

# Strengthening Financial Management in Asia and the Pacific

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# Overview of the Grant Scope

- ▶ Regional technical assistance grant - approved October 2014
- ▶ For \$ 1.2 million (including additional funds)
- ▶ Implementation from October 2014 – to December 2017, extended to December 2018
- ▶ Countries covered
  - ▶ Output 1 – 4 countries
  - ▶ Output 2 – 7 Countries
  - ▶ Output 3 – All ADB countries, and also open to non-member countries of ADB

# Output 1 - QA Systems in PAOs

- ▶ In technical collaboration with Confederation of Asian and Pacific Accountants (CAPA)
- ▶ Consultant – Institute of Chartered Accountants in England and Wales (ICAEW)
- ▶ Engaged from July 2015
- ▶ Implementation period – From July 2015 to Dec 2018
- ▶ Countries covered – Nepal, Myanmar, Cambodia, Samoa

# Output 1 - QA Systems in PAOs

- ▶ Deliverables
  - ▶ Phase 1 - Develop
    - ▶ Good Practice Guide “Quality Assurance for Audit”
    - ▶ Road Maps for Quality Assurance
  - ▶ Phase 2 (Expanded scope in Output 1)
    - ▶ Support Implementation of Road Maps from Phase 1

# Output 2 - Working Papers on PFM

- ▶ Deliverable – Working Papers on Key Elements Public Financial Management Systems
- ▶ Countries covered – Bangladesh, Fiji, Indonesia, Myanmar, Nepal, Sri Lanka, Viet Nam
- ▶ Objective – Guide ADB Project processing and implementation teams on PFM arrangements in the areas of
  - ▶ Budgeting
  - ▶ Financial reporting – accounting, systems, audits
  - ▶ Funds flow, including on-lending, on-granting, terms
  - ▶ Foreign exchange management arrangements
  - ▶ Institutional arrangements for managing externally financed projects

# Output 3 - eLearn Module on Cash Based IPSAS for Project Financial Reporting

- ▶ Consultant – Chartered Institute of Public Finance and Accountancy
- ▶ Status – Completed, available on ADB's Website at this address
- ▶ Objective – Help project accountants across all ADB members to prepare project financial reports following an internationally recognized standard
- ▶ This module is available also to non-members, as it is a product intended to enhance good practice

# Output 1 -Scope

## ▶ Phase 1

- ▶ Identify and assess the current state of audit QA systems in the participating PAO, frameworks, and institutional or regulatory arrangements
- ▶ Identify gaps and provide recommendations for improving existing QA systems, frameworks and requirements through benchmarking with international good practice
- ▶ Design, develop, and endorse the audit QA roadmap based on the preceding analysis

Continued ....

# Output 1 - Scope (continued)

- ▶ Launch the QA roadmap in a workshop, and the participating PAO to commit to implement the roadmap over a specified period of time
- ▶ Report to ADB and CAPA, at least for 3 years after development of the roadmap, on implementation

