Diagnostic Study of Accounting and Auditing Practices in Selected Developing Member Countries

Azerbaijan
Fiji Islands, Republic of the
Marshall Islands
Philippines
Sri Lanka

Prepared Under Regional Technical Assistance (RETA) 5980: Diagnostic Study of Accounting and Auditing Practices in Selected Developing Member Countries
EXECUTIVE SUMMARY

A rapidly growing body of compelling economic research reveals that governance arrangements strongly influence development outcomes including social indicators such as infant mortality and adult literacy rates. Sound accounting and auditing practices are an integral part of good governance arrangements.

Moreover, the 1997-98 East Asian financial crisis taught us a lot about the way structural weaknesses of institutions, bad regulatory policies and poor supervision of financial institutions can have huge costs, even where macroeconomic management is fundamentally sound. It taught us that good governance in both the public and private sectors is very important. Good corporate governance requires the enforcement of bankruptcy and corporate laws, the use of internationally acceptable accounting and auditing standards, and the existence of independent auditors and regulators.

These lessons are relevant for all countries; not just those from East Asia. Even the United States—which has a strong financial market framework—is currently struggling with a string of financial governance failures. The Asian Development Bank (ADB) heeded these lessons and identified two key reform priorities: strengthening banking supervision and regulation, and improving financial reporting standards and their enforcement.

If ADB is to provide effective assistance to address these priority areas, we must first understand each country’s existing accounting and auditing arrangements and the particular challenges they face. To get this understanding, Diagnostic Studies of Accounting and Auditing (DSAAs) were undertaken for seven developing member countries (DMCs) in 2000; Cambodia, People’s Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan and Viet Nam. These studies were conducted in consultation with governments, other donor agencies and the accounting and auditing professions. Each country study identified issues and developed actions to remedy revealed weaknesses.

The first seven diagnostic studies were particularly successful. Indeed the People’s Republic of China study had to be reprinted within weeks of its release to meet high demand. The studies did not end with report publication. In most cases, the participating governments are acting to implement the recommendations. In some cases, ADB is providing relevant assistance to the participating governments.

Given this success, ADB management agreed to extend the diagnostic work undertaken in 2000 to five additional DMCs: Azerbaijan, Fiji Islands,
Marshall Islands, Philippines and Sri Lanka. This report summarizes the results of the individual country studies. Each country has a different background and faces its own challenges. Four are island nations and one is landlocked. Two countries have British accounting backgrounds, one has a Soviet accounting history and two have been influenced by American arrangements. Whatever their differences, all five are committed to improving their accounting and auditing practices.

Sound accounting and auditing arrangements are not just important for avoiding crises. Good arrangements reduce opportunities for growth-sapping corruption. They also enable countries to attract investment and to develop at a faster pace. The studies, which this report summarizes, were conducted between January 2001 and March 2002 in consultation with other donor agencies, government organizations, and accounting and auditing professions. The studies identified gaps and weaknesses in the current accounting and auditing infrastructure of the five countries and came up with recommendations and action plans to remedy the identified weaknesses. ADB intends to develop such profiles for other DMCs in the future.

Izal Ali
Chief Economist
Economics and Research Department
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1 The DSAAs for Azerbaijan, Fiji Islands, Marshall Islands and Sri Lanka were prepared under ADB Regional Technical Assistance (RETA) 5980: Diagnostic Study of Accounting and Auditing Practices in Selected Developing Member Countries. The Philippines DSAA was prepared under ADB RETA 5765: Banking, Capital Market and International Competitiveness Reforms in Response to the Currency Turmoil.
Preface

This report was prepared under Regional Technical Assistance (RETA) 5980: Diagnostic Study of Accounting and Auditing Practices in Selected Developing Members Countries for ADB by Francis B. Narayan, Lead Financial Management Specialist, ADB; Sarath Lakshman Athukorala, Financial Management Specialist, ADB; and Barry C. Reid, Consultant, ADB. Maria Rosa (Bing) P. Ortega, ADB coordinated logistical arrangements.

This report summarizes the results of DSAAs in five ADB DMCs: Azerbaijan, Fiji Islands, Marshall Islands, Philippines and Sri Lanka. Individual reports are also available for each of the five countries. These studies extend work conducted in 2000, when DSAAs were prepared and published for seven ADB DMCs: Cambodia, People’s Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan and Viet Nam.

The World Bank has a similar initiative in their Country Financial Accountability Assessment (CFAA) program. These exercises are generally coordinated to avoid overlap. For instance, the World Bank used the Sri Lankan DSAA as the basis for their public sector-focused CFAA.

The individual country studies were undertaken between January 2001 and February 2002. The issues and recommendations identified in each country report were discussed and debated with representatives from government, the private sector and international organizations at workshops in each of the participating countries. The reports were also reviewed by government officials, private sector representatives, ADB officials, and officials from other bilateral and multilateral donor organizations. The study results and recommendations were further discussed and debated at an international workshop at ADB headquarters in Manila on 5-6 March 2002. In the coming months, ADB will work with each respective government and other donor agencies to identify funding sources to support the implementation of the study recommendations, where appropriate.

The authors would like to offer their appreciation to the numerous officials, researchers and agencies that gave up their valuable time and made

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2 The DSAAs for Azerbaijan, Fiji Islands, Marshall Islands and Sri Lanka were prepared under ADB Regional Technical Assistance (RETA) 5980: Diagnostic Study of Accounting and Auditing Practices in Selected DMCs. The Philippine DSAA was prepared under ADB RETA 5765: Banking, Capital Market and International Competitiveness Reforms in Response to the Currency Turmoil.

3 Under ADB RETA 5877: Strengthening Financial Management and Governance in Selected DMCs.
materials available during the course of the research. We would particularly like to thank: Ping Yung Chiu (Controller, ADB), Dezider Stefunko (United Nations Conference on Trade and Development, UNCTAD), Jean-Pierre A. Verbiest (Assistant Chief Economist, Macroeconomics and Finance Research Division, Economics and Research Department, ADB) and Ranel T. Wijesingha (President, Confederation of Asian and Pacific Accountants, CAPA), for their presentations at the Manila international workshop; Abbas Allahverdiyev (Deputy Chair, Azerbaijan Chamber of Accounting), Professor V. Novruzov (Chair, Azerbaijan Chamber of Auditors), Elkhan Jafarov (Head, Accounting Policy Department, Azerbaijan Ministry of Finance), Eroni Vatuloka (Auditor General of Fiji), Paula Uluinaceva (Acting Director, Budget Management, Fiji Ministry of Finance and National Planning), Franklin Henry (Federal Grants Coordinator, Budget Division, Marshall Islands Ministry of Finance), Erma W. Myazoe (Chief Accountant, Marshall Islands Ministry of Finance), Antonieta Fortuna-Ibe (Chair, Philippine Professional Regulation Commission), Carlito Fuentespina (President, Philippine Institute of Certified Public Accountants), Tito S. Nabua (Director, Region IV, Philippine Commission on Audit), Purita A. Fajilan (Consultant, SEC), V. Kanagasabapathy (Additional Director General, Sri Lankan Department of Public Finance), A.D.B. Talawatte (President, Institute of Chartered Accountants of Sri Lanka), for their attendance and presentations at the Manila international workshop; Elaine Glennie (Financial Management Specialist, ADB), Peter N. King (Director, Pacific Operations Division, ADB), Thuy Mellor (Financial Management Specialist, ADB), Masaaki Nagata (Principal Programs Officer, Operations Coordination Division, South Asia Department, ADB), Richard Ondrik (Senior Programs Officer, Philippines Country Office, ADB), Kunio Senga (Director, Operations Coordination Division, East and Central Asia Department, ADB), Robert Y. Siy Jr. (Director, Pacific Operations Division, ADB), Neside Tas-Anvaripour (Financial Management Specialist, ADB) and Samiuela T. Tukuafu (Financial Management Specialist, Mekong Department, ADB), for chairing, moderating or supporting sessions at the Manila international workshop; and Yvonne Osonia, Aileen Pangilinan and Maria Carolina Faustino-Chan for their support throughout the study.
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ADB Diagnostic Studies on Accounting and Auditing

The Asian Development Bank (ADB) publishes this series to: (i) provide reference materials on accounting and auditing for government officials, ADB officials, officials from other donor agencies, and other interested parties; (ii) identify potential actions that the participating government and/or the accounting profession can take to rectify weaknesses, in partnership with donor agencies where appropriate, and (iii) provide the participating country with a benchmark against which to measure their progress in improving financial management and governance arrangements.

Orders can be placed with the Publications Information Center, Office of External Relations, ADB, P.O. Box 789, 0980 Manila Philippines. The reports may also be downloaded from www.adb.org.

Summary Reports


Individual Reports: By ADB Region

All ADB DMCs are listed by region. Economies for which a DSAA has been prepared are bolded and the year of publication is shown in brackets:

East and Central Asia: Azerbaijan (2002); People’s Republic of China (2000); Hong Kong, China; Kazakhstan; Kyrgyz Republic; Republic of Korea; Mongolia (2000), Tajikistan; Taipei, China; Turkmenistan; and Uzbekistan (2000).


Southeast Asia: Indonesia, Malaysia, Philippines (2002), Singapore.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AAC</td>
<td>Azerbaijan Accounting Chamber</td>
</tr>
<tr>
<td>AASC</td>
<td>Accounting and Auditing Standards Committee (Fiji Islands)</td>
</tr>
<tr>
<td>AATSL</td>
<td>Association of Accounting Technicians of Sri Lanka</td>
</tr>
<tr>
<td>ACAAz</td>
<td>Association of Certified Accountants of Azerbaijan</td>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>ANB</td>
<td>Azerbaijan National Bank</td>
</tr>
<tr>
<td>APEC</td>
<td>Asia Pacific Economic Cooperation</td>
</tr>
<tr>
<td>ASC</td>
<td>Accounting Standards Council</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
</tr>
<tr>
<td>ASPC</td>
<td>Auditing Standards and Practices Council</td>
</tr>
<tr>
<td>AusAID</td>
<td>Australian Agency for International Development</td>
</tr>
<tr>
<td>AuSC</td>
<td>Auditing Standards Committee</td>
</tr>
<tr>
<td>BIR</td>
<td>Bureau of Internal Revenue (Philippines)</td>
</tr>
<tr>
<td>BOA</td>
<td>Board of Accountancy (Philippines)</td>
</tr>
<tr>
<td>CAPA</td>
<td>Confederation of Asian and Pacific Accountants</td>
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<tr>
<td>CFA</td>
<td>Compact of Free Association (RMI)</td>
</tr>
<tr>
<td>CFAA</td>
<td>Country Financial Accountability Assessment (World Bank)</td>
</tr>
<tr>
<td>CHED</td>
<td>Commission on Higher Education (Philippines)</td>
</tr>
<tr>
<td>CICPA</td>
<td>Chinese Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>CIDA</td>
<td>Canadian International Development Agency</td>
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<tr>
<td>CMASL</td>
<td>Society of Certified Management Accountants of Sri Lanka</td>
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<tr>
<td>CMI</td>
<td>College of the Marshall Islands</td>
</tr>
<tr>
<td>COA</td>
<td>Commission on Audit (Philippines)</td>
</tr>
<tr>
<td>COAA</td>
<td>Chamber of Auditors of Azerbaijan</td>
</tr>
<tr>
<td>CPA</td>
<td>Certified Public / Practicing Accountant</td>
</tr>
<tr>
<td>CPE</td>
<td>Continuing Professional Education</td>
</tr>
<tr>
<td>DMC</td>
<td>Developing Member Country (ADB)</td>
</tr>
<tr>
<td>DSAA</td>
<td>Diagnostic Study of Accounting and Auditing (ADB)</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>ED</td>
<td>Exposure Draft</td>
</tr>
<tr>
<td>EFTS</td>
<td>Equivalent Full-Time Student</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>EU-TACIS</td>
<td>European Union—Technical Assistance to the Commonwealth of Independent States</td>
</tr>
<tr>
<td>FAS</td>
<td>Fiji Accounting Standard</td>
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</tbody>
</table>
In 2001, the International Accounting Standards Board (IASB) assumed responsibility from the International Accounting Standards Committee (IASC) for promulgating IASs. In future, IASB-issued standards will be called International Financial Reporting Standards (IFRSs). While the IASB now expects its standards to be called IFRSs, this report uses the term IASs (in the interests of continuity).
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>IPSAS</td>
<td>International Public Sector Accounting Standard (IFAC)</td>
</tr>
<tr>
<td>IRFAA Eurasia</td>
<td>International Regional Federation of Accountants and Auditors Eurasia</td>
</tr>
<tr>
<td>ISA</td>
<td>International Standard on Auditing (IAASB)</td>
</tr>
<tr>
<td>ISAR</td>
<td>Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (UNCTAD)</td>
</tr>
<tr>
<td>LIFO</td>
<td>Last-in First-out (inventory valuation method)</td>
</tr>
<tr>
<td>MIITF</td>
<td>Marshall Islands Intergenerational Trust Fund</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MOFANP</td>
<td>Ministry of Finance and Planning (Fiji Islands)</td>
</tr>
<tr>
<td>MTEF</td>
<td>Medium-Term Expenditure Framework</td>
</tr>
<tr>
<td>NZAID</td>
<td>New Zealand Agency for International Development</td>
</tr>
<tr>
<td>OAG</td>
<td>Office of the Auditor General</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
</tr>
<tr>
<td>OGA</td>
<td>Office of the General Accountant (Philippines)</td>
</tr>
<tr>
<td>PFMA</td>
<td>Public Finance Management Act (Fiji Islands)</td>
</tr>
<tr>
<td>PFTAC</td>
<td>Pacific Financial Technical Assistance Center</td>
</tr>
<tr>
<td>PICPA</td>
<td>Philippine Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>PRC</td>
<td>Professional Regulation Commission (Philippines)</td>
</tr>
<tr>
<td>PSC</td>
<td>Public Sector Committee (IFAC)</td>
</tr>
<tr>
<td>RETA</td>
<td>Regional Technical Assistance (ADB)</td>
</tr>
<tr>
<td>RMI</td>
<td>Republic of the Marshall Islands</td>
</tr>
<tr>
<td>ROSC</td>
<td>Report on the Observance of Standards and Codes (IMF/World Bank)</td>
</tr>
<tr>
<td>SAI</td>
<td>Supreme Audit Institution</td>
</tr>
<tr>
<td>SASP</td>
<td>Statements of Auditing Standards of the Philippines</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
</tr>
<tr>
<td>SFAS</td>
<td>Statement of Financial Accounting Standards</td>
</tr>
<tr>
<td>SLAASMB</td>
<td>Sri Lanka Accounting and Auditing Standards Monitoring Board</td>
</tr>
<tr>
<td>SLAS</td>
<td>Sri Lankan Accounting Standard</td>
</tr>
<tr>
<td>SME</td>
<td>Small or Medium-sized Enterprise</td>
</tr>
<tr>
<td>SME-CG</td>
<td>Consultative Group of Experts on SME Accounting (ISAR)</td>
</tr>
<tr>
<td>SNA</td>
<td>System of National Accounts (UN)</td>
</tr>
<tr>
<td>TA</td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
</tbody>
</table>
USAID  United States Agency for International Development
USP  University of the South Pacific
VFM  Value for Money
WTO  World Trade Organization

**Note**

In this report, $ refers to US dollars.
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I. Introduction

The 1997-98 Asian financial crisis exposed structural weaknesses in the banking and corporate sectors of affected countries owing largely to poor governance, a lack of transparency, and weak supervision and regulation.5

ADB has been taking initiatives to assist its DMCs to overcome these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

In 2000, under ADB Regional Technical Assistance (RETA) 58776, DSAAs were prepared and published for Cambodia, Mongolia, Pakistan, Papua New Guinea, People’s Republic of China, Uzbekistan and Viet Nam. ADB approved RETA 5980—Diagncostic Study of Accounting and Auditing Practices in Selected Developing Member Countries7—for the purpose of carrying out initial studies to identify gaps and weaknesses in accounting and auditing arrangements and to recommend courses of action to overcome these problems. It extends the work conducted under RETA 5877 and involved the preparation of DSAAs for Azerbaijan, Fiji Islands, Republic of the Marshall Islands (RMI) and Sri Lanka.8 Objectives were to: (i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support to meet international standards and best practices and address the issue of training and capacity enhancement; (ii) determine the existing accounting and auditing standards of each selected country; (iii) assess the degree of deviation from international accounting and auditing standards while identifying weaknesses and possible corrective options; (iv) discuss the fieldwork findings and introduce the concepts of the international standards through

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6 Strengthening Financial Management and Governance in Selected DMCs.

