



# Compliance Audit Guide



**Office of the Auditor General  
Anamnagar, Kathmandu, Nepal  
2023**

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## Foreword

It is my immense pleasure to release the Compliance Audit Guide of the Office of the Auditor General of Nepal. This guide will be applicable in undertaking respective financial, compliance, performance audits of the entities as per the Audit Act, 2075.

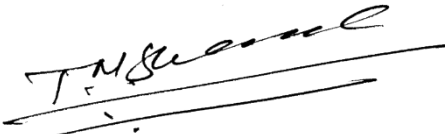
This guide provides a clear picture of methods and approaches to audit that the audit staff is required to comply with in imparting their duties. It has been built around the prevailing Audit Act, Nepal Government Auditing Standards (NGASs), and office policies that require conducting a high-quality audit. Since NGASs are based on INTOSAI framework for Professional Pronouncement (IFPP), this guide seeks to incorporate the Nepal audit practices at par with the international best practices.

This guide provides guidance and direction in all phases of the audit from pre-panning to follow-up including compliance audit concepts, initial considerations, planning, performing procedures and gathering evidences, evaluating and reporting, follow-up and quality control with necessary working papers which encourages professional judgment where it requires. The guide does not override the legal requirements and conditions of NGASs. Likely, it shall not limit the professionalism of the officials entrusted with the responsibility of conducting audits.

Our knowledge, skill, and experience with auditing practices continue to evolve, and so will this guide. This guide is expected to be updated for the continuous improvement of audit practices to meet legal provisions, audit standards, and practices to address emerging risks.

My special thanks to all staffs who prepared the guide and provided their valuable feedback and comments to make this guide implementable which, I do hope, will be of use to conduct audits efficiently and effectively.

April 26, 2023



**Tankamani Sharma, Dangal**  
**Auditor General**

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## List of Abbreviations

Abbreviation	Full Form
AAP	Annual Audit Plan
AG	Auditor General
CA	Compliance Audit
COTABD	Class of Transactions, Account Balances and Disclosures
FA	Financial Audit
FIU	Financial Information Unit
IFPP	INTOSAI Framework for Professional Pronouncements
INTOSAI	International Organisation of Supreme Audit Institutions
ISSAIs	International Standards of Supreme Audit Institutions
NGAS	Nepal Government Auditing Standards
NAMS	Nepal Audit Management System
OAGN	Office of the Auditor General of Nepal
PA	Performance Audit
PARF	Public Audit Restructuring Framework
QC	Quality Control

## **Background**

### **1. Overview**

Compliance Audit Manual has been developed under Strengthening Office of Auditor General of Nepal project to address the institutional and strategic issues that Office of Auditor General of Nepal might have to deal with when conducting compliance audits in accordance with applicable standards. This manual has been developed in accordance with Nepal's legal requirements and Nepal Government Auditing Standards (NGAS) which in turn are in agreement with INTOSAI Framework of Professional Pronouncements (IFPP).

With the periodic changes in the international standards on auditing as applicable to supreme audit institutions necessity was felt to restructure the auditing practices at OAGN. As a result, OAGN Public Audit Restructuring Framework was conceived allowing distinction of financial audits, performance audits and compliance audits. The erstwhile financial audit manual had provided for combined Financial and Compliance audits. This manual, which specifically provides for the compliance audits, supersedes the requirements of earlier financial audit manual.

As OAGN embarks on use of technology in auditing, the processes outlined in this Compliance Audit Manual have been aligned in Nepal Audit Management System (NAMS) for the conduct of compliance audits. There was a need from the users to have practical focused manual that the compliance auditor could use in conducting NGAS compliant compliance audits by using technology.

Public Audit Restructuring Framework (PARF) of OAGN requires auditors also to audit compliance matters for the 'offices' during the financial audit process. The process for such audit will be as determined under Financial Audit Manual, however auditors should also follow the principles of compliance audits as outlined in this Compliance Audit Manual.

### **2. Purpose of this manual and its users**

The manual is an audit methodology that contains explanations of the compliance audit process as well as audit working paper templates, that are designed to facilitate the application of standards in practice. OAGN may need to design and develop additional guidance materials, wherever required, to meet additional requirements that may be imposed by their law, regulation and practice. The methodology suggested in this manual extensively covers the audit work to be performed and documented at an audit engagement level.

The manual is solely for the purpose of compliance audits under the constitutional mandate of OAGN. The principal users of this manual are the auditors of OAGN. The manual should also be used by those auditors involved in compliance audits on behalf of the OAGN.

### **3. Structure of this manual**



The information in this compliance audit manual is aimed at providing the audit team with a methodology for completing a compliance audit. The audit working papers are standardised and the method of documenting and referencing information is also provided to ensure consistency.

▶ **Initial Considerations (Chapter 1)**

This phase of compliance audit includes conducting initial risk assessment to identify subject matter, team management and engagement (with discussions around clarification of expectations). Identification of intended users, defining subject matter, corresponding audit criteria and confirming level of assurance is also done at this stage. Also, principles with ethical significance are considered (e.g. independence and objectivity) and terms of engagement agreed with the responsible party.

▶ **Planning the Audit (Chapter 2)**

Planning process begins understanding the auditee and its control environment related to the subject matter, determining materiality. In addition, assessment of audit risk, risk assessment of the subject matter at auditee level is carried out. Here audit procedures are planned to enable assurance by development of overall audit strategy and audit plan.

▶ **Performing the Procedures (Chapter 3)**

The purpose of performing audit procedures is to gather sufficient and appropriate evidence through various methods and procedures and continually updating planning and risk assessment. Consideration is made at non-compliance that may indicate suspected unlawful acts.

▶ **Evaluation and Reporting (Chapter 4)**

In this process evaluation of whether sufficient and appropriate evidence is obtained is done considering materiality for reporting purpose. Then conclusions are formed, and compliance audit report is prepared including recommendations and responses from auditee as appropriate.

▶ **Follow-up (Chapter 5)**

Decide follow-up as appropriate, including a follow-up plan. Provides the concepts and procedures regarding follow-up audits and actions related to follow-up on audit observations and irregularities included in reports at different levels

▶ **Quality Control (Chapter 6)**

Review of work performed by auditors throughout all phases of the audit process to ensure that the audit complies with professional standards and applicable legal and regulatory requirements.

# 1. Introduction



## 1.1. Compliance Audit concepts

### 1.1.1 Compliance audit definition

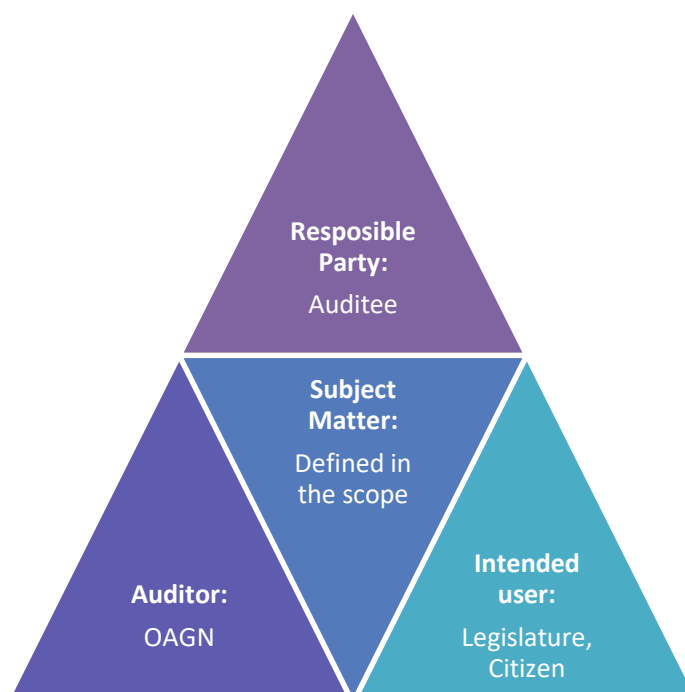
Compliance audit focuses on whether a particular subject matter is in compliance with authorities identified as criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the auditee. These authorities may include rules, laws and regulations, budgetary resolutions, policy, established codes, agreed terms or the general principles governing sound public- sector financial management and the conduct of public officials.<sup>1</sup>

#### Objective of the compliance audit

The objective of compliance auditing, therefore, is to enable OAGN to assess whether the activities of public-sector entities are in accordance with the authorities governing those entities.

Compliance Audit has three parties:

- Responsible Party (prepares);
- Auditor (audits); and
- Intended Users (uses)



Three parties in compliance audit are as follows:

<sup>1</sup> ISSAI 100.22; ISSAI 400.12

### **i. Auditor**

Auditor for public sector in Nepal is, as per the law, the Auditor General of Nepal.

### **ii. Responsible Party**

The responsible party is the executive branch of government and/or its underlying hierarchy of public officials and entities responsible for the management of public funds and the exercise of authority under the control of the legislature. The responsible party in compliance auditing is responsible for the subject matter of the audit<sup>2</sup>.

### **iii. Intended users**

In compliance auditing the users generally include the legislature as representatives of the people, who are the ultimate users of compliance audit reports. For public sector audit the other intended users could be and individuals, organisations or classes thereof<sup>3</sup>.

## **1.1.2 Subject Matter**

The subject matter of a compliance audit is defined in the scope of the audit. It may take the form of activities, financial transactions or information. It may take the form of<sup>4</sup>:

- ▶ Activities;
- ▶ Financial transactions; or
- ▶ Information

The subject matter depends on OAGN's mandate, the relevant authorities and the scope of the audit. Hence the content and scope of compliance audit subject matter can vary widely<sup>5</sup>. The subject matter of an audit may be either

- ▶ General or specific.;
- ▶ Quantitative (often, easily measured) or qualitative (more subjective in nature)

	Subject Matter e.g.	Subject Matter Information e.g.
1	Health's procurement sourcing practices with special emphasis on the procurement of medical equipment.	Tenders/contracts that form the basis for selection.
2	Expenditures related to training activities of an auditee.	Financial information and reports on training activities.

## **1.1.3 Criteria and Authorities**

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<sup>2</sup> ISSAI 400.37

<sup>3</sup> ISSAI 400.38

<sup>4</sup> ISSAI 400.33

<sup>5</sup> ISSAI 400.34

Criteria are the benchmarks used to evaluate or measure the subject matter consistently and reasonably<sup>6</sup>. Criteria are used to assessing activities of the public sector entities whether they are in accordance with the authorities governing the entities.

Authorities are the most fundamental element of compliance auditing. The structure and content of authorities furnish the audit criteria. Authorities include rules, laws regulations, budgetary resolutions, policies, established codes, agreed terms or general principles governing sound public-sector financial management and the conduct of public officials<sup>7</sup>.

Authority	Criteria
e.g. Subject matter is the procurement of medical equipment within health department	
Laws concerning procurement, health laws regulating procurement within the area etc.	Specific paragraph in a law regulating the way an auditee is supposed to procure medical equipment

### Conflicting Authorities

Because of the variety of possible authorities, there may be mutually conflicting provisions and they may be subject to differing interpretations. In addition, subordinate authorities may not be consistent with the requirements or limits of the enabling legislation, and there may be legislative gaps. These may feature as the sources of the criteria themselves<sup>8</sup>.

#### 1.1.4 Regularity and Propriety

Compliance auditing is concerned with<sup>9</sup>

- ▶ Regularity (adherence to formal criteria such as relevant laws, regulations and agreements); and
- ▶ Propriety (observance of the general principles governing sound financial management and the conduct of public officials).

While regularity is the main focus of compliance auditing, propriety may also be pertinent given the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

- ▶ Compliance auditing generally comprises the assessment of compliance with formal criteria such as authorising legislation, regulations issued under framework legislation and other relevant laws, regulations and agreements, including budgetary laws (**regularity**).
- ▶ Where formal criteria are absent or there are obvious shortcomings in the legislation concerning their application, audits may also examine compliance with the general principles governing sound financial management and the conduct of public officials (**propriety**).

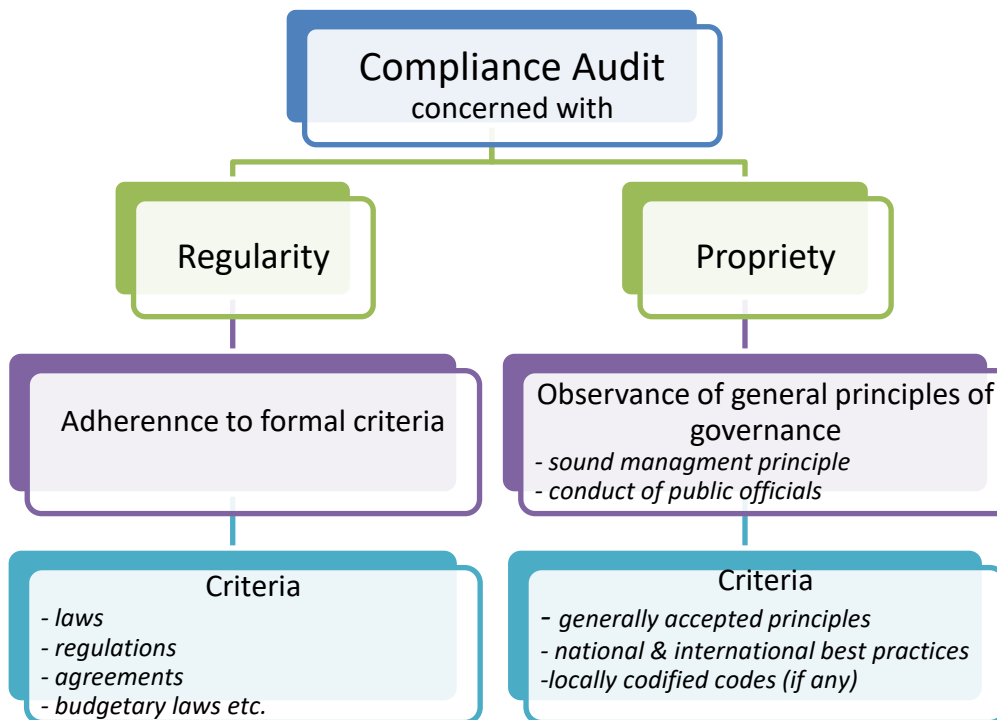
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<sup>6</sup> ISSAI 400.31

<sup>7</sup> ISSAI 400.28-29

<sup>8</sup> ISSAI 400.30

<sup>9</sup> ISSAI 400.13, 32



### 1.1.5 Transparency, accountability and good governance

Compliance auditing promotes transparency by providing reliable reports as to whether funds have been administered, management exercised and citizens’ rights to due process honoured as required by the applicable authorities. It promotes accountability by reporting deviations from and violations of authorities, so that corrective action may be taken and those accountable may be held responsible for their actions. It promotes good governance both by identifying weaknesses and deviations from laws and regulations and by assessing propriety where there are insufficient or inadequate laws and regulations. Fraud and corruption are, by their very nature, elements which counteract transparency, accountability and good stewardship. Compliance auditing therefore promotes good governance in the public sector by considering the risk of fraud in relation to compliance <sup>10</sup>.



<sup>10</sup> ISSAI 400.17

### 1.1.6 Professional judgement and professional scepticism

Auditors should plan and conduct the audit with professional scepticism and exercise professional judgement throughout the audit process to assess the elements of the audit, the subject matter, suitable criteria, the audit scope, risk, materiality and the audit procedures to be used in response to the defined risks<sup>11</sup>.

- **Professional scepticism**

The auditor should plan and conduct the audit with an attitude of professional scepticism, recognising that certain circumstances may cause the subject matter to diverge from the criteria. An attitude of professional scepticism means the auditor making a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit.

- **Professional judgement**

The concept refers to the application of relevant training, knowledge and experience, within the context provided by auditing standards, so that informed decisions can be made about the courses of action that are appropriate in the given circumstances of the audit.

### 1.1.7 Compliance audit as assurance engagement

A compliance audit is a systematic process of objectively obtaining and evaluating evidence as to whether a given subject matter is in compliance with applicable authorities identified as criteria.

Compliance audit as an assurance engagement enhances the credibility of information provided by the auditor. This assurance can either be provided through opinions and conclusions that explicitly convey the level of assurance, or it can be provided in other forms<sup>12</sup>.

Characteristics of compliance auditing	a. Assurance	a.1 Reasonable	Subject matter is in compliance or is not in compliance, in all material respects, with stated criteria
		a.2 Limited assurance	Nothing has come to the auditor's attention to cause the auditor to believe that subject matter is not in compliance
	b. Reporting formats	b.1 Attestation	Where is opinion is expressed
		b.2 Direct Reporting	<ul style="list-style-type: none"> <li>- Descriptions</li> <li>- Findings</li> <li>- Conclusions</li> <li>- Recommendations (optional)</li> </ul>

<sup>11</sup> ISSAI 400.43

<sup>12</sup> ISSAI 100.32

Both reasonable and limited assurance are possible in both direct reporting and attestation engagements in compliance auditing<sup>13</sup>.

Type of engagement	Attestation engagements	Direct reporting engagement
<i>Type of assurance</i>		
<i>Reasonable assurance</i>	Opinion (RA-AE)	Opinion/ Conclusion (RA-DR)
<i>Limited assurance</i>	Opinion (LA-AE)	Conclusion (RA-DR)

For Office of Auditor General of Nepal:

- Type of compliance audit engagements shall be - **limited assurance**.
- Type of reporting for compliance audits shall be - **direct reporting with conclusion**

### 1.1.8 Compliance audit and other streams of audit

Compliance audit can be carried out separately or as a part of the combined audit<sup>14</sup>.

- Undertaken separately
- Undertaken in relation with the audit of financial statements
- Undertaken in combination with performance audits

Compliance audits can be planned, performed and reported on separately from the audit of financial statements and from performance audits. Compliance audits may be conducted separately on a regular or an *ad hoc* basis, as distinct and clearly defined audits each related to a specific subject matter<sup>15</sup>.