# Output 1 - Scope (Phase 2)

Phase II – Expanded due to ground situation, to support implementation

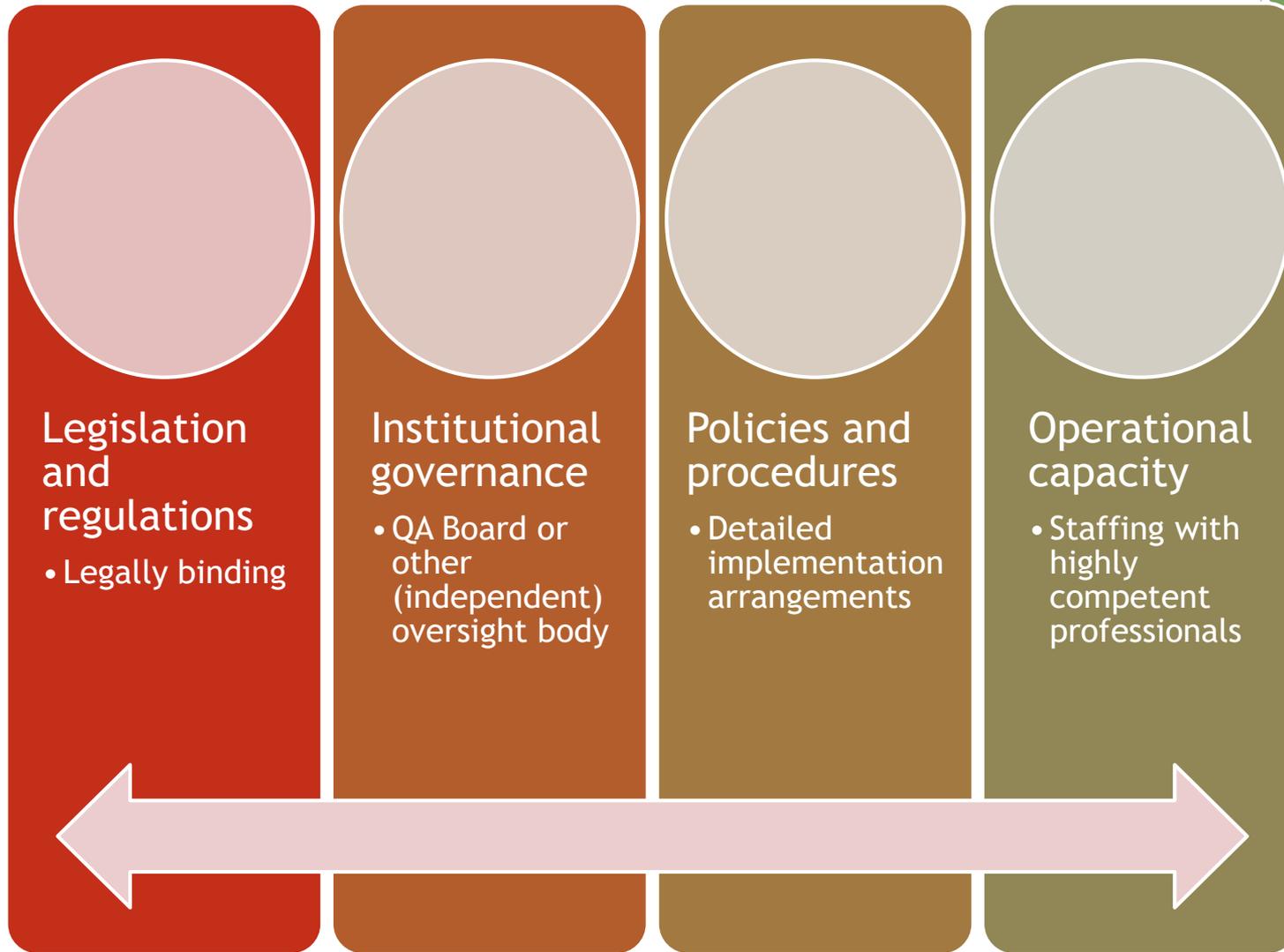
- ▶ Draft in-country by-laws and regulations on audit QA Framework.
- ▶ Prepare operational procedures and audit manuals for QA for audit, with proposed in-country audit monitoring procedures.
- ▶ Assist with selection and training of an audit quality monitoring team and QA board or equivalent.
- ▶ Pilot operational manual for Public Interest Entity auditors and other auditors
- ▶ Train audit firms to set up an appropriate structure for achieving compliance with QA requirements

# Outcomes from QA for Audit

Public interest depends upon auditors working to high professional and ethical standards. Major benefits include

- Reassurance and confidence in the financial reports
- Increased potential to strengthen public revenues
- Increased international confidence and investment
- Stronger foundations for sustainable economic growth

# Pillars for QA for Audit



# Good practice literature and considerations

IFAC SMO 1 - Quality Assurance

IFAC - International Standard for Quality Control 1 (ISQC 1) - Quality Control for Firms that Perform Audits and Reviews of Financial Statements

International Forum for Independent Audit Regulators - Core Principles of Audit Regulation

International Auditing and Assurance Standards Board - A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality

