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Final

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)
THE KINGDOM OF LESOTHO

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ACCOUNTING AND AUDITING
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PREFACE

Reports on Observance of Standards and Codes (ROSC) is a joint World Bank and International Monetary Fund (IMF) initiative that helps member countries strengthen their financial systems by adopting internationally recognized standards and codes. The ROSC program's goal is to promote greater financial stability in national financial systems, thereby reducing the potential for disruptions in financial markets, and lay essential foundations for sustained and higher rates of economic growth and the reduction of poverty and income inequality.

The ROSC involves preparation of reports in twelve key areas.[1] The ROSC Accounting and Auditing (ROSC A&A) evaluates a country's accounting and auditing standards and practices, using as benchmarks the International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA). It also uses international good practice as reference for assessing the strengths and weaknesses of institutions underpinning a country's financial reporting regime. The ROSC A&A focuses on the corporate financial reporting infrastructure that supports high-quality accounting and auditing practices.

The Lesotho ROSC A&A was carried out in March and April 2010 through a participatory process involving various stakeholders, including the Lesotho Institute of Accountants, Accountant General, Auditor General, Central Bank of Lesotho, Ministry of Finance and Development Planning, Registrar of Companies, Lesotho Revenue Authority, Commissioner for Cooperatives, National University of Lesotho, Center for Accounting Studies, audit firms, banks, insurance companies, state-owned enterprises, accountants, and academics. As the designated country counterpart to the ROSC A&A team, the Lesotho Institute of Accountants was instrumental in planning stakeholder meetings and obtaining information.

[1]The twelve ROSC areas are data transparency, fiscal transparency, monetary and financial policy transparency, banking supervision, securities, insurance, payment systems, anti-money laundering and combating financial terrorism, corporate governance, accounting, auditing, and insolvency and creditor rights.

The Lesotho ROSC A&A was prepared by a World Bank team comprising Gert van der Linde, Lead Financial Management Specialist and Task Leader (AFTFM); Zubaidur Rahman, Program Manager (OPCFM); Olawale Wale-Awe, International Consultant (AFTFM); Rebecca Chesney, Junior Professional Associate (OPCFM); and Aleksandar Kocevski, Junior Professional Associate (AFTFM). The report was peer reviewed by Patrick Kabuya, Senior Financial Management Specialist, (AFTFM); Richard L. Symonds, Consultant (LEGPS); Preeti Arora, Senior Economist (SARDE); and Thomas Zimmermann, Technical Manager, Member Body Development (IFAC).

ACRONYMS

A&A	Accounting and auditing
ACCA	Association of Chartered Certified Accountants (United Kingdom)
CIPFA	Chartered Institute for Public Finance and Accountancy
ECSAFA	Eastern, Central, and Southern Africa Federation of Accountants
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IDF	Institutional Development Fund
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
ISA	International Standard on Auditing
ISQC	International Standard of Quality Control
ROSC	Reports on the Observance of Standards and Codes
SACU	Southern African Customs Union
SME	Small and medium-sized entity
SMO	Statement of Membership Obligation

EXECUTIVE SUMMARY

The purpose of this report is to assist the development and implementation of a country action plan for strengthening institutional capacity to enhance corporate financial reporting in Lesotho. It assesses the strengths and weaknesses of the financial reporting infrastructure underpinning financial accounting and auditing practices in Lesotho, focusing on the six pillars of financial reporting: statutory framework, accounting standards, auditing standards, accountancy profession, professional education and training, and monitoring and enforcement.

Statutory Framework

Lesotho has several pieces of proposed legislation that will fill gaps in the legal framework for financial reporting and further align the country with international best practice. However, no current or proposed legislation adequately establishes the process for adopting and promulgating the applicable accounting and auditing standards.

Accounting and Auditing Standards

The Lesotho Institute of Accountants has adopted International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA). However, the process for disseminating new and revised standards and the applicability of IFRS for small and medium-sized entities are not clear.

Accountancy Profession

Lesotho suffers from a significant financial reporting capacity gap between multinational and large entities and those that are small and purely local. The Lesotho Institute of Accountants has provided more training and technical support in recent years, but it lacks capacity to fully serve its dual professional body and regulator mandates. In addition, the financial reporting community generally does not appreciate the benefits of membership, evidenced by the more than 75 percent of qualified accountants who have not joined the Institute as full-time members.

Professional Education and Training

Lesotho does not have its own national qualification program, and therefore all members hold foreign accountancy certification. Practical training and continuing professional development are required for membership of the Institute, but they are not adequately monitored and enforced. Training available in the country is considered too broad or irrelevant, and internships for students and practical guidance on the application of IFRS and ISA are not readily available.

Monitoring and Enforcement

The Central Bank of Lesotho lacks capacity to monitor accounting and financial reporting requirements in the banking sector, and growth in the breadth of non-banking financial institutions' activities will require the development of related regulations and more training for supervisors. The Lesotho Institute of Accountants recently began implementing quality assurance reviews, but it will need more financial and human resource capacity to properly conduct reviews, monitor follow-up of findings, and impose necessary sanctions.

The Government's national development plan prioritizes the creation of jobs and promotion of good governance to promote sustainable economic growth, and the Government and the Lesotho

Institute of Accountants are implementing broad reforms to strengthen public financial management, governance, and accountability. In line with these reform and development priorities, this report provides recommendations to serve as basis for preparing a country action plan to build institutional capacity to promote high-quality accounting and auditing practices in Lesotho.

With the help of the Lesotho Institute of Accountants, it is essential that the Government establish a national steering committee to advise on the development and implementation of the country action plan. The action plan should prioritize key actions, designate responsibilities and timeframes, and indicate the required financial and human resources. Implementation should be monitored to ensure progress and continued alignment with country needs and priorities.

Table 1. Summary of Policy Recommendations

Statutory Framework
• Modernize financial reporting requirements and related provisions in the legal framework • Extend legal backing for the Lesotho Institute of Accountants' mandate and process to adopt and promulgate accounting and auditing standards as issued by the International Accounting Standards Board (IASB) and standard-setting bodies of the International Federation of Accountants (IFAC) • Broaden legal definition of financial reports to include the full set of financial statements • Require all public interest entities to make audited financial statements readily available to the public • Clearly specify rotation of auditors in the Companies Bill • Update the Companies Bill to define and differentiate between categories of entities based on size • Enact the amendments to the Financial Institutions Act and the Insurance Bill • Consider consolidating company registration and renewal activities with the Companies Registrar
Institutional Capacity Building
• Increase the technical capacity of the Lesotho Institute of Accountants • Empower the Lesotho Institute of Accountants through partnerships with other associations and organizations • Initiate an awareness campaign to attract new entrants into the accountancy profession • Build technical capacity of the Central Bank of Lesotho to supervise the financial reporting
Monitoring and Enforcement
• Proceed toward the use of quality assurance reviews as a regulatory tool • Develop an audit fee scale to promote independence and quality of audits • Enforce requirements to submit financial statements to the Companies Registrar • Properly implement and enforce the Code of Ethics of Professional Accountants • Separate the Institute's Disciplinary Committee from the Council to ensure its ability to properly monitor the profession and comply with IFAC membership requirements
Professional Education and Training
• More accurately monitor and enforce membership requirements • Clearly define the eligibility criteria for use of the title qualified accountant • Review the adequacy of qualifications available in the country to meet local needs • Develop a channel to direct students from university education to professional qualification • Implement internship and attachment programs for students to obtain adequate practical experience • Direct more resources to the National University of Lesotho accountancy program • Align accountancy education and training with the interests of the professional accountancy community • Develop more structured and country-specific educational and training programs • Provide more training on general business skills, including information and communication technology • Form communities of practice within the accountancy profession to promote knowledge transfer and collaboration

I. INTRODUCTION AND BACKGROUND

1. The assessment of accounting and auditing practices in Lesotho is one part of the joint World Bank and International Monetary Fund (IMF) initiative to prepare Reports on the Observance of Standards and Codes (ROSC). Involving a review of both mandatory requirements and actual practices, the ROSC Accounting & Auditing (ROSC A&A) assessment focuses on strengths and weaknesses of the corporate accounting and auditing environment that influences quality of corporate financial reporting. It uses as benchmarks the International Financial Reporting Standards (IFRS)[2] and International Standards on Auditing (ISA)[3] and draws on recent global experiences and best practice. This ROSC A&A uses a diagnostic template developed by the World Bank to facilitate collection of information, complemented by the findings from a series of meetings with key stakeholders conducted by World Bank staff.

2. Lesotho is a small country in southern Africa. About 75 percent of its 1.8 million people live in rural regions where the mountainous terrain limits income generation to subsistence agriculture. However, with less than 10 percent of the country's highlands suitable for crop cultivation, more people are moving to the country's capital, Maseru, for employment. Lesotho has made notable gains in increasing access to education, and the country continues to focus on capacity development in both the public and private sectors to diversify the domestic economy and further integrate with the region.