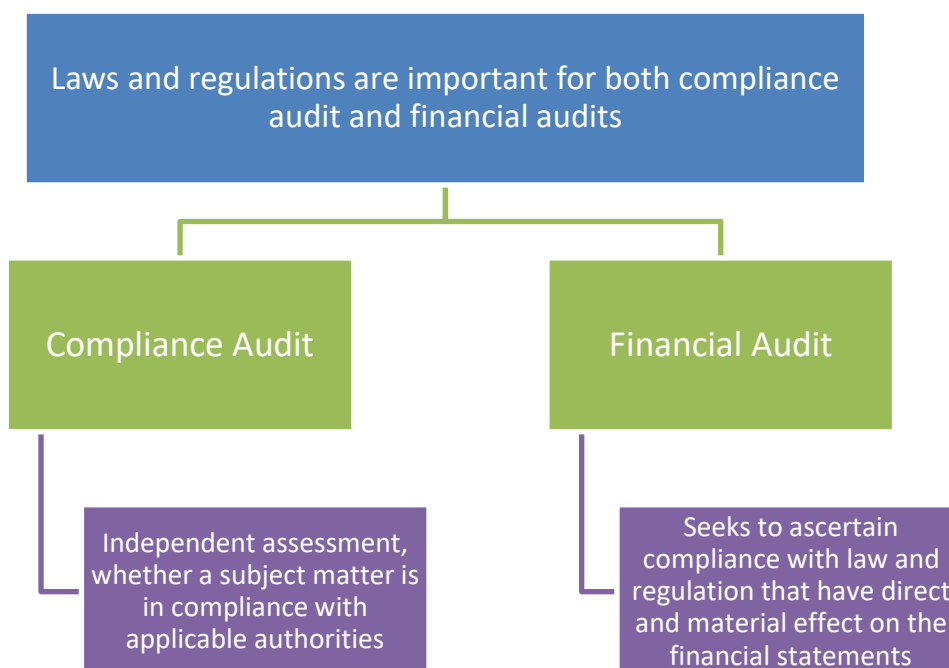
#### i. Compliance audit and financial audit<sup>16</sup>:

<sup>13</sup> ISSAI 400.41

<sup>14</sup> ISSAI 400.20

<sup>15</sup> ISSAI 400.25

<sup>16</sup> ISSAI 400.23



## ii. Compliance audit and performance audit

When compliance auditing is part of a performance audit, compliance is seen as one of the aspects of economy, efficiency and effectiveness. In combined audits of this kind, auditors should use their professional judgement to decide whether performance or compliance is the primary focus of the audit, and whether to apply the standards on performance auditing, compliance auditing or both <sup>17</sup>.

## 1.2. Legal Mandate for Compliance Audit

Compliance auditing is an integral part of AG's mandate. This is because legislation and other authorities are the primary means by which legislatures exercise control over income, and expenditure, management and the rights of citizens to due process in their relations with public sector. Also public-sector is entrusted with the sound management of public funds.<sup>18</sup>

### Constitution

Article 241(1) of the Constitution of Nepal: The accounts of public sector offices shall be audited by the Auditor General in accordance with law, having regard to, *inter alia*, the regularity, economy, efficiency, effectiveness and the propriety thereof.

- Therefore, constitution specifically mandates two basic areas of compliance audits namely, regularity and propriety.

### Audit Act

Sec 8 of the Audit Act, 2075 lists the areas to be audited taking into account, the regularity, economy, efficiency, effectiveness and the propriety. The specific areas related to

<sup>17</sup> ISSAI 400.26

<sup>18</sup> ISSAI 400.16



compliance audit that the auditors need to audit in accordance with Sec 8 of the Audit Act are; whether:

- accounts are maintained in prescribed formats and whether reporting been within the stipulated timeframe;
- central accounts have been maintained for all financial transactions including appropriation, revenue, deposits;
- disbursement of appropriated budget was done on timely basis;
- all expenditures are done by person with appropriate authority;
- records of public assets maintained as per prevailing laws or not;
- there is a system recording of public debt laws or not, and if yes, they are complied with;
- adequacy and compliance of internal controls;
- revenue and inflows collected in accordance with the law and deposited to treasury;
- deposits have been managed in accordance with prevailing laws;
- there are clear objectives, policies for planning, budget, programme formulation and they have been adhered to.

## 1.3. Common Audit Activities

The common audit activities overarching the compliance audit process are as follows:



### 1.3.1 Documenting the audit

Auditors should prepare audit documentation that is sufficiently detailed to provide a clear understanding of the work performed, evidence obtained, and conclusions reached<sup>19</sup>. Audit documentation should include an overall audit strategy and audit plan. It should record the procedures performed and evidence obtained and support the communicated results of the audit.

Auditors should prepare sufficient audit documentation. Documentation should be prepared at the appropriate time and should provide a clear understanding of the criteria used, the scope of the audit, the judgments made, the evidence obtained, and the conclusions reached. Documentation should be sufficiently detailed to enable an experienced auditor, with no prior knowledge of the audit, to understand the following<sup>20</sup>:

- the relationship between the subject matter, the criteria, the audit scope, the risk assessment, the overall audit strategy and audit plan and the nature, timing, extent and results of the procedures performed;
- the evidence obtained in support of the auditor's conclusion or opinion;
- the reasoning behind all significant matters requiring exercise of professional judgement;

<sup>19</sup> ISSAI 100.40; ISSAI 4000.89

<sup>20</sup> ISSAI 4000.48

- and the related conclusions.

The auditor should prepare relevant audit documentation before the audit report is issued. The documentation should be retained for the time as required under the law or as per OAGN's documentation practice.

The auditor shall prepare the audit documentation in a timely manner, keep it up to date throughout the audit, and complete the documentation of the evidence supporting the audit findings before the audit report is issued. The documentation includes as appropriate<sup>21</sup>:

- an explanation of the subject matter of the audit.
- risk assessment, overall audit strategy and plan, and related documents.
- the methods applied and the scope and time period covered by the audit.
- the nature, the time and extent of the audit procedures performed.
- the results of the audit procedures performed, and the audit evidence obtained.
- evaluation of evidences forming the finding(s), conclusion(s) opinion(s) and recommendation(s).
- judgments done in the audit process, including professional consultations and the reasoning behind them.
- communication with and feedback from the auditee.
- supervisory reviews and other quality control safeguards undertaken.

Documentation needs to be sufficient to demonstrate<sup>22</sup>:

- how the auditor defined the audit objective, subject matter, the criteria and the scope. (Note: scope needs to narrow things to enable the auditor to conduct proper audits);
- why a specific method of analysis was chosen, as well as the reasons;
- how information needed to understand the auditee being audited and its environment which enable the assessment of the risk were collected;
- how the assessment of the materiality of the subject matter was done; and
- how the possible sources of evidence were identified

The auditor needs to adopt appropriate procedures to maintain the confidentiality and safe custody of the audit documentation and retain it for a period sufficient to meet the needs of the legal, regulatory, administrative and professional requirements of record retention and to enable the conduct of audit follow-up activities<sup>23</sup>.

Documenting the key decisions made is important to demonstrate the independence and impartiality of the auditor's analysis. The existence of sensitive issues demands documentation of the relevant facts considered by the auditor in choosing a particular course of action or in taking a certain decision thus explaining and being transparent.<sup>24</sup>

## Alignment with NAMS

<sup>21</sup> ISSAI 4000.90

<sup>22</sup> ISSAI 4000.91-92

<sup>23</sup> ISSAI 4000.93

<sup>24</sup> ISSAI 4000.94

- ▶ All documentation shall be done in or through NAMS, to the extent possible, except where formally signed documents have to be prepared and retained. NAMS has the features to record audit processes, upload external documents and evidences.

### **1.3.2 Nature of audit documentation**

Audit documentation may be recorded manually, electronically or on other media. Electronic documentation may be created, generated or maintained through using audit management software, a spreadsheet, scanned documents or in picture form. Audit documentation includes working papers compiled by auditors containing audit programmes, analyses, issues memoranda, summaries of significant matters, letters of confirmation and representation, checklists, and correspondence (including e-mail) concerning significant matters. In addition, audit documentation may include abstracts or copies of the auditee's records, for example, significant and specific contracts and agreements.

### **1.3.3 Audit Review Process**

The review process has been divided into the following levels (please also refer to the audit process for recommended review levels for the different phases and working papers):

- First level – lowest level of review, e.g. at field level by the team leader;
- Second level – reviews done by the supervisor;
- Third level – review at the highest level and this include review by the person who has been delegated by the AG to conduct such review.

All three levels of review should consider the following fundamental issues when reviewing:

- All mandatory working papers and procedural steps have been adequately completed, signed (or signed off) by preparer and reviewer, dated and cross-referenced. When a working paper of procedural steps is omitted, adequate reasons are supplied;
- The audit subject matter, scope, criteria have been identified and clearly linked to the audit through the working papers;
- Knowledge of auditee and its environment obtained is adequate to inform the auditors' decision relating to the audit approach;
  - Conclusions were adequately drawn and supported by appropriate and sufficient audit evidence;
  - Significant deviations from the overall audit plan and any changes in the scope of the audit have been documented;
  - All significant professional judgements made have been documented and are supported by appropriate audit evidence;
  - The audit was conducted in accordance with the relevant audit approach, guidelines and other directives;
- All significant audit matters have been resolved or have been appropriately reported to management in the PAR as well as in the auditor's report;
  - The work performed and results obtained have been adequately documented;

- Based on the underlying audit work and findings the correct audit conclusion has been reached; and
- Reported findings are supported by adequate and sufficient audit evidence.

#### Alignment with NAMS

- ▶ The entire review process is facilitated through NAMS. i) The concurrent review of each Working paper in NAMS by the team leader ii) Final supervisor review is also done through NAMS in ER 1. iii) The quality control review that includes team leader's first level review and supervisor's second level review is also done through NAMS in QC 1.

### 1.4. Note for Reviewer

By the act of signing off a working paper at every stages of audit, the reviewer is attesting that following has been ensured:

- All relevant information for the purposes of concluding on the stage of the audit process has been duly considered; and
- Reviewer agree with the conclusions made on each working paper and all coaching notes have been addressed appropriately.

Should the reviewer require additional material to ensure compliance with IFPP, the reviewer need to refer to the relevant INTOSAI principle / standard/guidance.

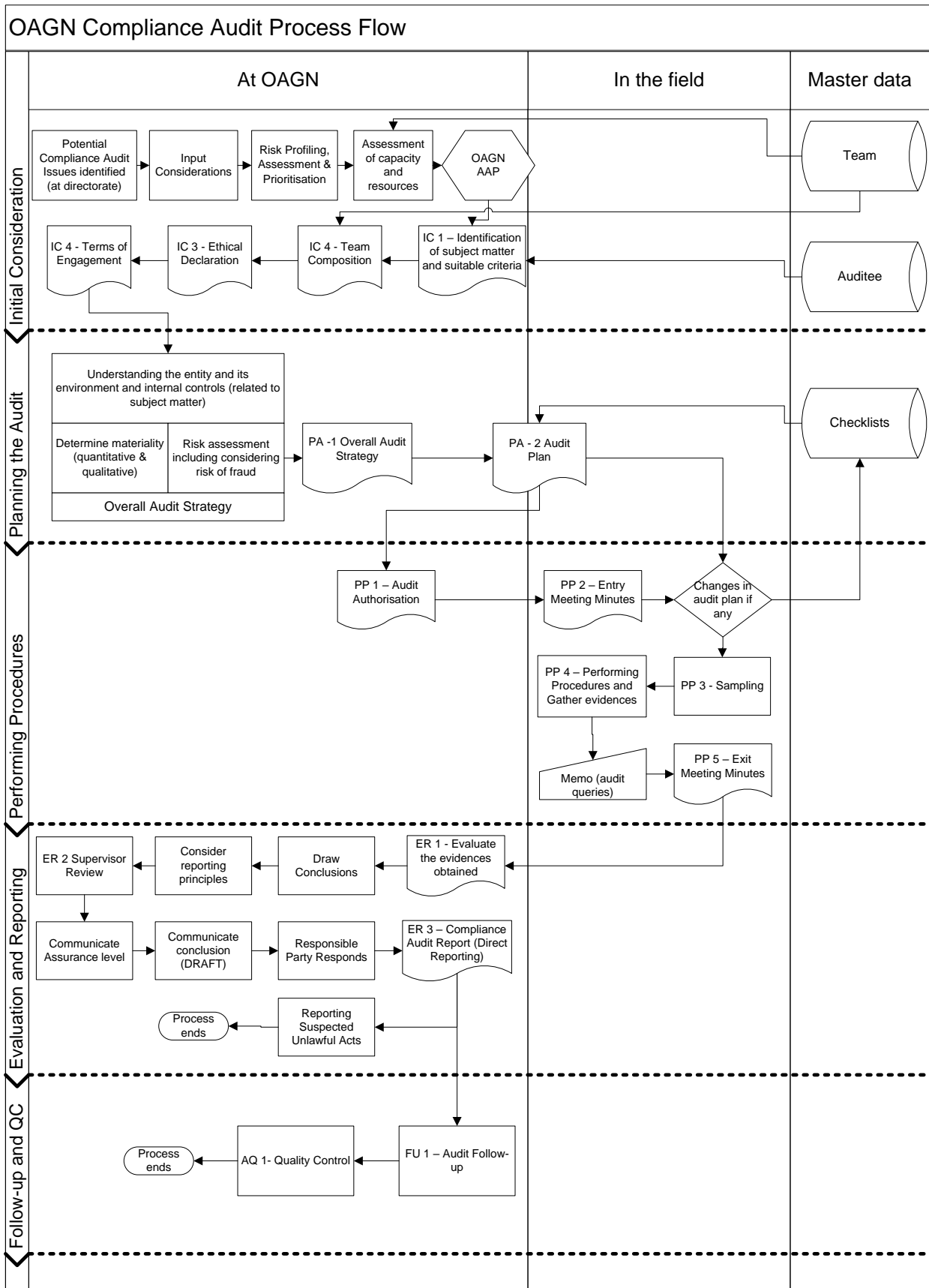
### 1.5. Compliance to international standards

This manual ensures the compliance with the Nepal Government Auditing Standards (NGAS). These standards are substantially aligned with INTOSAI Framework of Professional Pronouncements (IFPP) that include INTOSAI Principles, INTOSAI Standards (ISSAIs).

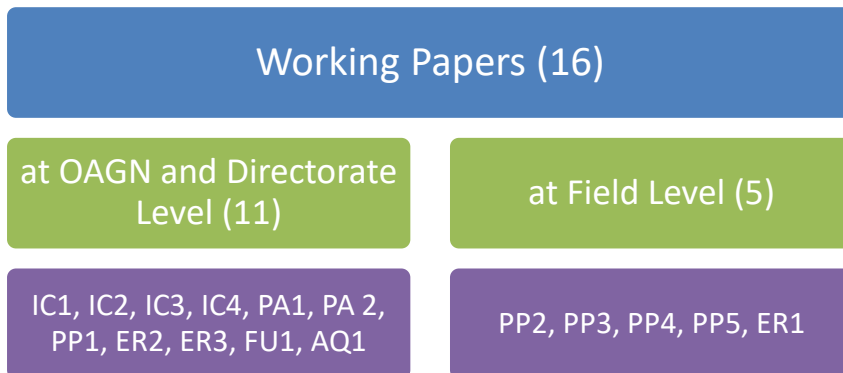
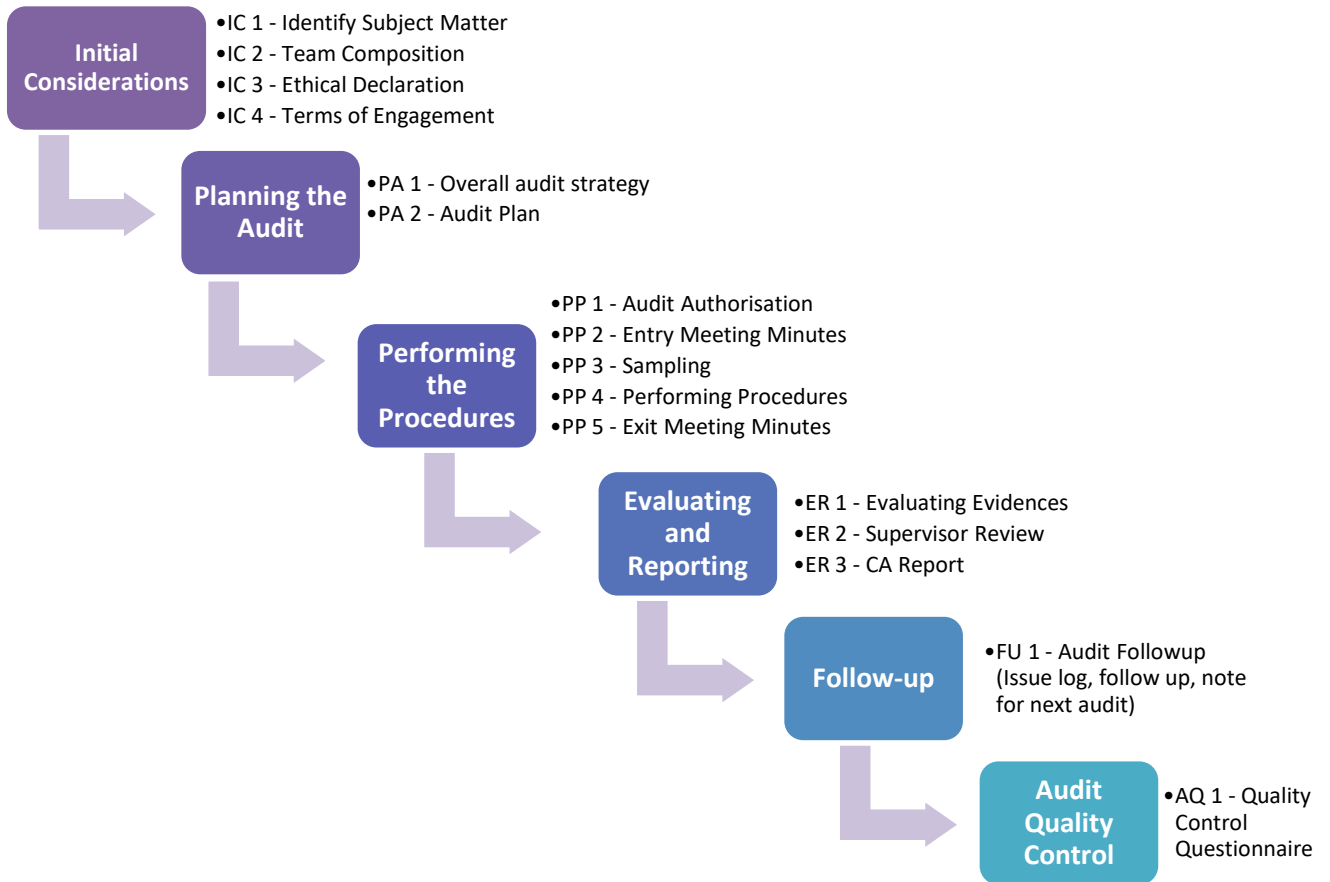
### 1.6. Body of Knowledge

This manual borrows body of knowledge from different sources relating to Supreme Audit Institutions mainly from INTOSAI Framework of Professional Pronouncements (IFPP) that include INTOSAI Principles and INTOSAI Standards (ISSAIs), publications of regional SAI organisations such as ASSOSAI and AFROSAI, INTOSAI Development Initiatives (IDI). Relevant legal provisions as applicable in Nepal are also included in the manuals, in force as on the date of publication.