7 For $230,000 approved on 20 March 2001.

8 The Philippine DSAA was prepared under RETA 5765 Banking, Capital Market and International Competitiveness Reforms in Response to the Currency Turmoil.
workshops; and (v) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

Each DSAA involved an in-depth study of the key issues relating to accounting and auditing support in the selected DMC. Where appropriate, efforts were made to ensure that DSAA exercises were coordinated with World Bank activities to minimize overlap (i.e., for Azerbaijan, the Philippines and Sri Lanka).

The first part of each country study examined accounting and auditing structures and systems. It also: (i) analyzed the political, institutional, and regulatory and legal framework on accounting and auditing practice, and the level of enforcement of existing laws, rules and regulations; (ii) identified gaps and weaknesses in accounting and auditing support available, and deviations from international standards; and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

The second part of each study disseminated the country-research findings through in-country workshops. Each workshop provided a cross-section of views on the research findings and established ways to move forward to improve accounting and auditing arrangements. The overall study results and recommendations were further discussed and debated at an international workshop at ADB headquarters in Manila on 5-6 March 2002.

This report examines selected accounting and auditing issues and summarizes the results of the five country studies. It was finalized following the March 2002 Manila workshop. In addition to this introduction, the report has the following chapters:

- **Chapter II** examines the importance of sound accounting and auditing practices.
- **Chapter III** provides contextual background information on the five countries that participated in the study.
- **Chapter IV** identifies and examines selected accounting and auditing issues.
- **Chapters V-IX** describe the situation in each country, identify weaknesses and present corrective recommendations to address these weaknesses.
- **Chapter X** presents the country action plans and examines region-wide issues.
II. Importance of Sound Accounting and Auditing Practices

1. Introduction

Governance arrangements affect development outcomes. One examination of 175 economies found strong positive relationships between good governance arrangements and per capita incomes, infant mortality rates and literacy rates. Another study reinforced evidence that while gross domestic product (GDP) growth is the most powerful poverty reducer, it is not enough; among other things, countries can double their living standards by improving their legal systems and combating corruption, special emphasis should be placed on deepening domestic financial markets, strengthening regulation and financial supervision, and introducing effective corporate governance mechanisms. There is certainly a strong correlation between an economy’s number of accountants and per capita income (see Figure 1).

Accounting and auditing practices underpin governance arrangements. This chapter reviews evidence that sound accounting and auditing mechanisms: (i) attract investment; (ii) support financial market development; (iii) reduce country risk premiums; (iv) improve privatization outcomes; and (v) lower the risk of financial crises, but when crises do occur, reduce their severity and duration.

2. Attracting Investment

In 2001, despite an estimated 42 percent fall in global Foreign Direct Investment (FDI) to $760 billion, net FDI flows to emerging market countries were estimated to have held steady at $163 billion.11

10 Thomas, Vinod, Ashok Dhareshwar, Ramon E. Lopez, Yan Wang, Nalin Kishor, Mansoor Dailimi, and Daniel Kaufmann. 2000 August. The Quality of Growth. World Bank and Oxford University Press.
However, the International Monetary Fund (IMF) expects net FDI flows to emerging markets to reduce.\textsuperscript{12}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fig1}
\caption{Accountants and Per Capita GDP (2000-02)}
\end{figure}

A recent cross-country survey of institutional investors revealed that most are prepared to pay a premium for companies exhibiting high governance standards. Premiums averaged 12-14 percent in North America and Western Europe, 20-25 percent in Asia and Latin America, and over 30 percent in Eastern Europe and Africa. More than a third stated they would avoid investments in countries with poor governance. Importantly, the survey reveals that accounting practices strongly influence investor decisions (see Figure 2).\textsuperscript{13}

\begin{itemize}
\item \textsuperscript{13} McKinsey & Company. 2002 July. \textit{Global Investor Opinion Survey on Corporate Governance: Key Findings}.
\end{itemize}
3. Supporting Financial Market Development

Financial markets (arguably) facilitate economic development through more efficient allocation of capital. It is contended that sound accounting and auditing arrangements encourage financial market development.

Figure 2: Very Important Factors Influencing Investor Decisions

McKinsey & Company asked 200 major institutional investors from Africa, Asia, Europe, North America and South America to identify very important factors that influenced their investment decisions. The top ten factors—and the percentage of respondents who included these factors in their top ten list—are shown.


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ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

“High quality accounting standards result in greater investor confidence, which improves liquidity, reduces capital costs and makes fair market prices possible.”

– Arthur Levitt (1998), p. 81.16

Indeed, a recent study found that higher quality accounting and auditing practices are positively associated with financial market development in countries with stronger legal protection.17 Furthermore, developing and transitional countries often have weak investor protection laws, which are associated with concentrated ownership, lower levels of outside (minority) ownership and less developed financial markets.18 It has been suggested that weak investor protection may be more effectively addressed through strengthened accounting and auditing practices, rather than by more-difficult-to-implement legal reforms.19

4. Lowering Country Risk Premiums

In early 2001, PricewaterhouseCoopers (PwC), an international consulting firm, produced an Opacity Index. This measure weighs the effects of unclear legal systems and regulations, macroeconomic and tax policies, accounting standards and practices, and corruption on the capital markets of 35 countries. Russia is the most opaque, and the US and Singapore the most transparent.20 Opacity generates a country risk premium that deters foreign investors. For example, PwC estimates that the premium on an Indonesian government bond issue, relative to a US one, is more than 10 percent (see Figure 3). Some opacity premiums are higher than the actual interest rate at which particular countries are able to borrow. PwC contends that certain capital market dynamics and hidden subsidies explain this apparent anomaly.

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The *Opacity Risk Premium* indicates the increased cost of borrowing faced by countries due to opacity. On average, countries with more opacity pay higher interest rates on issued debt. For example, a score of nine indicates that countries need to pay international investors an extra 9 percent on their sovereign debt due to opacity.

The *Tax Equivalent Effect* estimates opacity impacts when viewed as a hidden tax. For example, the number 30 indicates that opacity in that country is equivalent to levying an additional 30 percent corporate income tax. The best-practice country is scored at zero and serves as the benchmark (i.e., US and Singapore for opacity, and Singapore for the tax equivalent effect).21

Figure 3: Estimated Opacity Effects: Seven Selected Economies


5. **Improving Privatization Outcomes**

Country and enterprise accounting systems, financial information and audit methodologies, play a critical role in the success of privatizations. However, the accounting structures and processes of many government enterprises are inadequate.

21 The Opacity Factors for Singapore and the US are 29 and 36, respectively. Although the study assigns zero *Opacity Risk Premiums* to both countries, it differentiates for *Tax Equivalent Effects* (i.e., Singapore is scored at zero and the US at five).
Evidence suggests that privatization will be more difficult if financial management issues are not addressed beforehand. There is also evidence that unreliable or inadequate financial information can reduce privatization proceeds, through valuation difficulties.\textsuperscript{22}

6. **Reducing Crisis Risks and Mitigating Crisis Effects**

An ADB study found that poor enforcement of corporate regulations, underdeveloped capital markets and high concentrations of corporate ownership were the main reasons for weak corporate governance in the economies that were most affected by the 1997-98 Asian financial crisis.\textsuperscript{23} It recommended: (i) rationalizing corporate ownership structures (ownership concentration should be reduced); (ii) bolstering corporate internal controls and shareholder protection; (iii) improving external monitoring and discipline; and (iv) developing capital markets and improving the efficiency of corporate financing. The study concluded that measures to strengthen corporate internal control, improve standards of accounting, auditing and financial reporting systems and their enforcement “should be placed on top of the reform agenda”.\textsuperscript{24}

There is also evidence that the buildup, duration, and severity of bubbles in equity and real estate markets, as well as the restructuring that occurs in their aftermath, are related to the availability of skills in financial sector services. Countries that have capable professionals such as accountants, appraisers, analysts and insolvency experts, recognize and respond more swiftly to asset bubbles than countries with limited financial sector skills.\textsuperscript{25, 26}


\textsuperscript{24} Ibid, p. 86.


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“The strong correlation among the base of skills, the growth of non-bank financial intermediation and the stability of the financial system suggests that poor prevention and weak responses to financial crises are linked to inadequate skills and human capital in the financial services sector.” 27

7. Conclusion

This chapter reviewed evidence that sound accounting and auditing practices support economic development. The importance of accounting and auditing arrangements should not be understated; even minor reductions in a country’s risk premium will free up significant public sector resources (by reducing debt-servicing payments) and make more private sector investments viable (by lowering investment-hurdle rates).

27 Ibid. p. 175.
III. Participating Country Backgrounds

1. Introduction

The ADB has 41 DMCs. In 2001, five were approached and invited to participate in a Diagnostic Study of Accounting and Auditing (DSAA). All accepted the invitation. The decision to invite this particular group was based on several factors including their willingness to participate, geographical location, involvement in the World Bank Country Financial Accountability Assessment (CFAA) exercise, stage of development and the extent of ADB assistance. It was intended that the participating countries should represent a cross-section of all ADB DMCs.

This chapter presents background information on the five DMCs. It provides context for the following chapters, which examine individual country accounting and auditing practices.

2. Comparative Information

The information presented in Table 1 illustrates the social and economic similarities and differences between the five DMCs.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Azerbaijan</th>
<th>Fiji Islands</th>
<th>Philippines</th>
<th>RMI</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population (thousands, 2000)</td>
<td>8,049.0</td>
<td>811.0</td>
<td>78,400.0</td>
<td>52.0</td>
<td>19,359.0</td>
</tr>
<tr>
<td>Population density (people per km², 2000)</td>
<td>93.0</td>
<td>44.0</td>
<td>263.0</td>
<td>282.0</td>
<td>295.0</td>
</tr>
<tr>
<td>Urban population (% of total, 2000)</td>
<td>57.3</td>
<td>42.3</td>
<td>58.6</td>
<td>71.9</td>
<td>23.6</td>
</tr>
<tr>
<td>Average annual population growth rate (%)</td>
<td>1.0</td>
<td>1.1</td>
<td>2.2</td>
<td>1.5</td>
<td>1.3</td>
</tr>
<tr>
<td><strong>Social</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under-five mortality rate (per 1000, 1999)</td>
<td>16.0</td>
<td>18.0</td>
<td>31.0</td>
<td>63.0</td>
<td>15.0</td>
</tr>
<tr>
<td>Life expectancy at birth (years, 1999)</td>
<td>71.0</td>
<td>67.0</td>
<td>69.0</td>
<td>65.0</td>
<td>74.0</td>
</tr>
<tr>
<td>Adult literacy rate (15-yr+, %, 1999):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Females</td>
<td>97.0</td>
<td>90.0</td>
<td>95.0</td>
<td>97.0</td>
<td>89.0</td>
</tr>
<tr>
<td>– Males</td>
<td>97.0</td>
<td>93.0</td>
<td>95.0</td>
<td>97.0</td>
<td>94.0</td>
</tr>
<tr>
<td>Population in poverty (%, 1995-99)</td>
<td>68.1</td>
<td>25.5</td>
<td>40.0</td>
<td>...</td>
<td>26.7</td>
</tr>
<tr>
<td>Human Development Index (1999)</td>
<td>0.74</td>
<td>0.76</td>
<td>0.75</td>
<td>0.56</td>
<td>0.74</td>
</tr>
</tbody>
</table>

ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

Table 1: Comparative Information on the Participating DMCs (continued)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Azerbaijan</th>
<th>Fiji Islands</th>
<th>Philippines RMI</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross National Product (GNP) ($million, 1999)</td>
<td>3,705.0</td>
<td>1,848.0</td>
<td>77,967.0</td>
<td>99.0</td>
</tr>
<tr>
<td>GDP per capita ($, 2000)</td>
<td>654.0</td>
<td>1,978.0</td>
<td>959.0</td>
<td>1,890.0</td>
</tr>
<tr>
<td>GDP growth rate (%) -2000</td>
<td>11.4</td>
<td>-9.3</td>
<td>4.0</td>
<td>-2.3</td>
</tr>
<tr>
<td>- 1999</td>
<td>7.4</td>
<td>9.6</td>
<td>3.4</td>
<td>0.8</td>
</tr>
<tr>
<td>- 1998</td>
<td>10.6</td>
<td>1.4</td>
<td>-0.6</td>
<td>-16.0</td>
</tr>
<tr>
<td>- 1997</td>
<td>8.8</td>
<td>-0.9</td>
<td>5.2</td>
<td>-9.4</td>
</tr>
<tr>
<td>Consumer Price Index (Annual % change, 2000)</td>
<td>1.9</td>
<td>1.1</td>
<td>4.4</td>
<td>-1.9</td>
</tr>
<tr>
<td>Fiscal Balance / GDP (%, 2000)</td>
<td>-1.0</td>
<td>…</td>
<td>-4.2</td>
<td>-35.5</td>
</tr>
<tr>
<td>Total External Debt / GNP (%, 1999)</td>
<td>30.0</td>
<td>9.3</td>
<td>64.8</td>
<td>…</td>
</tr>
<tr>
<td>Official Development Flows</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$ million (1999)</td>
<td>207.2</td>
<td>23.2</td>
<td>295.0</td>
<td>62.9</td>
</tr>
<tr>
<td>Dollars per capita (1999)</td>
<td>25.7</td>
<td>28.6</td>
<td>3.8</td>
<td>1,219.0</td>
</tr>
<tr>
<td>Percentage of GNP (1999)</td>
<td>5.6</td>
<td>1.3</td>
<td>0.4</td>
<td>63.5</td>
</tr>
</tbody>
</table>

3. Azerbaijan

Azerbaijan is located in the South Caucasus region, on the western shore of the Caspian Sea. In the 19th century, it experienced an unprecedented oil boom and—by 1900—was supplying almost half of the world’s oil.

