15	The entity's track record in production of records to audit
16	Changes in key management and accounts personnel in last 3 years, with reasons for change
17	Public visibility of operations
18	Any complaints about the audited entity
19	Any newspaper/other media information about the audited entity in last one year
20	Dependence on few suppliers/contractors, etc.
21	The degree to which the financial circumstances of the audited entity may motivate the entity's management to misstate the accounts / records
22	Use of special purpose vehicles for financing arrangements
23	Any changes in IT Systems (hardware and software) / computerization during the period under audit
24	Any changes in account heads, accounting policies, accounting standards, etc.
25	Pending litigation and contingent liabilities
26	Other Risk Indicators like: • Expenditure trends • Persistent and unexplained excess withdrawals. • Unadjusted account bills. • Transfers to Personal Ledger Accounts. • Large purchases. • Delivery under programs not being susceptible to verification. • Political or managerial sensitivity of activities.

11.4 Risk of Fraud: When planning financial audits, auditors should also assess the risk that fraud may cause the financial statements to contain material misstatements or record material irregular transactions. Based on risk assessment, auditor should design audit procedures so as to have a reasonable expectation of detecting and evaluating material misstatements and irregularities arising from fraud.

11.5 The auditors should prepare overall audit strategy and detailed audit plan and submit to the concerned directorate of OAGN. The concerned Directorate of OANG may review such plan and may issue additional instruction, if any issue to be examined is not covered in audit plan prepared by the auditor.

12. Government specific considerations at planning stage

The audit mandate, or obligations for public sector entities, arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature may result in additional objectives. These additional objectives may include audit and reporting responsibilities, for example, relating to reporting whether the public sector auditors found any instances of non-compliance with authorities including budgets and accountability frameworks and/or reporting on the effectiveness of internal control. However, even where there are no such additional objectives, there may be general public expectations in regard to public sector auditors' reporting of non-compliance with authorities or reporting on effectiveness of internal control. Therefore, public sector auditors keep such expectations in mind, and are alert to risks that may give rise to non-compliance or risks relating to effectiveness of internal control when planning and performing the audit.

In the public sector environment, additional planning considerations may include:

- ✓ Obtaining an understanding of the legal and regulatory framework applicable to the entity due to the broader objectives of the audit;
- ✓ The implications for the audit of the financial statements of knowledge obtained from other audit activities relevant to the entity, including the implications of previous recommendations;
- ✓ The implications for the audit of the financial statements of knowledge obtained from planning activities related to the relevant department and ministry; and
- ✓ The expectations of the legislature and other users of the auditors' report.

13. Discussion with management about Audit Plan

The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

14. Discussion with Concerned Directorate of OAGN about Audit Plan

The auditors appointed by OAGN should always remain in contact with the concerned directorate of OAGN and discuss the matters relevant for planning purposes and the specific matters auditors want to include in audit strategy and detailed audit plan.

15. Gathering Audit Evidence

15.1. It is the responsibility of an auditor, before certifying an account, to make sure that competent, relevant and reasonable evidence was obtained to support the auditor's opinion and conclusions. There are some general audit objectives designed to ensure that the right sort of evidence is obtained; for example, to show whether the accounts are complete and whether the recorded transactions have properly occurred and are properly classified. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

15.2 For the purpose of expressing an opinion on the financial statements being audited, an Auditor collects evidence. To be relevant, audit evidence must relate to the general audit objectives (also called 'assertions'). Assertions are positive statements about the "state of being". For example, an assertion may be that all receipts were accounted for, or that all the investments shown in accounts were really owned by the entity. These general audit objectives (assertions) are designed to ensure that the auditor obtains evidence to support all aspects of the opinion required to be expressed on an account.

There are 7 audit assertions (general audit objectives) as below:

SN	Assertions – Audit Objectives	Definition of Assertions and their Testing
1	C -Completeness	Whether all the transactions have been recorded – test of potential understatement 'Completeness' means that all transactions relevant to the year of account have been recorded. This implies that no transaction has been overlooked. This assertion directly tests for potential understatement of figures in accounts. To take an example, if the accounts are prepared for the financial year 2015-16 and an item of expenditure which takes place during 2015-16 is omitted from accounts, the 'completeness' objective is not fulfilled.
2	O - Occurrence	Whether all recorded transactions were relevant – test of potential overstatement 'Occurrence' means that all recorded transactions occurred and wererelevant to the year of account. For instance, if an item of receipt was booked in theaccounts for the financial year 2015-16, to satisfy the 'occurrence' objective, the itemshould properly relate to only 2015-16 and not to any other financial year. This assertiondirectly tests for potential overstatement of figures in the accounts.
3	M -Measurement	Whether all the recorded transactions have been correctly valued, properly calculated, or measured as per accounting policies – test of accuracy and consistency on measurement 'Measurement' means that the recorded transactions have been correctly valued, properly calculated, or measured in accordance with established accounting policies, on an acceptable and consistent basis. This involves much more than clerical accuracy as it requires the auditor to check the conformity with established accounting policies and standards and the consistency in the measurement.