# Good Practice Guide

- ▶ Under the ADB TA, we have developed a Good Practice Guide.
- ▶ This Guide is of particular relevance to countries intending to set up QA for Audit for the first time.
- ▶ The purpose of the guide is to
  - ▶ Identify essential building blocks for audit regulation
  - ▶ Highlight different approaches to QA for audit
  - ▶ Help countries design and implement country roadmaps
  - ▶ Drive the journey to greater improvement in financial reporting and auditing

# The Steps in QA for Audit

## Diagnostic review

- Consultation with stakeholders
- Review national context
- Obtain comparative information from other countries

## Vision

- Identify various possible options
- Assess the cost of each option
- Assess available funding sources
- Develop stakeholder consensus
- Discuss the affordability, sustainability, and achievability of each option, with pros and cons, a cost benefit analysis
- Recommend the way forward, including policy recommendations

# The Steps in QA for Audit

## Design of the System

- Roadmap with clear milestones

## Implement the System

- Based on the Roadmap, implement steps
- Will usually require an international partner with prior experience in developing and implementing such roadmaps
- Monitor interim milestones to ensure the process is on track, and take prompt corrective action

# Different Approaches to QA

## Self-regulation

- Internal review by the firm only
- Peer review by other firms
- Peer review under a PAO framework and oversight

## Shared regulation

- QA is undertaken by a PAO unit
- Independent oversight of PAO inspections
- QA for PIE auditors with independent oversight board, other firms under PAO

## External regulation

- Independent oversight body for all QA

# Costs and International Practice

- ▶ **Cost** - Self-regulation is relatively the least expensive, shared regulation is somewhere in the middle, and external regulation is at the most expensive.
- ▶ **Independence** - External regulation is the most independent, and self-regulation the least independent (from the profession).
- ▶ **Choice** – affordability, sustainability, and country context. There is no one model that will fit all countries, or even the same country as it evolves over time economically, politically and socially.
- ▶ **International Experience** – shared regulation is the most prevalent, including in major economies like the USA, UK and Japan.

# Choice of Regulatory Model

- ▶ In the four countries that ADB will pilot this effort, the preferred model is a shared arrangement, where the PAO and the Government at some level are involved.
- ▶ Three of the four are embarking on this journey for the first time, and preferred that the Inspection Unit for QA should comprise independent professionals, to avoid issues of confidentiality and ensure high quality.
- ▶ Nepal, which has tried out a limited extent of peer review approach, has found this to be a failure.

# Financing for QA for Audit

Cost of QA for audit is largely determined by the cycle of inspections, intensity, and number of practitioners to be inspected. The country context will determine the funding mechanism.

- ▶ Government funding from budgetary sources (independent of the profession, fund requirements are usually quite small).
- ▶ Levy on the audit firms (perception of conflict of interest)
- ▶ Levy on the audited companies (perception of double-funding, once for audit, once for auditing the auditors!).
- ▶ Funding from external donors (there is a moral hazard of lack of ownership in this scenario, if dependency is created).

# Nepal

TA Findings and Roadmap

# Nepal - Current status

- ▶ The PAO in Nepal is the Institute of Chartered Accountants of Nepal (ICAN).
- ▶ It has the legal mandate under the Company Law of 2006 to conduct QA for audit.
- ▶ It has tried out a peer review based QA for audit over the last few years, which has failed.

# Nepal - Current status

- ▶ Stakeholders have generally proposed a more independent, shared regulatory model.
- ▶ ICAN has constituted the Audit Quality Assurance Board (AQAB), with membership from ICAN, the Securities Board of Nepal, and the Office of the Auditor General. Other stakeholders like the Nepal Rastra Bank, Insurance Board are not represented.

# Nepal - Assessment

- ▶ Legislative requirements – NFRS, NSA and Code of Ethics are converged with IFRS, ISA and IFAC Code.
- ▶ However, they are not moving in tandem with changes in international standards.
- ▶ Audit threshold is very low (all companies, even family-owned) need to be audited, though there is not much public interest. This is overloading the capacity of auditors, of whom there are barely 1,000 qualified CAs.