This oil-rich country’s population of about 8 million comprises different ethnic groups, including Azeris, Dagestanis and Russians. It gained independence from the Soviet Union in 1991 amid war and political turmoil—a 1994 ceasefire agreement ended an armed conflict with Armenia. However, about one-seventh of Azerbaijan’s territory remains occupied, while around 800,000 refugees and internally displaced persons are scattered throughout the country. Almost 70 percent of the population lives in poverty.

In 1994, Azerbaijan signed a 30-year contract worth $7.4 billion with a British Petroleum-led consortium. A number of production-sharing arrangements have since been negotiated with foreign firms, which have thus far committed $60 billion to oil field development. Oil production under the first production-sharing agreement began in November 1997.

Azerbaijan shares all the problems of other Former Soviet Union (FSU) countries, but its economic reforms were delayed by the unstable domestic situation. Since the mid-1990s, it has made progress towards establishing
a market economy and restoring macroeconomic stability. A privatization program was introduced in September 1996. Within three years, over 21,000 small enterprises had passed into private hands. Inflation of 1,500 percent in 1994 was reduced to just 2 percent in 2001.

Overall economic performance has been consistently strong—real GDP growth for 2001 was estimated at 9.9 percent. However, this growth is concentrated in the oil and oil-related sectors. Other sectors remain weak and unemployment was estimated at 18 percent in 2000.

The unresolved conflict impedes economic progress and deters foreign investment. Long-term prospects depend upon world oil price levels, the location of new regional pipelines and Azerbaijan’s ability to manage its oil wealth. Maintaining the competitiveness of non-oil exports is a serious long-term challenge.

4. Fiji Islands

The Fiji Islands are located in the southwest Pacific Ocean. Seventy percent of Fiji Islanders reside on the large island of Vitu Levu. The Fiji Islands became a British colony in 1874 and around 60,000 indentured laborers were brought from India to work in the sugarcane fields.

The country’s population is now around 811,000 and mainly comprises (indigenous) Fijians (50 percent) and Indo-Fijians (45 percent). The Fiji Islands became independent 1970. In 1987, a military-backed coup d’état removed an elected government from office. Although democracy was restored in 1999, an Indo-Fijian-led government was forced from office in May 2000. Democracy was again restored at the end of 2001.

Since 1987, emigration levels have been extremely high; particularly of skilled and professional personnel. More than 70,000 people emigrated in the aftermath of the 1987 coup. Emigration increased significantly following the events of May 2000.

Although the Fiji Islands is one of the most developed Pacific Island economies, it remains a developing country with a large subsistence agriculture sector. Tourism has expanded rapidly since the early 1980s and is now the leading economic activity. Other significant sectors include sugar and garments; each makes up about one-quarter of export revenues.

The government-owned National Bank of Fiji (NBF) nearly collapsed in the mid-1990s. The subsequent government bailout, while politically inevitable, cost the economy dearly. NBF’s collapse was largely due to poor supervision and poor corporate governance.

Aside from political uncertainty, the key economic management issues
Accounting and Auditing Practices in Selected DMCs

include the instability of the sugar industry due to expiring land leases and the expected cessation of the Lomé Agreement, poor productivity in the sugar industry, and uncertainty in the garment industry over the future of preferential trading agreements with Australia.

5. Republic of the Marshall Islands

The Republic of the Marshall Islands (RMI) has a population of 51,600. It is situated in the Central Pacific Ocean, between Hawaii and Papua New Guinea. Like several other smaller Pacific countries, RMI is remote from major markets, deficient in both the quality and quantity of land resources, and acutely short of skilled labor, although it does possess potentially rich marine resources built on fish and seabed minerals.

In 1986—after about four decades as a United States (US)-administered United Nations Trust Territory—RMI became a freely associated state with the US, through a Compact of Free Association (CFA). Since then, RMI has received considerable economic and technical assistance from the US. However, the first 15-year CFA expired in September 2001 and a new CFA is currently under negotiation.

In the past 15 years, RMI has made significant progress in developing infrastructure but the economy has been largely stagnant—although GDP increased by 17 percent from 1986 to 1999, the population increased by 35 percent at the same time; the net effect was a decline in per capita income of about 12 percent.

6. Philippines

Around 80 million people live in the Republic of the Philippines—12 million of these reside in the capital Manila. Ethnicity is diverse with people of Chinese, Malay and Spanish descent; more than half the population is aged less than 20 years.

Foreign powers governed the Philippines for almost four centuries up until independence in 1946. The country has had a rocky ride since then. In 1972, President Ferdinand Marcos declared martial law, ostensibly in response to growing unrest, prevalent corruption and high crime levels. Changes were noticeable as crime decreased and public health services improved. But dissatisfaction grew with the dictatorial regime and a nonviolent campaign of civil unrest and national protest culminated with Marcos’s exile in February 1986. The Supreme Court and a democratic parliament were subsequently reestablished.
Following economic and financial crises in the late 1980s and early 1990s, the Philippines launched a robust economic reform program—including improved debt management, trade liberalization, privatization, deregulation and financial reforms—that contributed to declining public sector deficits, accelerating growth and rising capital inflows after 1992. By 1996, real GNP was growing at 6.9 percent and poverty had been significantly reduced.

The Philippine economy was among the first to be hit by the Asian financial crisis. The initial symptoms were similar to those in Indonesia, Korea, Malaysia and Thailand and included a loss in investor confidence resulting in large capital outflows, a decline in reserves, stock market collapses and a large currency depreciation. However, the Philippines weathered the crisis relatively well. There was no need for the Government to recapitalize private banks and most large corporations remained solvent. This has been attributed to: (i) relatively sound precrisis capital positions and portfolio quality among banks; (ii) a relatively strong banking regulatory and supervisory framework due to reforms after the 1980s banking crisis; (iii) low debt-equity ratios—by regional standards—in the corporate sector; (iv) less overheated real estate markets; and (v) strong export growth and remittance flows.

Joseph Estrada was elected president in 1998. However, the Japanese economic deterioration combined with uncertainties over the Estrada administration’s policies, caused a new downturn that culminated in the September 1998 emerging market crisis. Financial markets subsequently recovered with equity prices up twofold, peso appreciation, a large increase in official reserves and significant declines in interest rates. But, President Estrada, amidst political turmoil in January 2001, was forced out of office. The administration of President Gloria Macapagal Arroyo has professed commitment to economic reform. In the meantime, the Philippines slipped from being one of East Asia’s richest countries at independence to one of its poorest today.

7. Sri Lanka

Sri Lanka is located in the Indian Ocean (just off India’s southern tip). In 1948—after more than three centuries of colonization—Sri Lanka gained independence from Britain. Back in the 1960s, Sri Lankans had the same per capita income as Koreans, Malaysians and Singaporeans. With a strategic location, strong institutions, sound infrastructure and comparatively high education standards, they faced a promising future.
Indeed, Sri Lanka has achieved human development outcomes more consistent with those of high-income countries. There are now about 19 million Sri Lankans comprising Sinhalese (74 percent), Tamils (18 percent) and Muslims (7 percent). For almost two decades, attempts have been made to resolve a separatist Tamil insurgency in the island’s north and east. Over 60,000 lives have been lost and more than 170,000 people are living in welfare centers. Indirect costs of the conflict include disruptions to commerce, distortions to labor markets and missed revenues from potential investment and tourism—it is estimated that the conflict reduces GDP growth by 2-3 percentage points each year.

The per capita incomes of Koreans, Malaysians and Singaporeans are now several times higher than those of Sri Lankans. Several factors contributed. First, the conflict has taken a heavy social and economic toll. Second, until recently, Sri Lanka had an extremely high population growth rate. Third, public institutions and governance arrangements have gradually weakened since the 1970s. Fourth, Sri Lanka has for many years assigned the public sector a significant role in creating jobs and transferring resources across groups. The size of the public sector has declined slightly over the years, but it continues to dominate the financial sector and utilities, and includes many commercial enterprises. Per capita employment in the public sector is Asia’s highest. With public sector productivity typically well below that of the private sector, this has meant missed growth and employment opportunities.

Despite these factors, Sri Lanka is today South Asia’s most open economy, and has a relatively well-developed capital market infrastructure. Its per capita income remains the highest in the region, after Maldives. Sri Lanka posted high economic growth rates during the 1990s and weathered the 1997-98 Asian financial crisis reasonably well. However, the global economic slowdown threatens prospects for further improvements.
I. Selected Accounting and Auditing Issues

1. Introduction

This chapter examines selected accounting and auditing issues. Section two describes moves to develop international guidelines and to monitor their application. Sections three and four examine International Accounting Standards (IAS) and financial reporting for small- and medium-sized enterprises (SMEs). Auditing standards and practices are considered in section five. Section six discusses the need for a strong accountancy profession and associated guidance and training materials. Section seven summarizes recent public sector reporting developments. The chapter concludes with section eight.

2. International Guidelines and Surveillance

The international community is supporting the development of guidelines, standards and codes that promote sound financial management and governance practices (see Table 2).

<table>
<thead>
<tr>
<th>Guideline, Standard or Code</th>
<th>Promulgated By</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principles of Corporate Governance</td>
<td>Organisation for Economic Cooperation and Development (OECD)</td>
</tr>
<tr>
<td>Code of Good Practices on Fiscal Transparency</td>
<td>IMF</td>
</tr>
<tr>
<td>Code of Good Practices on Transparency of Monetary and Financial Policies</td>
<td>IMF</td>
</tr>
<tr>
<td>Implementation of the Objectives and Principles for Securities Regulation assessment surveys</td>
<td>International Organization of Securities Commissions</td>
</tr>
<tr>
<td>International Accounting Standards (IAS)</td>
<td>International Accounting Standards Board (IASB)</td>
</tr>
<tr>
<td>International Standards on Auditing (ISA)</td>
<td>International Auditing and Assurance Standards Board (IAASB)</td>
</tr>
<tr>
<td>Banking Supervision Guidelines</td>
<td>Basel Committee on Banking Supervision (BCSB) of the Bank for International Settlements</td>
</tr>
</tbody>
</table>

These guidelines, standards and codes—to varying extents—all involve accounting and auditing arrangements. Furthermore, to help identify and avoid potential crises before they occur, the IMF and the World
Bank have together embarked on a series of *Reports on the Observance of Standards and Codes (ROSCs)*. ROSCs summarize the extent to which countries observe certain internationally recognized standards. They are intended to be voluntary, but the information provided by each country (or not provided, as the case may be) is likely to influence country dealings with international financial institutions, and the level of confidence that the international financial community has in a country.

3. **International Accounting Standards (IAS)**

**Introduction**

The International Accounting Standards Committee (IASC) was established in 1973 to develop and promulgate a set of international accounting standards (IAS). It published the first bound set of IAS in 1987. IAS is intended to enhance the comparability of financial information by reducing national accounting differences. As of July 2002, IAS was available in English and 20 other languages.

In 2001, the IASB superseded IASC and adopted existing IASs. Future IASB-issued standards will be called International Financial Reporting Standards (IFRSs). IASB is funded by contributions from national and international professional accountancy bodies, financial institutions and industrial companies, major accounting firms, central banks and multilateral development banks. As of June 2002, 34 IASs were supplemented by 31 statements issued by the IASB Standing Interpretations Committee (SIC) (see Appendix 2 and Appendix 3, respectively).

Few countries embraced IAS immediately. Nevertheless, by 2002, many ADB DMCs and more than half of the OECD member economies have either directly adopted, or are in the process of directly adopting, IAS. The G8, International Organization of Securities Commissions and the Bank of International Settlements now endorse it. There is strong support for uniform global accounting standards, although consensus has yet to be reached on the basis for these standards (see Figure 4 and Box 1).

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31 Approved translations at July 2002: Arabic, Bulgarian, Chinese, Croatian, Czech, Finnish, French, Georgian, German, Italian, Japanese, Latvian, Macedonian, Polish, Romanian, Russian, Slovak, Slovenian, Spanish and Ukrainian.
32 While IASB now expects its standards to be called IFRSs, this report uses the term IAS, for continuity.
Figure 4: McKinsey Institutional Investor Survey

<table>
<thead>
<tr>
<th>To what extent is a single global accounting standard desirable?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undesirable</td>
</tr>
<tr>
<td>Not sure</td>
</tr>
<tr>
<td>Desirable</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>If an existing standard were to be chosen as a global one, which one would you prefer?</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="chart_url" alt="Bar chart showing preferences for IAS vs. US GAAP across regions." /></td>
</tr>
</tbody>
</table>


Box 1: Will US GAAP Converge with IAS?

On 30 July 2002, the Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act was signed into US law. Among other things, it requires the US SEC to examine the adoption of principles-based accounting. SEC must report its findings by July 2003 on: (i) the current use of such accounting in the US, (ii) the time required to adopt principles-based accounting, (iii) the feasibility of and proposed methods for introducing such a system, and (iv) an economic analysis of the implementation of principles-based accounting.

The law also permits SEC to look to private-sector accounting standard-setters, such as the Financial Accounting Standards Board (FASB), if they: “consider, in adopting accounting principles, ... the extent to which international convergence on high quality accounting standards is ... appropriate in the public interest and for the protection of investors.”

Benefits of Direct IAS Adoption

There is an increasing international trend for direct IAS adoption. Countries who have taken, or who are taking, this path include Australia, Pakistan and European Union (EU) member countries. Subject to government clearance, from 1 January 2005 Australian audit reports will refer to compliance with IASB standards. Australian Financial Reporting Council (FRC). 2002 July 3. Adoption of International Accounting Standards by 2005. Bulletin of the Financial Reporting Council. 2002/4.

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credibility of country financial reporting, because investors dislike national deviations; and (iii) provides access to a greater range of directly applicable training and guidance materials.

The benefits of access to high quality training materials cannot be overstated, particularly for DMCs. For instance, Deloitte Touche Tohmatsu publishes an excellent set of IAS-compliant model financial statements, which are cross-referenced to IAS (a comprehensive disclosure checklist is also available). Moreover, the anticipated EU adoption of IAS has strengthened demand for training materials and programs. Furthermore, the IASC Foundation (IASCF) intends to certify certain programs as IASCF-approved training.