4	P – Presentation and Disclosure	Whether the recorded transactions are properly classified and disclosed – test of classification, presentation and disclosure. ‘Presentation and Disclosure’ means that the recorded transactions have been properly classified and disclosed where appropriate. This implies that the receipts and expenditure were booked to the proper account head and the disclosures in the notes and foot notes in the accounts are appropriate and adequate.
5	A – Accuracy, Compliance and Regularity	Whether the recorded transactions are in compliance with the relevant rules and regulation and are accurately recorded – test of accuracy, compliance and regularity. ‘Regularity’ is a unique requirement for Government Accounts. This requiresthat the recorded transactions are in accordance with the legislation and other specific authorities required by them. Regularity of the expenditure and receipts is an important element to be considered. A payment may be correctly recorded and properly disclosed in the right year of account at the right value, but the payment would be irregular if it did not accord with the compliance of the governing legislation or regulations.
6	R – Rights and Obligations	Whether the rights and or obligations have been created because of the transaction – test of right and obligation ‘Right and Obligation’ means that the assets are owned by the entity, the liabilities are properly those of the entity and both arise solely from regular activities. The balance sheet represents an accumulation of the entity’s rights and obligations. ‘Ownership’ assertion requires that the assets and liabilities reported actually represent those rights and obligations. For example, if an item is shown in the accounts as amount receivable, the entity should have the legal right to sue and collect the amount.
7	E - Existence	Whether the assets or liability or the value created because of the transaction exist – test of existence. ‘Existence’ means that all recorded assets and liabilities exist. This objectivedirectly tests for potential overstatement of assets and liabilities. For example, if theaccounts show some amount as cash balance, which does not exist, the ‘existence’objective is not satisfied.

15.3. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. The key to the risk based approach is to apply the audit criteria to each of the financial statement assertions in turn listed below.

Assertions pertaining to Assets and Liabilities	Assertions pertaining to Income and Expenditure
Completeness	Completeness
Existence	Occurrence
Measurement	Measurement
Right and Obligation	Accuracy, Compliance and Regularity
Disclosure	Disclosure

Examples

1. **One of the audit concerns is whether the transactions were properly disclosed. If some item of revenue expenditure is misclassified as capital expenditure, it can be said that the disclosure is not proper. The auditor has to be satisfied about the classification of transactions.**
2. **To take another example, another concern of the auditor is whether any items have been omitted from the account. The auditor must obtain evidence to the effect that all transactions relevant to the year of account have been recorded. This is the completeness objective. The auditor has to design audit tests to ensure that the completeness objective is met. If the monthly accounts of some branches of PEs are excluded from the Accounts of a PE, it affects the completeness objective.**
3. **Items omitted from the accounts would be revealed by tests designed to meet the completeness objective.**
4. **Included items not relevant to the period ofthe account would be identified against the occurrence objective.**
5. **Themeasurement objective seeks out any misstated figures.**
6. **The regularityobjective would seek out if expenditure was not in accordance with theintention of governing legislation.**
7. **Tests against the disclosure objective wouldbe aimed at showing up items which had not been properly disclosed.**

15.4 If the auditor has not obtained sufficient appropriate audit evidence for a material financial statement assertion, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should consider whether to modify the opinion.

15.5 The audit findings, conclusions and recommendation must be based on evidence and therefore, it is crucial that the data collection and sampling techniques are carefully chosen. When computer based system data are an important part of the audit, auditors need to satisfy themselves that the data are reliable and relevant.

15.6 While audit evidence is primarily obtained from audit procedures performed during the course of the audit, it may also include information obtained from other sources such as, for example, previous audits, in certain circumstances. The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based

15.7 Auditors should analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements. Financial statement analysis aims at ascertaining the existence of the expected relationship within and between the various elements of the financial statements, identifying any unexpected relationships and any unusual trends. The auditor should therefore thoroughly analyze the financial statements and ascertain whether: a) Financial statements are prepared in accordance with acceptable accounting standards; b) Financial statements are presented with due consideration to the circumstances of the audited entity; c) Sufficient disclosures are presented about various elements of financial statements; and d) The various elements of financial statements are properly evaluated, measured and presented.

16 Risk-based Audit Approach

It is the policy of OAGN to adopt a risk based approach that focuses audit efforts on areas of greatest risk to the proper presentation of financial statements of government entities, while respecting all areas of his audit mandate. Risk in auditing means that Auditor accepts some level of uncertainty in performingthe audit. Only a very small degree of audit risk would be acceptable as otherwise the audit processmay lose its purpose. Hence, a very high level of assurance (or confidence) is requiredwhen expressing the audit opinion. This is one of the most important steps in the planningphase in ensuring that the auditor will gather competent, relevant and reasonable auditevidence at minimum cost. Normally, a level of 95% assurance is considered appropriate in which the auditrisk would be 5%.

The amount of assurance the auditor needs from the audit tests (i.e., the amount ofrisk the auditor is prepared to accept) and the materiality level set by the auditor are interrelated factors in determining the number of transactions and items which the auditorneeds to examine.

There is an inverse relationship between materiality and the level of audit risk,that is, the higher the materiality level, the lower the audit risk and vice versa. Auditor should take note of the inverse relationship between materiality and audit risk whendetermining the nature, timing and extent of audit procedures

The risk model enables the auditor to calculate the level of assurance (orconfidence) needed from substantive audit tests. The level of assurance required thendetermines the size of the sample to be tested.

17. Methods of Collecting Audit Evidences

The principal source of evidence for audit conclusions is the records of the audit entity. It is the primary duty of the auditor to ensure that the audit conclusions drawn about the organization and various projects and programs, activities, transactions, etc. subjected to audit are based on sufficient, competent and relevant evidence. Evidence must be planned, gathered and analyzed before any conclusion can be reached. Evidence may be gathered by:

a. Physical observation, including joint inspection by the auditors and the executive, the resultant observations being signed by both as confirmation of performance or achievements;

b. Re-performance of accounting routines (e.g., checking computations);

c. Analysis of financial statements and interrelationships or comparison between elements of relevant information;

d. Vouching, i.e., checking of documents in support of transactions;

e. Critical scrutiny of documents (e.g., reviewing data to identify unusual items);

f. Confirmation and enquiry;

g. Evaluation of the quality of internal control mechanisms;

h. Interviews with executives; and

i. Computer assisted audit techniques (CAATs).