3. Lesotho suffered from serious macroeconomic and fiscal challenges from the recent global economic crisis, which occurred at the very time the country was making economic gains. Lesotho's economic growth averaged 3.4 percent per year during the four years starting 2004, reaching a high 4.5 percent in 2008. This growth is attributable to the country's ability to attract foreign direct investment to support its diamond and textile industries, capitalize on its water surplus to create sustained revenue from South Africa, and improve access to services and create jobs by developing roads. The crisis-induced decrease in demand for clothing exports, lower diamond prices, and the reduction in inflows from the Southern African Customs Union all contributed significantly to Lesotho's curbed development. To secure future growth, Lesotho must accelerate improvements to its business climate, encourage domestic entrepreneurship, and promote a more vigorous private sector.

4. Multinational institutions, primarily from South Africa, dominate Lesotho's financial market. Four commercial banks operate in the country, including government-owned PostBank. The banking system does not provide adequate services to households and small, micro, and medium enterprises. By opening branches in rural areas, offering financial literacy training to rural customers, and providing rural credit, PostBank is expected to increase access. Non-banking financial institutions in Lesotho consist of 5 insurance companies, about 70 money lenders, 2 collective insurance schemes, 2 foreign exchange bureaus, and a money transfer provider. The insurance companies are all subsidiaries of larger foreign companies. In addition, approximately 1,800 cooperative societies are operating in Lesotho to promote the economic and

[2] IFRS refers to all standards and related interpretations issued by the International Accounting Standards Board (IASB) and its predecessor the International Accounting Standards Committee (IASC), which issued International Accounting Standards (IAS). In this report, IFRS also refers to IAS.

[3] ISA are issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants.

social interests of members. These cooperatives operate mainly in the agriculture, catering, industrial, consumer, youth, and financial sectors – the latter as savings and credit cooperatives.

5. Lesotho has no securities market, but public and private sector institutions have access to South African capital and money markets under the Capital Market Authority. In addition, the Lesotho Unit Trust collective investment scheme was established to provide individuals with the opportunity to invest in private entities. The Central Bank of Lesotho plans to establish a securities market but has yet to set a concrete strategy and timetable. The Central Bank recently began issuing treasury bills to help increase the overall savings level and encourage the evolution of secondary markets and competition in the money market.

6. Capacity within the Lesotho economy is highly segregated between multinational and large entities and local-level small, micro, and medium enterprises. Multinational and large entities have adequate managerial capacity, access to credit, and the ability to attract and train highly skilled employees. Small, micro, and medium enterprises employ 130,000 people, the largest of any sector. However, weak business management skills, inadequate access to credit and capital markets, and deficient understanding of market needs stunt this sector's growth. The capacity gap between these two disparate yet fundamentally similar groups needs to be narrowed to promote domestic growth and provide adequate opportunities for all enterprises in the country.

7. The Small, Micro, and Medium Enterprise Network was established in 2007 to promote coordination and the transfer of skills among business development service providers and owners of Lesotho's small businesses. Members benefit from training on basic business processes and concepts, including understanding sales and profit, managing credit, and maintaining solvency. The Government recently supported a training-of-trainers program with the International Labor Organization to help small, micro, and medium enterprises develop business plans. The program aims to encourage these enterprises to register as legitimate companies to gain business credibility and greater access to credit.

8. Other organizations are also promoting private sector growth. The Lesotho Chamber of Commerce, Mohloli Chamber of Business, and the Office of the Commissioner for Cooperatives provide training on business management and accountancy issues. There is a general belief that Lesotho's private sector provides many opportunities for growth, as several niches are untapped and young professionals are establishing businesses in innovative sectors such as information and communication technology.

9. To develop a competitive and vibrant private sector, Lesotho's financial system must be reasonably robust to earn investors' confidence and assist market participants in economic decision-making processes. A strong financial reporting regime for corporate entities in the private and public sectors will benefit Lesotho economy in various ways, including:

- *Enhancing the institutions and skills that underpin the entire economy*, providing a knowledge base that promotes innovation and diversification;
- *Contributing to financial sector development* through strengthening the country's financial architecture and helping reduce the risk of financial crises and corporate failures, together with their associated negative economic impacts that have been witnessed in many industrialized and developing countries;

- *Increasing foreign direct investment*, which can be achieved through greater confidence in, and improved comparability of, financial information;
- *Facilitating economic integration on the regional and sub-regional levels,* through further alignment of Lesotho's accountancy practices with those of its main trading partners; and
- *Improving access to financing for the small, micro, and medium enterprise sector* by providing banks and venture capitalists with standardized, useful, and reliable information.

10. The benefits of a strong financial reporting regime support the development plans proposed by the Government of Lesotho and World Bank. The Government's 2009 Interim National Development Framework prioritizes the creation of jobs and promotion of good governance to promote sustainable economic growth. The World Bank Country Assistance Strategy for Lesotho[4] includes enhanced competitiveness and improved public sector accountability as two of its three key areas of engagement. The Government is improving governance by implementing broad reforms in public financial management,[5] and the Lesotho Institute of Accountants recently received the first disbursement of a World Bank-facilitated grant from the Institutional Development Fund (IDF) to promote governance and accountability in the country. This ROSC A&A builds upon these efforts to identify opportunities to broaden the scope and impact of development objectives. Follow up to the ROSC A&A is specifically included in the 2010 Lesotho Country Assistance Strategy as a means to improve institutional capacity for better accountability and efficiency. The Government's country action plan resulting from this ROSC A&A will help determine potential areas of engagement..

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

11. **The Companies Act 1967 sets primary requirements for financial reporting of all entities incorporated in Lesotho.** The Companies Act 1967 requires companies to keep proper books of account with respect to all sums of money received and expended, all sales and purchases of goods, and assets and liabilities of the company. The accounts are required to give a true and fair view of the state of the company's affairs and explain its transactions. Specific requirements for form and content of the balance sheet and profit and loss account are contained in the Sixth Schedule of the Act. The Companies Act 1967 does not require preparation of other important financial reports, including a cash flow statement and statement of changes in shareholders' equity. It also does not specify the mandate or process for development of accounting standards that are to be applied for financial reporting purposes.

12. **Directors have statutory responsibility to prepare accounts and present the auditor report at the annual meeting of company shareholders.** Two directors must sign the balance sheet on behalf of the board. Failure to comply with the requirements of timely

[4] *Country Assistance Strategy for the Kingdom of Lesotho,* World Bank Report No. 51787 - LS. (International Development Association, June 2010).
[5] A key pillar of the Second Poverty Reduction Support Credit (PRSC) and Grant, approved by the World Bank in March 2010, is to improve public expenditure management and the fiduciary framework that advances progress made under the first PRSC and with support from other donors.

preparation of financial statements can lead to a fine, imprisonment, or both. Directors are also obligated to undertake an audit of their financial statements every year. Specific auditor qualifications or auditing standards to be applied are not included in the law. However, the Companies Act 1967 requires certain responsibilities of the auditor that conflict with ISA. Private companies are not required to send an annual report to shareholders or make financial statements available. Section 122 (7) of the Companies Act 1967 exempts these companies from engaging an auditor if "(a) the number of shareholders in such company does not exceed ten; (b) none of the shareholders in such company is a company; (c) all the shareholders in such company agree that an auditor shall not be appointed."

13. **A proposed Companies Bill requires that financial statements and auditor reports be prepared in accordance with the financial reporting standards issued, adopted, and published by the Lesotho Institute of Accountants.** The Companies Act 1967 does not support current financial reporting practices. The Ministry of Trade is sponsoring the proposed Companies Bill to replace the Companies Act 1967. However, the proposed legislation still requires submission of only the balance sheet and profit and loss account. It also does not require large private limited companies to submit audited financial statements to the Registrar of Companies for public viewing, compromising quality of financial information and transparency of a number of public interest entities operating in Lesotho.

14. **The vast majority of entities do not comply with the requirements to submit financial statements to the Registrar of Companies.** According to the Companies Act 1967, companies must file annual returns and audited financial statements with the Registrar of Companies within 42 days after the annual general meeting. The penalties for not filing or filing late are grossly insignificant and are not enforced. The Registrar of Companies is computerizing its records, but the system for tracking financial statements has not yet been modernized. Auditors attempting to verify information with the Registrar have been unable to obtain financial statements that were not submitted. The availability of company information is further compromised by the Government's policy to maintain certain records within the line ministry that best matches the industry in which the business operates, rather than housing all documents with the Registrar of Companies.

15. **The Accountants Act 1977 does not specifically provide for a process to establish the applicable accounting and auditing standards.** The Accountants Act 1977 establishes the Lesotho Institute of Accountants and stipulates the minimum registration requirements to practice accountancy in Lesotho. The law does not stipulate the process for establishing accounting and auditing standards. The 1977 Accountants Act is being updated. A new draft Accountants Act will strengthen the Institute, but it still does not clearly stipulate a process to establish the required standards.

16. **In 2001, the Lesotho Institute of Accountants adopted IFRS and ISA for financial reporting and auditing in Lesotho.** However, the legislative framework does not explicitly state the mandate and process to establish good accounting and auditing standards. To provide the proper underpinning for sound corporate reporting in Lesotho and increase the enforceability of IFRS and ISA, the mandate and process to establish accounting and auditing standards should be clear in the legal framework of the proposed Companies Bill and draft Accountants Act. The Government has not yet formally adopted International Public Sector

Accounting Standards (IPSAS), although the Institute encourages adoption. There will need to be a similar process for updating revised IPSAS when adopted.