General Criticisms of IAS

IAS has faced considerable criticism at times. Critics have highlighted their lack of detailed guidance (see Box 2), their perceived Anglo-Saxon bias, the acceptance of alternative accounting treatments within standards and the need for a strong auditing profession to ensure their effective implementation. However, these criticisms are gradually waning or are being addressed. In particular, the 2002 IASB work program centers on addressing issues through the Improvements Project.

Box 2: Detailed Standards

The [IASB] has stated that it has no intention of trying to duplicate [US GAAP], and indeed, subscribes to a philosophy of providing general guidance rather than detailed standards addressing every nuance of business practice. There are many who believe that the troubles experienced by accountants in recent years, particularly the explosion of litigation against them, can be traced to the attempt (doomed to fail, some would argue) to establish specific guidance for a vast array of transactions and events.

34 See www.iasplus.com
35 The Improvements Project’s objectives include reducing or eliminating alternatives, redundancies and conflicts within existing IAS and making other improvements to them. This includes dealing with certain convergence issues and incorporating related SICs into relevant IASs, where appropriate. The timetable is to finalize the standards by 2002 year-end.
Challenges of Direct IAS Adoption

IAS offers a range of accounting policy choices to accommodate diverse views. For instance, whereas some countries adamantly support asset revaluation, others are fervently opposed (Appendix 2 identifies significant IAS benchmark and alternative treatments). While available choices have been significantly reduced since 1996, IAS is sometimes still criticized for being too flexible. For example, IAS 2 Inventories allows several valuation methods.

Most IAS adopters limit these alternative accounting policy choices to improve the consistency of national financial reporting. In many cases, accounting choices are restricted to those allowed for taxation purposes. In particular, depreciation rates are often mandated and Last-in First-out (LIFO) inventory valuations are disallowed.\(^{37}\)

Moreover, where IAS does not address country-specific issues, there is a case for promulgating a national accounting standard. For instance, Papua New Guinea uses IAS directly but has released a national accounting standard on plantation accounting.\(^{38}\) Likewise, Indonesia has an accounting standard on Shariah (Islamic) banking. Many other direct IAS adopters have national accounting standards on value added tax.

IAS Copyright and Pricing

For DMCs to effectively implement IAS-compliant accounting standards, accountancy teachers and academics, accountants, investors, lenders and regulators must have affordable access to standards and associated explanatory and training materials.

The IASCF holds copyright for IAS, IAS-Exposure Drafts (EDs) and other IASB publications in all countries and all languages, but does negotiate usage agreements (for example, payments for its license to use IAS comprise a significant proportion of the Fiji Institute of Accountants’ outgoings). As of July 2002, while discounts of 50 percent were available to residents from developing countries, IAS materials remain expensive (see Table 3). For instance, the full set of Philippine accounting standards is available from Manila bookstores for P295 ($6.00).

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\(^{37}\) The Improvements Project is likely to remove the LIFO option from IAS 2.

\(^{38}\) The plantation accounting standard was originally developed in Sri Lanka. IASB has since issued IAS 41 Agriculture.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

In contrast, International Education Standards (IESs), International Education Guidelines (IEGs) and International Public Sector Accounting Standards (IPSASs) are freely available from the International Federation of Accountants (IFAC) web site. Furthermore—in an effort to improve access to auditing standards—IFAC has agreed that all final IAASB pronouncements will be freely available from January 2003.

Table 3: Prices for IAS Materials

<table>
<thead>
<tr>
<th>Publication</th>
<th>List Price</th>
<th>With Developing Country Discount (50 percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002 International Accounting Standards Bound Volume (printed)</td>
<td>$74 (£120)</td>
<td>$74 (not applicable)</td>
</tr>
<tr>
<td>2002 International Accounting Standards Bound Volume (CD-ROM)</td>
<td>$188 (£120)</td>
<td>$94</td>
</tr>
<tr>
<td>Individual IASs</td>
<td>$24 (£15)</td>
<td>$12</td>
</tr>
<tr>
<td>Training Materials on IAS 7 Cash Flow Statements</td>
<td>$78 (£50)</td>
<td>$36</td>
</tr>
</tbody>
</table>

4. Financial Reporting for Smaller Enterprises (SMEs)

Introduction

In many DMCs, SMEs must comply with IAS-based accounting standards. However, IAS is intended for financial reporting by publicly listed companies; SMEs may lack the capacity to correctly apply the provisions of certain IAS accounting and disclosure requirements.

For example, IAS 19 Employee Benefits requires regular actuarial valuations of certain employee benefits for financial disclosure purposes. These valuations must be conducted whether the reporting organization is listed on the Hong Kong Stock Exchange or is an unlisted Fijian manufacturing enterprise.

Disclosure benefits are greatest where many external users depend on general-purpose financial reports for company information. But, because SMEs are usually not listed on stock exchanges, public interest is limited. Moreover, although SME shareholders may be separate from management, shareholdings are generally closely held. In most cases, the main external users of SME financial statements are special purpose users (e.g., lenders and taxation authorities). As these organizations can obtain financial

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39 www.ifac.org
40 Source: www.iasc.co.uk (accessed on 28 July 2002).
information directly, it can be argued that the benefits of SMEs providing a full set of financial reporting disclosures are limited.

The issue of whether SMEs should comply with a full set of financial reporting disclosures is not limited to DMCS. A number of developed countries including Canada, New Zealand, the United Kingdom and the US have formalized full or partial exemptions from accounting standards for certain entities, usually smaller or closely-held entities (often called differential reporting).41

Given shortcomings in professional and regulatory frameworks, and shortages of suitably qualified and experienced accountants and auditors, SMEs in DMCS often face more difficulties than those in developed countries when applying IAS. Two initiatives to alleviate these problems are discussed next.

**UNCTAD ISAR Framework for SME Accounting and Reporting**

In July 2000, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), under United Nations Conference on Trade and Development auspices, established an *ad hoc* Consultative Group of Experts on Accounting by SMEs (SME-CG) to recommend an SME financial accounting and reporting framework.

ISAR requires the specified framework to: (i) be simple, understandable and user-friendly; (ii) produce useful management information; (iii) be as standardized as possible; (iv) accommodate business growth and eventual full IAS adoption; (v) be reconcilable for tax purposes; and (vi) recognize the SME operating environment.

The 2001 SME-CG report considered: (i) SME classifications for accounting and reporting purposes; (ii) suitable accounting and reporting frameworks for these SME classifications; (iii) possible implementation difficulties; and (iv) associated SME education needs.42 It proposed three classification tiers:

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ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

- Level I (Full IAS). Entities that issue public securities, banks and financial institutions, and entities in which there is a significant public interest would comply completely with IAS.
- Level II (Abridged IAS). Larger SMEs would use an abridged IAS version that technician-level preparers could apply (Appendix 2 identifies the proposed components of the abridged IAS version).
- Level III (Simple Accruals). Smaller entities and new entrants would apply a basic accruals system, supported by a simple chart of accounts and standard financial statement formats.

National regulators adopting the framework would decide on the exact Level I, Level II and Level III criteria. The SME-CG contends that the Level II rules will not only provide an achievable step on the path to full IAS-compliance, but would support the development of professional accounting technicians.

ISAR's September 2001 meeting agreed with the SME-CG report, but requested that the proposals be further refined. In particular, ISAR suggested that SME-CG expand the Level III guidance and provide additional rationale for the Level II structure (i.e., the inclusion of certain IASs). The SME-CG will present its revised proposals to ISAR’s 19th session in late 2002. ISAR is cooperating with IASB to address this urgent issue.

IASB Initiatives on SME Accounting and Reporting

In April 1998, IASB added the Accounting by Small and Medium Entities and in Emerging Economies project to its agenda. Although no progress has been made to date and IASB has yet to determine further activity, IASB officials have participated as observers at the ISAR SME-CG meetings.

5. Auditing Standards and Practices

Introduction

In 2002, IAASB superseded the International Auditing Practices Committee (IAPC). IAASB is an independent standard-setting body under IFAC auspices. Its key pronouncements are ISAs and International Auditing Practice Statements (IAPSS) (see Appendix 4).

Recent US corporate accounting scandals have forced auditing standards and practices into the international limelight. The US has taken
decisive action to improve financial reporting arrangements (see Box 3). Other countries have also reviewed their arrangements.

This section uses an analytical framework to examine mechanisms that strengthen audit quality in the area of auditor: (i) appointment and dismissal mechanisms; (ii) independence; (iii) reporting requirements; and (iv) liability. These mechanisms are considered with reference to Sri Lankan and Singaporean arrangements.

**Box 3: Stricter Rules for US Capital Markets**

On 30 July 2002, the Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act 2002 was signed into US law. Among other things, the Act will bring about the following changes:

- The General Accounting Office will examine and report on the mandatory rotation of auditing firms by July 2003. Meanwhile, five-yearly mandatory audit partner rotation has been introduced.
- A Public Company Accounting Oversight Board will: (i) register public accounting firms; (ii) establish auditing and other standards; (iii) inspect public accounting firms; (iv) conduct investigations; and (v) impose sanctions on public accounting firms. Only two of the Board's five full-time members may be certified public accountants (CPAs).
- Chief Executive Officers and Chief Financial Officers must certify that the financial statements fairly present, in all material respects, the issuer's operations and financial condition. Fines and imprisonment may be imposed for misstatements.
- Public accounting firms may no longer provide the following services to audit clients: (i) bookkeeping or accounting services; (ii) information systems design or implementation; (iii) appraisal or valuation services, fairness opinions, or contribution in-kind reports; (iv) actuarial services; (v) internal audit; (vi) management functions or human resources; (vii) broker or dealer, investment adviser, or investment banking services; (viii) nonaudit related legal services and expert services; and (ix) any other service the Board determines impermissible.
- Audit committees must be established and must pre-approve the provision of any other nonaudit services (e.g., taxation advice).
- Annual reports must include internal control reports: (i) stating that management is responsible for establishing and maintaining adequate internal control systems; and (ii) assessing the effectiveness of internal control systems. Auditors must attest to, and report on, management's internal control assessment.

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43 See, for example:


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Auditor Appointment and Termination

Mechanisms for appointing and dismissing auditors can enhance audit quality when they: (i) distance auditors from management—involving shareholders in the appointment and dismissal process strengthens auditor independence; (ii) match auditor skills to the audit assignment—for instance, only auditors with suitable financial sector experience should audit banks; (iii) ensure that incoming auditors are fully briefed on potential issues; (iv) protect auditors from financial coercion—for example, management may influence auditors who are given the alternative of dismissal without compensation (see Box 4); and (v) allow auditors to defend their position when dismissed.

Sri Lankan and Singaporean mechanisms compare well with these criteria. In particular, the Singaporean mechanism for compensation on termination is noteworthy (see Table 4).

Box 4: Sacking of Auditors in China a Worrying Trend

The Chinese Institute of Certified Public Accountants (CICPA) has expressed concerns over several cases of 'malignant sacking' of auditors who failed to issue an opinion over the fairness and completeness of the financial statements and their notes to the accounts. CICPA also reiterated that it wants to make sure that unreasonable client demands won’t [pass] by switching auditors.

Tianjin Xinde Certified Accountants, one of the largest audit firms in Shenzhen, was sacked by its long-standing client, Tonmac International, a machine-tool company over disagreements concerning financial statements last year and declining to give an opinion on the accounts. The audit firm also complained that client sales for the years 2001 and 2002 were overstated and the company used the money raised from issuing new shares last year in security trading and asset management, which violated the issue prospectus. Zhongtian Huazheng CPA suffered the same fate when it failed to see eye-to-eye with one of its clients, Shenzhen-listed Neimengu Hongleng Industry.

Sri Lankan and Singaporean mechanisms compare well with these criteria. In particular, the Singaporean mechanism for compensation on termination is noteworthy (see Table 4).

Table 4: Auditor Appointment and Dismissal

<table>
<thead>
<tr>
<th>Factor</th>
<th>Sri Lanka</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominating party</td>
<td>Shareholders (see below for bank auditor nominations)</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Appointing party</td>
<td>Shareholders</td>
<td>Shareholders</td>
</tr>
</tbody>
</table>

---

Auditor Independence

Auditor independence is absolutely fundamental to audit quality. However, potential mechanisms for ensuring independence—such as compulsory auditor rotation and restrictions on nonaudit services—are the ongoing subject of intense debate. The authors take the position that, while evidence regarding the effectiveness of some of these mechanisms may not be clear cut; their adoption has a lot of potential upside and minimal downside.

Whatever the case, mechanisms to enhance auditor independence include: (i) ensuring auditors are free of any interest that might be regarded as incompatible with integrity, objectivity and independence—this includes limiting financial, personal or commercial relationships; (ii) placing limits on the nonaudit services that auditing firms provide to audit clients—one article reports that, for a sample of 307 listed US firms, fees paid for nonaudit services were almost three times the amount paid for audit fees; (iii) requiring regular rotation of audit partners or audit firms to support objectivity and independence; and (iv) establishing effective audit committees. Sri Lankan and Singaporean mechanisms generally compare well with these criteria (see Table 5).

ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

Table 5: Auditor Independence and Incompatible Activities

<table>
<thead>
<tr>
<th>Factor</th>
<th>Sri Lanka</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restrictions on relationships: personal commercial financial, or influential</td>
<td>Yes</td>
<td>Some restriction on financial relationships</td>
</tr>
<tr>
<td>Restrictions on services provided by audit firms to audit clients (other than the audit)</td>
<td>Auditors may not provide services that effectively make them company officers or servants</td>
<td>Auditors may not provide accounting, tax advice, consulting, financial and investment advice or corporate recovery services</td>
</tr>
<tr>
<td>Rules to avoid low balling</td>
<td>Yes. Incoming auditors are not allowed to accept fees lower than those of outgoing auditors, at least for the first year</td>
<td>Yes</td>
</tr>
<tr>
<td>Required rotation of audit partners</td>
<td>No (But, the Auditor General informally rotates the private auditors of public corporations on a four yearly basis)</td>
<td>Every five years for listed companies</td>
</tr>
<tr>
<td>Safeguards to objectivity:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Challenges to objectivity disclosed</td>
<td>Yes (if significant)</td>
<td>Yes</td>
</tr>
<tr>
<td>• Quality reviews</td>
<td>Recently adopted (to be implemented)</td>
<td>Yes</td>
</tr>
<tr>
<td>• Internal quality reviews</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>• Potential threats to objectivity monitored by third party</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>• Audit committees required</td>
<td>No (but recommended by Colombo Stock Exchange and encouraged by ICASL Corporate Governance Guidelines)</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Audit Reporting Requirements

Although mandated audit reporting requirements can increase audit quality, there is a risk—particularly in developing and transitional countries—that auditors are seen as ‘bloodhounds’ rather than ‘watchdogs’. Assigning quasi-regulatory functions to auditors may limit their access to company information thereby impairing their ability to issue an opinion as to the fairness of company financial statements. Table 6 indicates that Sri Lankan and Singaporean audit reporting requirements stray into quasi-regulatory territory.
Table 6: Audit Reporting

<table>
<thead>
<tr>
<th>Issue</th>
<th>Sri Lanka</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Auditor’s Report:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Fraud or irregularities</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Illegal acts</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Internal controls and systems</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Maintenance of proper records</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Reporting to Other Parties:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Fraud or irregularities</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Illegal acts</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Internal controls and systems</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>• Maintenance of proper records</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Standard forms of audit reports required by law</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Matters to be included in reports specified by law</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
| Standard forms of audit reports established by pro-
  fessional bodies                                | Yes       | Yes       |
| Qualified audit reports due to uncertainties       | Yes       | Yes       |

Auditor Liability

Exposing auditors to civil liability creates strong incentives to raise quality and maintain independence.