18. Audit Procedures

18.1 **Substantive Procedures**: The substantive procedures can be performed at one of three levels, depending on the amount of assurance required. In decreasing order of assurance, they are: (a) Focused (b) Standard (c) Minimum. In general, the lower the level of assurance required, the lesser will be the extent of audit procedures. The level of the procedures to adopt depends on whether any specific risk factors were identified and whether any reliance is proposed to be placed on controls. These procedures are explained in the following table.

Type of Substantive Procedure	Circumstances in which Performed	Audit Procedures generally Included
Focused Substantive Procedures	Performed if the audit team identifies a risk that could lead to potential material misstatement and where no reliance can be placed on mitigating controls to address the risk	Substantive Procedures: • Testing high value and key Items • Sample testing of representative transactions • Confirmation from third parties • Reliance on internal audit work Analytical Procedures are unlikely to be used
Standard Substantive Procedures	Performed if the audit team has not identified risks that could lead to material misstatement and no reliance is planned to be placed oncontrols.	• Modeling / ComparativeType Analytical Procedures • Other SubstantiveProcedures

Minimum Substantive Procedures	Performed if the audit team plans to take assurance from mitigating controls (where there are risks of material misstatement) or from other controls (where there are no risks of material misstatements).	• Comparison Type Analytical Procedures or • Other Substantive Procedures

18.2 **Tests of Controls:** Before seeking to place reliance on controls, the audit team should perform tests to confirm that they have been operating effectively and consistently throughout the period under audit. If the audit tests confirm that controls are effective, the audit team should perform a minimum level of substantive procedures. If the audit tests do not confirm that controls are effective, the audit team should not place reliance on them and the audit team should revise the audit plan. There are two controls testing approaches that can be adopted (a) Tests of mitigating controls - where the audit team tests the operation of a singlecontrol, which seeks to mitigate a specific risk. (b) Controls reliance strategy - where the audit team tests and relies on the overallsystem of controls for one or more audit objectives.

18.3 **Tests of Detail:** Very rarely, an audit team will be able to obtain competent, relevant and reasonable evidence in respect of each audit objective through tests of control and analytical procedures alone. Tests of detail involve obtaining evidence about all, or a sample of, transactions in a population. For example, if the focused substantive procedures have pinpointed a specific risk to a small population, the audit team may test all such transactions. The audit team may also test all transactions where, even without specific identified risks, the total population is small. Where it is not feasible or cost-effective to test all transactions in a population, the audit team can adopt a sampling approach. Where the audit team plans to test an audit objective using tests of detail, it should identify the relevant population and: (a) apply an appropriate sampling technique to select items from the population and examine supporting evidence for those items; or (b) examine supporting evidence for the entire population.

If the tests of detail, including tests of accounting estimates, identify errors, the audit team should evaluate the impact of those errors to determine whether there is material misstatement in the financial statements or material irregularity in the financial transactions included in them. If the tests of detail have been applied to a sample of items, the audit team should estimate the expected error in the population from which the sample was drawn.

18.4 **Sampling techniques for Tests of Detail**: Before sampling any transactions the auditors should carry out a preliminary review of the listing of population items. This preliminary review should include the application of planning analytical procedures. The auditors should document these judgements and completion of this preliminary review in the working papers. When all the planned testing has been completed, the auditors should analyze any errors detected in the sample and draw inferences for the population as a whole. In case the audit team identifies errors in a sample of transactions, it should consider the nature and circumstances of the error to determine whether it is a systematic error or random error.

A **systematic error** is one which will only occur in defined circumstances and hence affects only a proportion of the population. A **random error** is one which could have also occurred in any of the transactions that were not selected for testing.

18.5 **Analytical Procedures:** Analytical Procedures consist of the evaluation of financial information in audit made by a study of plausible relationships among both financial and non-financial data. It involves analysis of significant ratios and trends including the fluctuations that are inconsistent with other relevant data or which deviate from expectations. "Expectations", in this context, refer to the auditor's expectations of what a figure in the accounts being audited should approximately be as worked out from other relevant financial and non-financial information. Their use is based on the assumption that there are relationships between items in the accounts and that these relationships may be expected to continue.

Examples

The reasonableness of the figure of expenditure on salaries can be verified bymultiplying the average number of the employees in each grade with the average salaryfor the grade.

The reasonableness of the interest on General Provident Fund balance can be verifiedby multiplying the average balance in the General Provident Fund with the prescribedrate of interest.

The steps involved in analytical review are as follows:

a. Develop an expectation: The basic premise of analytical review is the expectation that there are relationships between different types of data and that these relationships will continue to exist unless conditions to the contrary arise, which may then have to be investigated. For example, based on the quantity of cotton imported and its import price, Audit may develop an expectation that the annual value of cotton imports could be of the order of magnitude of Rs 1,000 million.

b. Define significant differences: Only very rarely will the actual recorded amount equal our expectation. It will perhaps not be worthwhile to investigate all cases of differences between recorded amounts and expectations. Instead, only those that are significant will need to be investigated. For example, Audit may, based on professional judgment, decide in the example given in (a) above that variations of up to Rs 50 million from expectations are acceptable.

c. Compare the actual with the expectation: Continuing with the above example, let us assume that Audit discovers that actual value of the annual cotton imports is Rs 910 million. In this situation, the difference between the expectation of Rs 1,000 million developed at (a) above and the actual is Rs 910 million, which is significant because the auditor has decided in (b) above that variation above Rs 50 million between expectations and actual is significant.

d. Investigate any significant differences between actual and expectation: As the difference of Rs 90 million is more than Rs 50 million considered as being significant, Audit will have to investigate the reasons for this significant difference.

e. Document the first four steps and make an audit conclusion as to whether assurance can be drawn: Assuming that the investigation referred to at (d) above has revealed that,of the difference of Rs 90 million, a sum of Rs 25 million is attributable to themisclassification of cotton imports as textile imports, an amount of Rs 65 million will stillremain unexplained. This amount being greater than the significant difference of Rs 50 million defined at (b) above, Audit can derive very little or no assurance from the analyticalreview procedure adopted in this case.