17. **The Central Bank of Lesotho licenses, regulates, and supervises financial institutions under the Financial Institutions Act 1999.** Financial institutions must be granted a license by the Central Bank and be incorporated as a public company under the Companies Act 1967 before conducting any banking or credit business. All financial institutions are subject to oversight by the Central Bank Supervision Department, which is divided into four divisions: banking supervision, insurance supervision, non-banking supervision, and exchange control division. The non-banking financial institutions department oversees money lenders, foreign exchange bureaus, collective investment schemes, and the upcoming rural credit program. Each division is responsible for licensing institutions; preparing and implementing regulatory guidelines; and conducting on-site and off-site analyses, for which the Central Bank has recently adopted a risk-based approach according to international practice.

18. **The Financial Institutions Act 1999 requires the annual submission of audited financial statements within three months of the financial year end.** The auditor should state whether the balance sheet and profit and loss account are properly drawn up and exhibit a true and correct statement of the affairs of the institution. The auditor must be approved by the Central Bank, which does not maintain a list of approved auditors for financial institutions. The financial institution must publish a copy of the audited balance sheet in the Government-published Gazette and at least one newspaper of general circulation in Lesotho, as well as post a summary of the latest balance sheet in all its places of business in Lesotho. The board of directors must form an audit committee that includes three directors to help evaluate the financial institution's systems and practices and the auditing process to be applied.

19. **Proposed amendments to the Financial Institutions Act 1999 provide for more sound accountancy practices.** Unlike other effective and draft legislation, the proposed amendments specify that financial statements should be prepared in accordance with the requirements of internationally accepted accounting practices and standards as adopted by the accounting bodies in Lesotho. However, it does not require preparation of a full set of financial statements. The draft changes also would prevent financial institutions from appointing the same auditor continuously for a period longer than five years without an exemption from the Central Bank. Additionally, the amendments introduce new regulations to combat the formation of pyramid schemes, which caused serious problems in the financial sector in 2007.

20. **Draft insurance legislation would also impose enhanced financial reporting and auditing requirements on insurance companies in Lesotho.** The Insurance Act 1976 requires insurance companies to submit reports every quarter and audited annual financial statements to the Commissioner of Insurance within six months of the financial year. Building upon this requirement, the new Insurance Bill would require the auditor to be a member of the Lesotho Institute of Accountants and approved by the Commissioner in writing. Rotation of external auditors would be required every three years. The current and proposed insurance laws do not specify which accounting standards to apply and only require preparation of balance sheet and profit and loss account. Through its membership in the International Association of Insurance Supervisors, the Central Bank has effectively been enforcing the application of IFRS. However,

there is need for the insurance legislation to specify required standards are those adopted, issued, and promulgated by the Lesotho Institute of Accountants.

21. **Money lenders have increased in recent years, and some are venturing into microfinance activities.** The amended Money Lenders Act 1993 requires money lenders to appoint an auditor approved by the Central Bank to audit accounts and report on the annual balance sheet and the profit and loss account within three months of the financial year. The Central Bank maintains a list of approved auditors for money lenders. Lax entrance requirements have led to an increased presence of money lenders in Lesotho, although the numbers have dropped in the past year. Large money lending establishments have capacity to comply with financial reporting requirements, while the small and medium money lenders submit inadequate, often late, financial statements. Some money lenders have expressed interest in offering microcredit. The Central Bank is developing microfinance policies with the help of the World Bank-managed, multi-donor-supported Financial Sector Reform and Strengthening (FIRST) Initiative to accommodate this desire.

22. **The Commissioner for Cooperatives regulates the cooperative societies under the Cooperate Societies Act 2000.** The Act requires cooperative societies to provide annual audited financial statements. Due to lack of auditing personnel within the Office of the Commissioner for Cooperatives, cooperative societies are encouraged to engage private audit firms for the purpose of conducting examination of their annual accounts. The Commissioner approves the selected auditor, who does not necessarily have to be on the Lesotho Institute of Accountants' list of approved auditors. Cooperatives have recently complained that local audit firms have little knowledge of cooperative society policies, misinterpret financial statements, and inadequately explain findings and recommendations to members.

23. **Tax legislation does not require all public interest entities to submit audited financial statements with tax filings.** The Income Tax Act 1993 requires companies to submit tax returns by June 30 each year. Entities that must have an audit under the Companies Act 1967 are also required to submit audited financial statements. Tax returns are often late because of the lack of capacity of many audit firms to perform audits. Additionally, many entities that do not meet the audit requirement earn high revenues, and the Lesotho Revenue Authority has less confidence in their accounts. Staff members of the Lesotho Revenue Authority recently received tax audit training from the United States Treasury's Office of Technical Assistance and will begin investigating accounts in more detail, an even more important activity considering the introduction of a self-assessment tax system. There is a need for the Lesotho Revenue Authority to also consider implementing a threshold over which entities are required to submit audited financial statements to increase the credibility of accounts and accuracy of tax assessed. To ensure proper tax reporting of small, micro, and medium enterprises, the Lesotho Revenue Authority is partnering with commercial banks in Lesotho to ensure those obtaining bank credit hold a valid tax certificate.

24. **The Audit Act 1973 empowers the Auditor General to audit state-owned enterprises.** The current law does not specify which auditing standards should be applied. The draft Public Audit Act 2006 requires the Office of the Auditor General to determine which auditing standards should be applied. The Auditor General focuses on public sector audits, outsourcing most audits to private sector firms obtained from the Lesotho Institute of

Accountants' list of approved auditors. Bids from these private firms are perceived to be unreasonably low by many in the profession, mainly because the Auditor General appears to accept low fees and potential auditors are not allowed to adequately scope the audit. Audit firms would benefit from a fee scale, set by the Auditor General, as guidance in developing reasonable bids.

B. The Profession

25. **Established by the Accountants Act 1977, the Lesotho Institute of Accountants is both a regulator of the accountancy profession and a professional accountancy body.** As a professional accountancy body, the Institute determines member qualifications; provides training, education, and examination of persons practicing or intending to practice accountancy; regulates the practice of the accountancy profession; promotes the interests of the accountancy profession; renders pecuniary or other assistance to members; sets accounting, auditing, and ethics standards; and takes on other activities necessary to achieve its objectives.

26. **The Lesotho Institute of Accountants became a member of the International Federation of Accountants (IFAC) in 1985 and has recently increased its influence within the business community in Lesotho.** In April 2009, the Institute developed an action plan as part of the IFAC Member Body Compliance Program that lays out specific activities to make progress toward the IFAC Statements of Membership Obligations (SMOs).[6] The Lesotho Institute of Accountants is governed by a Council of 18 members, of whom 9 are chartered accountants, 4 general accountants, 3 accounting technicians, and 2 ex officio members representing the Accountant General and Auditor General. With support from the Government, the Institute has recently hired additional staff and established 10 committees: Education and Training, Compliance, Marketing and Promotions, Editorial and Publications, Public Sector, Admissions, Technical Accounting and Auditing Standards, Practice and Review, Presidential, and Disciplinary. The Disciplinary Committee falls under the authority of the Council, jeopardizing its ability to fully monitor members and take necessary actions.

27. **The Lesotho Institute of Accountants has adopted the Code of Ethics for Professional Accountants issued by IFAC's International Ethics Standards Board for Accountants, but recent litigation indicates that it is not fully enforced.** The Institute requires members to adhere to all three parts of the Code and has developed a fourth section specific to Lesotho circumstances. The Institute's Council has yet to adopt the new section at an annual general meeting. The Compliance Committee has the mandate to monitor compliance and impose sanctions, although this task falls within the disciplinary chambers for most IFAC members. Two local audit firms are presently facing court actions due to issues of fraud and refusal to cooperate with investigators. This litigation reflects the Institute's weakness in assuring adequate enforcement of the Code of Ethics and executing prescribed sanctions against

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[6] Statements of Membership Obligations are issued by the IFAC Board and establish requirements for members and associates to promote, incorporate, and assist in implementing IFRS issued by the IASB and the international education, ethics, auditing, and public sector accounting standards issued by IFAC's independent standard-setting bodies. They also establish requirements for quality assurance and investigation and discipline activities. The Lesotho Institute of Accountants action plan, assessment of regulatory and standard-setting framework, and self-assessment of IFAC Statements of Membership Obligations are available on IFAC's Member Body Compliance website (http://www.ifac.org/ComplianceAssessment/published.php).

violators. There is need to strengthen the Institute's capacity to comply with IFAC's disciplinary requirements.[7]

28. **Most Lesotho Institute of Accountants members hold foreign accountancy qualifications.** The Institute conducted its own examination and qualification scheme, the Chartered Accountant Lesotho but, due to lack of human resources and financial constraints, was forced to terminate the local certification process. All subsequent entrants into the profession have obtained foreign qualification. Some members, who earlier qualified under Chartered Accountants Lesotho, sought foreign qualification after the local scheme was terminated. The Lesotho Institute of Accountants recognizes 12 foreign professional accountancy qualifications for membership without requiring further examination or experience, although the vast majority of members hold the Association of Chartered Certified Accountants (ACCA) qualification.