“A two-pronged approach may be adopted to encourage small shareholders to actively monitor their management. One is to require transparency and disclosures ... The other is to install provisions in the company laws to facilitate class action suits against corporate directors, management and external auditors. In a class action suit, all minority shareholders potentially benefit from the fruits of activism by a few shareholders. The threat of such action can be a powerful deterrent to management decisions that could result in the expropriation of wealth of minority shareholders.”

Nevertheless, there must be a balance between providing this incentive and avoiding a decline in audit services due to excessive litigation costs. However, in developing and transition economies—particularly those with weak judicial systems—the possibility of civil litigation against auditors may not be a credible threat. Alternatively, regulated quality assurance reviews and sanctions may be more effective in encouraging better audit


quality. Sri Lankan and Singaporean arrangements generally compare well (see Table 7).

### Table 7: Auditor Liability

<table>
<thead>
<tr>
<th>Issue</th>
<th>Sri Lanka</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional Sanctions:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Warning</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Reprimand</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Fine</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Temporary suspension</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Permanent exclusion</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Legal liability cap between contract parties</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Contractual liability cap between contract parties</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Legal liability caps between contract parties and third parties</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

6. **The Accountancy Profession**

**Introduction**

If ADB DMCs are to effectively apply IAS, they require financial statement preparers and auditors who can exercise significant professional judgment. Among other things, financial statement preparers and auditors must have a good understanding of accounting theory and be fully conversant with the IAS conceptual framework. Furthermore, they must keep abreast of changes to accounting and auditing standards through ongoing continuing professional education (CPE). This generally relies on the presence of strong professional bodies.

Moreover, the absence of suitable qualified and experienced accountancy professionals retards economic growth, impedes the effective implementation of donor-supported programs, and increases the severity and duration of asset and equity crises (see Chapter II).

**Factors Affecting Development of the Accountancy Profession**

Some economies have a better professional infrastructure than others because of their legal traditions. Former British colonies (e.g., Canada and Malaysia) use common law systems and rely on independent judges and juries and legal principles supplemented by precedent-setting case law to respond to evolving circumstances. Civil law countries (e.g., Indonesia and the Republic of Korea) rely on legal codes that contain very specific rules and are less adept at responding to changing environmental needs. Indeed,
legal traditions affect the development of professions to a remarkable degree—researchers have found a robust negative correlation between the civil law tradition and lack of professions, on the one hand, and a supporting and beneficial impact of professions on the rule of law, on the other.51

Relevant Professional Standards and Guidance

In 1998, to assist member countries develop strong and ethical accountancy professions, the Confederation of Asian and Pacific Accountants (CAPA) issued the Guide on the Essential Components of a Professional Accountancy Body.

The Guide identifies 10 components of a professional accounting body including admission standards, membership requirements, CPE, technical standards, quality assurance processes and disciplinary rules. Appendix 5 describes other relevant materials.

IFAC Education Standards and Guidelines

The IFAC Education Committee is reviewing IESs and IEGs (see Appendix 6). The Committee has already released EDs on Competence-Based Approaches to the Preparation and Work of the Professional Accountant52 and Guiding Principles for International Education Statements.53 The discussion paper on competence-based approaches explores accountant competency and examines various country approaches. It defines competencies and capabilities, provides guidance on developing competence and assesses country approaches.

The IFAC Financial and Management Accounting Committee (FMAC) study on Competency Profiles for Management Accounting Practice and Practitioners highlights the competencies related to best management accounting practices. It also discusses competency standards and related assessment methodologies.54

IFAC Public Sector Committee (PSC) Study No. 14 Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities discusses issues associated with the identification, design and delivery of

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training to support the adoption of accrual accounting. Although developed to assist public sector entities moving to accrual accounting, this guidance may be useful in other contexts.\textsuperscript{55}

UNCTAD Initiatives

A 1999 UNCTAD report considered accountancy education and qualifications.\textsuperscript{56} It provides a useful set of benchmarks, in particular:

- Guideline for a Global Accounting Curriculum and Other Qualification Requirements (Includes the requirements for the qualifications of professional accountants, and the guideline for national systems for the qualifications of professional accountants); and
- Global Curriculum for the Professional Education of Professional Accountants (Includes organizational and business knowledge; information technology; and accounting and accounting-related knowledge).

Establishing a global curriculum will: (i) provide a benchmark for mutual recognition; (ii) enable employers and educators to compare qualifications of foreign students; (iii) support the free flow of professionals across borders; and (iv) support the work of the World Trade Organization (WTO) to implement the General Agreement of Trade and Services (GATS).

Another UNCTAD project will assess the competence of accountants. Its objective is to rate professional accounting qualifications from around the world and, in doing so, create impetus for improvements and support international skill transferability.

7. Public Sector Reporting

Introduction

Most countries are adopting IAS for private sector financial reporting. Meanwhile, the financial reports of public sector organizations vary significantly across the world—most countries require businesses to prepare and publish balance sheets—few require this basic discipline of public sector organizations.


There are compelling arguments in favor of accrual-based budgeting and reporting for governments. A number of developed countries including Australia, Canada, Iceland, Italy, New Zealand and the US have adopted accrual-based financial reporting.

Box 5: Accrual Accounting in the United Kingdom

The United Kingdom has adopted accrual accounting at the agency level and is looking to produce aggregate consolidated financial statements for 2006. It plans to prepare consolidated financial statements in a staged manner:
- Stage 1 will involve consolidating the unaudited central government accounts using 2001-02 National Accounts information.
- Stage 2 will involve consolidating accrual 2003-04 central government accounts.
- Stage 3 will involve a whole-of-government accounts consolidation for 2005-06.

Likewise, some ADB DMCs are considering, or are in the process of, moving to the accrual accounting basis (see Table 8). This study recognizes the benefits of the accrual accounting basis, but urges caution in its adoption. For instance, we recommend that RMI defer its move to accrual accounting (even though this conflicts with US accounting standards). This recommendation is based on the absence of formally-qualified accountants in the RMI government. Moreover, it should be stressed that the developed countries that adopted accrual reporting did so over a period of years (e.g., Canada took several years and New Zealand took three).

IFAC Public Sector Committee (PSC)

The IFAC PSC promulgates International Public Sector Accounting Standards (IPSAS) and other guidance for public sector entities. As of June 2002, PSC had issued 18 IPSASs (see Appendix 7). It also publishes guidance materials and studies (see Appendix 8).

Table 8: Eleven Selected ADB DMCs: Accounting Status

<table>
<thead>
<tr>
<th>Country</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Azerbaijan</td>
<td>Accrual-based Soviet Accounting System. Agencies prepare balance sheets, but aggregate government financial statements are cash-based. The IMF and the World Bank are encouraging the implementation of cash-based accounting</td>
</tr>
<tr>
<td>Fiji Islands</td>
<td>Uses cash-based accounting, but has recently purchased an accrual-based computer system (SAP) and intends to move to accrual accounting in the next few years.</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Uses cash-based accounting. The State Accounting Office plans to introduce accrual accounting.</td>
</tr>
</tbody>
</table>
TABLE 8: Eleven Selected ADB DMCs: Accounting Status (continued)

<table>
<thead>
<tr>
<th>Country</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mongolia</td>
<td>Accrual-based Soviet Accounting System. Agencies currently prepare balance sheets, but aggregate government financial statements are cash-based.</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Uses cash-based accounting, but is implementing accrual-based accounting.</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>Uses cash-based accounting, but is implementing accrual-based accounting.</td>
</tr>
<tr>
<td>People's Republic of China</td>
<td>Accrual-based Soviet Accounting System. Agencies currently prepare balance sheets, but aggregate government financial statements are cash-based. Agency accounting is a mixture of cash and accrual—the adoption of full accrual accounting is planned.</td>
</tr>
<tr>
<td>Philippines</td>
<td>Uses cash-based accounting. Government has announced its intention to introduce accrual budgeting and accounting. Groundwork has commenced.</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Uses cash-based accounting, but intends to move to the accrual accounting basis over time.</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Accrual-based Soviet Accounting System. Agencies prepare balance sheets and aggregate government financial statements are cash-based. Accounting standards are sector-neutral (i.e., the same IAS-based accounting standards apply equally to the public and private sector).</td>
</tr>
</tbody>
</table>

In May 2000, PSC issued ED 9 Financial Reporting under the Cash Basis of Accounting. ED 9 proposes requirements for the preparation and presentation of cash flow statements under the cash accounting basis. It included requirements relating to the definition of the reporting entity and the structure and content of the cash flow statement. PSC is currently considering its response to comments received on ED 9 and has indicated that it intends to allow greater flexibility in the presentation format adopted.

Other recent PSC documents include Study 14 Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities (see Box 6) and occasional papers on the modernization of government accounting in France and the United Kingdom.

In response to donor community requests, PSC is considering developing an IPSAS on development assistance, which could replace many existing special-purpose reporting requirements, thereby reducing DMC compliance costs.
This section briefly outlines the relationship between national accounts prepared in accordance with the UN System of National Accounts (SNA), IMF Government Finance Statistics (GFS) and IPSAS. SNA and GFS are based on the same principles, but have different objectives and involve different reporting entities:

- **SNA** compiles aggregate financial statistics for an entire economy; government and private sector activities are combined together.
- **GFS** is a specialized system intended to support public sector analysis. The IMF designed GFS so that government financial information could be compared across economies.\(^5^8\)
- **IPSAS** is designed for use in the preparation of general-purpose financial reports by public sector entities (individual government agencies or whole-of-government reports). Entities applying the accrual-based IPSASs must also prepare cash flow statements in accordance with IPSAS 2 Cashflow Statements.

SNA, GFS and IPSAS are all accrual-based systems, but there are three key differences. First, as already described, the reporting entity may differ. Second, classification and measurement differences exist. For example, SNA classifies some military assets as capital expenditure (assets) and some as current expenditure (expenses). Conversely, IPSAS 17 *Property, Plant and Equipment* requires that all military equipment meeting the definition of

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property plant and equipment and asset recognition criteria be capitalized. Third, the three systems vary in focus. For instance, GFS highlights changes in opening and closing net worth.

8. Conclusion

The issues reviewed in this chapter are relevant to the five participating countries and to ADB DMCs more generally. In particular, country auditing practices are currently under intense scrutiny. This chapter reviewed mechanisms that potentially strengthen audit quality. Moreover, this chapter provides background context for the following chapters that examine individual country accounting and auditing practices.
V. Accounting and Auditing Practices in Azerbaijan

1. Challenges and Responses

The Azerbaijan Government established the State Oil Fund—an intergenerational trust fund—in November 1999. The Fund will enable better management of oil revenues. Progress has also been made in implementing policy reforms, such as the passage of the Civil Code (effective 1 September 2000) and the amended Tax Code 2000 (effective 1 January 2001). However, structural reforms, particularly in the banking sector, have lagged behind. Crucial reforms are needed in this sector to improve supervision and strengthen enforcement of prudential regulations in line with international best practice.

The amended Tax Code 2000 is expected to increase fiscal revenues. However, increasing social expenditures while maintaining fiscal discipline remains a challenge, as does managing projected oil revenues and developing the non-oil sectors.

To maintain investor confidence, government will need to implement structural reforms, including privatization, financial sector restructuring, and the establishment of institutions and the rule of law that are conducive to a market-based economy.

The principal elements of government's medium-term strategy include: (i) maintaining fiscal and monetary policies that support macroeconomic stability; (ii) implementing aggressive programs to strengthen energy sector governance and financial discipline; (iii) maintaining the liberal trade regime; (iv) accelerating structural reforms; and (v) implementing measures that will improve the legal and regulatory environment for private sector development.

A comprehensive anticorruption program is being developed as part of government's overall effort to enhance governance. To this end, the Azerbaijan Accounting Chamber (AAC)—Azerbaijan's Supreme Audit Institution (SAI)—has been established. The AAC has the authority to audit all government bodies, including all budgetary and extra-budgetary organizations and funds, and will publicly report its findings.

2. Accounting and Auditing in Azerbaijan

Azerbaijan developed its Soviet-based accounting system throughout the 1920s and 1930s. The ‘Soviet accounting system’ catered to the needs of
central planning, in particular, the system provided accounting information, including: (i) financial information; (ii) tax information; and (iii) statistical information. It emphasized standardization and uniformity so that information could be compared across sectors and industries.

Upon independence in 1991, Azerbaijan found itself in the same position as other Former Soviet Union (FSU) countries concerning accounting arrangements. However, the Soviet accounting system created a sound basis on which to build. The system used many concepts of modern accounting including accrual measurement and double entry bookkeeping. Furthermore, large numbers of bookkeepers were trained in these concepts and were proficient in their application.

In the decade since the beginning of the transition, Azerbaijan has made some progress in developing an accounting infrastructure suitable to the needs of a market economy. However, financial management reforms were slow-tracked due to emphasis on the conflict and development of the oil and gas sector. Consequently, Azerbaijan’s accounting and auditing reforms lagged behind those of many other FSU countries.

Articles 120–125 of the Civil Code 1999 govern accounting and auditing arrangements in Azerbaijan. In particular, the Civil Code 1999 stipulates the structure of Azeri financial statements. The Ministry of Finance (MOF) administers the Law on Accounting 1995, which regulates the maintenance of accounting records and the preparation of balance sheets by business entities and organizations in both the private and the public sectors. It also sets out financial reporting requirements. Other relevant laws include the Joint Stock Companies Law 1994, the Enterprises Law 1994, the Banking Law 1996 and the Tax Code 2000. These laws conflict in places regarding accounting and reporting arrangements. At the same time, the prescriptive nature of the Civil Code 1999 conflicts with the flexible provisions of the Tax Code 2000.

