

VI. Government Budgeting and Accounting

This chapter describes government budgeting, accounting and auditing arrangements. It focuses on the core government—public corporation accounting and auditing arrangements are discussed in Chapter II. The World Bank is undertaking a Country Financial Accountability Assessment (CFAA) for Sri Lanka—this Diagnostic Study has been coordinated with the CFAA, which is focusing on public sector issues. Consequently, this chapter only provides an overview of government budgeting and accounting. It is structured as follows:

- 1 – Introduction – describes fiscal pressures, challenges and associated responses.
- 2 – Legal Framework for Government Budgeting, Accounting and Auditing – sets out the key laws that govern government accounting and auditing arrangements.
- 3 – Organizational Roles and Responsibilities – describes key institutional roles.
- 4 – Budgeting, Accounting and Reporting Arrangements – describes accounting and reporting arrangements, including accounting bases.
- 5 – Accounting Information Systems – discusses the status of accounting information systems.
- 6 – Auditor-General’s Department – describes the status, organization and activities of the Auditor-General’s Department.
- 7 – Government Accounting Personnel – discusses government accounting personnel structures and issues.
- 8 – Fiscal Devolution to Provincial Councils – describes the fiscal devolution process.
- 9 – Issue Synopsis: Government Budgeting and Accounting – summarizes the issues identified in this chapter.

1. Introduction

The inefficiency and ineffectiveness of Sri Lanka’s enormous government bureaucracy—together with the ongoing civil conflict—fundamentally limit the country’s ability to realize its development potential. Despite a reduction in size over the past two decades, per capita employment in the public sector remains Asia’s highest.¹⁰⁸

¹⁰⁸ ADB. 2000 November 21. Report and Recommendation of the President: Private Sector Development Program (Sri Lanka)—Proposed Program Cluster, Loans, and Technical Assistance Grant. Manila: ADB.

The Sri Lankan Government's role has changed markedly since 1977, when efforts to open and liberalize the economy began. However, Government operations still comprise a very significant proportion of economic activity. Together with the high fiscal deficit, and high levels of domestic borrowings, this constrains private sector activity and undermines prospects for sustainable levels of economic growth and stable prices. To reduce the fiscal deficit, the Government is attempting to increase revenues, constrain expenditures and improve public sector efficiency. But, the intensified civil conflict has resulted in higher security-related expenditures (5.6 percent of GDP) that, combined with the effects of the global slowdown, is putting pressure on an already weak fiscal position (see Table 15).¹⁰⁹

At one time, Sri Lanka had a strong and effective civil service. It maintained its high professional traditions (e.g., entry through professional examinations) following independence and continued to attract talented persons. However, over time, the independence of the bureaucracy was undermined, its strength was sapped by inter-service rivalries and differences, and its quality was eroded by a steady reduction in entry standards. The Sri Lankan public service today is not well equipped to perform its role.¹¹⁰

The key governance and public management issues include the high fiscal deficit, excessive size of the civil service, insufficient operating and maintenance expenditures, severe skill and motivation problems, and fragmented government structures and systems.¹¹¹ Although attempts to reform the bureaucracy were made in the early 1990s, these efforts were less than successful.¹¹² Moreover, in the absence of fundamental civil service reforms or a curtailment of the conflict, the Government has minimal room in which to pursue fiscal savings.

Government efforts, supported by international organizations, have refocused on improving public sector accountability and transparency. Among other things, objectives include: (i) establishing clear priorities and objectives for government organizations; (ii) better defining roles

¹⁰⁹ ADB. 2001 June. *Country Strategy and Program Update: Sri Lanka (2002-2004)*: Manila: ADB. p. 1.

¹¹⁰ ADB. 1996 August. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Public Administration Reform*. TAR-SRI 29681. p.1.

¹¹¹ Schiavo-Campo, S. 1998. *Public Administration in Sri Lanka: A Bird's Eye View*. Strategy and Policy Office. Manila: ADB.

¹¹² World Bank. 1998. *Country Assistance Strategy: Sri Lanka*. World Bank. p. 6.