29. **Nearly 75 percent of the accountants certified at different levels in Lesotho have not joined the Lesotho Institute of Accountants since completing training programs.** The Institute has 296 members, divided into 3 categories: 117 chartered accountants (professional level), 53 general accountants (semi-professional level), and 126 technician accountants. About 1,200 accountants qualified at various levels in Lesotho have not joined. Many individuals do not see the added value of membership, particularly since they pay annual membership fees to foreign professional bodies. The recently established Marketing and Public Relations Office is promoting the benefits of membership in the Institute, including free access to important accountancy information, low-cost copies of IFRS books, and discounted fees for training seminars. The Institute also introduced different membership fees for practicing, non-practicing, and student members. Continued membership growth would benefit from increased membership revenues, a larger membership based for conducting training sessions, and a more unified cadre of professionals in Lesotho.

30. **There are inconsistent views about the adequacy of qualifications available in the country.** Many stakeholders believe more options should be given to allow accountants more opportunities to integrate into the economic sub-region. Many managerial-level accounting positions in Lesotho's largest companies are held by members of the South African Institute of Chartered Accountants to meet the requirements of their South African parent companies. Most accountants in Lesotho are ACCA members and therefore do not qualify for these attractive jobs in their own country. Equal employment opportunities for holders of different foreign professional qualifications are not available, a further hindrance to the development of the accountancy profession.

31. **Except for large and multinational entities present in the country, the corporate sector generally does not have access to professionally qualified accountants.** Many small, micro, and medium enterprises do not have accountants with the skills and knowledge required to prepare financial statements in accordance with IFRS. The managers and accountants of these entities frequently rely on auditors to produce a complete set of financial statements, often based on incomplete accounting records. Small and medium audit firms are also facing difficulties employing well-trained auditors and are investing significant time and funds for accounting courses and training. Once they reach qualified status, auditors often leave for higher-paying

[7] See SMO 6, *Investigation and Discipline.*

jobs in the private sector or in South Africa. Small and medium audit firms are concerned that audit skills in Lesotho are disappearing as these entrants to the profession shift away from auditing.

32. **The business community often misinterprets the level of qualification of non-practicing members of the Lesotho Institute of Accountants.** Many accountants who have qualified at the technician, general or professional certification level are not practicing members of the Institute but yet accept what can be regarded as professional accountancy positions with the private and public sector. This confuses the understanding of what qualifies a practicing member of the Institute, as well as the professional skills and knowledge one should posses. To minimize the risk of non-auditors performing auditing services, the Bankers Association established an agreement with the Lesotho Institute of Accountants to provide clients with an updated list of auditors and require clients to engage only registered auditors. Other organizations would benefit from looking to the Institute for guidance on selecting appropriate professionals for accounting and auditing services.

33. **The relatively small audit market is highly segregated into two groups: firms with access to international IFRS training, materials, and audit firm networks, and those without.** The Big 4 audit firms operating in Lesotho closed their offices around 2005 since physical presence in the country was not cost effective. The 4 largest local firms in Lesotho audit most financial institutions, large domestic entities, and entities affiliated with multinational companies. Two of these firms have working relationships with international firms in South Africa to accommodate multinational entities' requirement to engage an international firm. Small, micro, and medium enterprises generally engage smaller, local audit firms to conduct audits. The large audit firms are better equipped to apply ISA and understand IFRS. In addition, their larger and multinational clients have more access to training and more modern accounting policy within their own organizations, providing the audit firms with higher-quality financial information to audit. Conversely, smaller audit firms have less access to training and skilled audit staff, and they often are working with information from less-skilled clients. More collaboration among audit firms, encouraged by the Lesotho Institute of Accountants, would promote the transfer of knowledge and experiences. In addition, more focused training and implementation guidance would ensure all members of the Institute understand and can apply international accounting, auditing, and ethics standards.

34. **Company management does not always take full responsibility for preparing financial statements.** According to the Companies Act 1967 and international good practice, preparation of financial statements by an accountant is a responsibility of company management. However, due to the lack of qualified accounting professionals and misunderstanding of auditors' role, management of small, micro, and medium enterprises frequently shifts the responsibility for preparing financial statements to auditors. To be compliant with independence rules, auditors should not prepare and audit the same financial statements. Larger audit firms in Lesotho often refer clients to another accountant for preparation of accounts and try to avoid engagements with clients where extensive work needs to be done before commencing the audit. Smaller audit firms with less business do not have the luxury of being as selective in engaging audit clients.

35. **The Lesotho Institute of Accountants has introduced quality assurance reviews to help improve the auditing environment in Lesotho but does not have capacity to fully**

implement the program. Quality assurance reviews were introduced in January 2009 and are conducted by ACCA. All audit practices in Lesotho are subject to review every three years. The Lesotho Institute of Accountants intends to use the initial reviews as a learning tool to determine capacity and regulatory challenges of audit firms in Lesotho and then develop the program into a more regulatory role. The review program must be capable of identifying potential issues most relevant to the Lesotho environment, particularly given the recent litigation involving two audit firms in Lesotho. The litigation also indicates the Lesotho Institute of Accountants may need to provide more assistance to audit firms in complying with International Standard on Quality Control (ISQC) 1[8], which it has adopted. Before the Institute begins conducting the review on its own, it will need more capacity to communicate results to firms under review, monitor follow up, and impose sanctions.

36. **The Lesotho Institute of Accountants is taking steps to increase its capacity, but more needs to be done.** The Institute has made a significant contribution to development of the accountancy profession in Lesotho over the past decade. However, due to technical and financial constraints, there is widespread belief that the Institute may not be able to fully undertake its regulatory responsibilities. The Lesotho Institute of Accountants lacks the capacity to undertake monitoring activities to ensure adequate practical training and compliance with accounting, auditing, and ethics standards. Recognizing its capacity needs, the Institute is partnering with ACCA to conduct quality assurance reviews of the audit firms in Lesotho and implementing a 3-year strategy to increase confidence in the profession through enhanced regulation, promotion of financial sustainability, and more diversified education and training programs.[9] With World Bank support, an IDF grant complements the Institute's strategy by helping build capacity for anti-fraud and anti-corruption responses, implementing the quality assurance review program, better addressing public financial management and tax planning and assessment needs, as well as contributing to amendments to the outdated Accountants Act 1977. The Institute will need the continued support of its members, the Government of Lesotho, and international partners and donors to fully meet its mandate.

37. **The Lesotho Institute of Accountants has significantly increased its presence in the country, but further efforts to assert its statutory position as the leader of accountancy issues in Lesotho are necessary**. The Institute recently signed memoranda of understanding with both the Lesotho Chamber of Commerce and Mohloli Chamber of Business to help their members identify accounting personnel for preparation of accounts and audits, as well as provide training opportunities. The memoranda are not yet operational, as no proper action plan was put in place to ensure execution of the identified duties and responsibilities. The Lesotho Institute of Accountants should seek more opportunities to partner with other organizations in the business and education communities, as well as other accountancy bodies such as Eastern, Central, and Southern Africa Federation of Accountants (ECSAFA), to further develop the accountancy profession. However, it should make every effort to actively and effectively participate in these arrangements.

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[8] Issued by IFAC's International Auditing and Assurance Standards Board, this standard stipulates a firm's responsibilities for its system of quality control for audits and reviews of financial statements and other assurance and related services engagements (available at http://web.ifac.org/clarity-center/isa-isqc1).
[9] The Lesotho Institute of Accountants Three-Year Strategic Plan 2009-2011 is explained at www.lia.org.ls/documents/Strategic_Plan_final.pdf.

38. **The Institute of Internal Auditors Lesotho has recently been established to promote corporate governance within the public and private sector.** The Institute of Internal Auditors Lesotho has prospective status with the global body and is moving toward full membership within the year. Members must be university graduates and complete the global internal audit certification program. The Institute of Internal Auditors Lesotho has adopted the global body's Code of Ethics, but legal backing and enforcement mechanisms have yet to be implemented. Members are subject to review every 5 years to ensure compliance with global standards. The Government is sponsoring internal audit training programs for public sector internal auditors according to its strategic focus on public sector accountability. 22 candidates have completed the Technician Internal Auditor level, but progression to General Internal Auditor and full Certified Internal Auditor is delayed due to lack of funds. Additionally, qualified accountants are becoming members and pursuing internal audit certification to add a degree of specialization on top of their accountancy qualification and gain more expertise on risk management and internal controls. As an independent regional member of the Institute of Internal Auditors South Africa, the Lesotho body is receiving significant technical and financial resources as it grows. Collaboration between the Lesotho Institute of Accountants and Institute of Internal Auditors Lesotho in providing training on risk management and internal controls would promote proper governance in Lesotho.

C. Professional Education and Training

39. **Lesotho does not have its own national qualification program.** Following the termination of the Certified Accountant Lesotho qualification, only foreign qualifications are offered in Lesotho. The Center for Accounting Studies, the only training provider and examiner in the country, offers ACCA qualification and courses at the technician and full professional levels and has been a gold-level ACCA-affiliated member for the past three years. About 550 students are enrolled in all levels of ACCA courses at the Center for Accounting Studies, and roughly 12-15 students pass the final ACCA certification per year. With only foreign qualifications available, Lesotho accountants are deemed to enter the profession without training on laws and regulations specific to the Lesotho environment. The Center for Accounting Studies is also administering the Chartered Institute for Public Finance and Accountancy (CIPFA) certification program, a pilot being fully funded by the Ministry of Finance and Development Planning to build capacity of public sector accounting in Lesotho. The Lesotho Institute of Accountants has engaged a consultant to help it assess the rationale and need for establishing a local qualification program for public sector accountants. The final assessment should determine whether the country should adopt CIPFA certification once the pilot is completed or develop its own national certification program.