18.6 **Use of Analytical Procedures**: Analytical Procedures can be used for different purposes at different stages ofaudit:

a. In planning the audit, to assist Audit by pointing areas requiring examination

b. As substantive tests, in areas where analytical procedures can be used to obtainevidential matter regarding the accuracy of figures

c. In reporting stage, to assist in the final stage of the audit in assessing theconclusions Auditor has reached and in evaluation of the overall financial statementpresentation by identifying odd or unusual figures in the final accounts.

18.7 **Analytical Procedures as Substantive Procedures**: The decision about whether to use analytical procedures as substantive procedures and the nature, timing and extent of their use is based on the auditor's judgement about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions.

18.8 **Direct Substantive Testing (DST)**: When the audit objectives can be achieved without relying on the systems in place in the audit entity Direct Substantive Testing approach (DST) is undertaken without undertaking tests of control. Direct substantive tests are those tests of transactions and balances which seek to provide evidence as to the completeness, accuracy and validity of information in the accounting or financial statement. The testing involves examination of samples of transactions or account balances and is a form of inductive reasoning where the reasonableness of the aggregate results is inferred from the evidence of reliability of the individual details that have been tested.

Example

If the auditor wants to test whether purchases have been made by following the established procedures and have been accounted for correctly in the records, the auditor may test check some purchase transactions. If the transactions tested conform to procedures and have been correctly accounted for, the auditor can infer that purchase procedures have been adhered to.

18.9 **Analysis of Financial Statements:** Auditors should analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements. Financial statement analysis aims at ascertaining the existence of the expected relationship within and between the various elements of the financial statements, identifying any unexpected relationships and any unusual trends. The auditor should therefore thoroughly analyze the financial statements and ascertain whether:

a. Financial statements are prepared in accordance with acceptable accounting standards;

b. Financial statements are presented with due consideration to the circumstances of the audited entity;

c. Sufficient disclosures are presented about various elements of financial statements; and

d. The various elements of financial statements are properly evaluated, measured and presented.

19 Reporting Audit Results

19.1 The auditors should discharge reporting responsibilities as required by the relevant laws, and auditing standards being used to conduct audits.

19.2 These reporting responsibilities are in addition to the communications that auditors do with entity management, those charged with governance, law enforcing agencies as required by law and with the OAGN in different stages of audit process.

19.3 As a result of audit, the auditors should normally prepare following report.

(a) Preliminary Audit Report/ or Management Letter;

(b) Audit Report (with opinion);

(c) Final Management Letter;

(d) Any other reports such as long form audit reports required by regulatory bodies/ or by OAGN

19.4 As to form and content of audit reports, auditors should consider requirement of relevant laws, auditing standards used to conduct audit, the terms of condition contained in appointment letter of OAGN and any other instructions issued by the OAGN.

19.5 The reports and its contents 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.

19.6 As preliminary results of audit works, auditors should prepare preliminary audit report or preliminary management letter and submit it to the management of the entity for their comments with a copy to the OAGN. While preparing such report clearly indicate the audit findings leading to particular types of audit opinion, when such findings will not be corrected/ or adjusted in the financial statements.

19.7 Hold an exit meeting with the entity on audit finding and document it.

19.8 For the significant audit issues, discuss with the concerned officers of the OAGN before finalizing report.

19.9 Upon receipt of management response analyze responses and do further examinations if required and prepare audit report and final management report.

19.10 While preparing audit report and final management letter prepare a there column statement (Tin Mahale) as to what were audit observations, what is management responses and auditor's final comment on the responses; whether settled, or included in audit report or in management letter.

19.11 In a situation where there are additional reporting requirements as per law (e.g. Company Act, Bank and financial institutions Act) and directives of regulatory body, auditors have to prepare and submit such reports accordingly.

19.12 Audit report should be prepared in Nepali Language unless otherwise required by the law, regulation or agreement with the development partners or in the appointment letter.

19.13 Other reporting procedures shall be as specified in appointment letter.

20. Audit Opinion

An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse or a disclaimer of opinion.

20.1 Basis of Audit Opinion: The audit certificate should include the statements expressly setting out the basis of the audit opinion. This will include:

a. A statement whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

b. A statement whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account: (a) The auditor's conclusion, whether sufficient appropriate audit evidence has been obtained; (b) The auditor's conclusion, whether uncorrected misstatements are material, individually or in aggregate

c. A statement as to compliance or otherwise with Auditing Standards, together withthe reasons for any departure therefrom;

d. A statement that the audit process includes examining, on a test basis, evidencerelevant to the amounts, disclosures and regularity of transactions included in thefinancial statements; and

These statements are suitably modified where there a limitation of audit scope.

20.2 Expression of opinion: The audit certificates should contain a clear expression of opinion on both thetruth and fairness/proper presentation/fair presentation (as appropriate) and the regularityof the transactions recorded in the financial statements. The form of words used isgoverned by the basis of accounting used in the preparation of the statements.

Audit procedures are also carried out to form an opinion as to whether or not:

a. Proper accounting records have been kept by the entity and proper returns adequatefor the audit have been received from branches not visited;

b. The financial statements are in agreement with the accounting records and returns;

c. Other information published with the financial statements is consistent with thosestatements.

