

VIII. Issues and Recommendations

This chapter presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. These recommendations are intended to supplement and support existing strategies and projects, for instance the *Private Sector Development Program*.¹²⁸ Furthermore, 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. These actions are likely to include some of the postponed parts of the refocused Public Expenditure Management Systems project (e.g., revision of the *Public Finance Act (No. 38) 1971* and development of internal auditing).¹²⁹ However, this study does not attempt to pre-empt the findings of the CFAA study.

This DSAA concludes that, although Sri Lanka had reasonable financial management arrangements before the finance company crisis, as a consequence of the subsequent corrective improvements, these arrangements now compare very well with those of other countries: both developing and developed—at least for the private sector. In contrast, public corporation financial governance practices are poor—as are other public sector accounting arrangements.

- In the case of **public corporations**, several recommendations are made to strengthen governance. Most can be achieved with minimal resources and effort—for instance, appointing financial specialists to public corporation boards and raising the status of Chief Financial Officers. Others are more complex and will take time, such as strengthening the legislative regime that underpins transparency and parliamentary accountability.
- With regards to the **core public sector**, significant efforts are being made to address a plethora of vital issues. Most of these initiatives are critically dependent on the availability of sufficient numbers of suitably skilled and motivated accountants in the public sector. To this end, this study recommends establishing appropriate professional

¹²⁸ ADB Loan No. 1800(SF)-SRI: *Private Sector Development Program*, for \$85 million, approved on 12 December 2000 and Loan No. 1801-SRI: *Private Sector Development Program*, for \$15 million, approved on 12 December 2000.

¹²⁹ ADB TA No. 3301-SRI: *Public Expenditure Management Systems*, for \$3.0 million, approved on 16 November 1999.

qualifications for public sector accountants and establishing associated retraining courses.

The study makes other recommendations, however the issues that they are intended to address are not as critical. They include, for instance, relatively minor enhancements to director accountability and the introduction of mandatory continuing professional education for Chartered Accountants.

The issues and recommendations are divided into two parts as follows.

- Part One: Where the matter referred to may be considered and, if any action is to be taken, this would be better achieved with external assistance.
- Part Two: Where the matter referred to may be considered and, if any action is to be taken, this may be achieved without external assistance.

Part One. Where Donor Assistance Might be Appropriate

1. Strengthen Government Accounting and Auditing

There is a critical shortage of suitably skilled and motivated accountants and auditors in the public sector. The *Financial Management Training Project* developed training materials, strengthened training organizations and trained government accountants and auditors. It also strongly recommended the establishment of sound professional qualifications.¹³⁰ However, government accountants and auditors still do not have adequate or appropriate professional qualifications or representation. For instance, membership of the Institute of Public Finance and Development Accountancy (IPFDA) is attained by virtue of career experience and position. Membership does not require specified academic qualifications, professional examinations, practical experience or Continuing Professional Education (CPE) requirements. The establishment of suitable bookkeeping and accountancy certifications would provide: (i) stepping stones to higher professional qualifications; (ii) a basis to gauge competence to undertake bookkeeping and accountancy tasks; and (iii) personal career targets. It is **recommended** that assistance be provided to: (i) support the establishment of strong professional body for public sector accountants

¹³⁰ ADB Loan 1275: *Financial Management Training Project*, for \$13 million, approved on 29 November 1993.

and auditors;¹³¹ (ii) the design and establishment of an appropriate range of professional bookkeeping and accountancy qualifications; (iii) the development of licensure criteria and examinations for each qualification; (iv) the development of educational materials to support the qualifications.