40. **The practical experience requirement for practicing accountancy in Lesotho is not consistently enforced, and opportunities to obtain practical experience are not readily available.** Prior to obtaining full membership in the Lesotho Institute of Accountants, a candidate is required to have at least 5 years of practical experience and training obtained in the office of a public accountant, government department, bank, insurance company, or other organization as specified in the Accountants Act 1977. Despite this requirement, the business community generally believes that membership is allowed simply after passing a qualification exam. This misperception may contribute to the lack of internships and attachments available to aspiring members of the Institute. The Lesotho Institute of Accountants is making efforts to

enhance this practical experience rule, but it does not have a mechanism to screen the practical training documentation submitted by candidates for evidence of appropriate experience, nor does it have a formal arrangement with the business community or education and training institutions to provide practical experience opportunities for accountancy students. Improving the monitoring and enforcement of practical training would help the Lesotho Institute of Accountants to dispel the perception that practical training is not required of practicing accountants.

41. **Training provided by the Lesotho Institute of Accountants is considered insufficient, and the 40-hour minimum continuing professional development required for renewing annual membership is not adequately enforced.** The Institute provides latest copies of IFRS at a reduced cost through its membership with the ECSAFA, but it does not provide updated ISA or detailed training on implementing changes to specific standards. The training it does offer is considered too broad and irrelevant. While they generally attend the Institute's training, many stakeholders (particularly those with full qualification) rely on courses from international training providers and the Center for Accounting Studies Business Development Unit for technical guidance on implementing IFRS and ISA. The majority of members does not submit these external courses to the Lesotho Institute of Accountants since it does not monitor credit or impose fees or other sanctions for violators of continuing education requirements. The Institute should enforce this requirement to assert itself as a professional institution, maintain the quality of membership, and assist members with ongoing implementation of new and revised international standards as promulgated by the IASB and IFAC. In addition to sessions on accounting and auditing standards, small and medium enterprises and audit firms stress the need for training on general business skills, communication, and information systems.

42. **The National University of Lesotho academic program in accounting requires further enhancement and development.** Established 30 years ago, the Department of Business Administration offers three degrees, including a Bachelor of Commerce in Accounting. Approximately 140 students are enrolled in the fourth and final year of the degree program, which includes 7 accountancy-specific courses. To be eligible for full membership in the Lesotho Institute of Accountants, these graduates must pursue additional education under a qualification scheme recognized by the Institute. Lecturers are required to hold a master's level degree, but they are not required to have professional experience or qualification. The National University of Lesotho's accounting program suffers from a significant lack of financial and human resource capacity. To compensate for increased costs and the lack of additional Government funds, the National University of Lesotho admits larger groups of students each year without increasing the number of lecturers. The academic staff is overwhelmed with teaching and examinations, leaving little time for research and professional development. Also, the numbers of foreign training and educational institution visits are below minimum requirements. The IFRS and ISA coverage is inadequate, particularly since accounting textbooks covering a variety of international and national accounting and auditing standards and tax practices are most often available.

43. **As interest in the accountancy profession grows, the Center for Accounting Studies is expanding to provide more training opportunities**. The saturated market for accounting technicians in Lesotho is spurring interest in obtaining full qualification; consequently, enrollment doubled at the Center for Accounting Studies in the past five years. The Center obtained land outside Maseru to build a new facility four times the size of its present

one, which is located in the heart of the capital city. The present building will be used for short courses the Business Development Unit offers to professionals working in Lesotho. With 15 full-time and 10 part-time lecturers, the Center for Accounting Studies will require more staff to accommodate more students. It will also need to recruit lecturers to fill current teaching gaps for ethics and information and communication technology courses. Additionally, the Center will need to consider how to address concerns that its programs are not country-specific and do not provide adequate practical training.

44. **There are mixed observations about the quality of accounting students graduating from the Center for Accounting Studies and the National University of Lesotho.** The majority of students in the Center for Accounting Studies enroll in courses directly upon graduating high school. Many university graduates are interested in obtaining professional certification in addition to their degrees, but they often have trouble funding further studies. Graduates of the Center for Accounting Studies are often perceived to have more practical training, while graduates of the National University have more broad education and theoretical background. There is general belief that the quality of the University's program has declined in recent years, and exposure to implementation of IFRS and ISA in the Lesotho context and practical training opportunities could be improved at all education and training institutions in the country.

45. **All accounting students in Lesotho are eligible to apply for loans provided by the National Manpower Development Secretariat.** University graduates often are not able to obtain funds to pursue professional qualification until they first repay university loans, deterring possible entrants into the profession. Many employers prefer students to obtain Manpower funds and do not provide funding for study at either the Center for Accounting Studies or National University of Lesotho, particularly since many employees leave for opportunities with larger companies in Lesotho or South Africa after becoming qualified.

D. Setting Accounting and Auditing Standards

46. **The Accountants Act 1977 gives the Lesotho Institute of Accountants the mandate to issue, adopt, and publish financial reporting and auditing standards.** The Technical Accounting and Auditing Standards Committee has the responsibility to formulate and publish accounting and auditing standards, as well as a code of ethics for members. Although there is a general understanding within the business environment that the Institute has adopted IFRS and ISA, it has not issued a formal pronouncement requiring compliance. There is a need for the Lesotho Institute of Accountants to ensure it has an ongoing process for adoption of new and revised IFRS and ISA, document the adoption of IFRS and ISA in its official records and disseminate to the financial reporting community, and develop proper implementation guidance.

47. **Neither the Accountants Act 1977 nor the Lesotho Institute of Accountants itself distinguishes between the use of IFRS for large entities and small and medium enterprises.** Without proper guidance from the Institute, even the smallest entities assume they are required to follow full IFRS, not the modified IFRS for small and medium-sized entities (IFRS for SMEs). This burdens their financial reporting systems, which lack qualified accounting staff to prepare high-quality, reliable, and timely financial statements. There is a need for the Lesotho Institute

of Accountants to officially pronounce adoption of internationally recognized accounting and auditing standards, as well as distinguish between the use of regular IFRS and IFRS for SMEs.

E. Ensuring Compliance with Accounting and Auditing Standards

48. **Monitoring, enforcement, and accountability in Lesotho are weak.** Statutory financial reporting requirements are not monitored and enforced, thus compromising the authority of the laws and relegating the role of financial reporting in the business community. Those who rely on financial information are unable to conduct business without reliable and timely financial information, and those responsible for preparing financial statements have fewer incentives to do so. The Government has prioritized stronger systems to ensure accountability in public funds through its public financial management reforms. However, there is a need for the same level of accountability to be required of all enterprises in the Lesotho economy to achieve the Government's objectives in its Interim National Development Framework and upcoming development strategy.

49. **The Central Bank Supervision Department lacks the technical capacity to monitor and enforce accounting and financial reporting requirements in the banking sector.** With only two qualified accountants in the banking division and none in the other three divisions, the Central Bank of Lesotho relies heavily on audit reports and the financial reporting capabilities of the filing institution to assess financial statements submitted. Staff do not regularly attend IFRS training beyond those offered by the Lesotho Institute of Accountants, and the Central Bank's policies and workloads do not necessarily encourage the pursuit of a professional accountancy certification. More access to IFRS training could help to close the competency gap between Central Bank supervisors and those being supervised.

50. **The Central Bank of Lesotho's non-banking financial institutions supervision unit lacks specific training to address the anticipated growth in non-banking financial activity.** The increase in money lenders and their desire to move into microfinance poses potential risks to the financial sector, particularly given their lack of financial reporting knowledge. Additionally, the PostBank's plan to commence a rural credit program in July 2010 introduces risk to a new market for financial services in the country. The Central Bank of Lesotho is receiving technical assistance to address these issues, but additional training and proper policies and procedures are necessary to regulate new activities.

51. **Cooperative societies are required to prepare a basic set of accounts that must be audited annually, but larger cooperatives will soon be subject to stronger supervision.** Most cooperative members have little or no financial management experience, and the nature of cooperatives in Lesotho generally does not demand preparation of full financial statements in accordance with IFRS. Some financial cooperatives have grown large enough to merit stricter requirements and monitoring. The Commissioner for Cooperatives and the Central Bank of Lesotho have agreed to mutually supervise cooperatives over a certain threshold.

52. **The Lesotho Institute of Accountants' mechanism for monitoring and enforcing auditing standards and other audit requirements is new and therefore needs further**

development. The regulatory role of the Lesotho Institute of Accountants requires that it enforce compliance with the international standards it adopts and maintain quality of the accountancy profession in Lesotho. An independent review mechanism has recently been introduced and conducted by ACCA to ensure that audit firms have quality control arrangements that comply with IFAC requirements. The Lesotho Institute of Accountants will need more resources to execute this mandate and prescribe corrective actions on the weaknesses it identifies. Additionally, there is no effective mechanism for disciplinary action for violations of applicable accounting, auditing, and ethics standards.