## 1.7. Overview of Compliance Audit Process



## 1.7.1. Compliance Audit Process Flow



## 1.7.2. Working Papers to complete

SN	WP no.	WP Name	Objectives of the working paper	Implemented at
<b>Initial Consideration</b>				
1	IC 1	Identify subject matter	Identifying and defining subject matter and suitable criteria	Office
2	IC 2	Team composition	Assign, direct, supervise, monitor audits	Office
3	IC 3	Ethical declaration	Auditors comply with the ethical requirements	Office
4	IC 4	Terms of engagement	Understanding roles and responsibilities	Office
<b>Planning the Audit</b>				
5	PA 1	Overall audit strategy	Overall audit plan determining strategy	Office
6	PA 2	Audit Plan	Outline nature, timing and extent of audit	Office
<b>Performing the Procedures</b>				
7	PP 1	Audit authorisation letter	Legal authority to represent the AG	Field
8	PP 2	Entry minute minutes	Discussing roles and initiating audit	Field
9	PP 3	Sampling	To select items to be tested for audit assertions	Field
10	PP 4	Performing procedures	Applying procedures for obtaining evidenced	Field
11	PP 5	Exit meeting minutes	To discuss audit observations	Field
<b>Evaluation and Reporting</b>				
12	ER 1	Evaluating evidences	Assess whether evidences are sufficient to reach to an audit conclusion	Field
13	ER 2	Supervisor review	To assess that standard procedures are complied	Office
14	ER 3	Compliance audit report	Express conclusions on the compliance audit	Office
<b>Follow up of Audit</b>				
15	FU 1	Audit follow-up	To follow up on audit findings, past and present	Office
<b>Audit Quality Control</b>				
16	AQ 1	Quality control	Ensure that quality is maintained in audit	Office



## 2. Initial considerations (IC)



### 2.1. Objectives

This chapter builds on from the concepts of compliance audit covered in Introduction Chapter. It describes the issues that the OAGN management needs to address first at OAGN level before its starts conducting a compliance audit. These issues are included in the general requirements for compliance auditing standards. This chapter illustrates how subject matter is selected, team composition decided, ensure adherence to ethical matters and understanding the compliance audit process, subsequent chapters of this handbook explain the process.

### 2.2. Working papers and applicable standards

IC 1 Identify the subject matter	<ul style="list-style-type: none"><li>•ISSAI 400.37-38, 50-51</li><li>•ISSAI 4000.37-42, 44, 64-67, 101-112, 114, 116, 118, 121</li></ul>
IC 2 Team composition	<ul style="list-style-type: none"><li>•ISSAI 400.45</li><li>•ISSAI 4000.85</li></ul>
IC 3 Ethical declaration	<ul style="list-style-type: none"><li>•ISSAI 130; OAGN Code of Ethics</li><li>•ISSAI 4000.45-46, 48-49, 51</li></ul>
IC 4 Terms of engagement	<ul style="list-style-type: none"><li>•ISSAI 100.44</li><li>•ISSAI 4000.97</li></ul>

### 2.3. Audit Steps

Auditors need to go through the following audit steps to meet the requirements of the initial considerations phase:

#### 2.3.1 Identify the subject matter (IC 1)

Determination of the subject matter and criteria is one of the first steps in a compliance audit. Auditor should identify the subject matter and suitable criteria<sup>25</sup>. The identification process should emanate from OAGN's annual audit plan, which is the high level annual strategic document.

##### Subject Matter

The subject matter may take many forms and have a variety of characteristics. When identifying the subject matter, the auditor should employ professional judgement and scepticism to analyse the auditee and assess materiality and risk.

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<sup>25</sup> ISSAI 400.51

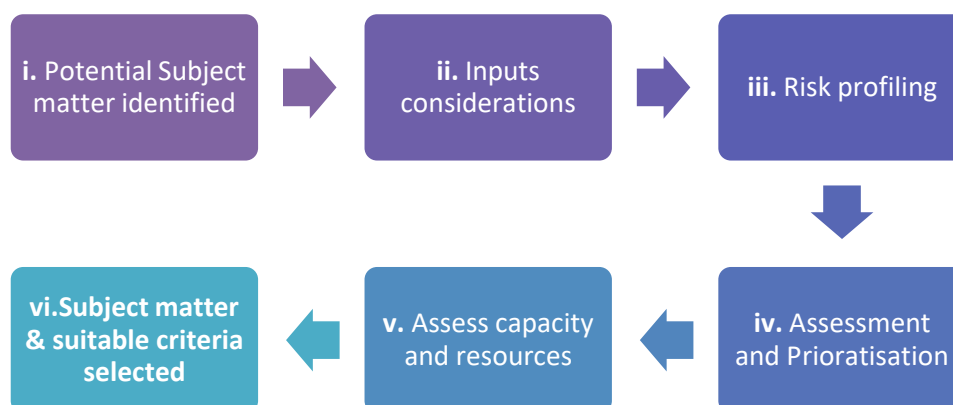
The subject matter should be:

- Identifiable;
- possible to assess it against suitable criteria;
- able to enable auditor to gather sufficient and appropriate audit evidence in support of the audit report, conclusion or opinion; and
- identifiable with an auditee, which is usually a government body and/or its underlying hierarchy and can be any entity/office within the scope of OAGN.

## Criteria

The auditor should identify suitable criteria to provide a basis for evaluating the audit evidence and developing audit findings and conclusions. The criteria should be made available to the intended users and others as appropriate. They should also be communicated to the responsible party.

## Process for selection of subject matter and suitable criteria



### i. Scope determination – Potential compliance audit subject matter identified

The scope defines the subject matter, and what is going to be audited. The scope depends on the needs of the intended user(s), the decided level of assurance (which for OAGN is limited assurance), the risk that has been assessed and the competence and resources available in OAGN<sup>26</sup>. Therefore, compliance audit should be included as a component of annual audit plan of OAGN.

The audit scope is a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The scoping of an audit is influenced by materiality and risk, and it determines which authorities and parts thereof will be covered. The audit process as a whole should be designed to cover the entire audit scope.<sup>27</sup>

### Alignment with NAMS

- ▶ Directorates shall identify and potential compliance audit subject matters in NAMS as input for OAGN annual audit plan. For each potential subject matter, the relevant

<sup>26</sup> ISSAI 4000.44

<sup>27</sup> ISSAI 400.50

information shall be populated in NAMS including identification of the auditee with the potential subject matter.

### **An example of audit objective and audit scope**

The **objective** is to verify that Department of Roads has planned, conducted and monitored the process of procurement of road construction projects as required under Procurement Act.

**Scope:** Road construction projects in the Department of Roads for 20XX, will be covered in this audit and evaluated against the criteria, Sec. XX of the Procurement Act, which requires that the auditee must include projects worth NRs XX million and above in the procurement plan. Irregularities in the process of awarding contracts, such as tailoring of bid specifications, will also be covered and evaluated against Sec. XX requiring an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective.

### **ii. Input considerations**

OAGN has the mandate to conduct compliance audits and has the discretion to select the subject matter, it performs the procedures necessary to identify significant areas and/or areas with a potential high risk of non-compliance. In performing these procedures, the auditor may take into consideration any of the following<sup>28</sup>:

- a) Public or legislative interests or expectations;
- b) Impact on citizens;
- c) Projects with significant public funding;
- d) Beneficiaries of public funds;
- e) Significance of certain provisions of the law;
- f) Principles of good governance;
- g) Roles of different public sector bodies;
- h) Rights of citizens and of public sector bodies;
- i) Potential breaches of applicable laws and other regulations;
- j) Non-compliance of internal controls or absence of an adequate internal control system;
- k) Findings identified in previous audits; and
- l) Risks of non-compliance signalled by third parties.

### **Alignment with NAMS**

- ▶ For each potential subject matter the auditor shall record input consideration within the NAMS.

### **iii. Risk profiling**

The exercise, as described above, would help in creating risk profile of the entities. Based on their risk profile risk assessment is done. Auditor need to describe/answer the following:

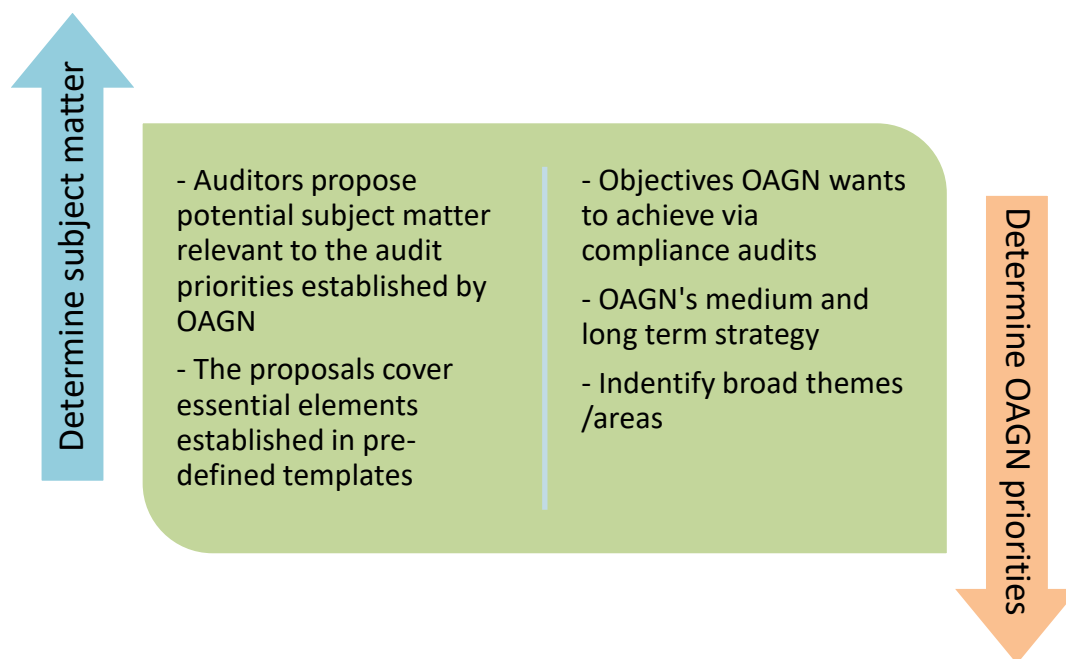
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<sup>28</sup> ISSAI 400.50; ISSAI 4000.64-67

- Is the subject matter within AG’s mandate or can AG apply discretion on the subject matter?
- Describe the risks of non-compliance that are related to the subject matter.
- How significant is the subject matter to the intended user(s)?
- What is the objective and scope of this subject matter?
- Does the OAGN has sufficient resources and required competence to conduct this audit?

OAGN should take into account its strategic priorities when establishing potential subject matter that best reflect risks, public interest and the potential for OAGN to add value and contribute to accountability. These potential subject matters can be identified in a bottom-up and / or top-down approach and should be documented. In the bottom-up approach, auditors propose potential audit tasks which are generally relevant to the audit priorities.

The top down approach flows from OAGN strategic plan, which spans a set number of years and identifies broad themes / areas of significance that are of national or international interest. The subject matter proposed from the directorates are assessed and decided in Annual audit plan of OAGN.



#### Alignment with NAMS

- ▶ Risks of non-compliance shall be identified for each potential subject matter from the input consideration and they should be populated in NAMS.

#### iv. Assessment and Prioritisation

Auditor should use a set of pre-established criteria such as relevance to the strategic priorities, importance of risks, public interest and potential added value through the audit.

##### A. Applying a risk chart/matrix to identify high-risk areas

Auditor needs to assess likelihood that there is a risk of non-compliance with the identified requirements (the criteria) and what would be the impact if that risk occurs. This gives a clear picture of the risks that are critical or high and, in this manner, help the auditor to prioritise if the risks are significant and whether the auditor should pursue the subject matter further and conduct a compliance audit. In the process of risk assessment, it is useful to apply a risk chart to place the risks in the right category as follows:

Likelihood (probability)	Very high					
	High					
	Moderate					
	Low					
	Very Low					
		Very Low	Low	Moderate	High	Very High
	Impact (consequences)					

Score guide

0	1	2	3
Low	Moderate	High	Critical

## B. Public interest

OAGN shall identify areas that are of significance for the intended user(s)<sup>29</sup>. Subject matter considered for audit should be of potential interest to OAGN’s main stakeholders, e.g. the parliament. Main sources of information are decisions made by parliament and reports and other documents it has produced. Additional points to take into account are the interest shown by the national administrations, by the press or the general public. The level of public interest (low – moderate – high - critical) should be determined for each proposed audit task.

0	1	2	3
Low	Moderate	High	Critical

## C. Assessing potential value added

OAGN should consider the potential added value of the topic in terms of the financial importance of the area concerned. Furthermore, OAGN should assess whether something new and useful can be said or not by conducting the compliance audit.

- Higher priority should be given to areas and topics that have never been audited, or audited only partially, or audited many years previously.
- The potential impact in terms of identifying weaknesses and making recommendations should be considered.

0	1	2	3
Low	Moderate	High	Critical

## D. Prioritisation

<sup>29</sup> ISSAI 4000.64

OAGN should compare all the potential and proposed subject matters with the strategic priorities for the planning period concerned and assesses the extent to which the priorities are covered. This analysis should identify the audit tasks best suited to address the strategic priorities and identify priorities that have not been sufficiently covered by the proposed potential audit tasks. This analysis should rank the proposed audit tasks and should be documented.

Potential Subject Matters	Risk Assessment Score	Public Interest	Value Added	Total	Rank
	0-3	0-3	0-3		

Assessing the proposed audit tasks against pre-established criteria is not an exact science. Professional judgment based on knowledge and experience is needed.

#### Alignment with NAMS

- ▶ Risk Analysis for each potential subject matter – Input to be given by the auditor in NAMS (i) Risks shall be analysed applying likelihood (probability) and consequences (impact). Mapping is done based on the matrix and risk score is derived. (ii) based on the auditor’s professional judgement, score is assigned for public interest and potential value added.
- ▶ The scoring for each potential subject matter shall be tabulated and Ranking is generated based on the total score will be done automatically.

#### v. Capacity and Resources

Availability of other resources: Reasonable assurance audits usually require more time and resources, compared to a limited assurance audit conducted on the same subject matter with the same scope. Therefore, OAGN should consider conducting a limited assurance audit if the resources are limited. However, this should be considered carefully by giving precedence to user needs, and by considering other factors such as materiality and risk.

- Auditability or feasibility should also be taken into account and assessed, that is, whether it is technically or practically possible to carry out the audit and whether OAGN has the capacity and skills needed. External expertise, for example, might be needed.
- A key element is also timeliness. The selection of topics should be timed to contribute to changes such as major reforms or the introduction of new initiatives. A report that is late will be unable to influence events and it therefore loses relevance.

#### Alignment with NAMS

- ▶ For each potential subject matter capacity and resources needs to be assessed. Auditor shall use NAMS to input capacity and resource assessment.

#### vi. Selection and defining subject matter and suitable criteria in OAGN AAP

The auditor shall define the subject matter to be measured or evaluated against criteria based on the identified audit areas. The subject matter should be identifiable, and possible to assess against suitable audit criteria. It should be of such nature that it enables the auditor to conclude with the necessary level of assurance. This means to gather sufficient and appropriate audit evidence to support the audit conclusion or opinion<sup>30</sup>.

#### Alignment with NAMS

- ▶ Selection decision for compliance audit subject matter shall be recorded in NAMS. The subject matter shall specifically be identified with the entity/office where the compliance audit shall be undertaken and reported to.

### OAGN's Annual audit plan and Compliance audit

The annual audit plan of OAGN should be prepared by adopting a holistic approach of covering entities for each type of audit and leveraging common processes. This plan would therefore also indicate entities for which compliance audits would be conducted. The risk profile of the audit units would have to be reviewed and updated periodically to assess continued maintenance or to consider revision of the risk profile assigned to the entities based on new intervening developments, changes and increase / decrease in irregularities noticed by various stakeholders, etc.

Annual audit plan of OAGN should cover following components for compliance audits:

1. Deciding the type of compliance audit engagement: i.e. direct reporting<sup>31</sup>;
2. Determination of specific subject matter, where considered necessary;
3. Allocation of audit resources for the audits to be undertaken.
4. Decision the assurance level the compliance audits shall provide i.e. limited assurance<sup>32</sup>; (i.e. as per OAGN's policy or strategy)
5. Identify the intended user(s) and the responsible party and consider the implication of their roles in order to conduct the audit and communicate accordingly<sup>33</sup>.

Compliance audit subject matter may be added or removed by the Auditor General anytime during the audit calendar. This can be done with or without any amendments to the annual audit plan.

#### Alignment with NAMS

- ▶ AAP preparation shall be preceded by the process of Identification of Subject matter for compliance audit.

Some examples (BUT NOT LIMITING TO) of audit areas for identifying subject matter are:

- Financial performance:
  - use of appropriated funds (budget execution)
  - revenue collection, e.g. council taxes, application of fines and penalties

<sup>30</sup> ISSAI 4000.107-109

<sup>31</sup> ISSAI 4000.37-42

<sup>32</sup> ISSAI 4000.121

<sup>33</sup> ISSAI 400.37-38: ISSAI 4000.101-106

- use of grants and loans
- Procurement
- Expenditure
- Service delivery – health (medical), education, etc.
- Public complaints
- Heritage protection
- Propriety of auditee’s officials/decision making
- Health and safety
- Environmental protection
- Internal control framework
- Payment of social benefits, pensions
- Physical characteristics, density, access to government buildings etc.
- Extractive industries – contracts, etc.

The auditor shall identify relevant audit criteria prior to the audit to provide a basis for a conclusion / an opinion on the subject matter. The subject matter and audit criteria are linked and consistent. Therefore, identifying the corresponding audit criteria is an iterative process.

When auditing a subject matter, the auditor has to make sure that there are corresponding audit criteria<sup>34</sup>.

An example of a **subject matter** in the audit area of procurement can be

**"Procurement of services for road construction for the Department of Roads"**

By this it means that the Department is responsible for procuring services for construction of roads. Therefore, it must ensure awarding of the contracts for road construction to suppliers according to the requirements of the Procurement Act.

The criteria should demonstrate the following characteristics: relevance; completeness; reliability; neutrality; understandability; usefulness; comparability; acceptability and availability<sup>35</sup>.

Suitable regularity (legal) criteria can derive from<sup>36</sup>:

- a) Laws, rules, regulations, directives etc.
- b) Treaties and other agreements.
- c) Codes of conduct.