2. Strengthen Public Corporation Accountability through Legislative Amendments

The existing *Public Finance Act (No. 38) 1971* provides a weak accountability regime for public corporations. In particular, reporting and auditing timeframes are lax. Moreover, the Act's weak incentive mechanisms for compliance further dilute the regime's strength—for instance, public corporations that submit late financial statements are liable for a small fine of not more than SLRs 1,000 (\$11) [Section 13(6)]. Requiring public corporations to report to Parliament on the actions that they are taking to address audit issues would strengthen compliance incentives. An effective report would briefly: (i) describe each issue; (ii) describe the actions planned to address each issue; (iii) specify the timeframe in which each issue will be addressed; and (iv) provide the name and position of the person who is responsible for implementing the corrective action. It is **recommended** that assistance be provided to review the legislation governing public corporations and to draft a Public Corporations Act. The revised legislation should: (i) impose tighter reporting timetables on public corporations; and (ii) strengthen compliance incentives.

3. Appoint Accountants to Public Corporation Boards

Public corporation boards do not usually include suitably qualified financial appointees. It is **recommended** that assistance be provided to design and establish mechanisms that ensure that board appointees of public corporations include at least one Chartered Accountant, or a similarly qualified person. Efforts should first focus on commercial and then move to non-commercial public corporations. The design should consider legislative amendments to the *Public Finance Act (No. 38) 1971* to set out

¹³¹ Although this body might continue under the auspices of IPFDA, it must be associated with a reputable, established professional organization if it is to be successful. To this end, ICASL successfully supported the establishment of the Association of Accounting Technicians of Sri Lanka (AATSL). Given this proven success, ICASL would be the ideal parent or partner for this public sector professional accounting organization.

appointment and removal processes. Furthermore, nominees for board appointment should be selected from an ICASL-provided short-list.

4. Strengthen Public Corporation Internal Auditing and Controls

Public corporations have weak internal auditing functions and internal control systems. Furthermore, very few have effective audit committees. It is **recommended** that assistance be provided to: (i) strengthen the internal auditing functions and internal control systems of public corporations; and (ii) establish audit committees within public corporations.

5. Publish a Scorecard of Public Corporation Reporting

Despite the weak accountability regime for financial reporting, public corporations have difficulty providing timely annual reports. As a short-term measure, a publicly available scorecard of public corporation reporting would provide impetus for reporting improvements. It is **recommended** that assistance be provided to support the development of a scorecard on public corporation reporting. Such a scorecard might be prepared and published by the Ministry of Finance and Planning (MOFP), within two weeks of each quarter-end. The scorecard would group public corporations by responsible Minister and: (i) provide the corporation Chairperson's details; (ii) identify where the annual report is at, in terms of the reporting and auditing processes; and (iii) highlight where deadlines have been exceeded.

Part Two. Where External Assistance is Not Required

6. Create Chief Financial Officer Positions in Public Corporations

Financial management is given low priority by, and has poor status within, public corporations. It is **recommended** that all public corporations have suitably qualified Chief Financial Officers with senior manager status.

7. Require SLAASMB Review of all Public Corporation Annual Reports

The Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) currently reviews all the annual reports that it receives. This

universal review will be replaced by selective sampling as operations move to a steady state. Given the Board's resources and authority, it can plan a key role in strengthening public corporation financial reporting and disclosure practices. It is **recommended** that SLAASMB review all public corporation annual reports as a matter of course.

8. Enhance Director Accountability

Sri Lanka Accounting Standard (SLAS) 3 *Presentation of Financial Statements* requires directors to sign a responsibility clause as part of the Financial Statements. Accountability for financial management could be strengthened by requiring directors to include specific statements in the Annual Report on: (i) whether they have taken all necessary steps to ensure that the organization's internal control systems are adequate; and (ii) their satisfaction that the company is a going concern. It is **recommended** that company directors be required to include specific statements in the Annual Report on: (i) the organization's internal control systems; and (ii) their satisfaction that the company is a going concern.

9. Close the Emerging Gaps Between SLASs and IASs

A gap has begun to emerge between SLASs and International Accounting Standards (IASs). In the absence of corrective actions or arrangements, this gap will widen during the coming four years as the International Accounting Standards Board (IASB) reviews existing IASs and issues new standards. One possible corrective option would be to prepare a very brief SLAS for each IAS that stipulates: (i) the effective date of the SLAS (IAS); and (ii) any modifications that apply for Sri Lankan purposes. This approach would reduce standard-setting efforts and costs, and enable the gap to be closed between IASs and SLASs. It is **suggested** that SLASs be promulgated as overlay regulations rather than as amended IASs.