# Nepal - Assessment

- ▶ ICAN functions as regulator, cooperates with NRB and SEBON to publish list of auditors for banks and listed companies.
- ▶ Policies and procedures for AQAB are yet to be developed. Earlier policies for peer review exist, but are not effective.
- ▶ Operational capacity is weak, as regulators do not have professional accounting staff capacity to effectively review the financial reports being submitted.

# Nepal - Costs of AQAB, Sources

- ▶ The estimated staffing requirement in AQAB is 3 inspectors, one director, plus administrative support adding up to about \$86,500 per annum.
- ▶ Sources of funding – government, audit firms, audited companies, or external donor sources.
- ▶ Due to low audit fees, audit firms are less likely to contribute. Kickstarting may require the government to secure external funding, while ICAN identifies alternate sustainable sources.

# Samoa

TA Findings and Roadmap

# Samoa - Current status

- ▶ The PAO is the Samoa Institute of Accountants (SIA).
- ▶ It has the legal mandate under the Company Law to conduct QA for audit, except for auditors of State Owned Enterprises which is allocated to the Auditor General.
- ▶ Auditor General is regularly performing quality review for auditors under its supervision, but SIA has not performed any.

# Nepal - Current status

- ▶ Stakeholders have generally preferred a more independent, shared regulatory model.
- ▶ SIA has constituted the Practice Review Committee, which is responsible for QA for audit, but has not been implementing this activity. The AG is a member of the PRC.
- ▶ The Central Bank undertakes a review of financial reports of regulated entities.

# Samoa - Assessment

- ▶ Legislative requirements – SIA Law and Company Law clearly constitute SIA as the regulator. The AG and SIA jurisdiction is clearly demarcated.
- ▶ SIA has not developed internal capacity to undertake QA for audit.
- ▶ The preferred approach is to recruit an international professional (perhaps a retired partner or senior officer from a big network firm) to perform this service.

# Samoa - Costs, Sources

- ▶ The estimated staffing requirement is one international inspector, estimated at about \$24,000 per annum.
- ▶ Sources of funding – government, audit firms, audited companies, or external donor sources.
- ▶ Audit firms are willing to contribute a part of the costs. Kickstarting may require the government to fund, or secure external funding, while SIA identifies alternate sustainable sources.

# Cambodia

TA Findings and Roadmap

# Cambodia - Current Status

- ▶ The country does not have a national accountancy education arrangement, and depends upon auditors who acquire an international qualification.
- ▶ Due to the perceived costs and small size of the profession, till now there has been no attempts at QA for audit.
- ▶ With the approval of the new Law on Accounting in 2016, things are set to change.

# Cambodia - Current Status

## Legislation and regulations

- ▶ Law on Accounting approved.
- ▶ Sub-decrees for the National Accounting Council (NAC) and KICPAA are being drafted.
- ▶ National Bank of Cambodia, Securities and Exchange Commission of Cambodia, the Department of Financial Industry are drafting regulations for areas being regulated by them.

## Institutional Arrangements

- ▶ No single regulator for auditors.
- ▶ NBC, SECC and DFI have some knowledge and oversight of auditors under their ambit.
- ▶ No visits, inspections, etc. happen.
- ▶ QA Committee of NAC members include Government, KICPAA, NAC, DFI, NBC and SECC.

# Cambodia - Current Status

## Policies and procedures

- ▶ As the QA for audit is not established, there are no written policies or procedures.

## Operational capacity

- ▶ NAC (newly established) and KICPAA have about 7 staff each, inadequate for QA functions.
- ▶ Due to limited enforcement, only between 10% and 25% of entities that should be preparing financial reports are actually preparing them.
- ▶ NBC, DFI and SECC do not have many professional accountants on their rolls, who can review the financial statements of regulated entities.

# Vision

- ▶ Stakeholders have opted for an independent regulatory arrangement for QA, and not supported peer review.
- ▶ Peer review, though the least expensive, was perceived as ineffective, inconsistent, unreliable and not independent.
- ▶ A shared regulation, with the Government and the PAO having specific roles, is preferred.