53. **Lack of targeted training and implementation guidance constrains full compliance of accounting and auditing standards**. The training that the Lesotho Institute of Accountants provides is too broad and not aligned with the various competency levels and industries of members. Many stakeholders receive the bulk of their practical IFRS and ISA training from foreign sources. The larger companies and audit firms have greater access to such practical training, including modern standards implementation and audit practice manuals, and are better equipped to apply adequate professional judgment. There is a need for guidance that incorporates these concepts with cases and illustrations relevant to Lesotho to extend professional skills to all accountants in the country, including guidance developed by IFAC such as its Guide to Quality Control for Small- and Medium-Sized Practices and Guide to Using International Auditing Standards in the Audit of Small- and Medium-Sized Entities.[10]

III. ACCOUNTING STANDARDS AS DESIGNED AND PRACTICED

54. **The Lesotho Institute of Accountants adopted IFRS in 2001 but has yet to make a formal announcement.** In absence of national accounting standards, international standards have always been applicable in Lesotho. The financial reporting community is aware of the Institute's requirement and claims to implement IFRS. Therefore, the ROSC A&A team used IFRS as the benchmark for assessing accounting practices in Lesotho. Company directors stated IFRS compliance in the financial statements the ROSC A&A team reviewed. Lesotho-based branches of larger companies rely on the foreign parent for preparation of financial statements, which are then audited by international audit firms. Smaller companies often use local accountants for the preparation of financial statements.

55. **Companies face significant practical difficulties in implementing IFRS.** Corporate accountants without expertise find preparing financial statements in accordance with the IFRS difficult, especially since many lack adequate knowledge of industry-specific standards. Compliance problems appear to be more pervasive for small and medium enterprises in Lesotho. There is a need for the Lesotho Institute of Accountants to provide guidance to the Ministry of Trade and Development for setting categories of entities that may be used for financial reporting purposes. Current and proposed legislation do not indicate thresholds that would render an entity in Lesotho as large, medium, or small. This lack of definition has serious implications in the application of financial reporting standards, particularly given the recent promulgation of IFRS for SMEs. Many subsidiaries in Lesotho are applying full IFRS while their larger counterparts in other countries apply IFRS for SMEs. Such a difference in the application of international

[10] Issued by IFAC's Small and Medium Practices Committee. These and other resources are available at the Committee's website (http://web.ifac.org/publications/small-and-medium-practices-committee).

standards increases complexity and negates their purpose—to promote consistency and comparability of financial information across borders. Simplified standards would also address the capacity issues faced by most local companies and auditors in Lesotho. The new Companies Bill should include thresholds for classifying entities to facilitate proper application of standards. The Lesotho Institute of Accountants should encourage use of IFRS for SMEs and provide targeted training, particularly the IASC Foundation's implementation guidance and illustrative examples.[11]

56. **Tax rules tend to influence the preparation of general purpose financial statements.** Preparers of general purpose financial statements tend to diverge from applicable financial reporting standards, preferring to follow the taxation regulations for the purpose of recognizing taxable revenues and deductible expenses. Deviation from IFRS is particularly possible in Lesotho since tax laws do not require preparation of financial statements by a professionally qualified accountant who would understand the difference between tax reporting and general purpose financial reporting. This gives room for potential manipulation of accounting policies such as revenue recognition and inventory valuation to reduce tax liability.

57. **Compliance gaps demonstrate weaknesses in corporate financial reporting.** The ROSC A&A team's review of a sample of published financial statements and discussions with practitioners in the country revealed compliance gaps. The review involved examination of financial statements of four banks, three insurance companies, two state-owned enterprises, and one public interest entity. The ROSC A&A team also conducted interviews with experienced corporate accountants, practicing auditors, academics, members of the professional association, and regulators. From the review and interviews, the ROSC A&A team learned of the following areas of noncompliance with international accounting standards:

- ***Disclosures***. Required disclosures in financial statement notes are often inadequate or omitted – most commonly requirements to disclose accounting policies; disclosure of contingencies according to IAS 37, *Provisions, Contingent Liabilities, and Contingent Assets*; and explanation of earnings per share under IAS 33, *Earnings Per Share*. Comprehensive and accurate notes to the financial statements allow users to gain a full understanding of the financial information to make informed decisions. Incomplete and incoherent notes potentially reduce confidence in financial statement quality, deterring potential investment and lending decisions made on the basis of the financial statements.

- ***Financial statement presentation.*** IAS 1, *Financial Statement Presentation*, stipulates certain requirements in the presentation of financial statements to increase their usability and promote consistency of financial information across financial periods and between entities. Deviations from these requirements are apparent in the sample financial statements reviewed, For example, inconsistencies in the use of financial statement titles and account names are common, either within the financial statements or between the auditor report and financial statements. While IFRS permits the use of titles different from those prescribed in the standards, they should be consistent within a single set of financial statements and with industry practice. Other examples include inconsistencies between figures in tables and their explanation in the notes, presenting finance income on

[11] See http://www.iasb.org/IFRS+for+SMEs/IFRS+for+SMEs.htm.

a net basis without separately showing finance costs, and disagreements between opening balances and the audited closing balance of the previous year's financial statements. The last example resulted in a qualified opinion for the 2007 and 2008 financial statements for one entity.

- ***Related party transactions.*** Many entities, including some financial institutions, omitted important disclosures required under IAS 24, *Related Party Disclosures*. Common gaps include the relationship between the entities and equity holdings, pricing policies, volume of related party transactions, and key management compensation policies and amounts. Adequate disclosure of related party activities promotes transparency and allows users of financial statements to assess management of the business.

- ***Employee benefits.*** Financial statements do not always indicate whether actuarial or other forms of valuation were used to quantify outstanding liabilities for post-employment benefits as required by IAS 19, *Employee Benefits*.

- ***Inventory.*** Some companies did not properly value inventory at the lower of cost or market value, a violation of IAS 2, *Inventories*.

- ***Property, plant, and equipment.*** IAS 16, *Property, Plant, and Equipment*, requires detailed disclosure of the measurement basis used for determining carrying value and a reconciliation of the carrying amount at the beginning and end of the reporting period. Several financial statements did not include either of these disclosures.

- ***Operating Segments.*** Although preparers indicated awareness of requirements for segment reporting in IFRS 8, *Operating Segments*, in the notes to the financial statements, practice is often inadequate. For example, some companies state in the notes the inapplicability of segment reporting requirements because they have no distinguishable reporting segments. These same reports suggest existence of geographical segments and product lines through wholly owned and majority-owned subsidiaries, indicating the need to report on segments. Financial statements that include notes on segments do not provide sufficient information about revenues, operating profits, total assets, and total liabilities of the segments.

53. **Financial statements of companies are not always readily available.** Public interest entities are required to submit financial statements to the Registrar of Companies, but they generally do not comply. Many companies are not comfortable opening their books to outsiders, and large private companies did not make their financial statements available to the ROSC A&A team.

IV. AUDITING STANDARDS AS DESIGNED AND PRACTICED

54. **The Lesotho Institute of Accountants has adopted ISA, but a formal decision is yet to be documented.** Compliance with applicable auditing standards varies greatly across audit firms. The ROSC A&A team reviewed a sampling of audit reports and met with practicing auditors in the country to assess ISA compliance. Audit firms associated with international accounting firm networks have greater capability to comply with ISA, but information in the

sample review of audited financial statements still indicates areas of weakness. Smaller audit firms have less access to the latest issued or updated standards and proper audit methodology with built-in processes to ensure compliance. In the absence of proper guidance, auditors generally have difficulty with important concepts such as audit risks, audit planning, internal control, materiality, going concern, and documentation. Areas of noncompliance with ISA include:

- ***Professional care and diligence.*** Auditors do not always apply proper care in carrying out their audit assignments. Omissions of general information, inconsistencies in financial reports, and wrong dates are all items that indicate a lack of internal review processes and potential misrepresentations to financial statement users. For example, a particular audit firm fails to include its name, address, signature, and date on the audit report of a large public entity for two consecutive years. Some reports for joint audits often include only one signature, even when both auditors are named. In another case, an auditor signs the audit report for a large public entity 34 days before the board approved the financial statements and is thus unable to notice a wrong date on the director signature page. And, two audit firms include pages outside the financial statements in their audit reports, giving the impression that management reports were part of the audit.

- ***Audit opinion.*** Audit opinions do not always indicate the financial statements were prepared in accordance with the Financial Institutions Act 2003 and Companies Act 1967. One auditor did not reference the cash flow statement even though it was presented with the financial statements. The same auditor omits a sentence from the opinion paragraph, rendering the entire opinion ambiguous. An audit report for a group indicates the subsidiary financial statements comply with IFRS and the consolidated financial statements with "Generally Accepted Accounting Practice", giving the impression that the two sets of statements were prepared using different accounting standards. Both the subsidiary and group financial statements do in fact appear to comply with IFRS.

- ***Independence.*** Auditors who prepare accounts before auditing do not normally disclose this fact in the audit report. The cover page of a particular set of financial statements bears the audit firm's letterhead, suggesting the auditor prepared the statements.

- ***Audit procedures.*** Some auditors do not apply rigorous audit procedures necessary to obtain reliable and complete audit evidence to support the opinion due to a combination of the client's poor record keeping and a weak audit culture that promotes low audit fees. There is a widespread view that auditors are taking shortcuts to complete audits.