If any of these requirements have not been met, it should be stated in the auditcertificate. The certificate should also state whether or not all the information andexplanations required for the purposes of audit were obtained or not.

20.3 Unqualified Audit Opinions: An unqualified opinion is given when, in the judgement of the auditor (OAGN), the financial statements properly present receipts and payments or give a true and fair view and have been prepared in accordance with relevant accounting requirements.

20.4 Qualified Audit Opinions: The audit opinion should be qualified where the auditor (OAGN) is unable to satisfy himself that the financial statements are free from material misstatement whether caused by fraud, error or other irregularity. Three types of opinion other than unqualified can be issued - **"except for", adverse and disclaimer** of opinion.

20.5 Reasons for Qualification: The reasons for qualification fall into two groups:

a. Uncertainty: The audit may have caused the auditor (OAGN) to be uncertain as to whether material error does, or does not, exist in the accounts

b. Disagreement: The auditor (OAGN) may disagree with the way something has been dealt within the accounts.

20.6 Uncertainty: Uncertainty can arise in either of the following circumstances:

- The auditor (OAGN) is unable to obtain all the information and explanations he considers necessary to complete his audit (resulting in a limitation on the scope of his audit); the absence of proper accounting records might be the cause, or the auditor might be prevented from carrying out a necessary audit procedure so that a material figure in the account cannot be confirmed.

- The auditor cannot reach an objective conclusion as to the outcome of a situation due to the circumstances themselves; for example, there may be doubts about the obligations under a guarantee given which would have material financial consequences for the audit entity.

20.7 Disagreement: Disagreement qualifications arise where the auditor disagrees with something the audit entity has included in, or omitted from, the accounts. There are various circumstances in which disagreement may occur, such as:

a. The audit entity may present figures in the accounts which are not in accordance with the applicable accounting rules or not based on appropriate accounting policies or principles;

b. The auditor may disagree with facts or amounts in the accounts (disagreement needs to be distinguished from uncertainty in this regard);

c. The auditor may disagree with the way the audit entity has disclosed facts or amounts in the financial statements;

d. The audit entity may fail to comply with legislation or regulations; the auditor might then need to disagree on the grounds that there wereregularity errors in the accounts, or the accounts were not in the required form.

20.8 Manner of Qualification: The manner in which the auditor (OAGN) qualifies his opinion depends on two things:

a. Which of the groups the qualification falls into: uncertainty or disagreement;

b. The strength of the qualification.

- The strength of the qualification can be determined by asking a basic question: Is the matter fundamental to an understanding of the financial statements, so that in the auditor's opinion, a person reading the financial statements would be totally misled as a result of the error in them? The manner of dealing with cases of fundamental uncertainty or disagreement, which are not common, is given in the later paragraphs.

- A qualification on grounds of material uncertainty which arose from limitation on the scope of the audit would be reflected in both paragraphs of the certificate. The scope paragraph would indicate the limitation by reference to the auditor's report which should give the reasons for being unable to carry out his examination fully. The normal opinion would then be given 'subject to' the limitation on the scope of his examination.

- In other cases of material uncertainty, the scope paragraph is not affected. The uncertainty does not arise because the auditor's examination has been restricted, but because the outcome of a matter, which in the auditor's opinion would have material effect on the financial position of the audit entity is not known. If the auditor considered that something caused material uncertainty, he would qualify his normal opinion that the accounts 'properly present' / 'give a true and fair view' by saying 'subject to.. (This uncertainty)' and he would report separately on the circumstances.

- With regard to the second group of qualifications, material disagreement is reflected in the opinion by stating 'subject to ..(The irregular expenditure or the failure to)' followed by the normal opinion. The auditor's report should provide the details of the disagreement.

- Qualifications of the audit opinion therefore fall into the following categories:

Nature of Circumstances	**Material but not Fundamental**	**Fundamental**
Uncertainty	'Subject to' opinion	Disclaimer of opinion
Disagreement	'Except for' opinion	Adverse opinion

- The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification in Audit Opinion (Qualified Audit Report)	**Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements**	
	Material but Not Pervasive*	**Material and Pervasive**
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion
Financial statements are materially misstated	Qualified opinion	Adverse opinion

*Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment: (i) Are not confined to specific elements, accounts or items of the financial statements; (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

Example of Qualified Opinion - Uncertainty

Basis of Qualification

- The company has not updated its list of Property Plant & Equipments and has not fully complied with the recognition and measurement criteria set forth in NAS 06: Property Plant and Equipment and NAS 18: Impairment of Assets therefore we could not be satisfied ourselves on value so reported.
- The company has not updated its list of inventories and the inventories have not been assessed for any changes from cost to Net Realizable Value as required by NAS 04: Inventories therefore we could not be satisfied ourselves on the value so reported.

Opinion

In our opinion, based on the information and explanation provided to us and our audit, except for the matter raised in the preceding *Basis of Qualification* Paragraph, the financial statements give true and fair view of the financial position as of 32nd Asadh 2071 (16th July 2014), and of the results of its operations and cash flows of the Company for the year then ended in accordance with Nepal Accounting Standards and comply with the requirements of the Companies Act 2063.

Example of Qualified Opinion - Uncertainty

Basis of Qualification

We did not observe the counting of the physical inventories as of December 31, 2014, since that date was prior to the time we were initially engaged as auditors for the Company. Owing to the nature of the Company's records, we were unable to satisfy ourselves as to inventory quantities by other audit procedures.

Opinion

In our opinion, based on the information and explanation provided to us and our audit, except for the matter raised in the preceding *Basis of Qualification* Paragraph, the financial statements give true and fair view of the financial position as of December 31, 2014, and of the results of its operations and cash flows of the Company for the year then ended in accordance with Nepal Accounting Standards and comply with the requirements of the Companies Act 2063.