Suitable propriety criteria may derive from<sup>37</sup>:

- a) Public financial management expectations (e.g. effective and efficient internal control).
- b) Beneficiaries’ expectations regarding the utility of goods, quality of services and works.
- c) Requirements for a transparent and unbiased allocation of public funds and human resources.

Examples of audit question and criteria

<sup>34</sup> ISSAI 4000.110-112

<sup>35</sup> ISSAI 4000.118

<sup>36</sup> ISSAI 4000.114

<sup>37</sup> ISSAI 4000.116



**Audit question #1:** Has the dept. included road construction projects in the annual procurement plan?

**Criteria:** Section X(Y) of the Procurement Act requires that the Ministry must include projects worth NRs XX million and above in the procurement plan.

**Audit question #2:** Has the method of procurement been fair, equitable and transparent? **Criteria:** Section XX(Y) requires that an officer must ensure that a ministry maintains an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective.

### 2.3.2 Team composition (IC 2)

The individuals in the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being undertaken, familiarity with the applicable standards and authorities, an understanding of the auditee's operations and the ability and experience to exercise professional judgement<sup>38</sup>.

OAGN shall ensure that the audit team collectively has the necessary professional competence to perform the audit<sup>39</sup>. Depending on the subject matter, this may include:

- a) Auditing skills and skills regarding data collection/analysis;
- b) Legal competence;
- c) An understanding and practical experience of the type of audit being undertaken;
- d) Knowledge of the applicable standards and authorities;
- e) An understanding of the auditee's operations and appropriate experience for the type of auditee and operations being audited;
- f) The ability and experience to exercise professional judgement; and
- g) Producing an auditor's report that is appropriate in the circumstances.

#### Alignment with NAMS

- ▶ Team composition shall be pulled from the scheduling module of NAMS. Details relating to the team shall be pulled in from team master data in NAMS such as name, position, experience in no. of years, highest degree obtained, special qualification, past relevant experience (if any) etc. as appropriate.

### 2.3.3 Ethical declaration (IC 3)

It is a requirement that the auditor shall comply with the relevant procedures relating to objectivity and ethics, which in turn shall comply with the related ISSAIs on objectivity and ethics. The auditor is to demonstrate professional behaviour and integrity, be objective, possess the required professional competence, and exercise due care. Auditor is also to maintain independence in fact and appearance and confidentiality regarding all audit matters<sup>40</sup>.

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<sup>38</sup> ISSAI 400.45

<sup>39</sup> ISSAI 4000.85

<sup>40</sup> ISSAI 4000.45-46

The auditor shall take care to remain objective so that findings and conclusions will be impartial and shall be seen as such by third parties. The auditor demonstrates objectivity in selecting their audit objectives and identifying the criteria. The auditor needs to ensure that communication with stakeholders does not compromise the objectivity of OAGN. The auditor needs to avoid undue influence from any stakeholders in formulating a balanced report and maintains their objectivity so that their work and report will be seen as impartial by reasonable and informed third parties<sup>41</sup>.

All auditors, other staff and other person(s) working on behalf of OAGN need to comply with the ethical codes and need to give compliance declaration in the manner prescribed in OAGN Code of Ethics<sup>42</sup>.

#### Alignment with NAMS

- ▶ The templates for ethical declaration as per OAGN Code of Ethics shall reside in NAMS and auditors shall confirm to the compliance to the declaration in the NAMS. These declarations shall be auditee and audit specific where the auditors shall be involved in compliance audit.

### 2.3.4 Terms of engagement (IC 4)

Auditors should ensure that the terms of the audit have been clearly established even when audits may be required by statute or initiated by OAGN. In all cases the auditor, the auditee's management, those charged with governance and others as applicable should reach a common formal understanding of the terms of the audit and their respective roles and responsibilities. Important information may include the subject, scope and objectives of the audit, access to data, the report that will result from the audit, the audit process, contact persons, and the roles and responsibilities of the different parties to the engagement<sup>43</sup>.

The matters that are communicated in writing to the auditee include the audit subject matter, audit criteria, the level of assurance, the time period for the audit, and the organisations and/or programs to be included in the audit through confirming the terms of engagement. Communicating these matters can help in achieving mutual understanding of the audit process and the auditees operations<sup>44</sup>.

#### Alignment with NAMS

- ▶ The auditor shall pull the engagement letter template in the NAMS and make appropriate changes as applicable to the auditee and subject matter, print (at least) two copies, one for OAGN and one for the auditee to sign. The signed document may be uploaded in NAMS for document recording.

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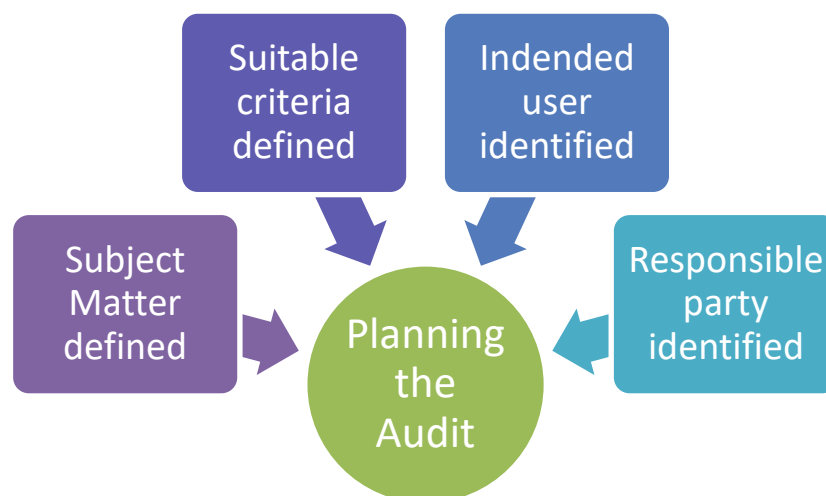
<sup>41</sup> ISSAI 4000.48-49, 51

<sup>42</sup> OAGN Code of Ethics; ISSAI 130

<sup>43</sup> ISSAI 100.44

<sup>44</sup> ISSAI 4000.97

### 3. Planning the Audit (PA)



#### 3.1. Objectives

Planning an audit involves collecting and assessing information and making decisions as to the audit scope, approach, timing and resources. The aim is to reduce the audit risk or the risk of reaching a wrong conclusion or opinion on the audit, where required, to an acceptably low level by developing an overall audit strategy and audit plan that describes how the audit will be performed and the resources needed to efficiently deliver the audit.

Adequate planning helps to devote appropriate attention to important areas of the audit, identify potential problems on a timely basis and properly organise and manage the audit to respond to users' needs efficiently and effectively. Adequate planning also assists the auditor to properly assign work to the team members, and facilitates the direction, supervision and review of their work. Further, it assists, where applicable, the coordination of work done by auditors and experts, if applicable. The nature and extent of planning activities will vary with the circumstances of the audit; for example, the complexity of the underlying subject matter and criteria.

The auditor shall develop and document an overall audit strategy and an audit plan that together describe how the audit will be performed to issue reports that will be appropriate in the circumstances, the resources needed to do so and the time schedule for the audit work<sup>45</sup>.

#### 3.2. Working papers and applicable standards

PA 1 Overall audit strategy

- ISSAI 400.46-47, 52-56
- ISSAI 4000.54-55, 58, 60, 126, 128-130, 132-137

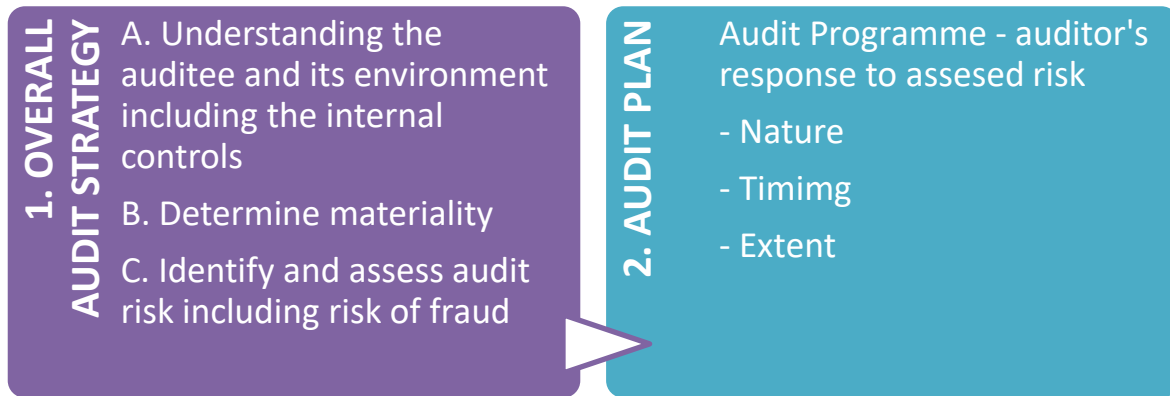
PA 2 Audit Plan

- ISSAI 400.54, 56
- ISSAI 4000.137, 141

<sup>45</sup> ISSAI 400.56; ISSAI 4000.137

### 3.3. Audit Steps

The purpose of the overall audit strategy is to devise an effective response to the risk of non-compliance. It should include consideration of the planned audit responses to specific risks through the development of an audit plan. Both the overall audit strategy and the audit plan should be documented in writing<sup>46</sup>.



#### 3.3.1 Overall audit strategy (PA 1)

The overall audit strategy is the basis for making the audit execution possible. The overall audit strategy describes what to do, and the audit plan how to do it. The purpose of the overall audit strategy is to design and document the overall decisions. The strategy may contain the following:

Covered under Initial Consideration under Chapter 1

- The subject matter, scope, criteria of the compliance audit, under OAGN's mandate;
- The type of engagement (attestation engagement or direct reporting engagement);
- The level of assurance to be provided;
- Composition and work allocation of the audit team, including any need for experts;
- Communication with the auditee and/or those charged with governance.

Covered here under Chapter 2

- Understanding the auditee and its environment and internal controls
- Determine materiality
- Identify and assess audit risk including risk of fraud



<sup>46</sup> ISSAI 400.56

## **i. Understanding the auditee and its environment and internal controls**

### **Understanding auditee's environment**

Auditors should understand the auditee in the light of the relevant authorities. Compliance auditing may cover all levels of the executive and can include various administrative levels, types of entities and combinations of entities. The auditor should therefore be familiar with the structure and operations of the auditee and its procedures for achieving compliance. The auditor will use this knowledge to determine materiality and assess the risk of non-compliance<sup>47</sup>.

The auditor needs to understand the auditee and its environment and how this may influence the subject matter and the subject matter information. To obtain an understanding of the auditee and its environment, the auditor may consider the<sup>48</sup>:

- relevant business;
- laws and regulations – legal basis for the activity and relevant parts of the Financial Regulation, Implementing Rules and other rules and regulations.;
- other external factors;
- the nature of the auditee's operations - the policy concerned, objectives and strategies, locations, and types/volume/values of programmes/projects;
- governance arrangements - including operational structure, resources and management arrangements;
- objectives and strategies; or
- performance measures - consider whether pressures to achieve performance targets may result in management actions that increase the risk of misstatement or irregularity.

This understanding shall be documented in the overall audit strategy.

### **Understanding internal controls**

Auditors should understand the control environment and the relevant internal controls and consider whether they are likely to ensure compliance. The control environment is the culture of honesty and ethical behaviour that provides the foundation for the system of internal controls to ensure compliance with the authorities.

In compliance auditing, a control environment that focuses on achieving compliance is of particular importance. In evaluating internal controls, that may be quantitative or qualitative internal controls, or a combination thereof, the auditor assesses the risk that they may not prevent or detect material instances of non-compliance<sup>49</sup>. Auditors need to understand:

- What these controls are;
- Whether the controls are adequate and can detect, prevent, and correct instances of non-compliance; and most importantly; and
- Whether the controls are working as intended.

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<sup>47</sup> ISSAI 400.52

<sup>48</sup> ISSAI 4000.132-133

<sup>49</sup> ISSAI 400.53

To obtain an understanding of the internal control, it may be relevant to consider the auditee's:

- communication and enforcement of integrity and ethical values,
- commitment to competence,
- participation by those charged with governance,
- philosophy and operating style,
- organizational structure,
- existence and level of internal audit activity,
- assignment of authority and responsibility, and
- human resource policies and practices.

The auditor identifies the internal controls that are in place to reduce the risk of non-compliance with criteria or material misstatements in the subject matter information. By using professional judgment, the auditor decides whether a control is relevant to the audit or not. An internal control system is composed of policies, structures, procedures, processes and tasks that help the auditee to respond appropriately to risks of non-compliance with the criteria. An effective system may safeguard the auditee's assets, facilitate internal and external reporting and help the auditee to comply with relevant authorities<sup>50</sup>.

#### Alignment with NAMS

- ▶ Auditors shall record their understanding of the auditee environment and internal controls related with the subject matter in NAMS. The templates for recording such understanding are to be filled in for such purpose. The templates / formats are flexible and dynamic to suit and tailor-make for wide arrays of compliance audit subject matters.

#### ii. Determine materiality

Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. This judgement may relate to an individual item or to a group of items taken together. Materiality is often considered in terms of value, but it also has other quantitative as well as qualitative aspects. A matter may also be material because of the context in which it occurs<sup>51</sup>.

An essential part of determining materiality is to consider whether reported cases of compliance or non-compliance (potential or confirmed) could reasonably be expected to influence decisions by the intended users. Assessment of materiality requires comprehensive professional judgement on factors such as<sup>52</sup>:

- mandated requirements;
- public interest or expectations;
- specific areas of legislative focus, requests and significant funding; and
- Issues at a lower level of value or incidence may be material, such as fraud.

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<sup>50</sup> ISSAI 4000.134-136

<sup>51</sup> ISSAI 400.47

<sup>52</sup> ISSAI 4000.126

The auditor has to determine materiality to form a basis for the design of the audit<sup>53</sup>:

- In the planning phase, assessing materiality helps the auditor to identify the audit questions which are of importance to the intended user(s).
- In performing the audit, the auditor uses materiality in the decision of the extent of audit procedures to be executed and the evaluation of audit evidence.
- In evaluating and concluding the audit, the auditor uses materiality to evaluate the scope of work and the level of non-compliance to determine the impact on the conclusion.

The concept materiality includes nature, context and value therefore materiality has both quantitative and qualitative aspects<sup>54</sup>.

- **Quantitative materiality** - determined by applying a percentage to a chosen benchmark as a starting point. Quantitative materiality is mostly used in attestation engagement.
- **Qualitative materiality** – in compliance audit qualitative factors are more important than the quantitative factors. Qualitative factors e.g. public expectations and public interest.

Examples of qualitative factors that may impact the auditor's determination of materiality or that have a higher risk of non-compliance material by nature or context. Such as

- Instances of excess spending over appropriations authorized by the legislature or introduction of a new service not provided for in the approved appropriations, even if quantitatively not material, will be instances of non-compliance but may still warrant communication to the auditee due to their nature, due to their qualitative characteristics.
  - The number of persons or entities affected by the particular subject matter, or the monetary amounts involved; and
  - The number of observed deviations from a control may be a relevant quantitative factor when the subject matter information is a statement that the control is effective.

Qualitative factors may include such things as:

- The interaction between, and relative importance of, various components of the subject matter information when it is made up of multiple components, such as a report that includes numerous performance indicators;
- The chosen subject matter information that is expressed in narrative form;
- The nature of an instance of non-compliance; for example, the nature of observed deviations from a control when the subject matter information is a statement that the control is effective;
- Whether an instance of non-compliance affects compliance with laws or regulations;

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<sup>53</sup> ISSAI 4000.125, 128

<sup>54</sup> ISSAI 4000.127, 129-130

- Whether an instance of non-compliance is the result of an intentional / unintentional act;
- When the subject matter information relates to a conclusion on compliance with laws or regulations, the seriousness of the consequences of non-compliance; and
- When the underlying subject matter is related to a particular aspect of a program/ auditee and is significant regarding the nature, visibility and sensitivity of the program / auditee.

#### Example - 1

##### **Road construction project not included in the procurement plan**

It is qualitatively material that the road construction project is not included in the procurement plan as this might lead to construction of roads that were not needed most to be constructed, according to the public needs and expectations, and the infrastructure might not be developing in the desired direction for the community/region/nation.

#### Example - 2

##### **False diplomas**

In the case of employment of new employees, **it is qualitatively material that the auditee verifies that the submitted diplomas are genuine documents.** In this case it would mean that a person is hired on a false background and receiving a salary on wrong terms. It is not important to check whether the salaries are correct, but **what is material is that people are employed based on the right qualifications.** For instance, if a person is employed as a medical doctor and has a false degree/diploma and based on that will have serious consequences for the patients if the “doctor” prescribed wrong medicines.

#### Example - 3

##### **IT access control**

**It is qualitatively material if unauthorised persons/entities have access to the IT-systems.** For example, for the HR / payroll system, it is crucial that only those who are processing the information have access. If unauthorised persons have access, even though it is read-only access, and the persons cannot manipulate the information, there will be a breach of confidentiality. Another example is if unauthorised persons get access to classified information, for example to the database of the Ministry of Defence or Ministry of External Affairs that can be misused when/if it falls into the wrong hands, which may have serious implications for the nation.

##### **Alignment with NAMS**

- ▶ Qualitative materiality and Quantitative materiality functionalities are available in NAMS to be recorded. Considering the unique nature of each of the subject matter may possess, generic and flexible feature for materiality determination is in NAMS.

### **iii. Identify and assess audit risk, including risk of fraud**

The audit risk is the risk that the audit report – or more specifically the auditor’s conclusion or opinion -will be inappropriate in the circumstances of the audit. Therefore, auditors should consider audit risk throughout the audit process. Audits should be conducted in such a way as to manage or reduce the audit risk to an acceptable level. Consideration of audit risk is relevant in both attestation and direct engagements. The auditor should consider three



different dimensions of audit risk – inherent risk, control risk and detection risk – in relation to the subject matter (quantitative/qualitative) and the reporting (opinion/direct reporting)<sup>55</sup>.

Audit Risk = Inherent Risk X Control Risk X Detection Risk		
If the inherent risk is	and the control risk is	then auditor can respond by
<ul style="list-style-type: none"> <li>• High</li> <li>• Medium</li> <li>• Low</li> </ul>	<ul style="list-style-type: none"> <li>• No control</li> <li>• Weak control</li> <li>• Decent control</li> <li>• Strong control</li> </ul>	<ul style="list-style-type: none"> <li>• Spending more time on it</li> <li>• Spending less time on it</li> <li>• Scanning it</li> <li>• Not consider it for audit</li> <li>• Writing a finding</li> <li>• Recommending few controls</li> </ul>

The components of audit risk are<sup>56</sup>:

- the subject matter’s inherent risk (IR);
- the control risk (CR)—the risk that the relevant internal controls associated with the inherent risks are inappropriate or do not work properly;
- the detection risk (DR)—the risk that the procedures performed by the auditor will lead to an incorrect conclusion/opinion.