Table 15. Summary of Fiscal Operations (percent of GDP) 1996-2000¹¹³

Item	1996	1997	1998	1999	2000
Total Revenue (A)	19.0	18.5	17.2	17.6	16.8
• Tax	17.0	16.0	14.5	14.9	14.5
• Non-tax	2.1	2.5	2.7	2.7	2.3
Expenditure and Net Lending (B)	28.5	26.4	26.3	25.1	26.7
Current Expenditure	22.8	20.8	19.6	18.7	20.3
• Goods and Services	10.4	9.4	9.6	8.8	...
• Transfers	6.0	5.1	4.6	4.2	...
• Interest	6.4	6.2	5.4	5.6	...
Capital Expenditure and Net Lending	5.7	5.7	6.7	6.4	6.4
Of which Lending less Repayments	0.8	0.7	1.4	1.0	...
Overall Balance (A-B)	-9.4	-7.9	-9.2	-7.5	-9.9
Financing:	9.4	7.9	9.2	7.5	9.9
• Grants	1.0	0.8	0.7	0.6	0.4
• Foreign Borrowing	1.3	1.1	1.0	0.1	0.7
• Domestic Financing	6.5	3.4	7.0	6.7	8.8
• Privatization Proceeds	0.6	2.5	0.4	0.0	0.0
Memorandum Items:					
• Defense Expenditure	5.8	5.1	5.0	4.4	...
• Interest Payments	6.4	6.2	5.4	5.6	...
• Public Debt	93.3	85.8	90.8	94.7	...

and accountabilities; (iii) improving interfaces between government agencies, service users, and the general public; (iv) improving flexibility through effective delegation of authority; (v) strengthening the institutional framework and procedures for strategic management; and (vi) improving the monitoring and evaluation of performance. ADB is supporting the Government's efforts to reform public expenditure management.¹¹⁴

2. Legal Framework for Government Budgeting, Accounting and Auditing

The legal framework for government finance comprises Chapter XVII of the 1978 Constitution and the Public Finance Act (No. 38) 1971. Chapter XVII

¹¹³ Government of Sri Lanka. 2000 November. *Budget at a Glance 2001*. p. 4.

¹¹⁴ TA No. 3301-SRI: *Public Expenditure Management Systems*, for \$3.0 million, approved on 16 November 1999.

(Articles 148-154) of the 1978 Constitution provides the overall basis for the control of all public finances by Parliament. It provides for the imposition of taxes and other levies and stipulates that payments, from the Consolidated Fund, may only be made within the provision of Annual Appropriation Acts.

Day-to-day rules and procedures on finance are contained within the Government Financial Regulations that are promulgated by the MOFP.¹¹⁵ The Financial Regulations are Administrative Regulations with no legal backing. This 600-page book, was last issued by the Treasury, under the authority of the Minister of Finance, in 1966. The Regulations were most recently revised in 1992. In 1996, the MOFP published a section of the Financial Regulations on Tender Procedures as the Guidelines on Government Tender Procedures. Both public and private sectors are extensively using these Guidelines. Based on this experience, an updated set of Financial Management Guidelines was compiled under the MOF-ADB *Financial Management Training Project* in four volumes:

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| I | Planning, Budgeting and Foreign Aid Guidelines | This volume provides a broad perspective on the planning process as well as a detailed methodology for project planning. It includes guidance and instructions on: macro planning, sectoral planning, project planning, project feasibility, project appraisal, project approval procedures, project monitoring and evaluation, and sub-national planning. |
| II | Assets Management and Advance Accounts Guidelines | This volume describes the procedures and requirements for the management and monitoring of: fixed assets, stores and advance accounts. |
| III | Government Accounting Guidelines | The government accounting guidelines provide comprehensive guidance on concepts and procedures. |
| IV | Internal Auditing Guidelines | This volume describes internal auditing policies and procedures. It includes guidance and instructions on: internal audit policy, audit management, and general audit techniques. |

The revised Financial Management Guidelines were intended to take effect from 1 January 2000 and were to apply to all government ministries, departments and state employees. However, the Guidelines were never formally promulgated. A primary objective of the ADB-supported Public Expenditure Management project was to develop a new Public Finance

¹¹⁵ Government of Sri Lanka. 1992. *Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka*. Department of Government Printing: Colombo.