Example of Qualified Opinion – Disagreement on Accounting Policy

Basis of Qualification

As discussed in Note 23 to the financial statements,no depreciation has been provided in the financialstatements the practice, in our opinion, is not in accordance with International Accounting Standards. The provision for the year ended December 31, 2014 should be Rs. 677,775 based on the straight-line method of depreciation using annual rates of 5% for the building and 20% for the equipment. Accordingly, the
fixed assets should be reduced by accumulated depreciation of Rs. 3,075,880 and the loss for the year and total deficit should be increased by Rs. 677,775and Rs. 3,075,880respectively.

Opinion

In our opinion, based on the information and explanation provided to us and our audit, except for the matter raised in the preceding *Basis of Qualification* Paragraph, the financial statements give true and fair view of the financial position as of December 31, 2014, and of the results of its operations and cash flows of the Company for the year then ended in accordance with Nepal Accounting Standards and comply with the requirements of the Companies Act 2063.

- **Communication with those Charged with Governance**: When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification. Before issuing a qualified opinion or a disclaimer of opinion, the matter should be discussed with the management of the audit entity in full regarding the circumstances giving rise to the qualification and the audit management should be given the opportunity to make corrections to the financial statements or provide further information in support of the figures contained in them.

- The audit certificate should describe the **reasons and basis** for the opinion being other than unqualified and should quantify the effects on the financial statements whenever this is practicable. The opinion section should also be clearly headed to advise the reader that the opinion is qualified.

Example on 'Qualified Opinion' due to Likely Aggregate Error crossing the Materiality Threshold The following errors were found during the financial audit of a DDC	
1. Misclassification of expenditure of Rs.450 million in sample; projected to population Rs.1800 million	
2. Funds transferred to DDF; noticed from payment vouchers Rs.222 million	
3. Overpayment of Salaries Rs.134.5 million; recovered Rs.36.7 million	
4. Under assessment of revenue Rs.62 million	
5. Expenditure without approval of competent authority Rs.323 million; regularization orders received for Rs.201 million	
6. Fraudulent payment of grants to Educational Institutions Rs.12 million	
The gross disbursements to DDC were Rs.150 b and materiality is to be taken at 1%.	
Calculation of Likely Aggregate Error	
1. Misclassification of expenditure of Rs.450 million in sample; projected to population Rs.1800 million	1800 million

2. Funds transferred to DDF; noticed from payment vouchers Rs.222 million	222 million
3. Overpayment of Salaries Rs.134.5 million; recovered Rs.36.7 million	97.8 million
4. Under assessment of revenue Rs.62 million	Not taken into account as this would not affect the proper presentation of accounts
5. Expenditure without approval of competent authority Rs.323 million; regularization orders received for Rs.201 million	122 million
6. Fraudulent payment of grants to Educational Institutions Rs.12 million	12 million
Likely Aggregate Error	Rs.2253.8 m
Audit Opinion	
Materiality Threshold	Rs. 1500 m
Likely Aggregate Error	Rs. 2253.8 m
As the Likely Aggregate Error exceeds the Materiality Threshold, clean audit certificate cannot be given. The audit opinion should be either qualified or adverse depending upon the overall circumstances and the policy of the OAGN.	

21. Emphasis of Matter in the Auditor's Report

- If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

(a) Include it immediately after the Opinion paragraph in the auditor's report;

(b) Use the heading "Emphasis of Matter," or other appropriate heading;

(c) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements; and

(d) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Example of Qualified Audit Opinion and Emphasis on Matters in Audit Report

Basis for Qualified Opinion:

The company's short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from Nepal Financial Reporting Standards. The company's records indicate that had management marked the marketable securities to market, the company would have recognized an unrealized loss of xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at ……..and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion :

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects give a true and fair view of the financial position of ABC Company as at …….. and of its financial performance and its cash flows for the year then ended in accordance with Nepal Financial Reporting Standards.

Emphasis of Matter:

We draw attention to Note X to the financial statements which describe the uncertainty related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

Example of Audit Opinion with Emphasis on Matters in Audit Report

Notes to Financial Statements:

23. On January 15, 2015, the Company issued 8% redeemable debentures of Rs. 200 million for the purpose of financing plant expansion. The debenture agreement restricts the payment of future cash dividends to the shareholders till the redemption of the debenture after December 31, 2015. The debenture shall be redeemed on January 14, 2020.

Audit Opinion :

In our the financial statements present fairly, in all material respects give a true and fair view of the financial position of ABC Company as at December 31, 2014 and of its financial performance and its cash flows for the year then ended in accordance with Nepal Financial Reporting Standards.

Emphasis of Matter:

We draw attention to Note 23 to the financial statements which describe that the company shall not declare cash dividend before January 14, 2020. Since on January 15, 2015, the Company issued 8% redeemable debentures of Rs. 200 million for the purpose of financing plant expansion. The debenture agreement restricts the payment of future cash dividends to the shareholders till the redemption of the debenture after December 31, 2015. The debenture shall be redeemed on January 14, 2020.Our opinion is not qualified in respect of this matter.

- Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

  a. An uncertainty relating to the future outcome of exceptional litigation or regulatory action.

  b. Early application (where permitted) of a new accounting standard (for example, a new Nepal Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date.

  c. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Example of Disclaimer of Opinion and Emphasis on Matters on Going Concern Uncertainty in Audit Report

Basis of Audit Opinion -Audit Scope Limitation

D-Nepal had been conducting Micro Finance Program till April - end 2015. D-Nepal transferred the entire Micro Finance Program to N Micro Finance Ltd. on April-end 2015. Assets and liabilities were transferred as per the handover-takeover agreement signed between two parties based on the provisional figures subject to adjustment of the amount at the time of adoption of DDA. It was noticed that no DDA was carried out after the demerger. Furthermore, we were unable to carry out branch audit of Micro Finance Program operated by D-Nepal till April-end 2015 due to employees' strike in N Micro Finance Ltd. We were unable to confirm or verify by any audit methods the figures stated in financial statements of Micro Finance Program of D-Nepal and hence the scope of audit was substantially limited in case of Micro Finance Program which represents the significantly material amount in the Consolidated Financial Statement of the entity.