### Risk Assessment

Auditors should perform a risk assessment to identify risks of non-compliance i.e. the subject matter will not comply with the criteria. Non-compliance may arise due to fraud, error, the inherent nature of the subject matter and/or the circumstances of the audit. The identification of risks of non-compliance and their potential impact on the audit procedures should be considered throughout the audit process. As part of the risk assessment, the auditor should evaluate any known instances of non-compliance in order to determine whether they are material. <sup>57</sup>.

The risk assessment will vary from auditee to auditee and are influenced by factors such as:

- The newness and complexity of the applicable compliance requirements;
- Auditor’s knowledge of the auditee's internal control over compliance with the applicable compliance requirements obtained in previous audits or other professional audits;
- The nature of the applicable compliance requirements;
- The services provided by the auditee and how they are affected by external factors; and
- The level of oversight by the government.

### Risk of fraud

<sup>55</sup> ISSAI 400.46

<sup>56</sup> ISSAI 4000.54

<sup>57</sup> ISSAI 400.54

Auditors should consider the risk of fraud throughout the audit process and document the result of the assessment<sup>58</sup>. Fraud in compliance auditing relates mainly to the abuse of public authority, but also to fraudulent reporting on compliance matters. Instances of non-compliance with authorities may constitute deliberate misuse of public authority for improper benefit. The execution of public authority includes decisions, non-decisions, preparatory work, advice, information handling and other acts in the public service. Improper benefits are advantages of a non-economic or economic nature gained by an intentional act by one or more individuals among management, those charged with governance, employees or third parties.

While detecting fraud is not the main objective of compliance audit, auditors should include fraud risk factors in their risk assessments and remain alert to indications of fraud when carrying out their work. If the auditor comes across instances of non-compliance which may be indicative of fraud, he or she should exercise due professional care and caution so as not to interfere with any future legal proceedings or investigations.<sup>59</sup>

Due to the inherent limitations of an audit, there is an unavoidable risk that unlawful acts, including fraud may occur and not be detected by the auditor. The risk of not detecting an unlawful act resulting from fraud is higher than the risk of not detecting one resulting from error as fraud generally involves organised schemes designed to conceal it, deliberate failure to record transactions, collusion or intentional misrepresentations being made to the auditor.<sup>60</sup>

The primary responsibility for the prevention and detection of fraud lies with the auditee's management through designing, implementing and maintaining an adequate internal control system. Although an audit may act as fraud prevention, it is normally not designed to detect fraud. The auditor is responsible for maintaining professional scepticism throughout the audit and recognising the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

#### Alignment with NAMS

- ▶ Auditors identifies and analyses in NAMS the possible risk of non-compliances including risk of non-compliances as a result of fraud. The risk assessment will contribute towards auditors focusing on risky areas while developing risk response in the NAMS in the form of Audit Plan.

#### Risk assessment and direct reporting engagement

In a direct reporting engagement, the auditor is involved in producing the subject matter information. The auditor may apply the audit risk model in forming a conclusion on the subject matter<sup>61</sup>.

The overall audit strategy shall also include

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<sup>58</sup> ISSAI 400.55; ISSAI 4000.58

<sup>59</sup> ISSAI 400.55

<sup>60</sup> ISSAI 4000.60

<sup>61</sup> ISSAI 4000.55

- Resources planning – i.e. resources required and available
- Audit schedule – i.e. time schedule

#### Alignment with NAMS

- ▶ The NAMS shall summarise the processes such as Understanding the Auditee Environment, Materiality determination and Risk Assessment and auto generate the Overall Audit Strategy for the subject matter for the specific auditee.

### 3.3.2 Audit plan (PA 2)

In light of the audit criteria, the audit scope and the characteristics of the auditee, and the risk assessment auditor determines the nature, timing and extent of the audit procedures to be performed<sup>62</sup>. The auditor shall develop and document an overall audit strategy and an audit plan that together describe how the audit will be performed to issue reports that will be appropriate in the circumstances, the resources needed to do so and the time schedule for the audit work<sup>63</sup>.

Audit plans, that can be in the form of checklists / audit programmes shall have to be developed separately and vetted through the OAGN approval process.

The auditor develops an audit plan for the compliance audit. The overall audit strategy is an essential input to the audit plan. The audit plan may include:

- a) Nature, timing and extent of planned audit procedures and when they will be performed.
- b) An assessment of risk and of internal controls relevant for the audit.
- c) The audit procedures designed as a response to risk.
- d) The potential audit evidence to be collected during the audit.

#### Periodic update of planning.

Planning is not a distinct phase of the audit, but a continuous and iterative process. The auditor updates both the overall audit strategy and audit plan as necessary throughout the audit<sup>64</sup>.

#### Alignment with NAMS

- ▶ Audit team shall prepare Audit Plans, in the form of audit checklists / audit programme to be used for compliance audit (subject matters are unique and checklists catering to one subject matter generally will not be same for another). These Audit plans may be retained in the NAMS repository for future access if they shall be required in future. Some indicative templates shall be retained at NAMS master data for areas like procurement, revenue, payroll for reference for use to develop other checklists relevant to the relevant subject matter if repeated in future compliance audits.

<sup>62</sup> ISSAI 400.54

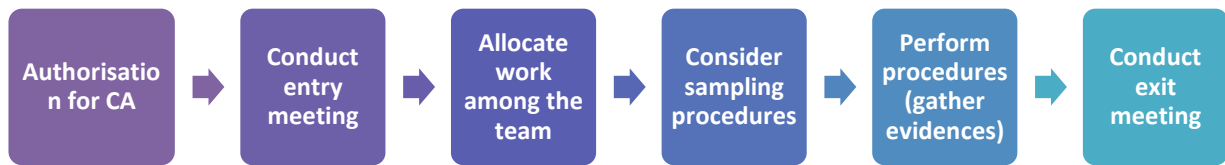
<sup>63</sup> ISSAI 4000.137

<sup>64</sup> ISSAI 400.56; ISSAI 4000.141

## Summary of the planning process



## 4. Performing procedures and gathering evidences (PP)



### 4.1. Objectives

Auditors move into the audit execution phase after they have reviewed the subject matter, criteria, scope prepared overall audit strategy and audit plan. Based on the audit procedures identified in planning the audit, auditor gathers and documents evidences to form a conclusion or opinion as to whether the subject matter, in all material respects, complies with established criteria. The nature and sources of the necessary audit evidence shall be determined by the desired level of assurance, the criteria, materiality, the subject matter and the scope of the audit. Sufficient audit evidence is related to the decision about the level of assurance. The nature of audit evidence is also different for the two types of audits. For limited assurance engagements, the audit evidence is mostly analytical procedures and inspections while for reasonable assurance engagements, you would normally need to perform mostly all the audit techniques.

### 4.2. Working papers and applicable standards

PP 1 Authorisation letter	
PP 2 Entry meeting minutes	•ISSAI 100.43
PP 3 Sampling	•ISSAI 4000.172-176
PP 4 Performing procedures	•ISSAI 400.57 •ISSAI 4000.144-152, 158-169
PP 5 Exit meeting minutes	

### 4.3. Audit Steps

#### 4.3.1 Authorisation letter (PP 1)

OAGN shall issue audit authorisation letter for the audit team, addressed to the auditee whose compliance is to be audited. The authorisation letter shall include the following

- When the audit shall commence
- Who will be in the audit team

In addition, the authorisation letter shall include request to the auditee to provide the audit team with:

- i. Access to all information that is relevant to the audit of subject matter such as records, documentation and other matters;
- ii. Additional information that auditor may request from for the purpose of the audit; and
- iii. Unrestricted access to persons within the auditee from whom the auditor determines it necessary to obtain sufficient and appropriate audit evidence.

#### Alignment with NAMS

- ▶ Authorisation letter template resides in NAMS and auditor should tailor it to be relevant for the audited subject matter and to the auditee.

### 4.3.2 Entry meeting minutes (PP 2)

It is essential that the auditee be kept informed of all matters relating to the audit<sup>65</sup>. The entry meeting shall be conducted at the commencement of audit as a communication process. Among others, the audit entry conference can be used as a forum to discuss and communicate with the management and those charged with governance where appropriate on the terms and conditions of the audit engagement.

The Entrance conference is conducted to achieve the following purposes;

- Introduce members of the audit team to management;
- determine appropriate persons within the auditee, with whom to communicate;
- determine the matters that need to be communicated:
  - responsibilities of the auditee management and the auditor team, as it has been agreed in the engagement letter and included in the audit authorisation letter;
  - planned scope and timing of the audit; and
  - auditor independence;
- establish the communication process (the process, form, timing and adequacy).

Documentation of communication may include a copy of minutes retained as part of the audit documentation where those minutes are an appropriate record of the communication.

#### Alignment with NAMS

- ▶ NAMS contains the template for entry meeting meetings minutes that can be filled in printed and signed by both the auditors and auditee. This can be uploaded in the NAMS for documentation.

### 4.3.3 Allocate work among the team members

Audit team leader shall allocate works among the field team members considering the experience and expertise and output required from each of the member of the team.

#### Alignment with NAMS

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<sup>65</sup> ISSAI 100.43

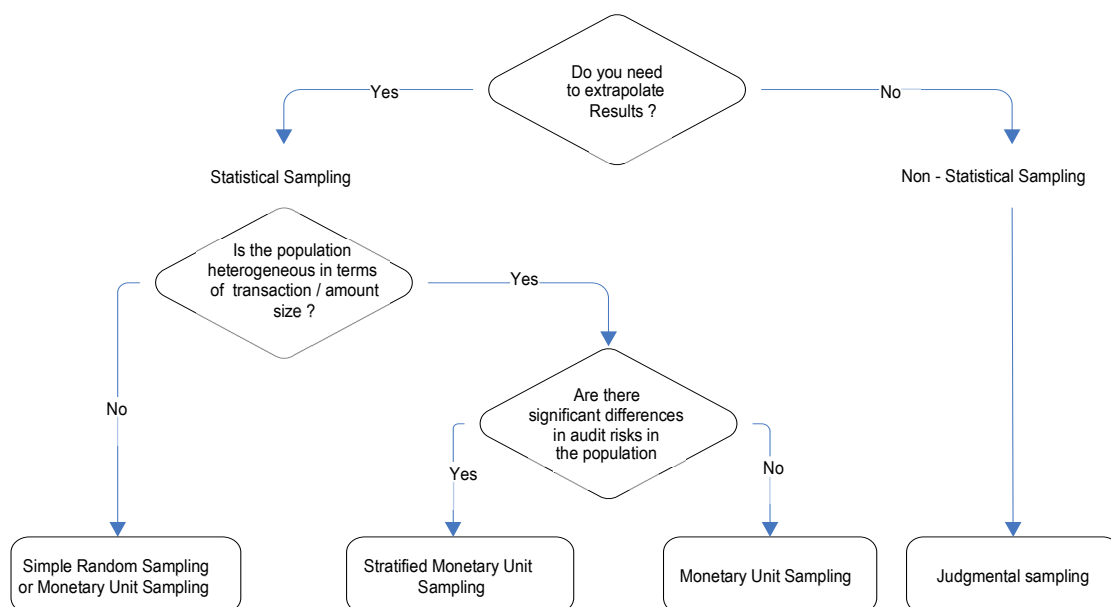
- ▶ The audit team leader allocates work to individual team member in the NAMS. Without allocation of work team members will have access to perform audit tests. Allocation of audit area is done in the NAMS through access to specific audit plans (checklists).

#### 4.3.4 Sampling (PP 3)

Audit sampling is defined as the application of audit procedures to less than 100 percent of items within a population of audit relevance. The auditor shall use audit sampling, where appropriate, to provide a sufficient amount or number of items to draw conclusions about the population from which the sample is selected. When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn<sup>66</sup>.

A sample may be quantitative or qualitative depending on the audit scope, and the need for information to illuminate the subject matter from several angles<sup>67</sup>.

- **Quantitative sampling** - is used when the auditor seeks to draw conclusions about the whole population by testing a sample of items selected from it. In quantitative sampling, the sample risk must be reduced to an acceptable low level. This requires statistical techniques and if the audit team does not have the skills expert's support may be required. Sample selection method shall be as follows
- **Qualitative sampling** - is a selective procedure conducted as a deliberate and systematic process to identifying the factors of variation in the subject matter based on characteristics of individuals, groups, activities, processes or the auditee as a whole that requires careful assessment and sufficient knowledge of the subject matter.



- With statistical sampling, sample items are selected in a way that each sampling unit has a known probability of being selected (based on laws of probability).
  - random selection – use of random numbers

<sup>66</sup> ISSAI 4000.172-173

<sup>67</sup> ISSAI 4000.174-176

- systematic selection – using sampling intervals
- monetary unit selection – every Rupee has equal chance of selection; therefore, larger amount has more chance of (getting hit) selection.
- With non-statistical sampling, judgment is used to select sample items.
  - judgemental selection – high value, key-items
  - haphazard selection – no structured technique
  - block selection – selection of a block within a population

#### Internal controls and sample size

Recommended sample size	
Level of reliance on controls	Sample size
• Low reliance	40-60%
• Moderate reliance	20-40%
• High reliance	10-30%

#### Alignment with NAMS

- ▶ NAMS will take the extent from the audit plan (PA 2) and assess high value item from quantitative materiality. NAMS will allow key item selection for the auditors using their judgement for qualitative materiality and then allow application of methods such as random number or similar statistical sampling method to select transactions for audit testing.

### 4.3.5 Performing procedures (PP 4)

The auditor shall select a combination of audit techniques to be able to form a conclusion with the selected level of assurance. The auditor performs effective audit procedures in line with the audit plan to gather audit evidence and fulfil audit objectives. The auditor will often need to combine and compare evidence from sources using different techniques/methods in order to meet the requirements for sufficiency and appropriateness. Based on the scope, the auditor will gather quantitative or qualitative audit evidence, or a combination thereof<sup>68</sup>.

Audit evidence is gathered using a variety of methods such as<sup>69</sup>:

- a) Observation - looking at a process or procedure being performed by others;
- b) Inspection - examining books, records, documents etc whether internal or external;
- c) Inquiry - seeking information from relevant persons, both within and outside the auditee;
- d) External confirmation - direct written response to the auditor from a third party;
- e) Re-performance - independently carrying out the same procedures already performed;
- f) Re-calculation - of checking the mathematical accuracy of documents or records;
- g) Substantive testing - testing detailed transactions or activities against the audit criteria;
- h) Test of key controls - testing the controls that management has put in place;

<sup>68</sup> ISSAI 4000.158-159

<sup>69</sup> ISSAI 4000.160-169



- i) Analytical procedures - comparing data, investigating fluctuations, identifying relationships and their inconsistencies, if any;

Analytical procedures can never be the only technique used. However in a limited assurance engagement analytical procedures and inspections may normally be enough to form a conclusion with limited assurance depending on the auditor's judgement while a conclusion with reasonable assurance must be formed on the basis of a combination of the audit techniques as mentioned above

The audit procedures should be appropriate in the circumstances of the audit and suited to the purpose of obtaining sufficient and appropriate audit evidence. The nature and sources of the necessary audit evidence are determined by the criteria, the subject matter and the scope of the audit. As the subject matter may be qualitative or quantitative, the auditor will focus on quantitative or qualitative audit evidence, or a combination thereof, according to the audit scope. Compliance auditing thus includes a variety of procedures for gathering evidence of both a quantitative and a qualitative nature<sup>70</sup>.

The auditor should consider both the relevance and the reliability of the information to be used as audit evidence and must respect the confidentiality of all audit evidence and information received.

#### Alignment with NAMS

- ▶ Compliance Audit procedures should be performed through and recorded in NAMS. NAMS contains templates to perform procedures and record conclusions.

### 4.3.6 Gathering audit evidences

The auditors should plan and perform procedures to obtain sufficient and appropriate audit evidence to form a conclusion with the selected level of assurance. The nature and sources of the necessary audit evidence shall be determined by the desired level of assurance, the criteria, materiality, the subject matter and the scope of the audit<sup>71</sup>.

The auditor should gather sufficient and appropriate audit evidence to cover the audit scope so as to provide the basis for the conclusion or opinion.<sup>72</sup>

- Sufficiency - is a measure of the quantity of evidence needed to support the audit findings and conclusions and is related to the decision about the level of assurance.
- Appropriateness - relates to the quality of evidence – its relevance, validity and reliability
  - Relevance refers to the extent to which the evidence has a logical relationship with, and importance to, the issue being addressed.
  - Validity refers to the extent to which the evidence is a meaningful or reasonable basis for measuring what is being evaluated

However, the sufficiency and appropriateness of audit evidence are interrelated. Auditors

<sup>70</sup> ISSAI 400.57

<sup>71</sup> ISSAI 4000.144-145

<sup>72</sup> ISSAI 400.57; ISSAI 4000.146-152

are required to follow these steps for gathering sufficient and appropriate evidence:

- 1) Gather evidence through various methods and perform procedures;
- 2) Consider non-compliance that may indicate fraud;
- 3) Re-assess risk and gather more evidence; and
- 4) Documentation

#### Alignment with NAMS

- ▶ NAMS has features to facilitate recording audit evidences. Auditors should use NAMS to record all audit evidences that can be in the form of documents, pictures etc.

### 4.3.7 Audit queries (memos)

The auditor should communicate significant findings, including material weaknesses on a timely basis to (auditee) management. The findings after having been reviewed by the audit team leader are presented to the auditee in the form of audit queries (memos). The auditee is required to respond to the audit queries (memos), within the stipulated timeframe and auditor shall analyse this response for drafting the audit conclusion. Audit queries (memos) can be sent batch-wise or in a single set as determined by the audit team leader.

#### Alignment with NAMS

- ▶ NAMS houses the contact addresses such as email addresses of the auditee personnel, to whom the audit queries are to be sent. Access is also given to the auditee in NAMS to provide response to the audit queries.

### 4.3.8 Exit meeting minutes (PP 5)

An audit exit meeting is not a specific requirement of standards but is often used to ensure that the audit findings discussed and agreed with management and, where relevant, those charged with governance. This meeting also reduces the risks of misunderstanding between the management and the auditor at a later stage on issues reflected in the final audit report. Some refer to this as the audit clearance meeting.