Act.¹¹⁶ However, this activity has been postponed as part of the refocusing of the technical assistance.

3. Organizational Roles and Responsibilities

The 1978 *Constitution* gives Parliament full control over public finances (Article 148). Parliamentary control over finance is expressed through the following institutions:

- In each ministry there is a Secretary who is appointed by the President in terms of Article 52 of the 1978 *Constitution*. The Secretary is responsible, as the Chief Accounting Officer, for the implementation and effective administration of the Ministry as well as the departments under the Ministry.
- The Auditor-General is appointed by the President and is responsible for auditing the public accounts and reporting findings direct to Parliament in terms of Article 154 of the 1978 *Constitution*.
- The Committee on Public Accounts (COPA) is appointed by Parliament with members drawn from the Government and the Opposition.
- The Committee on Public Enterprises (COPE) is appointed by Parliament to examine the affairs and reports of public enterprises.

4. Budgeting, Accounting and Reporting Arrangements

The Sri Lankan Government adopted the Planning, Programming and Budgeting System (PPBS) approach to public expenditure management in the 1970s. However, the system has changed little since its implementation—a series of detailed rules and input controls has developed in the meantime. Budgeting and reporting are on the cash accounting basis.

5. Accounting Information Systems

Two computerized systems have been developed to manage public expenditure. First, CIGAS is used for financial reporting and is installed in all ministries and departments. CIGAS is a cash-based accounting system that was developed by the MOFP and is used across government for transaction recording (although not in all departments), and for reporting

¹¹⁶ TA No. 3301-SRI: *Public Expenditure Management Systems*, for \$3.0 million, approved on 16 November 1999.

to the MOFP. CIGAS records only *ex post* financial information (i.e. actual results). *Ex ante* information (e.g., estimates and forecasts) and non-financial information (e.g., on project implementation progress) are collected by other means. Furthermore, accounting coding errors lessen the usefulness of information provided through CIGAS. Second, the Computerized Government Payroll Management System was released in 1997. As with CIGAS, the payroll system is installed in all ministries and departments.

InGAF trains government accountants in the use of both CIGAS and the payroll system.

A primary objective of the ADB-supported Public Expenditure Management project was to identify user requirements, and develop specifications, for a new public expenditure information system (PEIS).¹¹⁷ This activity has been de-emphasized as part of the refocusing of the technical assistance. Activities now focus on upgrading the capacity of the existing CIGAS system.

6. Auditor-General's Department

The beginnings of the present Auditor-General's department are traceable to 1799, just three years after the British occupation. The 1978 Constitution strengthened the position of the Auditor-General who is appointed (but cannot be removed) by the President. Article 154 of the Constitution makes the Auditor-General responsible for auditing the public accounts and reporting findings directly to Parliament.

The Department is a member of the International Organization of Supreme Audit Institutions (INTOSAI), Asian Organization of Supreme Audit Institutions (ASOSAI) and the Commonwealth Auditors-General Conference. The organization has 240 professional and 1,079 support staff. Professional staff must either: (i) have a Diploma in Public Finance; (ii) have a Degree in Commerce; or (iii) hold membership of an approved professional body. The Auditor-General's Department has a separate cadre that embraces professional and support levels—as well as a separate recruitment scheme. Few professional staff members are ICASL or CIMA members.

The World Bank is in the process of providing technical assistance to the Auditor-General's Department. The objectives of the assistance are to: (i) strengthen and reorganize the department, and (ii) develop a separate Audit Act to underpin these activities.

¹¹⁷ TA No. 3301-SRI: *Public Expenditure Management Systems*, for \$3.0 million, approved on 16 November 1999.