The main reporting requirements for legal entities are the quarterly tax return and statutory annual accounting reports that are filed in March-April. The accounting arrangements for relevant foreign companies usually exempt these companies from following Azeri accounting practices. The MOF has prepared a five-year program to develop accounting practices. This program is currently being considered and covers legislation, accounting standards, certification, ethics and training.

Auditing in the FSU reflected the highly controlling nature of the underlying accounting system. It was primarily a verification exercise, with the final accounts being compared to the bookkeeping records by accountants from another enterprise, or from the control and revision board.
Moreover, with the state undertaking controlling, crediting and investment functions, there was no need for a fully functioning audit profession. The auditing profession has only been created within the short time frame of 10 years.

The *Auditing Services Law 1995* governs auditing activities in Azerbaijan. Other laws stipulate audit requirements. In general, all organizations must be audited. The *Auditing Services Law 1995* describes the ‘Audit Conclusion’ as an estimation of an organization’s financial state. As of April 2001, 160 individuals and 32 firms were licensed to conduct audits in Azerbaijan (five of these firms were foreign).

### 3. Professional Infrastructure

The Soviet accounting system required neither professional accountants nor an accountancy profession. This changed with Azerbaijan’s transition to a market economy, following independence in 1991.

The Chamber of Auditors of Azerbaijan (COAA) began operations in 1996 in accordance with the provisions of the *Auditing Services Law 1995*. Under these provisions, the Chamber is responsible for: (i) overseeing auditing activities in Azerbaijan; (ii) issuing auditing instructions, standards and guidance; (iii) licensing individual auditors and auditing firms; (iv) considering complaints against individuals and auditing firms; (v) consulting the profession on relevant legislative issues; (vi) reviewing the compliance of foreign individuals and foreign audit firms with the *Auditing Services Law 1995*; and (vii) conducting audits. The COAA may also establish auditing firms and, until January 2001, it also conducted fee-paying audits on its own behalf in competition with its members.

The Supreme Council of Azerbaijan appoints the Chamber’s Chairperson and Deputy Chairperson. Individual auditors and auditing firms are required to pay membership fees to COAA. The Chamber holds memberships in several international and regional bodies, including those for SAIs, but it will be relinquishing the SAI memberships in favor of the recently established AAC.

As of April 2001, the COAA had issued renewable five-year audit licenses to 160 individuals, 27 local firms and five foreign firms. Auditing firms must comprise at least three qualified individuals. Individuals must be Azerbaijan citizens, although the Chamber may accept the qualifications of foreigners, who are licensed to practice in their own countries. To qualify for an audit license, individuals must: (i) have completed higher education in accounting, finance, economics or law; (ii) pass the auditor’s license examina-
tion set by a COAA-appointed Commission; and (iii) have at least three years practical experience related to their education field. CPE is not mandatory.

The COAA has also created a local chapter of the US-based Institute of Internal Auditors (IIA). More recently, the nongovernment, not-for-profit Association of Certified Accountants of Azerbaijan (ACAAz) was established in 2000. The Association currently has 18 active practitioner members, all of whom have completed training in international accounting standards and practices. Nineteen other specialists are undergoing certification and around 80 others are undertaking courses.

The International Regional Federation of Accountants and Auditors Eurasia is not an Azerbaijan-based professional accountancy body, but influences accountancy developments within the FSU and within Azerbaijan. This Federation was established in 1999—its members include 20 professional accountancy organizations from 10 FSU countries. The Federation’s mission is to develop and strengthen the accounting and audit profession, promote the implementation of international professional standards and professional standards on ethics as developed by IFAC and IASB through its member bodies.

The Federation provides support and assistance to national organizations of accountants and auditors in the following areas: (i) developing national organizations in preparation for IFAC recognition; (ii) ensuring high quality accounting and audit services; (iii) developing the theory and practice of accounting and audit based on international standards; (iv) preserving the professional independence of accountants and auditors; and (v) developing and strengthening professional contacts at the regional and international levels. Azerbaijan is represented on each of the Federation’s five standing committees: accounting standards, auditing standards, legal reform, membership and ethics, and professional education and certification.

The Azeri accountancy profession is in its infancy. Not surprisingly, COAA has noted that fees charged by foreign auditors are around 23 times higher than those charged by domestic auditors. The profession can narrow this gap over time by pushing accountants to higher certification standards.

4. Accounting and Auditing Standards

In common with most other countries transiting from the Soviet accounting system, Azerbaijan continues to emphasize uniform accounting systems. These comprise sector-specific charts of accounts supported by detailed accounting rules and instructions.
In the 1990s, while government focused on the conflict and on developing the oil and gas sector, accounting reform was accorded a low priority. Moreover, the MOF worked, and continues to work, within tight resource constraints (it has received no external technical assistance to date for accountancy reform). Consequently, Azerbaijan’s transition towards IAS-based accounting standards has generally been slower than other FSU countries.

The Accounting Law 1995 and the Banking Law 1996 assign accounting-standard-setting responsibilities to the MOF and to the Azerbaijan National Bank (ANB). Neither law explicitly refers to IAS. Furthermore, the oil production sharing agreements exempt relevant foreign companies from following Azerbaijan accounting standards; most of these companies use IAS.

Substantial progress has been made towards implementing IAS-based financial reporting in the banking sector. The MOF recently presented an Accounting Reform Plan to the Cabinet of Ministers for consideration and approval. The draft plan reflects objectives that are largely inconsistent with accounting in a market economy. For instance, a primary purpose of financial accounting is considered to be the provision of information, in a standard format, that is needed to prepare consolidated country financial statements, which incorporate all entities, both private and public sector. The plan also emphasizes the continued development of UASs.

COAA promulgates auditing instructions in accordance with regulations issued under the Auditing Services Law 1995. These instructions are directly based on ISAs. The development process is consultative. Once approved by the COAA Board, auditing standards are registered with the Ministry of Justice. As of December 2001, the Chamber had reviewed, amended and promulgated about 24 of the 30 ISAs.

5. Education and Training

Together with other FSU states, Azerbaijan has a high literacy rate and comparatively high educational standards. Indeed, Azerbaijan education was renowned within the Soviet Union and more widely (particularly education related to the oil and gas sectors).

However today, most higher education institutions suffer from resource constraints and infrastructures have deteriorated considerably. Moreover, post-independence difficulties have constrained the development of quality academic materials including textbooks. Furthermore, computer hardware and software is lacking and high Internet
fees exclude most academics and students from accessing web-based information resources.

One state institution—the State University of Economics—offers undergraduate and postgraduate accountancy programs. As of November 2001, 1,100 students were enrolled in its accountancy-based bachelor programs and 90 were undertaking Masters programs. The state specialist schools, for instance the Oil and Gas Academy, also teach specialist accountancy studies.

Eight private tertiary institutions offer accountancy programs, two of these teach predominantly in English. Furthermore, practical accountancy training is given by 26 vocational schools and the newly-established Azerbaijan Banking Training Center provides specialist education in banking and finance. The ACAAz, the Azerbaijan Association of Entrepreneurs and COAA also conduct accounting and auditing training.

The quality of higher education is constrained by ad hoc curriculum development and a general absence of continuing education for accountancy lecturers and professors—the latter is critical in the dynamic environment of transitional Azerbaijan. The move towards the Azeri language further exacerbates problems. For accountancy in particular, there is a chronic lack of textbooks and other teaching materials. Moreover, those that are available are either outdated or unsuitable in the Azeri context.

6. Government Budgeting and Accounting

Although government finances are in deficit, projected revenues from the oil and gas sector make the current situation sustainable. Indeed government has established a significant Oil Fund and has indicated a medium-term intention to substantially reduce reliance on external assistance. The Oil Fund will support the competitiveness of the non-oil sectors and contribute to intergenerational fiscal stabilization.

However, public sector management arrangements have been characterized as inefficient, ineffective and nontransparent. In the past two years, the Government has prioritized public expenditure management reforms. These include: (i) the ongoing development of a Medium-Term Expenditure Framework (MTEF) for use in budget preparation. Future budget submissions will provide reference to the MTEF, as well as detailed information on expenditure classifications, contingent liabilities, extra-budgetary activities, and the consolidated and general government budgets outturns for the previous year; (ii) drafting amendments to the Budget Systems Law and revisions to budget regulations; (iii) beginning in 2001, the
publication of quarterly reports on the consolidated government budget execution, including revenues, expenditures, expenditure arrears, stock of government and government-guaranteed debts, and new loans contracted or loan guarantees issued prepared by the MOF; (iv) integration of extra-budgetary activities into the state budget beginning with the 2002 budget; and (v) strengthening the MOF internal audit function.

Government activities are generally accounted for on an accrual accounting basis at the organizational level and on a cash basis for consolidated budgeting and reporting—the cash basis was introduced with support from international institutions, particularly the IMF and the World Bank.

Government organizations prepare monthly cash reports and quarterly accrual reports that are submitted to the MOF. In 2001, the MOF began publishing consolidated quarterly reports incorporating revenues, expenditures, expenditure arrears, stock of government and government-guaranteed debts, and new loans contracted or loan guarantees issued. A revised Budget Systems Law has been drafted and is currently being considered.

Although government organizations are staffed with 'accountants' and bookkeepers, these personnel have received little ongoing training. Moreover, concerns over the suitability of their qualifications have been raised, given the changed economic environment and the transition from the centrally planned to the market economy.

7. Donor Assistance

Government has announced its intention to significantly reduce its reliance on external assistance within five years. Azerbaijan joined ADB in December 1999. Although no active or planned loan projects are directly related to improving financial governance arrangements, Technical Assistance (TA) No. 3661: Capacity Building for Strategic Economic Policy Formulation in the Ministry of Finance ($0.762 million: 2001-2002) includes: (i) assisting the development of a Macroeconomic Policy Group (MPG); (ii) providing strategic policy advice on structural reform and macroeconomic policy; (iii) improving the information base for MOF economic policy development; (iv) enhancing MOF forecasting and program design capacity and improving fiscal analysis; and (v) developing a macroeconomic framework and public investment program criteria in coordination with MPG and the MOF’s Debt Management Department, and strengthening the Project Evaluation Unit.
The European Bank for Reconstruction and Development (EBRD) emphasizes programs and activities that support privatization, financial reforms, industrial restructuring, the creation and strengthening of infrastructure, foreign investment inflows and environmental rehabilitation. EBRD also provides assistance to organizations to improve their accounting and financial reporting capabilities. Furthermore, EBRD is currently considering providing assistance to the State Securities Committee to align securities laws and regulations with international practices. The IMF has provided assistance to improve macroeconomic policies and to strengthen central bank functions.

The World Bank is the key player in supporting improved financial governance arrangements. In addition to strengthening executing agency accounting arrangements and financing external financial audits, the following projects are relevant:

- **Pipeline:** *Institution Building Technical Assistance Project II* ($16.0 million: 2002–). This project has two components: Public Sector Reform (PSR) and Financial Sector Reform (FSR). The PSR component is intended to: (i) improve public resource management; (ii) strengthen the accountability, efficiency and policy implementation capacity of the central government; (iii) improve public service delivery; and (iv) develop the legal system and an independent judiciary. The FSR component will focus on: (i) assisting the Government to privatize state banks; (ii) assisting the ANB to strengthen banking supervision; and (iii) strengthening the legal and regulatory environment.

- **Project P055131:** *Second Structural Adjustment Credit Project* ($60.0 million: 2002–). This project will support the Government's public sector reforms. In doing so, it is intended to contribute to improved public financial management, including: (i) better management of public resources—human, financial and natural; (ii) improved delivery of public services; and (iii) an enabling environment for private sector development.

- **Loan 35180:** *Financial Sector Technical Assistance Loan Project* ($5.4 million: 2001–2006). This project supports implementation of the Government’s financial sector development strategy, including: (i) introducing IAS-based National Accounting Standards for commercial banks; (ii) establishing IAS-compatible National Accounting Standards; (iii) passing laws and regulations to reinforce these National Accounting Standards; (iv) developing commercial bank financial reporting based on ANB-prescribed standards, and (v) preparing a banking manual of procedures and guidelines for accounting practices.
• Loan 27690: Institution Building Technical Assistance Project ($18.0 million: 1995–2001). This project had four focal areas: (i) assisting privatization and enterprise reform; (ii) strengthening macroeconomic management; (iii) developing the financial sector; and (iv) providing legal technical assistance. Among other things, the assistance supported the development of accounting and auditing systems and standards for enterprises and banks, and the implementation of a computerized accounting system within ANB.

European Union—Technical Assistance to the Commonwealth of Independent States (EU-TACIS) assistance includes: supporting institutional, legal and administrative reforms; and supporting the private sector and assisting economic development. Particular attention is focusing on developing internationally-acceptably accounting standards. The United States Agency for International Development (USAID) is providing assistance to support the introduction of IAS and to develop qualified financial experts in order to facilitate a countrywide transfer to international standards of financial reporting (through assistance to the ACAAz).

8. Issues and Recommendations

This part presents the issues and recommendations that are associated with gaps or weaknesses in Azerbaijan’s accounting and auditing arrangements. These recommendations are intended to supplement and support existing strategies and projects. Where actions are already planned or underway, no recommendations are made.

The study concludes that—with some exceptions—much remains to be done to align Azerbaijan accounting and auditing arrangements with international practices and with the needs of the mixed market economy. These changes include developing a supportive and appropriate legislative and institutional environment, reforming accounting standards and strengthening the accounting and auditing profession. Internationally-compatible arrangements can only be successfully implemented with the support of a strong profession comprising skilled accountancy professionals.

Azerbaijan is now in a position to closely examine other countries’ efforts and—by doing so—to develop a comprehensive road map for accountancy reform that (hopefully) will enable it to avoid the errors made by other countries. To this end, this DSAA recommends that a coordination group be established to: (i) develop a strategic plan for accountancy reform; and (ii) design and agree a legislative and institutional framework that will support implementation of the strategic plan.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

Each study recommendation—and the issues that it is intended to address—is summarized below. The Azerbaijan DSAA report provides further detail.

Establish Coordination Group, Develop Strategic Plan and Review Framework

In addition to conflicts between governing legislation, some laws will impede development of accounting arrangements. Moreover, assignments of institutional responsibilities are inappropriate in some cases. Finally, there is much to be done regarding accountant certification and general accounting training.

Although the MOF has prepared the draft *Accounting Reform Plan* covering legislation, management accounting, internal auditing and external auditing, it has done so within its limited resources. In general, the development of financial management arrangements is fragmented with several organizations taking initiatives. A high-level, representative coordination group could do much to ensure that these efforts are mutually supportive and do not overlap or conflict.