Opinion

Because of audit scope limitation as described in the Basis of Audit Opinion Paragraph, we were not able to obtain sufficient evidence and the reasonable assurance necessary to express an opinion on the financial statements of Micro Finance Program. Hence, we are unable to express our opinion on the consolidated financial position of D – Nepal as at July 17, 2015 and of its financial performance and its cash flow for the year then ended in accordance with Nepal Accounting Standards as the Micro Finance Programrepresents the significantly material amount in the Consolidated Financial Statement of the entity.

.

Emphasis on Matter

D-Nepal has been a tax exempted entity as it had obtained tax exemption certificate from Inland Revenue Department (IRD) on Bhadra 21, 2061 under Section 2 of Income Tax Act, 2058. Tax authority has issued assessment order of NRs. 190 million in respect of income years 2056/57 and 2057/58 on 2071/08/05 and of F/Y 2058/59 to 2067/68 on 2071/08/14. D-Nepal has contested the tax demand and filed a writ petition in the Supreme Court on 2071/08/22 and the case is pending in the Supreme Court. D-Nepal has not made any provision for tax purpose. Since the amount of contingent tax liability is significantly material, in case of crystallization of the contingent liability the going concern ambit of the organization may be on question. Our opinion is not qualified in respect of this matter.

Example of Audit Opinion with Emphasis on Matters on Going ConcernUncertainty

Notes to Financial Statements:

23. Because of the massive damage of the building and structure and work-in-progress during earthquake, the Company incurred a net loss of Rs 250 million during the year ended June 30, 2015 and, as of thatdate, the Company's current liabilities exceeded its current assets by Rs 150 million and total liabilities exceeded its total assets by Rs.250. There was no any insurance coverage for the damage.

Audit Opinion :

In our the financial statements present fairly, in all material respects give a true and fair view of the financial position of ABC Company as at June 30, 2015 and of its financial performance and its cash flows for the year then ended in accordance with Nepal Financial Reporting Standards.

Emphasis on Matter:

Without qualifying our opinion we draw attention toNote 23 in the financial statements. Because of the massive damage of the building and structure and work-in-progress during earthquake, the Company incurred a net loss of Rs 250 million during the year ended June 30, 2015 and, as of thatdate, the Company's current liabilities exceeded its current assets by Rs. 150 million and total liabilities exceeded its total assets by Rs.250 million. These factors, along with other matters as set forth in Note 23, raise doubt that the Company will be able to continue as a going concern.

22. Other Matter in the Auditor's Report

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter," or other appropriate heading. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section. If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph.

23. Corresponding Prior Period Figures

- When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures. However, if the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. The auditor shall either: (a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or (b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

- If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, and the corresponding figures have not been properly restated or appropriate disclosures have not been made, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.

- **Prior Period Financial Statements Audited by a Predecessor Auditor:** If the financial statements of the prior period were audited by a predecessor auditor and the auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report: (a) That the financial statements of the prior period were audited by the predecessor auditor; (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and (c) The date of that report.

- **Prior Period Financial Statements Not Audited**: If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

Example of a Qualified Audit Report

Basis for Qualified Opinion:
Because we were appointed auditors of ABC Company after closure of the financial year under audit, we were not able to observe the counting of the physical inventories at the beginning of that period or satisfy ourselves concerning those inventory quantities by alternative means. Since opening inventories affect the determination of the results of operations, we were unable to determine whether adjustments to the results of operations and opening retained earnings might be necessary for adjustment. Our audit opinion on the financial statements for the period ended was modified accordingly. Our opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.

Qualified Opinion
In our opinion, except for the possible effects on the corresponding figures of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, give a true and fair view of the financial position of ABC Company as at December 31, 2014 and of its financial performance and its cash flows for the year then ended in accordance with Nepal Financial Reporting Standards.

24. Written Representation

The auditor shall obtain a written declaration signed by the management of the audited organization, certifying that there are no matters requiring specific disclosure to the auditor that shall include:

a. The acknowledgement of the organization's responsibility for the keeping of accounts and financial documents that are correct, complete, fair, representing the true facts and all financial records and related data are made available to the auditor;

b. The management is responsible for the fair presentation of financial statements;

c. There are no violations or possible violations of laws and regulations whose effects should be considered for disclosure in the financial statement.

d. All material liabilities, gain or loss including contingencies that are required to be accrued or disclosed are provided/disclosed;

e. The organization has satisfactory title to all owned assets and are free from any liens or encumbrances other than those disclosed in the financial statement

As to format of written representation, auditors may use illustrative written representation provided in auditing standards used (NSAs or ISSAIs) or use as provided in Financial Audit Manual issued by OAGN.

25. Specific Considerations

25.1 Going Concern

25.1.1 The auditor should be alert to the possibility that the going concern assumption on which the preparation of the financial statements is based may be subject to question. When such a question arises, gather sufficient appropriate evidence to confirm or dispel the doubt regarding the entity's ability to continue in operation for the foreseeable future, generally for a period not to exceed one year after the balance sheet date.

25.1.2 If the going concern questions are not resolved, ensure there is adequate disclosure in the financial statements of the principal condition that raise doubt about the entity's ability to continue in operation in the foreseeable future.