- ***Quality control and audit risk.*** Apart from firms with international affiliations, most firms do not fully comply with ISQC 1. Second partner peer reviews generally are not completed. Unlicensed and inexperienced auditors who do not understand the full scope of an audit create an environment in which it is difficult for qualified auditors to explain reasonable audit scope, timing, and fee to clients.

58. **Inadequate capacity and poor recordkeeping practices hinder auditors' ability to obtain audit evidence and comply with ISA.** Small and medium enterprises often provide

auditors with a trial balance instead of a full set of financial statements and yet expect a full audit. Often the trial balance is based on incomplete records and may not even balance. Auditors are left to prepare the accounts before auditing, compromising their independence and ability to comply with ISA. Incomplete information and a backlog of unaudited accounts also reduce confidence in the opening balances on which the auditor must rely to audit reports for the period. Larger audit firms refer clients to accounting and bookkeeping services for the purposes of preparing accounts, but smaller firms often perform the work before commencing the audit to avoid losing the client to another firm.

59. **Low audit fees compromise quality audits and audit independence, and decrease morale within the audit community.** Small and medium audit firms often underestimate the scope of audit work required or price their services too low. Audit fees generally are perceived to be insufficient to cover the operational expenses of a particular audit engagement, compromising independence and the quality of audit work. Many audit firms do not feel they have the opportunity to properly scope the audit before submitting bids. The Office of the Auditor General needs a scale of audit fees to guide firms in pricing audits and the client in choosing appropriate bids. The acceptance of low audit fees appears to be most prevalent for parastatal audits.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

60. **The perception of quality of audited financial statements varies among investors and other users of financial statements.** Interviews and discussions with various stakeholders, including bankers and regulators, revealed a dichotomy in the perceived quality of financial reporting. Large or multinational financial statements audited by international audit firms or local firms with relationships with international firms are considered to fully comply with IFRS. However, there was widespread belief that low-level skills among accounting professionals of small and local companies and audit firms contribute to poor-quality financial statements, a perception further strengthened by the acceptance accountancy positions by those who are not practicing members of the Institute. Most interviewees shared the opinion that improving the quality of financial reporting requires significant improvements in the education and training of these professionals, greater awareness of IFRS and ISA, and a more robust regulatory regime for monitoring financial reporting practices.

VI. POLICY RECOMMENDATIONS

61. The policy recommendations in this section may be useful to Government and other stakeholders in developing a country action plan for strengthening Lesotho’s corporate sector accounting, financial reporting, and auditing practices. Without attempting to provide a detailed strategy and action plan, these principle-based policy recommendations support the implementation of accountancy reform, with the ultimate goal of expediting economic development in Lesotho.

62. Implementation of these recommendations as part of the country action plan will help further achievement of the Government’s development strategy in the following ways:

- Providing clarity on accounting and auditing standards to be applied, allowing for consistency of financial information;
- Building users' confidence of financial information to enhance the investment climate and bolster domestic and foreign direct investment in the private sector;
- Facilitating access to credit from the formal financial sector by shifting gradually from relationships- and collateral-based lending decisions to those based on financial performance;
- Supporting the development of the financial sector and mitigating the risk of crises due to inadequate regulatory capacity;
- Achieving greater financial transparency in the corporate sector, both state and private owned, thus allowing shareholders and other interested parties to assess corporate performance; and
- Strengthening regional and sub-regional integration while building local capacity by collaborating with and learning from other accountancy institutions.

63. The policy recommendations provide input for preparing and implementing a comprehensive country action plan to establish a high-quality corporate financial reporting regime in Lesotho. The Government should lead the establishment of a national steering committee and the prioritization of needs to develop the action plan. Relevant financial reporting stakeholders on the committee should include representatives of the Lesotho Institute of Accountants, Ministry of Finance and Development Planning, Office of the Accountant General, Office of the Auditor General, Central Bank of Lesotho, ECSAFA, accountancy education institutions, auditing firms, private and financial sectors, and others as appropriate. Once developed, the action plan should become part of the Government's development strategy and should be monitored and supervised according to the Government's development plan. The Government could collaborate with development partners to secure the resources to strengthen the accountancy profession and achieve a strong financial reporting infrastructure in Lesotho.

Legal Framework

64. **Modernize financial reporting requirements and related provisions in the legal framework.** To protect public interest, the legal framework should provide financial statement preparers, auditors, and regulators with the mandate to prepare and make available financial information that is aligned with international good practice. Lesotho law does not fully address all aspects of financial reporting. Several draft amendments and bills will bolster requirements in the country, but further changes are needed to address all gaps. Table 1 summarizes the required changes described earlier.

Table 2. Summary of Statutory Framework Recommendations

Recommendation	Proposed Legislation
Extend legal backing for the Lesotho Institute of Accounts' mandate and process to promulgate accounting, auditing, and ethics standards as issued by the IASB and IFAC standard-setting bodies	Draft Accountants Act, Companies Bill, Financial Institutions Act (proposed amendments), Insurance Bill, Draft Money Lenders Act
Require full set of financial statements	Companies Bill, Financial Institutions Act (proposed

	amendments), Insurance Bill
Make audited financial statements readily available to the public	Companies Bill
Clearly specify rotation of auditors	Companies Bill, Financial Institutions Act (proposed amendments), Draft Money Lenders Act
Define categories of entities based on size	Companies Bill
Consolidate company registration and renewal activities with the Companies Registrar	Companies Bill
	Companies Bill

65. **Extend legal backing for the Lesotho Institute of Accountants' mandate and process to adopt and promulgate accounting and auditing standards as issued by the IASB and standard-setting bodies of IFAC.** Defining the mandate and process to establish applicable standards in the law will assert the importance of financial reporting standards to the statutory level and provide proper legal backing for enforcement and the imposing of sanctions. The Lesotho Institute of Accountants should then establish a formal process for the adoption of IFRS and ISA in its internal documents and communications with members and the community at large, particularly since these sets of standards change over time. Current laws prescribing financial reports do not state which accounting and auditing standards are applicable in Lesotho. The Companies Bill and proposed amendments to the Financial Institutions Act 1999 stipulate the use of accounting and auditing standards as promulgated by the Lesotho Institute of Accountants. However, the Insurance Bill and draft amendments to the Money Lenders Act 2003 do not mention applicable standards. Laws requiring financial reports should specifically define the use of standards promulgated by the Lesotho Institute of Accountants. The Institute may also take this opportunity to set a process for updating the Code of Ethics of Professional Accountants and adopting IPSAS.

66. **Broaden required financial reports to include the full set of financial statements.** Current and draft legislation requires only the preparation and audit of the balance sheet and profit and loss account. The term financial statements should be broadly defined in accordance with international standards.

67. **Require all public interest entities to make audited financial statements readily available to the public.** The Companies Act 1967 and Companies Bill do not require private companies to send audited financial statements to the Registrar of Companies or shareholders. Many of Lesotho's largest companies fall in this category, including some that are partly owned by the Government. Since some of the large entities are major players in Lesotho's small economy, it is significantly important that they make their audited accounts publicly available to show higher level of corporate social responsibility and to increase the level of trust among the colleagues in the industry and the public overall.

68. **Clearly specify rotation of auditors in the Companies Bill.** Neither the Companies Act 1967 nor the Companies Bill clarifies the requirement for auditor rotation. The Insurance Bill will require rotation every three years and the proposed amendments to the Financial Institutions Act 1999 every five years. Some entities operating as branches of foreign multinational companies comply with the larger group's requirement for rotating their auditor

every three years. However, no standard practice is followed by the businesses in the country, and setting inconsistent requirements in difference laws creates more fragmentation and complexity in the legal framework. The rotation should be included in the revised Companies Act and consistently reflected in other legislation so all entities are subject to the same requirement.

69. **Update the Companies Bill to define categories of entities based on size.** The IASB issued IFRS for SMEs in July 2009 to respond to the strong international demand from both developed and emerging economies for a rigorous and common set of accounting standards for smaller and medium businesses that is much simpler than full IFRS. In the absence of authoritative guidance on what constitutes a small, medium, and large entity relative to the Lesotho economy, most entities assume they must follow full IFRS. More guidance would ensure that the intended beneficiaries of the simplified IFRS for SMEs would in fact benefit. Including such definitions in the law would provide legal basis and an objective tool for determining which IFRS to apply. Additionally, entity categories might be useful purposes other than financial reporting, such as determining audit requirements for tax filings and maintaining statistics on the various groups to monitor growth.

70. **Enact the amendments to the Financial Institutions Act and the Insurance Bill.** These two important pieces of legislation should be finalized and passed immediately to complete the legislative framework and strengthen the requirements for submitting IFRS-based audited financial statements on a timely manner.

71. **Consider consolidating company registration and renewal activities with the Companies Registrar.** Companies are required to register with the Companies Registrar and subsequently submit financial statements on an annual basis. They are not required to renew registration after formation, but are required to renew their operating license with the ministry overseeing the industry in which they operate. Such incomplete and fragmented reporting mechanisms provide opportunities for companies to operate without holding a proper registration or license. Members of the public who wish to verify information about a company cannot readily obtain the information, and Government monitoring of business activities in Lesotho is incomplete.