7. Government Accounting Personnel

“[An] important factor in the weakening of accountability for public expenditure is the weaker administrative service and inadequate staff of persons with accounting skills and knowledge. The dearth of skilled personnel is primarily due to a number of accounting officers leaving the country... and partly because those with such skills preferred work in the private sector which offered them much higher remuneration.”

– Sanderatne, Nimal (pp. 18-19)¹¹⁸

Accountants to the public service are recruited through an internal government examination conducted by the Commissioner on Examinations. There is a cadre (or full complement of maximum number of positions) provided for in the government budget. This cadre is based not only on the demand for accountants but also on the availability of funds for the government personnel budget.¹¹⁹

Public sector accounting functions are under the control of the Sri Lanka Accounting Service, which staffs not only central government, but also Provincial Councils, Divisions and local authorities. Entry is by a competitive examination on commercial accounting and other topics. A limited examination is given to those already in the public service. The Sri Lanka Accounting Service has no support grade but uses officers from the General Clerical Service as support staff. Budget officers are not necessarily members of the Accountants Service.

The Auditor-General has a separate cadre that embraces both professional and support levels. Very few members of either service are ICASL or CIMA members. Although some study interviewees contended that Sri Lanka Accounting Service standards were high, this contention was not supported by observation or by the comments of most interviewees.

8. Fiscal Devolution to Provincial Councils

Although the formation of Provincial Councils was allowed for by a 1987 Amendment to the 1978 Constitution, national-provincial fiscal relations are

¹¹⁸ Sanderatne, Nimal. 1998 January. Reflections on Accountability of Public Expenditure. *Institute of Public Finance and Development Accountancy (IPFDA) Newsletter*: No. 2(1). pp. 12-19

¹¹⁹ Ministry of Finance-ADB Financial Management Training Project. 1997. *Manpower Development Plans for the Sri Lanka Accountant's Service*. pp. 39-41

still not clearly defined due to a lack of understanding about the devolution of powers. The Amendment transferred development and many administrative functions to the Provincial Councils. An arrangement largely mirroring that of central government was established in the provinces, and the Finance Commission drew up criteria to allocate funds to the provinces. Nevertheless, some conflicts arose between the center and the provinces. Many Provincial Councils, due to lack of experience in handling development activities on their own, failed to use the funds in a rational way, or spent the funds without control (e.g., on vehicles). Since then, some controls have been introduced and central government line ministries have taken over development activities.

Provincial Councils have not been allowed to take part in many of the line ministries' actions. Understanding this situation and the weak capacity of the Provincial Councils, the Finance Commission began allocating funds as special grants to Provincial Councils in 1997, and issued guidelines for using the funds. However, in the utilization of funds, unwarranted political interference and the lack of commitment to strategic planning were demonstrated again. Beginning in 2000, funds were allocated based on projects developed by the provinces; training is now provided to ensure better implementation. For 2001, the Finance Commission asked the Provincial Councils to prepare specific development plans. However, certain provincial governments prefer block grants without specifying projects.¹²⁰

9. Issue Synopsis: Government Budgeting and Accounting

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. The World Bank is currently undertaking a Country Financial Accountability Assessment (CFAA) of Sri Lanka. The CFAA is focused on the public sector and involves a detailed review of public sector arrangements and reform efforts to date—it will identify a comprehensive set of reform actions. This study does not attempt to pre-empt the findings of the CFAA study. Rather, it concentrates on the availability of skilled accounting personnel in the public sector. Relevant issues that were identified in this area, include:

- Public management arrangements remain a key impediment to Sri Lanka's development. However, these arrangements can only be improved if there are sufficient numbers of suitably skilled and motivated accountants in the public sector.

¹²⁰ ADB. 2001. *Asian Development Outlook*. Manila: ADB. pp. 126-127.

- Sri Lanka has an historical shortage of qualified accountants—in both public and private sectors. There have been initiatives to address this shortage—notably in the past decade through the ADB-supported *Financial Management Training Project*.
- These initiatives have had some impact on skill levels, but the problem remains acute in the public sector. If anything, emigration and attempts to improve public sector accountability and transparency have exacerbated the effect of these shortages.