The auditor and management should maintain the minutes of the exit meeting detailing the discussions of the auditor's report and the specific audit findings, and the decisions reached on each discussion point.

#### Alignment with NAMS

- ▶ NAMS contains the exit meeting template. The details should be filled in, including the discussion of the findings yet to be settled, get it printed and signed by both the auditors and auditee. This can be uploaded in NAMS for documentation.

## 5. Evaluating and Reporting (ER)



### 5.1. Objectives

This part of the chapter explains the key considerations for the auditors in evaluating evidence and forming audit conclusions in a compliance audit, for both an attestation engagement and a direct reporting engagement. The results of the audit are then presented to the intended users as reports on the responsible party's compliance with the stated criteria.

Compliance audits involve reporting the deviations from the applicable criteria and violations of the applicable rules, regulations etc., so that corrective actions may be taken, and those responsible for such deviations or violations could be held accountable for their actions.

### 5.2. Working papers and applicable standards

ER 1 Evaluate evidences

- ISSAI 400.57-59
- ISSAI 4000. 179-187, 202-209

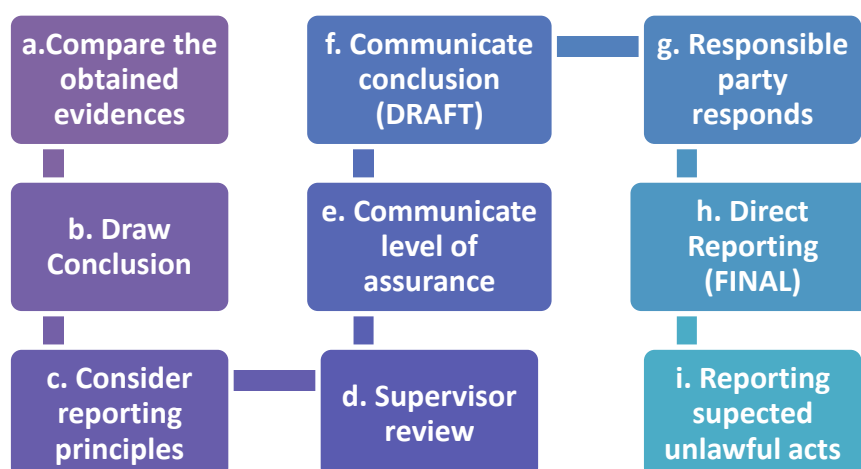
ER 2 Supervisor's review

- ISSAI 100.50; ISSAI 400.58
- ISQC-1 A35

ER 3 Compliance audit report

- ISSAI 400.59
- ISSAI 4000.188-192, 204, 210-220, 225-231

### 5.3. Audit Steps



### 5.3.1 Compare the obtained evidences (ER 1)

The compliance auditor will often need to combine and compare evidence from different sources in order to meet the requirements for sufficiency and appropriateness<sup>73</sup>. Auditors should evaluate and review whether sufficient and appropriate audit evidence has been obtained in order to reach a conclusion<sup>74</sup>.

- The evaluation process entails considering evidence that both supports and seems to contradict the audit report, conclusion on compliance or non-compliance. It also includes considerations of materiality.
- If audit evidence obtained from one source is inconsistent with that obtained from another, or if there are any doubts about the reliability of the information to be used as evidence, the auditor should determine what modifications or additions to the audit procedures would resolve the matter and consider the implications, if any, for other aspects of the audit.

#### Evaluating evidences

The auditor shall compare the obtained audit evidence with the stated audit criteria to form audit findings for the audit conclusion(s)<sup>75</sup>. The gathered evidence and the entities views are

- Evaluated using professional judgment and scepticism;
- Assessed for sufficiency and appropriateness to form a conclusion;
- Evaluated with a balanced and objective view, considering all evidences;

If the scope of work is insufficient, the auditor might consider performing further procedures or modifying the opinion due to scope limitation reporting in the conclusion.

#### Alignment with NAMS

- ▶ NAMS shall consolidate observation / findings of non-compliances relevant to the entity and the financial statements for auditor to make the judgement.

### 5.3.2 Draw conclusion

The auditor should consider how best to conclude in the light of the, gathered and evaluated, evidences, given the assurance level of the audit<sup>76</sup>. Based on the audit findings, and the materiality, the auditor shall draw a conclusion whether the subject matter is, in all material respects, in compliance with the applicable criteria.<sup>77</sup>

Considerations for drawing conclusions<sup>78</sup>:

- the audit findings are material enough to conclude that the subject matter in all material respect, both value, nature and context, is not in compliance with the audit criteria.

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<sup>73</sup> ISSAI 400.57

<sup>74</sup> ISSAI 400.58

<sup>75</sup> ISSAI 4000.179-183

<sup>76</sup> ISSAI 400.58

<sup>77</sup> ISSAI 4000.184

<sup>78</sup> ISSAI 4000.185-187

- materiality by value can involve amounts involved (monetary amounts) or other quantitative measures such as number of citizens or entities involved, carbon emission levels, time delays in relation to deadlines, etc.
- visibility and sensitivity of the program in question (for example, is it the subject of significant public interest, does it impact vulnerable citizens, etc.).
- needs and expectations of the legislature, the public or other users of the audit report.
- the nature of the relevant authorities.

### 5.3.3 Consider reporting principles

The auditor shall prepare an audit report based on the principles of completeness, objectivity, timeliness, accuracy and a contradiction<sup>79</sup>. Compliance audit report should conform to<sup>80</sup>:

- Completeness – auditor to consider all relevant audit evidence before issuing a report
- Objectivity - auditor to apply professional judgement and scepticism in order to ensure that all reports are factually correct, and that findings or conclusions are presented in a relevant and balanced manner
- Timeliness - preparing the report in due time to be relevant to the intended users
- Accuracy and consultation - checking the accuracy of facts with the auditee
- Contradiction (a contradictory process) - incorporating responses from the responsible auditee as appropriate and giving answers and assessments of the responses

Compliance audit report, whether in an attestation engagement or direct reporting should be sufficiently clear to remove risk of misinterpretation.

### 5.3.4 Supervisor review (ER 2)

After completing the audit procedures, the auditor will review the audit documentation in order to determine whether the subject matter has been sufficiently and appropriately examined. Before drawing conclusions, the auditor reconsiders the initial assessment of risk and materiality in the light of the evidence collected and determines whether additional audit procedures need to be performed<sup>81</sup>.

To maintain consistency and achieve an audit report of high quality, the report should go through a quality review process. Review consist of consideration whether<sup>82</sup>:

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;

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<sup>79</sup> ISSAI 400.59; ISSAI 4000.202

<sup>80</sup> ISSAI 400.59; ISSAI 4000.203-209

<sup>81</sup> ISSAI 100.50; ISSAI 400.58

<sup>82</sup> ISQC-1.A35

- The evidence obtained is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

#### Alignment with NAMS

- ▶ The supervisor shall review the results in the NAMS and conclude whether additional audit procedures are required or not. Supervisor also assesses whether the conduct of the audit has been as planned, in accordance with the manual and applicable standards.

### 5.3.5 Communicate the level of assurance

The auditor shall communicate the level of assurance provided in a transparent way giving the intended user(s) confidence in the audit results. This is done by explaining how findings, criteria and conclusions were developed in a balanced and reasoned manner and how certain overall conclusion(s) or recommendation(s) were reached based on the findings<sup>83</sup>.

- For direct reporting engagements, the auditor needs to implicitly state whether the conclusion is given with limited or reasonable assurance.
- For attestation engagement, the level of assurance will be conveyed by the appropriate use of standardised audit opinions.

### 5.3.6 Communicate conclusions (ER 3 – DRAFT REPORT)

The audit report should communicate the conclusion in an audit report based on the audit work performed. The conclusion will be expressed as a conclusion or answer to specific audit questions. The report may also provide constructive and practical recommendations for improvement where appropriate. Any limitations in the audit scope should be clearly described.<sup>84</sup>

#### Alignment with NAMS

- ▶ Draft Compliance audit report may be issued through NAMS, seeking response from the auditee management on the audit findings and observations.

### 5.3.7 Response from the responsible party

Responsible party will respond to the findings and conclusion to the draft conclusion shared with them.

#### Alignment with NAMS

- ▶ Auditee can provide responses and evidences in the NAMS portal whose access is provided for them in NAMS on the draft Compliance audit report.

### 5.3.8 Reporting for Direct reporting engagements (ER 3)

Reporting is one of the essential parts of the audit. The forms of reporting may be defined by OAGN's mandate and decisions. A written report, setting out findings, opinions, conclusions,

<sup>83</sup> ISSAI 4000.188-190

<sup>84</sup> ISSAI 400.59; ISSAI 4000.191

and recommendations in an appropriate form as applicable, is to be prepared at the end of each audit<sup>85</sup>. Reporting may vary between brief standardised opinions and various forms of conclusions, presented in short or long form.<sup>86</sup>

While an, the answering of specific audit questions is more often used in direct reporting engagements the conclusion may take the form of a more elaborate answer to specific audit questions. In direct reporting, the auditor provides assurance either by:

- a) making a clear statement of the level of assurance, through conclusions which explicitly convey the level of assurance, or
- b) explaining how findings, criteria and conclusions were developed in a balanced and reasoned manner and why the combinations of findings and criteria result in a certain overall conclusion or recommendation.

In some circumstances the results from the compliance audit are reported together with the audit of financial statements. The auditor then makes sure that the requirements are covered either through separate compliance audit elements or as part of the financial audit elements<sup>87</sup>.

<b>Types of report</b>	Long Form
	Short Form
<b>Conclusion expressed</b>	Single statement of conclusion
	Elaborate answer to specific audit question

## Reporting structure

The audit report shall include the following elements (although not necessarily in this order)

<b>Direct reporting engagement<sup>88</sup></b>	
<b>a</b>	Title
<b>b</b>	Identification of the auditing standards
<b>c</b>	Executive summary (as appropriate)
<b>d</b>	Description of the subject matter and the scope (extent and limits of the audit)
<b>e</b>	Audit criteria
<b>f</b>	Explanation and reasoning for the methods used
<b>g</b>	Findings
<b>h</b>	Conclusion(s) based on answers to specific audit questions
<b>i</b>	Replies from the auditee (as appropriate)
<b>j</b>	Recommendations (as appropriate)
<b>k</b>	Report date
<b>l</b>	Signature

## Explanations<sup>89</sup>:

<sup>85</sup> ISSAI 4000.204

<sup>86</sup> ISSAI 400.59

<sup>87</sup> ISSAI 4000.219

<sup>88</sup> ISSAI 4000.210; (also ISSAI 400.59)

<sup>89</sup> ISSAI 4000.211-218, 220

- Executive summary – give a brief summary of work performed.
- Audit criteria - state explicitly in the audit report the laws, legislation, rules, regulations etc. that were used as authorities in the audit
- Explanation and reasoning's of methods used- Explanation and reasoning's of the work performed and methods used helps the intended user(s) understand the auditor's conclusion. For many audits, broad variations in procedures are possible need to give a brief explanation for an outside reader of how the audit was performed and methods used.
- Findings - comprises the auditor's comparison of the obtained evidence against the stated criteria and how this comparison has led to the audit findings.
- Responses from the auditee - provides an indication of agreement to take action on the matter(s) reported. Discussing the draft report findings with the auditee helps ensure that these are complete, accurate and fairly presented. (this may or may not form the part of the report)
- Recommendations – provide where there is potential for significant improvement and significant compliance deviations are reported. (this may or may not form the part of the report)
  - constructive and practical recommendations assist in promoting sound public sector management
  - may highlight ongoing corrective actions
  - careful not to provide such detailed recommendations so as to be taking on the role of management and thereby risk impairing his or her own objectivity
  - may issue separately from the report as they are usually written mainly for the management of the auditee. In these instances, the recommendations might be issued separately in a letter to management.
  - normally recommendations are not included in the attestation engagement reports, in such case recommendations might be issued separately in a letter to management

#### Alignment with NAMS

- ▶ NAMS has a standard compliance audit report template and a letter to management to be issued separately in addition to the audit report that the auditor can appropriately tailor-make to suit the subject matter and the auditee.

### 5.3.9 Reporting suspected unlawful acts

While conducting compliance audits, if the auditor may come across instances of non-compliance which may be indicative of unlawful acts, the auditor should exercise due professional care and caution considering the legal requirement for further communicating those instances to the responsible body<sup>90</sup>. The example of responsible body is Financial Information Unit (FIU) of the central bank.

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<sup>90</sup> ISSAI 4000.225



It is up to OAGN to determine the appropriate action to be taken regarding instances of non-compliance related to fraud or serious irregularities. The responsibility of the auditor are as follows<sup>91</sup>:

- The auditor shall exercise due care not to interfere with potential future legal proceedings or investigations.
- Detecting potential unlawful acts, including fraud, is not the main objective of conducting a compliance audit, however, the auditor does include fraud risk factors in the risk assessments, and remains alert for indications of unlawful acts, including fraud in conducting audit
- The auditor may consider consulting with legal counsel or appropriate regulatory authorities.
- Only A court of law can determine whether a particular transaction is illegal and constitutes a criminal offence. Auditors do not determine if an illegal act constitutes a criminal offense or if civil liability and it is up to the court to impose sanctions.
- If suspicion of unlawful acts arises during the audit, the auditor may communicate this to the appropriate levels of management and those charged with governance and follow up to ascertain whether appropriate action taken or not.
- The auditor may also report such incidents directly to the relevant law enforcement authorities.

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<sup>91</sup> ISSAI 4000.226-231

## 6. Audit Follow-up (FU)

### 6.1. Objectives

A follow-up process facilitates the effective implementation of corrective action and provides useful feedback to the auditee, the users of the audit report and the auditor (for future audit planning). The need to follow up previously reported instances of non-compliance will vary with the nature of the subject matter, the non-compliance identified and the particular circumstances of the audit. Auditors should follow up instances of non-compliance when appropriate<sup>92</sup>.

### 6.2. Working paper and standards and legal requirements

#### FU 1 Audit Followup

- INTOSAI-P20.3; ISSAI 100.51; 400.60
- ISSAI 4000.232-236
- Audit Act 2075, Financial Procedure and Financial Accountability Act, 2076

### 6.3. Steps / Process

OAGN has a role in monitoring action taken by the responsible party in response to the matters raised in an audit report. Follow-up focuses on whether the auditee has adequately addressed the matters raised, including any wider implications. Insufficient or unsatisfactory action by the auditee may call for a further report by the OAGN<sup>93</sup>.

In audits carried out on a regular basis the follow-up procedures may form part of the subsequent year's risk assessment<sup>94</sup>.

The auditor should follow up on opinions/conclusions/ recommendations of instances of non-compliance in the audit report when appropriate. Follow up consideration<sup>95</sup>:

- OAGN has legal obligation to monitor and follow up on action taken by the responsible party is to follow-up on the matters raised in an audit report.
- Follow-up process facilitates the effective implementation of corrective action and provides useful feedback to the auditee, the user(s) of the audit report, the general public and the auditor for future audit planning.
- Follow-up processes may include reports, internal reviews and evaluations prepared by the auditee or others and a follow-up audit.

#### Alignment with NAMS

- ▶ OAGN holds a database for all audit paras identified with the auditee. The follow up under the law, at OAGN, is done in NAMS. Year-wise or auditee-wise pending audit observations (*berujus*) can be reported and analysed using NAMS. The *berujus* reported

<sup>92</sup> ISSAI 400.60

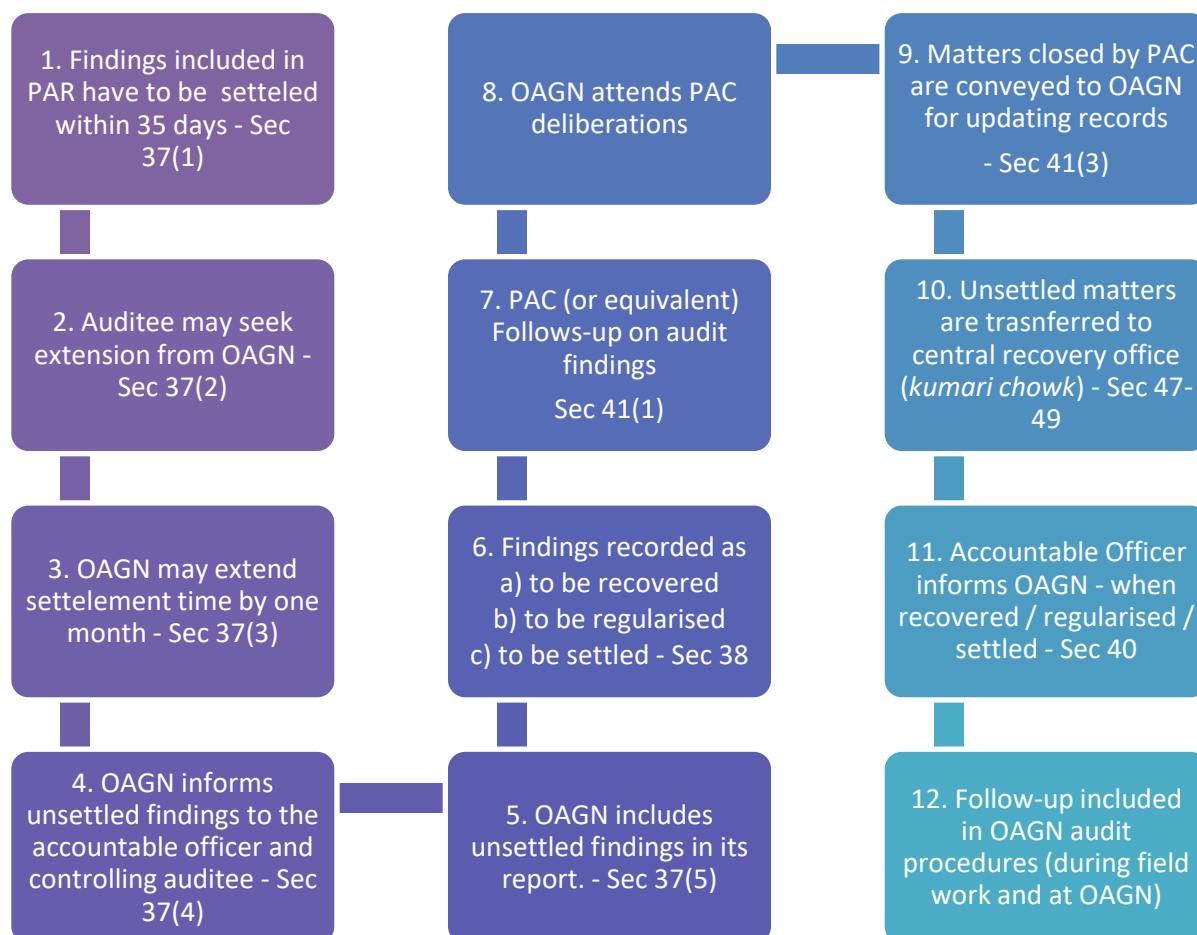
<sup>93</sup> ISSAI 100.51

<sup>94</sup> ISSAI 400.60; ISSAI 4000.235

<sup>95</sup> ISSAI 4000.232-236

in Auditor General's annual report can be electronically shared with Public Accounts Committee or similar legislative body through NAMS.