Institutional Capacity Building

72. **Increase the technical capacity of the Lesotho Institute of Accountants.** Having only one technical manager is insufficient for responding to the demanding needs of members and clarifying complex accounting and auditing issues. Additional technical staff with adequate skills, experience, and knowledge should be engaged to support both the Institute and its members. In addition, the Lesotho Institute of Accountants should initiate the creation of a forum with ECSAFA and other member bodies for sharing knowledge on implementing new standards and industry-specific practices in the sub-regional context. Beyond supporting Institute's technical unit itself, stronger collaboration and integration will help provide updated training materials, implementation guidance, and technical inquiry responses to members.

73. **Empower the Lesotho Institute of Accountants to meet its role as leader of the accountancy profession in Lesotho through partnerships with other associations and**

organizations. The Lesotho Institute of Accountants should build upon signed memoranda of understanding with professional organizations and associations in the country to develop action plans to execute delegated responsibilities. It should also seek similar partnerships with other organizations, such as the Bankers Association. Such collaboration will demonstrate a higher level of social responsibility and commitment toward development of the accountancy profession.

74. **Initiate an awareness campaign to attract new entrants into the accountancy profession.** The Marketing and Promotions Committee and Marketing and Public Relations Officer should develop a creative approach to properly advertise the Institute and promote the membership benefits. The upfront costs and time required to implement the campaign would eventually be offset by higher revenues from increased membership, access to a broader membership base for expertise, as well as commitment of the newly qualified staff to the development and strengthening of the accountancy profession. The Lesotho Institute of Accountants must be more proactive to attract newly qualified accountants, who are not joining its ranks because membership benefits are not clear.

75. **Build technical capacity of the Central Bank of Lesotho to supervise the financial reporting of its regulated entities.** In addition to monitoring compliance with prudential requirements, the Central Bank should assess application of IFRS and ISA in the financial statements of banks, insurance companies, and other non-bank financial institutions. Given its dearth of qualified accountants, the CBL supervision department is not empowered to take on this role. The Central Bank of Lesotho should encourage the pursuit of professional accountancy qualification, and it should work more closely with the Lesotho Institute of Accountants and the Center for Accounting Studies Business Development Unit to provide proper training on IFRS and ISA most important to the various supervision division industries.

Monitoring and Enforcement

76. **Proceed toward the use of quality assurance reviews as a regulatory tool and not only as mechanism for improving the accountancy environment.** As quality assurance reviews transition from a tool for learning to regulation, the Lesotho Institute of Accountants should consider employing more full-time staff and training employees to conduct quality assurance reviews. The current ACCA support is not sustainable and not guaranteed. The Lesotho Institute of Accountants should ensure proper transfer of knowledge to empower itself to carry out the reviews, and it should ensure the assurance review program is designed relevant to international best practice and the needs of the environment. The Institute should fund quality assurance reviews through membership fees and other general sources of income, rather than requiring firms to pay for each review. Quality assurance reviews should be seen as an obligation and benefit of membership. Recommendations and sanctions resulting from the reviews will be more difficult to enforce if the audit firm has directly financed the assessment. In addition to these quality assurance reviews, the Institute should continue to assist audit firms with the implementation of ISQC 1 by developing training and implementation guidance.

77. **Develop an audit fee scale to promote independence and quality of audits.** The Lesotho Institute of Accountants should advise the Office of the Auditor General to create an

audit fee scale that may guide the bidding and selection process for audits. The fee scale should be published to promote transparency and extend use beyond public sector and parastatal audits.

78. **Enforce requirements to submit financial statements to the Companies Registrar.** Most entities do not comply with requirements to send annual returns and audited financial statements to the Companies Registrar. Lax monitoring and enforcement of these financial reporting requirements does not adequately serve the public interest since financial information is not readily available. Weak enforcement also does little to reinforce the role of financial reporting in the economy, particularly its importance as the only information available to the public.

79. **Properly implement the Code of Ethics of Professional Accountants and introduce adequate enforcement mechanisms.** At an annual general meeting, the Institute's Council should adopt the fourth part of its Code of Ethics as it is designed to reflect the Lesotho context. In light of recent auditor litigation, the Lesotho Institute of Accountants should provide training and guidance and better enforce the Code of Ethics and sanctions to be applied against violators.

80. **Separate the Institute's Disciplinary Committee from the Council to ensure its ability to properly monitor the profession and comply with IFAC membership requirements.**[12] The Disciplinary Committee should be independent of the Council to ensure its independence, impartiality, and ability to fully monitor members and impose sanctions. In line with international practice, it should also include a lawyer who may advise on legal actions that may be necessary and their implications. The Disciplinary Committee's capacity to enforce ethical requirements and other professional standards should be strengthened.

Professional Education and Training

81. **More accurately monitor and enforce membership requirements.** The Lesotho Institute of Accountants should increase capacity to monitor and assess the practical experience for each candidate who applies for membership. This will improve the reputation of the profession within the business community and ensure that only individuals with sufficient and relevant practical experience are eligible to join the profession. Also, the Institute should strengthen its mechanisms for monitoring continuing professional education requirements – especially for training it does not provide – to ensure members have the most updated knowledge.

82. **Clearly define the eligibility criteria for use of the title qualified accountant.** It is crucial that the Lesotho Institute of Accountants clearly identifies what constitutes a "qualified accountant". The membership criteria must be strengthened and properly monitored to avoid deterioration of the profession by individuals who do not possess adequate accountancy training and knowledge but still perform accountancy services and call themselves professional accountants. The Lesotho Institute of Accountants is not able to apply sanctions against violators who are not members, posing serious risk to the credibility of the Institute and the profession.

[12] IFAC Statement of Membership Obligation No. 6, *Investigation and Discipline*, http://web.ifac.org/download/Statements_of_Membership_Obligations.pdf.

The Institute's Disciplinary Committee should have competence to enforce violations of membership requirements in addition to civil courts to protect the integrity and reputation of members.

83. **Review the adequacy of qualifications available in the country to meet local needs.** Given the common view that more options should be available to encourage integration into the economic sub-region, the Lesotho Institute of Accountants should consider reviewing the adequacy of professional qualifications available in the country to provide aspiring members of the Institute with access to proper training and members with access to attractive jobs, whilst building its membership base.

84. **Develop a channel to direct students from university education to professional qualification.** University graduates in Lesotho have difficulty obtaining professional qualification after graduating because they have university loans to repay and unable to secure more financing. The Lesotho Institute of Accountants should work with National University of Lesotho and Center for Accounting Studies to develop a formal channel through which students may be exempted from courses with Center for Accounting Studies. Also as a means to provide more options for students, the Institute should consider working with other professional bodies to recognize the University degree for their certification programs.

85. **Implement internship and attachment programs for students to obtain adequate practical experience.** The Lesotho Institute of Accountants should collaborate with the National University of Lesotho and Center for Accounting Studies to develop internship and attachment programs that will be attractive to the business community. At the same time, the Institute should implement a campaign to identify members who may potentially provide opportunities for students and coordinate communication between these members and the education institutions.

86. **Direct more resources to the National University of Lesotho accountancy program.** Lecturers are not required to have professional qualification or previous experience and therefore cannot impart knowledge on the implementation of IFRS and ISA. Strong incentive mechanisms should be introduced to attract and retain experienced academic staff, including providing more time for research and professional development. Efforts should be made to balance student fees with enrollment levels to lower the ratio of students to lecturers. Finally, up to date textbooks covering IFRS and ISA should be made available in the country.

87. **Align accountancy education and training with the interests of the professional accountancy community, including a focus on practical implementation of standards.** Professional organizations, university educators, training providers, relevant Government ministries and institutions, as well as leading large public interest entities should provide input to increase the market orientation of accounting and auditing courses. The Lesotho Institute of Accountants should also focus on training for a specific standard or industry, such as insurance and banks. This would result in a steady supply of professional accountants with IFRS and ISA knowledge and experience relevant to the needs of Lesotho. A twinning arrangement with an experienced professional body in the region may also be considered for this purpose.

88. **Develop more structured and country-specific educational and training programs.** The providers of accounting and auditing education in Lesotho, including university

lecturers and professional trainers, should be given the necessary support and assistance to stay informed on international best practice in accounting and auditing, including IFRS and ISA. It is also very important that the training courses and materials cover contemporary business law, regulation, accounting, auditing, and other relevant issues applicable to the specific context of Lesotho. The combination of updated information for the international and local contexts will lead toward better understanding of the national accountancy environment and ability to apply professional judgment of international good practice within the national business community.

89. **Provide more training on general business skills, including information and communication technology.** In addition to seminars on accounting and auditing standards, the Lesotho Institute of Accountants should provide courses that contribute to the overall professional development of members. Training on collaboration, communication skills, and advances in technology would contribute to the quality of the profession at all membership levels. The Institute should use such training as an opportunity to engage the broader business community as training facilitators. The National University of Lesotho and Center for Accounting Studies should ensure proper coverage of these areas in their programs.

90. **Form communities of practice within the accountancy profession to promote knowledge transfer and collaboration.** The Lesotho Institute of Accountants should follow the example of other industry and advocacy groups to form member groups based on firm size or industry. The groups would provide a forum for sharing experiences and discussing challenges particular to that group's specific needs and interests, either through regular discussion meetings or by phone or email. Communities of practice could provide the networking environment needed to foster more collaboration among audit firms and share practical knowledge at little financial cost.

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