25.1.3 If the disclosure considered necessary by the auditor not made, qualify audit opinion or express an adverse opinion for lack of such disclosure.

25.2 Events after the Balance Sheet Date

The auditor is not expected to conduct a continuing review of all matters to which he has previously applied procedures and reached satisfactory conclusions. However, he should perform procedures designed to satisfy him that all subsequent events up to the date of his report that may require adjustment of or disclosure in the financial statements have been identified and resolved.

25.3 Accounting Estimates

Accounting estimates are approximations of the amount of an item in financial statements in the absence of a precise means of measurement. The accounting estimates are usually associated with the preparation of accounts on an accruals or partial accruals basis. They may also be found in cash accounts, for example, when it is required to disclose estimates ofcontingent liabilities. The substantive audit procedures should provide competent, relevant and reasonable audit evidence in respect of accounting estimates. In particular, the audit team should obtain evidence as to whether an accounting estimates are (a) reasonable in the circumstances; and (b) are appropriately disclosed.

In auditing accounting estimates, the audit team can adopt one or more of the following approaches:

- Review and test the processes used by management to develop the estimate;
- Use an independent estimate for comparison with that prepared by management;
- Review subsequent events.

26. Follow up of Previous Year audit Observation

Auditors shall follow up the previous year audit observation including the any instructions issued by the public accounts committee of the legislature0parliament and include in the report with separate identifiable section.

27. Overarching Activities

The auditor should exercise due care about the activities which are carried and applied throughout audit process. These types of activities are cross-cutting and overarching in nature. Some of these activities have been discussed in following paragraphs.

27.1 Supervision and Review

27.1.1 The work of the audit staff at each level and audit phase should be properly supervised during the audit, and documented. A senior member of the audit staff should review work.

27.1.2 Supervision should be directed both to the substance and to the method of auditing. It involves ensuring that:

a. The members of the audit team have a clear and consistent understanding of the audit plan;

b. The audit is carried out in accordance with the auditing standards and practices of the Office of the Auditor General;

c. The audit plan and action steps specified in that plan are followed unless a variation is authorized;

d. Working papers contain evidence adequately supporting all conclusions, recommendations and opinions;

e. The auditor achieves the stated audit objectives; and

f. The audit report includes the audit conclusions, recommendations and opinions, as appropriate.

27.2 Documentation

27.2.1 Auditors should document all working papers and other information as required by auditing standards used to conduct audit and the other instructions issued by the OAGN. Auditors should adequately document the audit evidence in working papers, including the basis and extent of the planning, work performed and the findings of the audit.

27.2.2 Adequate documentation is important for several reasons. It will: a) Confirm and support the auditor's opinions and reports; b) Increase the efficiency and effectiveness of the audit; c) Serve as a source of information for preparing reports or answering any enquiries from the audited entity or from any other party; d) Serve as evidence of the auditor's compliance with Auditing Standards; e) Facilitate planning and supervision; f) Help the auditor's professional development; g) Help to ensure that delegated work has been satisfactorily performed; and h) Provide evidence of work done for future reference.

27.2.3 Working papers should be sufficiently complete and detailed to enable an experienced auditor having no previous connection with the audit subsequently to ascertain from them what work was performed to support the conclusions.

27.2.4 Auditors appointed to conduct audits of PEs are generally allowed to retain all working papers safe with them at their firm, however OAGN may require auditors at any point of time to furnish them to OAGN and it shall be duty of the auditors appointed to comply with such instruction.

27.3 Conservation of working paper documents

The auditor must properly maintain and store the working papers for a period of three years from the completion of audit and shall provide to OAG for inspection when requested during that period.

27.4 Confidentiality of information

All information related to an entity's affairs (other than that already in the public domain) acquired in the course of audit is, subject to legal requirement, strictly confidential. In particular no information on entity's affairs should be disclosed to anyone other than senior management of OAGN or the staff concerned either directly or indirectly with the work for that entity unless such disclosure is required by the law.

27.5 Quality Control and Assurance System

To ensure a high quality of work by the auditors, auditors should establish quality control and quality assurance system in their firms. Auditors should pay particular attention to quality assurance programs in order to improve audit performance and results. OAG may require an auditor to establish systems and procedures to confirm that integral quality assurance processes have been established and operated satisfactorily. OAGN may establish its own quality assurance arrangements and perform independent appraisal of auditor's works carried out by the appointed auditors.

27.6 Communication throughout audit process

The auditors should establish appropriate communication system and implement throughout audit process. Considering the relevant legal provision, applicable auditing standards and significance of the issue in question, auditor should determine at to whom to communicate, how to communicate and when to communicate.

Whom to communicate: To OAGN and its officers, Entity and its officers, Law enforcing Agencies (Anti-money laundering agencies, courts, anti-corruption agency, police etc.)

How to communicate: Written, oral, holding discussions, through telephone, email etc.

When to communicate: As and when required throughout audit process.

28. Audit Completion and Closure

28.1 Auditors should hold entrance meetingat the inception of audit work and exit meeting at the end of audit work with the appropriate level of management of audited organization and brief about audit objective, scope and timing of the audit and audit observations respectively.

28.2 While holding such meeting, auditors should inform concerned directorate of OAGN. OAGN may also attend such meetings.

29 Relationship and Responsibilities

The auditor shall perform his duties as assistance to Auditor General of Nepal and shall be responsible for implementation of relevant auditing standards in its work. Auditee will ensure that all records are available, all accounting and adjustments are made, and all other necessary steps are taken to make it possible for the auditor to perform the necessary work.

30 Maintenance of Roster

Concerned audit directorate at OAGN shall maintain roster of professional auditors and update periodically. Such roster shall be shall be prepared considering sector specific knowledge, skill and experience required to conduct audits.