### 6.3.1 Legal requirement of Audit Follow up<sup>96</sup>



Auditors must always follow-up on observations and recommendations to ensure the issues that have been identified have been resolved by the auditee. In the context of a compliance audit, the audit of the subject matter may or may not happen in the subsequent year therefore the auditor may typically perform follow-up during the financial audit cycle which are recurring. process of the subsequent year audit since unresolved prior year issues may represent risks of material misstatement of the financial statements of the subsequent year.

Legislative committees such as Public Accounts Committee(s), play an active role in the review and follow-up of the audit findings tabled in the legislature. Therefore, there could be two levels of follow-up of audit findings and recommendations, i.e. one at the Public Accounts Committee/legislative committee level for issues reported in annual report and another at OAGN level.

<sup>96</sup> Financial Procedure and Financial Accountability Act, 2076 Sec 37-42

### 6.3.2 Follow up – other considerations

- Issue Log – record of unsettled issues (*berujus*) is maintained at OAGN
- Follow up action – OAGN follows up during next audits or otherwise on the basis of documents and evidences brought forward by the auditee for clearance of audit issues (*berujus*).
- Points for next audits – the issues identified and pending issues (*berujus*) are considered for risk assessment for next audits (not limited to compliance audits)

## 7. Audit Quality Control

### 7.1. Objectives

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- (a) The audit complies with professional standards and applicable legal and regulatory requirements; and
- (b) The auditor's report issued is appropriate in the circumstances.

Auditors should perform the audit in accordance with professional standards on quality control. OAGN's quality control policies and procedures should comply with professional standards, the aim being to ensure that audits are conducted at a consistently high level. Quality control procedures should cover matters such as the direction, review and supervision of the audit process and the need for consultation in order to reach decisions on difficult or contentious matters<sup>97</sup>.

### 7.2. Working paper and applicable standards

QC 1 Quality Control Questionnaire

- INTOSAI-P 20.3, 5, 9; ISSAI 100.38; ISSAI 140.1-2; ISSAI 400.44
- ISSAI 4000.80.88; ISQC-1; GUID 9030

### 7.3. Steps / Process

#### 7.3.1 Elements of a system of Quality Control

OAGN shall establish and maintain system of quality control that addresses the following.

##### A. Leadership responsibilities

OAGN should establish policies and procedures designed to promote an internal culture recognising that quality is essential in performing all of its work. Such policies and procedures should be set by the Auditor General, who retains overall responsibility for the system of quality control. Such procedures should be aimed at ensuring that the audit complies with the applicable standards and that the audit report, conclusion or opinion is appropriate given the circumstances<sup>98</sup>.

##### B. Relevant ethical requirements

OAGN should establish policies and procedures designed to provide it with reasonable assurance that OAGN, including all personnel and any parties contracted to carry out work for OAGN, comply with relevant ethical requirements.<sup>99</sup>

<sup>97</sup> ISSAI 100.38

<sup>98</sup> INTOSAI-P 20.5; ISSAI 140.1; ISSAI 400.44; ISQC-1.18

<sup>99</sup> ISSAI 140.2; ISQC-1.20, INTOSAI-P10, GUID 9030

### **C. Audit engagements**

The policies and procedures should reflect the range of work carried out by OAGN. OAGN's work is mandated by the constitution. OAGN carries out audits in three broad categories<sup>100</sup>:

- ▶ Work that is required of by the mandate and statute;
- ▶ Work that is required by the mandate, but OAGN has discretion as to scope and/or nature;
- ▶ Work that OAGN can choose to carry out.

OAGN ensures that

- ▶ components to perform the work, time and resources have been ascertained;
- ▶ relevant ethical requirements are compiled; and
- ▶ has considered various risks associated with the auditee including ways to treat the risk to the quality that may arise

### **D. Human resource**

To perform audit engagements in accordance with legal and regulatory requirements professional standards, and issue quality reports OAGN should have policies & procedures<sup>101</sup>:

- ▶ performance evaluation;
- ▶ professional development;
- ▶ capabilities (including sufficient time to perform audits to the required quality standard);
- ▶ competence (including both ethical and technical competence);
- ▶ career development; and
- ▶ the estimation of personnel needs.

### **E. Engagement performance**

OAGN should ensure appropriate policies, procedures and tools, such as audit methodologies are in place for carrying out the range of work that is the responsibility of the OAGN, including work that is contracted out. Such policies and procedures include<sup>102</sup>:

- ▶ matters relevant to promoting consistency in the quality of engagement performance;
- ▶ supervision responsibilities; and
- ▶ review responsibilities"

### **F. Monitoring**

OAGN should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant and adequate and are operating effectively. The monitoring process should<sup>103</sup>:

- ▶ include an ongoing consideration and evaluation of the OAGN's system of quality control, including a review of a sample of completed work across the range of work

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<sup>100</sup> ISSAI 140.3; ISQC-1.26

<sup>101</sup> ISSAI 140.4; ISQC-1.29

<sup>102</sup> INTOSAI-P 20.3; ISSAI 140.5; ISQC-1.32,

<sup>103</sup> ISSAI 140.6; ISQC-1.49, INTOSAI-P 20.9

- carried out;
- ▶ require responsibility for the monitoring process to be assigned to an individual or individuals with sufficient and appropriate experience and authority; and
- ▶ require that those carrying out the review are independent (i.e. they have not taken part in the work or any quality control review of the work).

### 7.3.2 Quality control in compliance audit

OAGN should take responsibility for the overall quality of the audit to ensure that the audits are carried out in accordance with relevant professional standards, laws and regulations, and that the reports are appropriate in the circumstances. The considerations are<sup>104</sup>:

- Quality assurance system in place to secure overall quality of the audit.
- Adequate supervision, reviews, consultation procedures instituted
- Adequate training shall and might cover the planning, execution and reporting stage.
- Roles and responsibilities are clearly defined.
- Quality controls are documented ensuring that appropriate procedures are performed and that reviews are performed throughout the audit process.

OAGN shall ensure that the audit team collectively has the necessary professional competence to perform the audit. The considerations are<sup>105</sup>

- appropriate competence to conduct the audit, capable of selecting criteria free from bias
- depending the subject matter, skills and competence may include;
  - Auditing skills and skills regarding data collection/analysis
  - Legal competence
  - An understanding and practical experience of the type of audit being undertaken
  - Knowledge of the applicable standards and authorities
  - An understanding of the auditee's operations and appropriate experience for the type of auditee and operations
  - The ability and experience to exercise professional judgment
  - Producing an auditor's report that is appropriate in the circumstances
- general access to accurate information,
- sufficient time to complete the audit assignment.
- assembled audit team collectively have the necessary competence,
- where specialised techniques, methods or skills are not available within the team or within OAGN, external experts may be used to provide knowledge or conduct specific work.

#### Alignment with NAMS

- ▶ Every audit process has to be reviewed by the team leader in the NAMS. After the end of the audit execution supervisor reviews and approves the audit conclusions. Team

<sup>104</sup> ISSAI 4000.80-84

<sup>105</sup> ISSAI 4000.85-88

leader and supervisor completes the first and second level quality control reviews respectively in the NAMS.

### 7.3.3 Steps of engagement quality control <sup>106</sup>

#### i. Every audit process has to be reviewed

Every audit process has to be reviewed. The review should always be undertaken by a person of higher level than the person performing the work. The work process shall not be considered as closed or completed unless reviewed. This is to ensure that there is no self-review and segregation on role is ensured between 'the maker' and 'the checker'

#### ii. Supervisor's review before final reporting (PAR-ML/ Auditor's Report)

Supervisor shall review the work performed by the field team to ensure that the work has been performed as planned and in accordance with applicable standards. The review shall be done in ER 2. (detail guideline is given in 5.3.d).

#### iii. First level review by the audit team leader

To ensure the quality control of the audit, at the end of the field audit, team leader shall fill in the quality control questionnaire to ensure that the require procedures have been appropriately undertaken. (working paper reference QC 1)

#### iv. Second level review by the supervisor at the end of the audit

After the first level review by the field team leader the second level quality control review of the work is again done by the supervisor. (working paper reference QC 1)



<sup>106</sup> ISSAI 2220.15-21 A14-A26



### 7.3.4 Quality Assurance

Quality Assurance is an assessment process focusing on the design and operation of the quality control system by persons independent of the system / audit under review. This assessment is designed to ensure that the system of quality control in audit is working effectively and the individual audits are carried out in compliance with auditing standards, rules, practices, procedures, and code of ethics issued by OAGN.

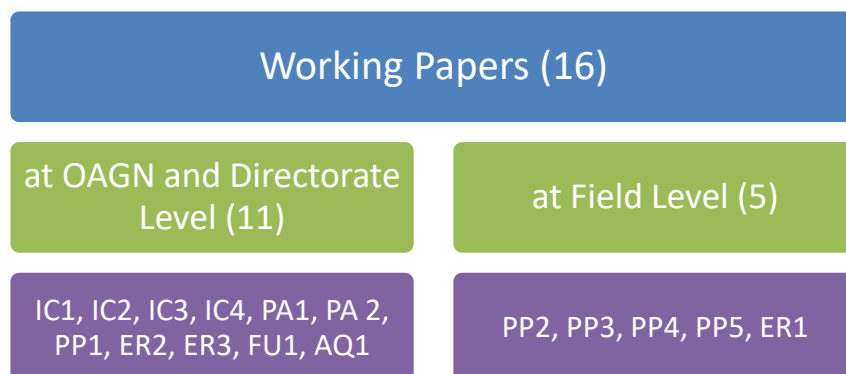
Quality assurance at OAGN is conducted under OAGN's quality assurance handbook.

#### Alignment with NAMS

- ▶ Access for independent quality assurance either from within OAGN or from outside OAGN can be given access for such assurance review in NAMS.

## Working papers

### *Working Papers Implementation Guide*



**Each working paper needs to be appropriated headed as follows**

Auditee Information	Name of the Auditee
	Auditee Code
	Financial Year
	Compliance Audit Code
Preparer Information	Name of the Auditor
	Date of completion

**Each working paper needs to be appropriated footed as follows**

Reviewer's decision	Approved	Reverted for rework
Reviewer's note	Comments / Suggestions / Directions	
Reviewer	Name of the reviewer	
	Date of review	

**IC 1 Identify Potential Subject Matter**

**A [For each potential compliance audit issue]**

1. Potential compliance audit issues identified [at each directorate]		
I. Title of the potential compliance audit issue:		
II. Link with OAGN 's strategic priority:		
III. Potential Auditee where the compliance audit subject matter will be audited:		
IV. Audit Field		
• Main activities		
• Legal framework		
• Financial and other information		
• Roles and responsibilities		
V. Reasons for audit		
• Risks		
• Stakeholders' interest		
○ Relevance:		
○ Materiality:		
○ External Recommendation:		
• Potential value addition		
○ Previous audits:		
○ Timeliness:		
VI. Audit details		
• Audit question (main question and possible sub-questions) or what could be assessed:		
• Audit criteria (or sources for criteria):		
• Main sources of audit evidence:		
VII. Others		
• Feasibility of audit:		
• Estimated audit resources		
• Others: (such as previous audit findings)		
2. Input Consideration		
	Yes/No/NA	Remarks
With significant public funding		
Beneficiaries of public funds		
Significance of certain provisions of the law		
Principles of good governance		
Roles of different public sector bodies		
Potential breaches of applicable laws and regulations		
Non-compliance of internal controls or absence of an adequate internal control system		
Non-compliance of standard operating procedures (SOPs)		
Risks of non-compliance signalled by third parties (media, whistle blower, public grievances)		
Others		

3. Risk Profiling [for all the potential compliance issues identified]

3.1. Risks of non-compliance shall be derived for each potential issue from the input considerations.

**Risks**

1.	
2.	

3.2. Risk: use the following risk matrix to analyse risks associated with potential issues

Likelihood (probability)	Very high					
	High					
	Moderate					
	Low					
	Very Low					
		Very Low	Low	Moderate	High	Very High
Impact (consequences)						

By plotting the risks give following risk score

0	1	2	3
Low	Moderate	High	Critical

3.3. Public Interest: Score using judgement on the extent of interest

0	1	2	3
Low	Moderate	High	Critical

3.4. Value Added: Score using the potential value addition using judgement

0	1	2	3
Low	Moderate	High	Critical

**B Consolidation of potential subject matter analysed in A above**

4. Risk Assessment & Prioritisation

Potential Subject Matters	Risk Assessment Score	Public Interest	Value Added	Total	Rank
	0-3	0-3	0-3		

5. Assessment of capacity and resources

Whether the subject matter(s) are technically feasible to be audited:	
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Whether OAGN has capacity and skills required:	
Whether external expertise might be needed:	
Whether audit can be completed on time to retain relevance and contribute to major reforms and introduce new initiatives:	

6. Selection of Subject Matter & Suitable Criteria

Proposed by directorate

	<b>Subject Matter</b>	<b>Subject Matter information (if any)</b>	<b>Criteria</b>	<b>Audit Questions (including sub-questions)</b>
<b>1.</b>				
<b>2.</b>				
<b>3.</b>				

Selected

	<b>Subject Matter</b>	<b>Subject Matter information (if any)</b>	<b>Criteria</b>	<b>Audit Questions (including sub-questions)</b>
<b>1.</b>				
<b>2.</b>				
<b>3.</b>				

**IC 2 Team Composition**

*From audit scheduling*

*From team master data*

*From team master data*

SN	Team Member's name	Position	Relevant subject matter know-how (if any)	Compliance audit Experience in no. of years	Qualification (highest degree obtained)
	Audit Supervisor				
1					
	Audit team leader				
2					
	Audit team members				
3					
4	Subject matter expert (if any)				
5					

Team Approved by:

Signature / System approval .....

Name: ..... (System extracted info)

Position: ..... (System extracted info)

Date:..... (System extracted info)

*From team master data*

**IC 3 Ethical Declaration**

*From standard template*

I confirm that for the audit work that I have been assigned or allocated to be involved for the audit year .....

1. Myself, or any members of my immediate family do not have any Compliance interest in the auditee.
2. I do not have any business or Compliance relationship with the auditee or any of its/their officers and employees.
3. I am not, and have not been in the last two Compliance years, an employee of the auditee. In conducting the audit I will not be reviewing my own work
4. I have not received, or I am not due to receive any gifts, donations, hospitality or any other benefits from the auditee or any third person in relation to the audit that could impair my objectivity.
5. I do not have any family or other relationship with any director, officer, and employee of the auditee under audit that may impair my independence.
6. I have read the OAGN Code of Ethics and understand the requirements of the code in there as far as:
  - I shall exercise due care and perform the audit in a professional manner and to the best of my abilities.
  - I shall perform the audit with honesty, integrity, objectively, impartially, prudence, and political neutrality.
  - My personal conduct shall be accordance to professional behaviour expected of the office that I represent and shall not do or be involved in anything that shall disrepute the OAGN.
  - I shall keep full confidentiality of information obtained during the audit process and shall not disclose such information to third parties except otherwise as explicitly required by the law.

I will immediately inform OAGN if any circumstance(s) that may change from the above declaration and come to my knowledge, which may have bearing on my compliance of the OAGN Code of Ethics.

Signature: .....  
Name: .....  
Designation: .....  
Date: .....

*From team master data*

#### IC 4      *Terms of Engagement*

[To the appropriate representative of management or those charged with governance of auditee whose Compliance is audited]

The objective and scope of the audit

Under the provision of [quote the applicable provision of the law] the Auditor General will have to audit the Compliance of [name of subject matter whose Compliance under the suitable criteria is being audited], which covers [name the area and period they pertain to]. We are conveying our understanding of this audit engagement by means of this letter.

Our compliance audit will be conducted with the objective of expressing our conclusion on whether the subject matter is in compliance with the suitable criteria. Compliance audit in accordance with OAGN Compliance Audit Manual is a limited assurance engagement. We will perform procedures, primarily consisting of making inquiries of management and others within the auditee, as appropriate, and applying analytical procedures, and evaluate the evidence obtained. We will also perform additional procedures if we become aware of matters that cause us to believe the subject matter may be in non-compliance, whether due to error or fraud. These procedures are performed to enable us to express our conclusion on the subject matter in accordance with OAGN Compliance Audit Manual. The procedures selected will depend on what we consider necessary applying our professional judgment, based on our understanding of the [auditee's name] its environment, and our understanding of relevant criteria and the subject matter.

A compliance audit is not an audit of the financial statements prepared under the applicable financial reporting framework.

Management's responsibilities

Management [or those charged with governance] acknowledge and understand that they have the responsibility:

- a) For compliance of the stated criteria related and relevant to the subject matter;
- b) For such internal control as management determines is necessary to enable such compliances and prevent and detect non-compliances, whether due to fraud or error; and
- c) To provide us with:
  - (i) Access to all information of which management is aware that is relevant to the subject matter, such as records, documentation and other matters;
  - (ii) Additional information that we may request from management for the purpose of the audit; and
  - (iii) Unrestricted access to persons within or outside the auditee from whom we determine it necessary to obtain evidence.



We look forward to full cooperation from the staff during our audit. [*add Other relevant information as appropriate*]

**Reporting**

We shall be reporting our conclusions as appropriate under the direct reporting engagements. The form and content of our report may need to be amended in the light of our findings obtained from the audit.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our compliance audit and our respective responsibilities.

For Auditor General of Nepal

Signature: .....

Name: .....

Designation: .....

Date: .....

Acknowledged and agreed on behalf of [*Name of auditee whose Compliance statement is audited*]

Signature: .....

Name: .....

Designation: .....

Date: .....