10. Enhance Auditor Independence and Objectivity

Auditor independence is undermined by not requiring separate disclosure of the fees paid for audit and nonaudit work in annual reports. Furthermore, the regular rotation of audit partners and teams would strengthen external audits. In line with international practice, these banks should be allowed to retain the same external auditors for at least three years at a time. This would ensure continuity of audit treatment and enable the auditors to

deepen their understanding and coverage of the banks' control systems. This practice could also result in improved service and more consistent accounting treatments and standards.¹³² It is **recommended** that auditing practices be reviewed in line with emerging international best practice, and that in particular: (i) fees paid to auditors for audit and nonaudit work be separately disclosed in annual reports; (ii) ICASL review its rules regarding the provision of non-audit services by auditors; and (iii) regular rotation of audit partners and teams be mandated.

11. Make CPE Mandatory for Continuing ICASL Membership

The International Federation of Accountants (IFAC) and UN Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) recommend a minimum of 30 hours CPE per year, or a minimum of 90 hours in every three-year period of structured learning activities.¹³³ In contrast, CPE is not a mandatory requirement for continuing ICASL Membership. It is **recommended** that ICASL require that members undertake CPE as a condition of membership continuation.

12. Enhance Institutional Support for Financial Governance

The SLAASMB is a key institutional support to good financial governance. Its effectiveness is compromised by remuneration arrangements. It is **recommended** that SLAASMB remuneration arrangements be investigated to ensure that this key organization is able to recruit and retain suitably qualified and experienced personnel.

13. Provide Resources to ICASL for Standing-Setting

There is a significant 'public good' component to the standing-setting activities of ICASL's Accounting Standards Committee (ASC) and Auditing Standards Committee (AuSC). These activities are supported entirely by ICASL. In 1995, the *Presidential Commission on Finance and Banking* recommended that resources be appropriated to ICASL to support ASC's activities, however no action was taken. The ASC's activities are funded entirely by ICASL (in contrast to the government-funded SLAASMB). It

¹³² World Bank. 1998 July 31. *Sri Lanka: Financial Sector Reforms*. p. 21.

¹³³ IFAC. 1998 May. *International Education Guideline (IEG) 2: Continuing Profession Education*. New York: IFAC.

is recommended that funding be appropriated to ICASL to support accounting and auditing standard-setting activities.

14. Advocate Changes to IASB Copyright and Pricing

IASB copyrights IASs and associated guidance materials. Many developing countries, including Sri Lanka, are moving towards IASs. Investors, lenders, academics, practitioners and regulators should have access to the IASs and associated materials. The IASB's copyrighting and pricing policies effectively limit this access. In doing so, they appear to conflict with the IASB's constitutional objectives. It is recommended that ADB raise this issue with other multilateral and bilateral donor organizations, so that a joint approach may be made to the IASB and the international accountancy profession.

15. Encourage the Development of Financial Reporting Standards for SMEs

IASs have been prepared on a one-size-fits-all basis. For instance, IAS 19 (Employee benefits) requires that actuarial valuations be undertaken of certain employee benefits. These valuations must be conducted whether the reporting organization is a corporation that is listed on the Frankfurt Stock Exchange or a small, unlisted manufacturing organization in Karachi. Many countries have implemented differential reporting regimes with regards to the application of accounting standards. Such a regime, for IASs, would be appropriate—particularly where developing countries are adopting IAS-compliant accounting standards. In April 1998, a project to examine the reporting requirements for small and medium-sized enterprises (SMEs) was added to IASB's agenda—however no progress has been made to date and further activity has yet to be determined by IASB. In the meantime, ISAR has developed proposals to provide a model framework for national accounting regulators that will cover the whole range of accounting entities from the one-person business through to the listed company. It is recommended that ADB, together with other multilateral development banks, should encourage ISAR and IASB efforts to develop a financial reporting regime suitable for SMEs.