It is recommended that assistance be provided to support financial management developments, through establishment of a Coordination Group. It is also recommended that assistance be provided to assist the Coordination Group to prepare a strategic plan for the development of Azeri accounting and auditing. The project would involve: (i) researching Azerbaijan accounting and auditing arrangements; (ii) identifying and analyzing existing problems; (iii) examining and drawing useful lessons from regional and international experience in terms of developing financial management arrangements; and (iv) using this information and the associated analyses to formulate a medium to long-term development plan for Azerbaijan financial management. It is further recommended that assistance be provided to assist the Coordination Group to review the legislative, regulatory and institutional framework and to identify necessary changes to this framework.

Amend Laws and Regulations

Among other things, the prescriptive provisions of the *Civil Code 1999* conflict with the adoption of international accounting practices. Several laws are currently under revision including the *Accounting Law 1995* and the *Banking Law 1996*. It is recommended that assistance be provided to develop a
legislative base that is conducive to the adoption of international accounting and auditing practices.

Clarify Accounting Standard-Setting Arrangements

The MOF and ANB both promulgate Azeri accounting standards in accordance with a Presidential Decree. It is recommended that the Accounting Law 1995 be revised to support the development of accounting standard-setting arrangements.

Clarify Legal Status of Auditing Standards

Relevant Azeri laws are largely silent regarding auditing standard requirements. It is recommended that all laws requiring audited financial statements be amended to stipulate that these audits must be conducted in compliance with Azeri auditing standards and practices.

Clarify Auditing Standard-Setting Arrangements

COAA sets Azeri auditing standards. However, the standard-setting process is not enshrined in law. For instance, the composition of the standard-setting body should be legally established (regulators and financial statement users should be strongly represented). It is recommended that the Accounting Law 1995 be revised to provide for the development of auditing-standard-setting arrangements.

Broaden and Strengthen Accounting Qualifications

COAA issues audit licenses to individuals and to auditing firms. The licensing process could be strengthened significantly. The revised accounting law, prepared by the MOF, envisages that this responsibility would be assigned to the MOF. Furthermore, while the Chamber has one membership category (licensed auditor), it is common international practice for professional bodies to have a range of membership categories with differing qualification criteria including Accounting Technicians, Management Accountants, Government Accountants and CPAs. The establishment of additional membership categories, with appropriate qualification criteria, would strengthen the Azeri accounting profession and broaden the Chamber’s membership and revenue base. It is recommended that assistance be provided to establish additional
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accounting qualifications including Accounting Technician, Management Accountant, Internal Auditor, Government Accountant and CPA. It is also recommended that assistance be provided to: (i) review existing licensing procedures and requirements (e.g., education, practical experience and professional examinations); (ii) develop improved licensing procedures and requirements, and (iii) implement these new licensing procedures. It is further recommended that individuals already holding audit licenses be required to re-qualify under the improved qualifications when their existing licenses expire.

Develop Training Materials

The COAA has developed training materials with EU-TACIS assistance. However, the rapidly changing environment and need for professional development present major challenges. Multimedia and Internet-based technologies present options to prepare effective interactive training materials that are easily redeveloped to reflect the changing environment and can easily be distributed to far-flung regions. It is recommended that assistance be provided to develop training materials for accountant continuing professional education. Similar ongoing ADB-supported initiatives for the People’s Republic of China, Nepal and the Philippines are directly relevant. The project would involve: (i) studying options for preparing and providing training materials to CPAs; (ii) developing a medium- to long-term plan for developing continuing professional education; (iii) studying options for developing and delivering training materials using modern technology, and (iii) developing training materials and training trainers.

Develop Accounting Curriculum and Materials

The move towards Azeri-language instruction combined with the rapidly changing accounting environment means that quality accounting educational materials are not generally available. Moreover, the academic curriculum has not kept pace with environmental changes. It is recommended that assistance be provided to: (i) review the accounting curriculum; (ii) revise the accounting curriculum; (iii) prepare suitable accounting textbooks and other training materials, and (iv) implement the new curriculum in universities.
Provide Continuing Training to Professors and Lecturers

Azerbaijan has extremely competent accounting professors and lecturers due to the country’s legacy of high educational standards. However, not all these professors and lecturers are conversant with the changes in the accounting environment. It is recommended that assistance be provided to design and implement a continuing education program for accounting lecturers and professors.

Establish Government Accountant and Auditor Certifications

As described above, professional qualifications for government accountants should be established. Furthermore, the recently established AAC intends to develop certification procedures and associated training programs for its auditors. It is recommended that assistance be provided to develop certification procedures and associated training programs for government accountants and auditors.
VI. Accounting and Auditing Practices in the Fiji Islands

1. Challenges and Responses

Investment has been very low in the Fiji Islands for many years: private investment averaged only 5 percent of GDP in the 1990s. The major constraints to Fiji Islands’ financial sector development have been identified as: (i) an inadequate economic environment; (ii) public sector domination; (iii) excessive government regulation; (iv) land tenure and leasing problems; (v) cultural and communal concerns; (vi) inadequate human resource skills; (vii) considerable government intervention in the financial sector; (viii) a need for standardized accounting practices; (ix) slow capital market development; (x) money and bond market distortions; (xi) inadequate market supervision; (xii) outdated corporate and bankruptcy laws; (xiii) constraints on the Fiji Development Bank (FDB); (xiv) constraints on microfinance; and (xv) education and training shortcomings.

Accountability breakdowns in the core public sector continue to make headlines. Most recently, it has been alleged that the Agriculture Ministry misused $8 million. In particular, it appears that civil servants ignored procurement, appropriation and accounting rules.

Government has publicly declared that curbing corruption and other unethical behavior is an integral part of its effort to promote transparency, integrity and good governance, and has announced several responsive measures. Furthermore, among other things, government announced—in the 2002 Budget Address and in the 2002 Economic and Fiscal Update—that it would:

- Establish a Financial Intelligence Unit to counter money-laundering practices.
- Reactivate the suspended Financial Management Reform (FMR) program. These reforms will be phased over a number of years, taking into account technical and human resource capability.
- Strengthen public enterprise reforms by continuing to divest shareholdings in selected enterprises, and improving the efficiencies, accountabilities and performances of public enterprises and statutory agencies, through the Public Enterprise Act 1996 and the new Public Finance Management Act (PFMA) 1999.

2. Accounting and Auditing in the Fiji Islands

Public sector-led growth was emphasized following independence in 1970. Amidst growing dissatisfaction, the Fiji Islands began to move towards a more open, market-oriented economy in the early 1990s. This move provided impetus for better accounting arrangements and improved financial disclosure.

The economic losses that were incurred when the NBF nearly collapsed emphasized the importance of good financial disclosures, sound corporate governance practices and robust banking supervision arrangements. In response: (i) the supervision of financial institutions was raised to international standards; (ii) a strengthened monitoring regime has been introduced for public enterprises; and (iii) financial disclosure requirements have been raised through the introduction of IAS-compliant accounting standards.

The ‘Fiji Islands’ Accounting System’ is strongly influenced by British and more recently by international arrangements and practices. However, many aspects of the system are dated. With regards to financial disclosure, a recent study that examined compliance with Fiji Accounting Standards (FASs) favorably concluded that:

"the extent of non-compliance identified in Fiji does not appear any greater than found in Australia, New Zealand, the United Kingdom and the United States. This is in spite of a weak monitoring system and lack of sanctions at the disposal of the Fiji Institute of Accountants (FIA)." 60

The effectiveness of accounting and auditing arrangements is undermined by the ongoing emigration of skilled accounting personnel. This trend accelerated following the events of May 2000. Consequently, many accountancy positions are vacant or are filled with less-than-suitably-qualified and experienced personnel. The problem is particularly acute in the core public sector, which is generally unable to pay accountants at prevailing market rates.

The Auditor General heads the Office of the Auditor General (OAG), which is the SAI of the Fiji Islands. To be effective, an SAI must be staffed with well-qualified and experienced professionals. The Ministry of Finance

and Planning (MOFANP) and the Public Service Commission have supported the OAG's efforts to strengthen its capacity—the OAG now offers competitive pay rates—at least for entry-level positions. Moreover, the minimum qualification requirement for OAG auditors has been raised—all recent OAG recruits are accounting graduates. The Auditor General actively encourages existing staff to undertake tertiary studies and professional training. These efforts have been successful—whereas the OAG employed just three graduates in 1996—70 percent of staff now hold qualifications. The Auditor General intends that all staff will be qualified by 2003.

3. Professional Infrastructure

The Public Accountants Registration Board was established in 1963 to register and supervise accountants. But it had limited supervisory powers and was ineffective in developing the Fiji Islands' accountancy profession. Registered accountant numbers grew from just 13 in 1963 to only 40 by 1970. In response to lobbying from practicing accountants, government approved the Fiji Institute of Accountants (FIA) Act 1971.

The FIA was subsequently established and now has around 500 members in six categories: chartered accountants in public practice, chartered accountants, provisional members, affiliate accountants, licensed accountants and student members.

The Institute conducts CPE activities and has recently reached agreement with CPA Australia and the Institute of Chartered Accountants of New Zealand (ICANZ) on CPE course delivery within the Fiji Islands. Furthermore, the FIA Annual Congress—which was first held in 1973—is not only a landmark event on the Fiji Islands' business and government calendar, but provides almost half of the Institute's revenue.

Today, despite its small size and limited resources, the Institute has developed into a strong and effective professional body. Its success is attributable to a small hard core of dedicated professionals with extensive support from the larger accountancy firms.

But the Fiji Islands' accountancy profession faces two major challenges. First, not only does the continued emigration of qualified accountants—which accelerated after the events of May 2000—have considerable social and economic implications, it also directly affects FIA's ability to maintain critical mass and saps the Institute's resources. Second, globalization has brought about major changes in professional requirements and in accounting and auditing standards. While these changes are largely transitory, the FIA must respond within its limited resources. To this end,
the Institute has developed, and started implementing, a Corporate Plan. The Plan details six key result areas and associated action plans.

Registered Tax Agents (RTAs) are registered with the Tax Registration Board (TRB) of the Fiji Islands Revenue and Customs Authority and advise clients on taxation matters. Some RTAs also provide accountancy services to small businesses. However, RTA qualification requirements are currently quite low, but FIA—through its representation on the TRB—is supporting moves to improve these requirements.

The 1987 turmoil triggered an exodus of professionals from the Fiji Islands' public sector. In recognition of the need to strengthen public sector financial management, significant efforts have been made in the past five years to professionalize the government accounting cadre. The 1998 founding of the Institute of Public Sector Accountants of Fiji is one such initiative. The institute convenes an annual conference and provides some support for professional training activities for members.

4. Accounting and Auditing Standards

The FIA began issuing non-mandatory Recommendations on Accounting Practice shortly after its establishment. The first FAS was issued in 1976. There were 28 FASs by 1998. These FASs were primarily IAS-based, but had an Australian or New Zealand influence where the Institute considered this suitable for Fiji Islands' conditions.

FIA’s Accounting and Auditing Standards Committee (AASC) recommends the promulgation of accounting and auditing standards to the Institute’s Council. The Council approves and promulgates standards. In January 1999, the Council agreed (in principle) to adopt IASs and ISAs as the basis for completely revised sets of Fiji Accounting and Auditing Standards. To this end, a comparative review of IASs and FASs began in November 1999 and was completed in 2001 with revised IAS-compliant FASs being issued.

Three FAS-related issues deserve attention. Other DMCs should be encouraged to examine the Fiji Islands’ approach. First, the IASCF holds exclusive copyright over IASs. In this respect, the FIA has negotiated a license for their usage. Second, FASs include a section that clearly identifies differences from the IAS text. Third, the IASB has been working on developing a differential financial reporting regime since 1998—in the Fiji Islands, only the more complex FASs apply to larger and publicly accountable organizations.

With the release of the revised FASs, priority has now shifted to reviewing ISAs and IAPSS for their application in the Fiji Islands. By January
2002, the AASC had reviewed 26 of the existing ISAs and IAPSs. The exercise should be completed by December 2002 after which the AASC intends to realign Fiji Standards on Auditing (FSAs) and Fiji Auditing Practice Statements (FAPSs) with ISAs and IAPSs every three years.

5. Education and Training

There is high and increasing demand for accountancy education, particularly since the events of May 2000. Among other things, this reflects: (i) well-paying employment positions that emigrants have vacated; and (ii) the international acceptability of accountancy qualifications.

The Fiji Islands’ accountancy education infrastructure comprises three key domestic institutions: the University of the South Pacific (USP), the Fiji Institute of Technology (FIT) and the Fiji National Training Council (FNTC). Each plays a different role.

Established in 1968, USP has 12 member countries: Cook Islands, Fiji Islands, Kiribati, Marshall Islands, Nauru, Niue, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu and Vanuatu. USP’s distance education program delivers academic courses throughout the member countries.

USP’s Department of Accounting and Financial Management is recognized for its high academic standards: it offers undergraduate and postgraduate degrees in accounting and financial management. While the number of students being taught by the Department is increasing rapidly, the Department faces problems filling vacancies—the net effect is that Student-Staff ratios have deteriorated significantly in the past two years.

FIT provides technical and vocational education and training. FIT’s School of Commerce had around 1,700 Equivalent Full Time Students in 2001. There has been a noticeable increase in the number of public sector accountants undertaking courses during the past four years.

FNTC is a tripartite body, comprising representatives from government, employers and employee unions. FNTC contracts training providers—such as Western Sydney Institute of Technology of New South Wales—to provide a variety of accounting courses.

A plethora of foreign (mainly Australian and New Zealand) education providers have established operations in the Fiji Islands. These institutions offer technician-level accountancy qualifications. While the quality of education offered by some of these institutions has been questioned—given their small size and limited resources (for instance, library materials)—their qualifications are extremely attractive due to the inherent emigration possibilities.
In the public sector, government appears committed to strengthening the qualifications and skills of accounting personnel. Civil servants performing accounting duties must successfully complete public service examinations prior to their employment or promotion. This requirement is waived where the officer has a recognized academic qualification (for instance, a USP accountancy degree). The examination syllabi differ from those for academic accountancy qualification.

In 2000, the Permanent Secretary for Finance established the MOFANP Training Committee on the basis that “there is an urgent need to update the qualifications and skills of existing staff especially in view of the upcoming reforms, technological advancement and changing management needs. Strategically, they must be equipped with appropriate skills and basic qualifications to enable them to meet the challenges of professionalism with efficiency, effectiveness, innovation and independence.” The Training Committee has developed a Training Policy, but recognizes that a thorough training-needs analysis must first be conducted to determine training requirements in relation to: (i) organizational needs; (ii) occupational needs; and (iii) individual needs.

6. Government Budgeting and Accounting

The Fiji Islands has a large and pervasive public sector, with high and growing public debt levels. The 2002 Budget signaled a significant loosening of fiscal policy with the intention of supporting higher levels of economic growth.

A cash basis of accounting is used in central government. However, the Government has signaled its intention to move to the accrual basis of accounting in the medium term. To support improvements, the government has procured, and is implementing SAP, a complex computer system. It will be progressively implemented over a period of some years.