**PA 1 Overall Audit Strategy**

1. Understanding the auditee and its environment related to subject matter		
1.1. Background of the auditee		
1.2. External environment affecting the auditee		
Parliamentary directives and interest	•	
Laws and regulation affecting the auditee	•	
Issues relevant to audit reported in media and other mediums	•	
Significant areas of work affecting the lives of the citizens	•	
Other (if any)	•	
1.3. Internal environment affecting the auditee		
Organisational set up and source of funding	•	
	•	
Objectives and strategies of the auditee	•	
Core functions of the auditee	•	
Objectives and strategies of the auditee	•	
Other (if any)	•	
1.4. Financial Management system		
Budget process	•	
Accounting systems	•	
Reporting requirements and deadlines	•	
1.5. Other considerations		
Key personnel	•	
Others (if any)	•	
Overall Conclusion: Significant risks affecting the auditee (operating risks)		
•		
•		
•		
2. Understanding the relevant control environment		
2.1. Control environment		
	Yes/No/NA	Remarks Comments
Demonstrates commitment to integrity and ethical values		
Exercise effective oversight responsibility		
Establishes structures, authorities and responsibilities		
Demonstrate commitment to competence		

Enforce accountability				
Others				
2.2. Management's Risk Assessment (if any)				
2.3. Assessment of Control activities				
2.4. Information and communication				
Overall Conclusion: on auditee's internal control environment (control risks)				
<ul style="list-style-type: none"> <li>•</li> <li>•</li> </ul>				
3. Determining Materiality				
3.1. Setting quantitative materiality				
Subject matter	Threshold	% used	Population amount	Materiality Amount
	1-5%	5%	XXXXXX	XXxx
Justification for benchmark used				
Justification for % used				

3.2. Setting qualitative materiality

Materiality by nature	
Materiality by context	
Setting qualitative threshold	

4. Risk of Fraud

4.1. General risks of fraud	Risks identified
Are process in place to identify and respond to fraud?	
Is management aware of any fraud or suspected fraud during the period?	
Material weakness in internal controls successfully & appropriately addressed?	
Complex transaction and procedures	

4.2. Identify risk of fraud and non-compliance due to management override of controls	Risks identified
Instances of unusual pressure exerted by the management	
Transactions outside the normal course of business	

4.3. Identify risk of fraud and non-compliance due to use of accounting practice	Risks identified
Unusual journals and adjustments	
Inappropriate accounting practices and accounting policies applied	

5. Risk Assessment

Conclusion:

	Audit Question / Areas under Subject Matter	Risks Identified			Auditor's overall response to risk of non-compliance
		Inherent Risks	Control Risks	Fraud Risks	
1.					
2.					
3.					
4.					
5.					
6.					

**PA 2      Audit Plan**

[Audit Programme / Audit Checklist]

<b>Audit Question/area 1</b>		<b>बोलपत्रबाट भएका खरिदको अध्ययन गर्ने</b>
Objective		
Sample / Extent		30 files
	<b>Criteria</b>	<b>Audit Procedure to perform (nature)</b>
1		
2		
3		
4		
<b>Audit Question/area 2</b>		<b>Def</b>
Objective		
Sample / Extent		2 months
	<b>Criteria</b>	<b>Audit Procedure to perform (nature)</b>
1		
2		
3		
4		
<b>Audit Question/area 3</b>		<b>Ghi</b>
Objective		
Sample / Extent		25%
	<b>Criteria</b>	<b>Audit Procedure to perform (nature)</b>
1		
2		
3		
4		

**PP 1      Audit Authorisation Letter**

To

[insert the auditee name]

[insert the auditee's address]

Date: [insert date]

Subject: Audit Authorisation Letter

Dear Chief of Auditee

Office of Auditor General of Nepal has planned the audit of [insert the auditee's name] to fulfil its obligations under the Article 241 of Constitution of Nepal and Audit Act, 2075. The audit shall commence from [insert date] and shall be undertaken by the following team.

Name of the auditor	Designation	Team designation
1.		Team Leader
2.		Team Member
3.		Team Member
4.		Team Member

It is requested through this letter that auditors are provided

- a. access to all information of which the office/unit is aware that is relevant for the audit, such as records, documentation and other matters;
- b. additional information that auditors may request from for the purpose of the audit; and
- c. unrestricted access to persons within the auditee, or outside the auditee, from whom the auditor determines it necessary to obtain audit evidence.
- d. Other matters (as per the list attached)

Regards

Signature

Name:

Designation:

**PP 2      Entry Meeting Minutes**

1. Date of the meeting			
2. Location of the meeting			
3. Present audit team members	Name		Designation
	1.		
	2.		
	3.		
4. Present auditee personnel	Name		Designation
	1.		
	2.		
	3.		
5. Issues discussed			
5.1. Introduction of audit team members			
5.2. Solicit management concerns (if any)	1. 2. 3.		
5.3. Determine appropriate person within the auditee with whom to communicate	Name		Phone No
	1.		
	2.		
	3.		
5.4. Matters needs to be communicated	<ul style="list-style-type: none"> <li>• Responsibilities of the auditee</li> <li>• Auditor's responsibilities</li> <li>• Planned scope and timing of the audit</li> <li>• Auditor's independent</li> <li>• Reporting forms and mechanisms</li> </ul>		
5.5. Resources to be provided to the auditor	<ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> <li>•</li> </ul>		
5.6. Establish communication process	1. Process		
	2. Form		
	3. Timing		
	4. Adequacy		

Print and sign by both the parties

PP 3 Sampling

Audit Area: Procurement						
	Transactions / Documents	No. of transactions/ documents	High Value (Material)	Key Items (Judgemental)	Remaining Population subjected to sampling	Total to be tested
			items/transactions above a particular monetary value which the auditor decides to examine on a 100% basis (e.g. all items above quantitative materiality level needs to be tested)	Auditor using judgment may decide that some items due to their nature are prone to error or important warranting a 100% audit (qualitatively material)	Apply sampling techniques, for example random number table, to select items to be tested from among remaining population after high value and key items (85 items in the example), say 17 items	
					Sampling techniques: from <b>random number table</b>	
	e.g. procurement files	100	2 (out of 2)	11 (out of 11)	17 (out of 85 i.e. 20%)	30
1.						
2.						
3.						
4.						

Application guide

- 30% comes from PA 2
- Test of control considers revision of planned extent
- If no revision required, 20% selection of the remaining is required to reach 30% (comes from test of control conclusion)
- High value and Key item are to be tested 100% irrespective of anything



**PP 4 Performing Procedures and Gathering Evidences**

**1. Testing operating effectiveness of controls**

[at auditee level and related with the subject matter]

**1.1 Link from planning risk, control activities and test procedures:**

	Audit Question / area	Risks	Control activity	Control test procedures performed	Comments
	PA 1 Sec 5	PA 1 Sec 5			
1.					
2.					
3.					
4.					

**1.2 Overall conclusion on control testing**

## 1. Performing substantive audit procedures

1.1 Substantive audit procedures performed:			
Audit Question		बोलपत्रबाट भएका खरिदको अध्ययन गर्ने	
Sample Reference		[file / voucher] File number NCB 420	
% or number of samples covered		1/30 files	
Sample	Audit Question tested	Observation	Finding Combined Y/N/NA
1.			
2.			
3.			
4.			
Audit Question			
Sample Reference		[file / voucher]	
% or number of samples covered			
Sample	Audit Question tested	Observation	Finding Combined Y/N/NA
1.			
2.			
3.			
4.			
Audit Question			
Sample Reference		[file / voucher]	
% or number of samples covered			
Sample	Audit Question tested	Observation	Finding Combined Y/N/NA
1.			
2.			
3.			
4.			

**2. Finding Form – for compliance audit procedures**

a. For individual finding

Finding Title:	
1. Background:	
2. Criteria:	
3. Condition or Fact:	
4. Non-compliance:	
5. Characteristics of non-compliance	
Detectable or not	
Classification of non-compliance	
Nature of non-compliance	
Quantification of non-compliance (if possible)	
Level of non-compliance	
Cause of non-compliance	
Finding description	

- b. For combined finding  
*[i.e. same / similar audit question observations identified in multiple sample and are to be reported in combined form]*

Finding Title:	
1. Background:	
2. Criteria:	
3. Condition or Fact:	
4. Non-compliance:	
5. Characteristics of non-compliance	
Detectable or not	
Classification of non-compliance	
Nature of non-compliance	
Quantification of non-compliance (if possible)	
Level of non-compliance	
Cause of non-compliance	
Finding description	

**PP 5 Exit Meeting Minutes**

1. Date of the meeting				
2. Location of the meeting				
3. Present audit team members	Name		Designation	
	1.			
	2.			
	3.			
4. Present auditee personnel	Name		Designation	
	1.			
	2.			
	3.			
5. Issues discussed				
5.1. Logistic and management feedbacks by the auditors	1. 2. 3.			
5.2. Concerns raised by the management relating to audit	1. 2. 3.			
6. Issues discussed <i>(from: log of findings, those findings that are pending after managements' explanation and clarification during audit and management's response to the memos (audit queries) raised and circulated to the auditee)</i>	Findings		Management clarification	Auditor's decision
	1.			
	2.			
	3.			
	4.			
	5.			
	6.			
	7.			

Print and sign by both the parties

**ER 1 Evaluating Evidences**

	Audit Question	Criteria	Audit findings	Amount (if applicable)	Evaluation against materiality (qualitative and quantitative)	Conclusion
1.						
2.						
3.						
4.						
5.						
6.						
7.						
8.						
9.						
10.						

**ER 2Supervisor Review**

Supervisor should review whether

	Yes/No/NA	Comments / Remarks
1. The work has been performed in accordance with professional standards and applicable legal and regulatory requirements		
2. Significant matters have been raised for further consideration		
3. Appropriate consultations have taken place and the resulting conclusions have been documented and implemented		
4. There is a need to revise the nature, timing and extent of work performed		
5. The work performed supports the conclusions reached and is appropriately documented		
6. The evidence obtained is sufficient and appropriate to support the report		
7. The objectives of the engagement procedures have been achieved.		

8. Are the results/ conclusions drawn from the Audit consistent with the Reviewer's knowledge of business	Yes /No	Remarks
9. Are fluctuations or relationship of elements of Compliance statement consistent with other information available with the Reviewer	Yes /No	Remarks
10. If any inconsistency with the other information, have those been investigated by enquiry with the management and performing other audit procedures	Yes /No	Remarks

Overall Comments / remarks of the supervisor

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## **ER 3 Compliance Audit Report**

**Auditor General's Compliance Report on** *[briefly describe the subject matter in a way that can be understood by the users]*

To the *[addressee as required by the law or as appropriate]*

We have conducted our *[compliance]* audit[s] in accordance with the requirements of Office of Auditor General of Nepal's Compliance Audit manual which are consistent with International Standards of Supreme Audit Institutions on compliance auditing.

Compliance audit in accordance with OAGN Compliance Audit Manual is a limited assurance engagement. Because of the inherent limitations of audit, it is possible that fraud, error or non-compliance may occur and not be detected. An audit is not designed to detect all instances of non-compliance with the *[requirements]* as measured by the *[suitable criteria]*.

Executive summary

We have performed procedures, primarily consisting of making inquiries of management and others within the auditee, as appropriate, and applying analytical procedures, and evaluate the evidence obtained. We have also performed additional procedures if we become aware of matters that cause us to believe the subject matter may be in non-compliance, whether due to error or fraud. These procedures are performed to enable us to express our conclusion on the subject matter in accordance with OAGN Compliance Audit Manual. The procedures selected will depend on what we consider necessary applying our professional judgment, based on our understanding of the *[auditee's name]* its environment, and our understanding of relevant criteria and the subject matter.

Description of subject matter, scope and identified criteria

We have audited the subject matter *[describe the subject matter which may be the information, condition or activity that is measured or evaluated under certain criteria. Also sets out the audit scope in the form of a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria.]* for the period from *[.../.../20XX to.../.../20XX – mention period covered under the audit]*.

Identified criteria

The subject matter has been measured *[and / or]* evaluated by the *[describe suitable criteria here – the criteria against which the subject matter is assessed should be identified in the auditor's report]*.

*[where appropriate and relevant disclose the following]*

- *Source of the applicable criteria*
- *Any significant interpretation made in applying the criteria]*



Explanation and reasoning's of methods used

[The auditor should make a clear statement of the procedures performed to gather evidence in answering the audit questions. This will enable a user to read and follow the report and have confidence that the conclusions made are correct. The details of the work performed have the following aspects:

- Circumstances specific to the auditee (e.g. the differing nature of the auditee's activities compared to those typical in the sector).
- Specific audit circumstances affecting the nature and extent of the procedures performed.
- The intended users' expectations of the level of detail to be provided in the report, based on market practice or applicable law or regulation.
- Measurement or evaluation methods used when the applicable criteria allow for choice among a number of methods.]

Findings, Conclusions based on answers to specific audit questions, Auditee responses (as appropriate) and Recommendations (as appropriate)

<b>Audit Risk / Audit Question</b>	<b>Condition / Evidence</b>	<b>Findings</b>	<b>Amount (if applicable )</b>	<b>Cause and effect of findings</b>	<b>Conclusions</b>	<b>Auditee response (as appropriate)</b>	<b>Recommendations (as appropriate)</b>
<b>1</b>							
<b>2</b>							
<b>3</b>							
<b>4</b>							
<b>5</b>							

Signature

Name: [name of the signatory]

Designation: [position of the signatory]

[Insert place]

Date: [insert date]

**FU 1      Audit Follow-up**

1.1. Detailed follow up report for the financial year 20X?

Finding Reference	Audit Finding	Amount	Management response current status	OAG's further action, comments and conclusion
<i>Guide</i>	<i>Extract an observation in brief from the compliance audit report</i>	<i>If relevant</i>	<i>Based on written response from the management along with supporting documents of actions being taken on audit observations</i>	<i>Indicate as implemented, not implemented, partially implemented. State further comments for status having "partially implemented" and "not implemented"</i>
00.00.01				
00.00.02				

1.2. OAGN Follow up report on compliance audit findings

Accounting year	Total number of audit findings	No. of audit findings implemented	No. of audit findings partially implemented	Balance of audit findings to be implemented
<i>Guide</i>	<i>Audit unresolved observations in the PAR/ML</i>	<i>Inquire the management or review the evidence (documents) of audit observations if resolved</i>	<i>Review evidence and apply professional judgement to record the status of audit observations as partially implemented</i>	<i>After considering the status of fully implemented and partially implemented, record balance to be implemented here.</i>
20X0				
20X1				

**AQ 1 Quality Control**

**1. Quality Control at field level (first level review)**

[to be completed by first level reviewer i.e. the Team Leader]

		Yes/ No/ NA	Reviewer's comment	Action Taken
1.	Have all procedural steps been adequately completed and signed off? When a working paper of procedural steps is omitted, adequate reasons are supplied			
2.	Have the conclusions drawn adequately and supported by appropriate and sufficient audit evidence?			
3.	Are significant deviations from the overall audit plan and any changes in the scope of the audit (if any) have been properly documented?			
4.	Have all significant professional judgements made been documented and are supported by appropriate audit evidence?			
5.	Was the audit conducted in accordance with the relevant audit approach, guidelines and other directives?			
6.	Have all significant audit matters been resolved or have been appropriately reported			
7.	Are the reported findings supported by adequate and sufficient audit evidence?			

**2. Quality control at supervisor level (second level review)**

[to be completed by second reviewer i.e. by supervisor]

1. Quality Control at second review –				
		Yes/ No/ NA	Reviewer's comment	Action Taken
1.	Review performed by the first reviewer is adequate and appropriate			
2.	The audited subject matter (and other subject matter information) have been identified and clearly linked to the audit through the working papers			
3.	Significant deviations from the overall audit plan and any changes in the scope of the audit have been documented			
4.	Based on the underlying audit work and findings the correct audit conclusion(s) can be expressed			
5.	The work performed and results obtained have been adequately documented			
6.	All key working papers are in place and are consistent with each other and the final report, findings reported			
7.	Audit is consistent with the applicable auditing standards and the audit procedures of OAGN			
8.	Audit have been conducted as planned and in accordance with the applicable legal requirements applicable to Compliance audits			



# महालेखापरीक्षकको कार्यालय Office of the Auditor General

बबरमहल, काठमाडौं, नेपाल  
Babar Mahal, Kathmandu, Nepal

नीति योजना तथा जनशक्ति विकास महानिर्देशनालय



पत्र संख्या २०७७/७८ च नं ०२

मिति २०७७/१४/१६



विषय नेपाल सरकारी लेखापरीक्षण मानक कार्यान्वयन सम्बन्धमा

श्री सबै विभागहरु

श्री सबै महानिर्देशनालयहरु

श्री सबै निर्देशनालयहरु

महालेखापरीक्षकको कार्यालय ।

उपरोक्त सम्बन्धमा लेखापरीक्षण ऐन, २०७५ को दफा २९ ले दिएको अधिकार प्रयोग गरी महालेखापरीक्षकले गर्ने लेखापरीक्षणलाई वस्तुपरक, विश्वसनीय र भरपर्दो बनाई लेखापरीक्षणको गुणस्तर अभिवृद्धि गर्न साविकमा स्वीकृत भएका सरकारी लेखापरीक्षण मानदण्ड एवं सरकारी लेखापरीक्षण नीति मानदण्ड खारेज गरी सर्वोच्च लेखापरीक्षण संस्थाहरुको अन्तर्राष्ट्रिय संगठनले जारी गरेका अन्तर्राष्ट्रिय लेखापरीक्षण मान (INTOSAI Framework for Professional Pronouncements, IFPP) मा आधारित "नेपाल सरकारी लेखापरीक्षण मान" (Nepal Government Auditing Standards, NGAS) २०७७/१४/१६ मा स्वीकृत गरिएको छ । अतः कार्यालयबाट यस वर्षदेखि लेखापरीक्षण गर्दा तपसीलका नेपाल सरकारी लेखापरीक्षण मानको कार्यान्वयन गर्नु हुन अनुरोध छ ।

## तपसील

NGAS नम्बर	नेपाल सरकारी लेखापरीक्षणमानको नाम
INTOSAI-P 1	The Lima Declaration
INTOSAI-P 10	Mexico Declaration on SAI Independence
INTOSAI-P 12	The Value and Benefits of Supreme Audit Institutions- making a difference in a life of citizens
INTOSAI-P 20	Principles of Transparency and Accountability
ISSAI 100	Fundamental Principles of Public-Sector Auditing
ISSAI 130	Code of Ethics
ISSAI 140	Quality Control for SAIs
ISSAI 200-299	Financial Audit Principles
ISSAI 300-399	Performance Audit Principles
ISSAI 400-499	Compliance Audit Principles
ISSAI 2000-2899	Financial Audit Standards
ISSAI 3000-3899	Performance Audit Standards
ISSAI 4000-4899	Compliance Audit Standards

## जानकारीको लागि

माननीय महालेखापरीक्षकज्यू ।

भवदीय

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"जनहितका लागि जवाफदेहिता, पारदर्शिता र निष्ठा प्रवर्धनमा विश्वसनीय लेखापरीक्षण संस्था"