# New System Roadmap

## Policies and procedures

- ▶ Inspection methodology, review procedures in field or desktop, need to be established.
- ▶ Procedures for making and following up on recommendations required.

## Operational Capacity

- ▶ Currently, the operational capacity remains to be established as this is a new function. The TA study has identified the staffing and funding requirements.

# Funding Arrangements

## Costs

TA study has estimated 3 professional staff will be required, at an annual cost \$63,500 including administrative support and infrastructure. A lower level of performance can be achieved at \$40,000 per annum.

**Sources** can be from the government budget, contribution from audit firms, contribution by audited companies, and external donor sources.

The government may consider securing donor sources to kickstart the process for the first cycle, while other arrangements for sustainability are put in place.

# Sequencing

- Start with PIE audit firms
- Next stage, move to auditors of larger firms
- In parallel, introduce QA for smaller audit practitioners through questionnaires to assess compliance with quality requirements

# Myanmar

TA Findings and Roadmap

# Myanmar - Current Status

- ▶ The country has recently opened up its economy after 50 years of isolation, and now intends to steadily expand economic growth, which is projected at about 8% per annum in the medium term.
- ▶ The country needs to significantly upgrade national accountancy education. PAO is in a nascent stage, and there are no institutionalized arrangements for QA of Audit.
- ▶ The Myanmar Accountancy Council was established recently by law.

# Myanmar Accountancy Council Law

- ▶ Law to increase the number and skills of qualified accountants, raise technical and ethical standards, and ensure financial reporting following IFRS / IAS.
- ▶ MAC is the sole authority for
  - ▶ prescribing curriculum and training, continuing professional development,
  - ▶ approval and recognition of local and foreign professional qualifications,
  - ▶ prescribing accounting, auditing and ethical standards,
  - ▶ monitoring compliance with the standards,
  - ▶ setting requirements for issuance of a practicing certificate, and
  - ▶ taking action against accountants for neglect or unethical behavior.

# Myanmar Institute of Certified Public Accountants

- ▶ MICPA is mandated to work with MAC on
  - ▶ education, training, continuing professional development
  - ▶ Recommend to MAC suitable arrangements for QC and professional ethics in accounting practice
  - ▶ Assess grievances and complaints against accountants and submit to the MAC
  - ▶ Report to MAC on its performance
- ▶ There are about 600 CPAs and members of MICPA

# Myanmar - Current Status

## Legislation and regulations

- ▶ MAC law in place, but regulations yet to be drafted on how to operationalize QA for Audit.
- ▶ Other relevant regulators (SEC, CBM) yet to develop regulations for audit.

## Institutional Arrangements

- ▶ MAC council includes representatives of Auditor General, CBM, Internal Revenue and MICPA.

# Myanmar - Current Status

## Policies and procedures

- ▶ While the Audit Practice Committee in MAC will be the responsible agency for QA for audit, no written policies or procedures are yet established to undertake this activity.

## Operational capacity

- ▶ There is no operational capacity for QA in MAC or MICPA.
- ▶ Funding source is yet to be identified for QA for audit.

# Vision

- ▶ Stakeholders have opted for an independent regulatory arrangement for QA, and not supported peer review.
- ▶ Peer review, though the least expensive, was perceived as ineffective, inconsistent, unreliable and not independent. It will require competitors access to confidential internal matters, and is not supported.
- ▶ A shared regulation, with the Government and the PAO having specific roles, is preferred.

# New System Roadmap

- Finalize the TOR for Audit Practice Review Committee,
- Finalize regulations for oversight of the QA process
- Finalize Regulations for auditors to cooperate, and
- Specify consequences of non-compliance
- Communicate with all stakeholders and secure consensus
- Propose formal structure and budget for the Inspection unit
- Develop inspection process and policies, methodology, and publish them
- Recruit staff, train them, and commence operations

# Estimated Costs and Sources

- ▶ Myanmar is estimated to require one Director, 2 part-time inspectors and one administrative staff, with an estimated cost of \$40,000.
- ▶ Sources are primarily only the Government or external donors, as the audit fees are too low to permit auditors to contribute to this activity. These arrangements are yet to be finalized.

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