The government accounting/finance cadre comprises several levels. Appointments and promotions are based upon experience and civil service examinations (the examination requirement is waived where personnel hold relevant academic qualifications). Few members of the accounting cadre hold formal accounting qualifications and—as of 31 December 2001—only 15 civil servants were full FIA members.

Government is placing increased emphasis on training and has indicated that significant numbers of accountants will be recruited and deployed within the public sector. But, in addition to losing staff to overseas emigration, the public sector must also compete with the private sector, which also has a shortage of accountants and bookkeepers.
The key changes under the FMR program include: (i) the availability of more accurate, reliable and timely information to support sound decision making; (ii) new banking and cash management systems; and (iii) the adoption of a new Public Finance Management Act (PFMA). The former Prime Minister suspended the original FMR program in August 1999, ostensibly due to concerns about implementation capability and pace. The broad strategy for revived FMR implementation is to implement the SAP software on a cash basis and then gradually move to accrual accounting and decentralization of input controls. However, the renewed FMR program is not starting from scratch—when the program was suspended in 1999—most ministries and departments had already prepared balance sheets and forecast financial statements, and had specified and costed outputs.

7. Donor Assistance

In comparison to other Pacific DMCs (PDMCs), the Fiji Islands is not heavily aid dependent. Studies of aid effectiveness have reached differing conclusions. On one hand, a Pacific-wide review contended, “... aid was judged to have been unsuccessful in facilitating growth. Aid had supported large public sectors and involved TA that financed line positions without leading to durable capacity building.” On the other hand, a Fiji Islands-specific empirical analysis concluded that bilateral aid, grant aid, and technical cooperation grants have had a significant impact on economic growth in the Fiji Islands. Conversely, the same analysis found that domestic resources did not contribute significantly to economic growth in the Fiji Islands. Whatever the case, many assistance projects were disrupted, curtailed or suspended following the events of May 2000.

To 31 August 2001, ADB had provided 13 loans totaling $161.1 million and TA grants totaling $18.9 million, since the Fiji Islands joined ADB in 1970. ADB is supporting broad governance activities through TA and loans. Directly relevant activities include:

- Proposed TA: 33129-01: Institutional Strengthening of the Capital Market Development Authority (CMDA) and South Pacific Stock Exchange (SPSE) ($200,000). This project is intended to support the development of an effective capital market in the Fiji Islands through building the capacity of the CMDA and the SPSE.
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- TA No. 3436: Fiji Development Bank (FDB) Review ($150,000: 2000–2002). This TA will: (i) evaluate FDB performance and procedures; (ii) identify operational obstacles; and (iii) provide recommendations for future improvements to best match with government development perspectives and to make FDB financially self-sustainable and functioning within sound banking practices.

- TA No. 3408: Preparation of a Medium-Term National Development Plan ($150,000: 2001–2002). This project is assisting the MOFANP to prepare a medium-term national development plan that presents government policies and strategies, together with performance indicators. A secondary objective is to formulate a medium-term capital expenditure program.

- TA No. 3391: Strengthening Debt Management ($150,000: 2000–2002). This project is assisting the MOFANP to improve the debt management function from macroeconomic, institutional, financial and data management perspectives.

- TA No. 3242: Public Enterprise Reform Program (Phase II) ($600,000: 2000). This TA supported public enterprise reform efforts, including the development of capacity, particularly in accounting, financial analysis, economics, commercial valuation, corporate governance and privatization.

- TA No. 3155: Strengthening Public Enterprise Reform (Phase I) ($150,000: 1999–2000). This TA supported capacity building in the Department of Public Enterprises concerning policy analysis, formulation and execution capacities for public enterprise reforms.

- TA No. 2463: Institutional Strengthening of the OAG ($550,000: 1996–1997). This project supported improvements to OAG procedures and practices.

- TA No. 2399: Institutional Strengthening of Fiji Electricity Authority (FEA) ($450,000: 1995–1996). This TA supported an examination of FEA’s operational efficiency before its corporatization and commercialization.

The World Bank has not directly focused on improving financial governance arrangements over the past few years. The United Nations Development Programme (UNDP) has supported improvements to the Fiji Islands’ aid coordination mechanism and contributes to the PFTAC. The Suva-based PFTAC advises PDMCs on budget management, tax administration, banking supervision, balance of payments, and national accounts statistics. The IMF manages PFTAC; funders include ADB, AusAID, IMF, NZAID and UNDP.
The Australian Agency for International Development (AusAID) is supporting significant projects in the health, education and community-based sectors—these projects include aspects of financial management. In relation to core financial governance, AusAID is providing long-term assistance (1999–2004) to improve Fiji's revenue base. Furthermore, the Fiji Institute of Accountants’ Corporate Plan 2001-2006 was developed with assistance from AESOP Business Volunteers (partially supported by AusAID).

The EU, through the National Indicative Program, is concentrating on human resources development and environmental issues. With regards to financial governance, EU is focusing on strengthening vocational training institutes, and improving planning and management capabilities in the national administration. New Zealand Agency for International Development (NZAID) provided support for the suspended FMR program—particularly advice on the development of the enabling legislation; the PFMA 1999.

8. Issues and Recommendations

The study identified 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. Where actions are already planned or underway—for instance, upgrading information systems—no recommendations are made. Issues are separated into: (i) those that are able to be resolved without external assistance; and (ii) those that are better able to be resolved with external assistance.

The study concludes that while Fiji Islands' accounting and auditing arrangements compare well with those of other countries, improvements could be made in two broad areas:

- Preemptive legislative and institutional actions would strengthen financial reporting arrangements. These actions include enhancing disclosure requirements and monitoring compliance with those requirements.
- Together with other PDMCs, the Fiji Islands lacks appropriate professional certifications for bookkeepers and accountants—particularly those in the public sector. To this end, this study recommends establishing appropriate Pacific-wide professional certifications for bookkeepers and accountants.

Each study recommendation—and the issues that it is intended to address—is summarized below. The Fiji Islands DSAA report provides further detail.
Strengthen Accounting Standards and Financial Disclosure Requirements

The AASC develops accounting and auditing standards. These standards are approved and promulgated by the FIA Council. The AASC mainly comprises financial statement preparers and auditors. Furthermore, Fiji Islands' legislation is largely silent on the basis for financial statement preparation (for instance, the Banking Act 1995 does not refer to FASs). It is recommended that assistance be provided to develop legislation that: (i) accords legal status to the AASC; (ii) prescribes the Committee’s composition and appointment processes—the composition should reflect a balance of constituency views; (iii) recognizes FASs; and (iv) stipulates the use of FASs in preparing financial statements.

Enhance Financial Disclosure Monitoring

Legislated financial disclosure requirements are generally consistent with international norms, in terms of timing and publication. Evidence also suggests that listed company and public enterprise compliance with accounting standards compares well with other countries.

The AASC is responsible for monitoring the application of FASs. However, in the face of resource constraints, the current focus on upgrading accounting and auditing standards to international levels, an absence of clear legislative support, and a reliance on volunteers, the Institute has been unable to perform this role. The Institute's Corporate Plan envisages this role being strengthened. The Ministry of Public Enterprises and Public Sector Reform (MOPEAPSR), Reserve Bank of Fiji and MOFANP also have monitoring roles. But, in some cases, a lack of suitably-skilled personnel and critical mass undermines the effectiveness of their monitoring activities.

It is recommended that assistance be provided to develop a financial disclosure-monitoring regime, under FIA auspices. This project would involve: (i) defining and agreeing the organizations to be included in the regime, for instance, listed companies, publicly accountable organizations (e.g., government companies, and statutory authorities and boards); (ii) designing and agreeing a suitable monitoring and penalty regime; (iii) preparing the necessary legislation and regulations; (iv) assisting FIA to establish the function; and (v) developing operational materials and training reviewers in their usage. Particular attention should be given to specialist materials (e.g., financial institutions and insurance companies). It is further recommended that public and private sector accountants be
seconded to the FIA monitoring function on short-term bases to undertake the financial statement reviews. Secondees would gain sound experience in the application of accounting and accounting standards and with financial disclosure requirements. Given the ‘public good’ nature of this function, it is also recommended that government consider appropriating funds to support ongoing operations.

**Review and (if necessary) Strengthen Auditing Practices**

FIA’s *Corporate Plan 2001-2006* indicates an intention to review auditing practices. It is recommended that the FIA comprehensively review auditing practices and arrangements (including auditor appointment and dismissal; auditor independence; auditor reporting requirements; and auditor liability). Should this review identify a need to strengthen these practices through legislation, it is further recommended that assistance be provided to develop legislation that strengthens auditing arrangements.

**Introduce Quality Assurance Mechanisms**

FIA’s *Corporate Plan 2001-2006* indicates an intention to introduce quality assurance procedures. To this end, it is recommended that assistance be provided to design, develop and implement a quality assurance regime that is appropriate to Fiji Islands’ conditions.

**Develop Appropriate Bookkeeping and Accountancy Certifications**

There are, in essence, three professional accountancy groups within the Fiji Islands: FIA members, government accountants, and Registered Tax Agents. But—even as a whole—the profession struggles to retain critical mass, let alone meet development challenges.

Furthermore, the requirements for FIA Chartered Accountant membership currently fall short of international guidelines in two respects: (i) the absence of a professional examination; and (ii) lower-than-expected requirements for CPE. However, the FIA *Corporate Plan 2001-2006* envisages that these issues will be addressed.

Most critically, government accountants do not have adequate or appropriate professional qualifications or representation. This will be essential if the revived FMR project is to be successful. The establishment of suitable bookkeeping and accountancy certifications would provide: (i) stepping stones to higher professional qualifications; (ii) measures to
gauge competence to undertake bookkeeping and accountancy tasks; and (iii) professional career targets. They would also provide a framework for a cohesive training program for government accounting personnel.

Other PDMCs also lack appropriate bookkeeping and accountancy certifications and professional representation. A Pacific-wide accountancy certification framework, which allowed for differing legal and taxation environments, would overcome the critical mass challenge that impedes development of accountancy personnel (particularly in the public sector).

It is recommended that assistance be provided to support: (i) a comprehensive review of bookkeeping and accountancy skills needs within the public and private sectors; (ii) design a framework of professional qualifications that is appropriate to the needs of both sectors in the Pacific and Fiji Islands’ environment; (iii) establish the professional bookkeeping and accountancy qualifications; and (iv) develop licensure criteria and examinations for each qualification.

Implement a Training Program for Government Accountants

Government recognizes the need for suitably skilled and experienced accountancy personnel. To this end, it has raised entry and promotion criteria. It is also encouraging incumbents to undertake further education. It is recommended that assistance be provided to: (i) design training programs that are appropriate to the qualification framework; (ii) develop associated materials; and (iii) train trainers in the delivery of these courses.

Extend the Reserve Bank of Fiji Supervision Regime to All Financial Institutions

The Reserve Bank of Fiji’s supervision role does not explicitly extend to two significant financial institutions; FDB and FNPF. Although these institutions do not generally issue to the public, it is essential that they are appropriately supervised, given their socioeconomic importance. It is recommended that all financial institutions be covered by Reserve Bank of Fiji’s financial supervision regime.

Educate IASB on the Fiji Islands Differential Reporting Approach

IAS has been developed on a one-size-fits-all basis. For instance, IAS 19 Employee Benefits requires that actuarial valuations be undertaken of certain employee benefits (such as long-service leave). The Fiji Islands has
developed a simple, workable approach to differential reporting that offers smaller organizations (that are not publicly accountable) relief from the more onerous accounting standards. It is recommended that the FIA formally advise IASB of its approach to allowing the differential application of FASs.

Retain Focus of OAG Activities

The Auditor General has made laudable progress in strengthening the skills and qualifications of government audit personnel. The Public Service Commission and MOFANP have supported these efforts. However, the OAG continues to lose staff to emigration and to the private sector. In the face of capacity constraints, the OAG’s mandate may soon be broadened to include “audits” of environmental impact assessments. Other proposals to widen the OAG’s operational scope include auditing additional entities, auditing grant recipients, and conducting performance audits. Given existing constraints, it is recommended that the OAG remain focused on developing capacity to conduct financial attest audits.
VII. Accounting and Auditing Practices in RMI

1. Challenges and Responses


Financial governance challenges include: (i) improving basic public sector record keeping, internal controls and accountability; (ii) addressing low levels of efficiency in public service, weak government financial management, and a slow buildup of funds in the Marshall Islands Intergenerational Trust Fund (MIITF); (iii) renegotiating a favorable and effective CFA with the US; and (iv) being removed from the Financial Action Task Force on Money Laundering (FATF) list of Non-Cooperative Countries or Territories.

In response to these challenges, government has recently prepared Vision 2018, a strategic development framework for the second CFA period (2003-2018). Vision 2018 sets 10 national goals and objectives, and presents broad strategies to meet them. It recognizes that sound financial management is essential to achieving and monitoring progress towards government’s goals.

2. Accounting and Auditing in RMI

The 1979 Constitution prescribes rights and governance structures; it also sets out high-level budgetary arrangements and establishes the position of Auditor General. Private sector accounting laws are largely modeled on US corporate laws.

The private sector operates on the accrual basis of accounting. Government accounting is currently on a modified accrual accounting basis, but accounting standards require that government move to full accrual accounting starting with the financial year beginning on 1 October 2002.

There is an acute shortage of qualified bookkeepers and accountants in both the public and the private sectors. As of October 2001, there were no professionally qualified Marshallese accountants in RMI. This gap is only partly filled by foreign CPAs employed within the private sector and in government.
RMI laws and regulations are reasonably clear about financial reporting requirements and timeframes. However, public sector financial reports are often years overdue. Furthermore, they are sometimes unauditable due to deficiencies in basic record keeping and internal control arrangements. To this end, efforts have been made to improve the timeliness of financial reports, but more remains to be done.

The Auditor General—who heads the OAG—is appointed by the President, with the approval of the Nitijela (Parliament). Appointees to this position must either have a professional accounting qualification (with practical experience) or have extensive relevant knowledge and experience. With just seven staff, the OAG faces severe resource constraints. In this respect, the Auditor General's independence could be strengthened.

3. Professional Infrastructure

There are no professionally qualified Marshallese accountants in RMI; nor is there a professional accountancy body. In contrast, RMI law recognizes and regulates other professions and occupations including health care providers, nurses, land surveyors, notaries public and the legal profession.

4. Accounting and Auditing Standards

In RMI, US GAAP is used directly. US GAAP—as applied to the nongovernment (private) sector—represents a detailed framework of principles largely based on accounting standards and guidance issued by the US FASB. The requirement to report in accordance with US GAAP is enshrined in RMI law (although some laws are ambiguous or silent on this point). US GAAP—as applied to the nongovernment sector—is largely consistent with IAS.

US GAAP—as applied to the government sector—is based on statements issued by the Government Accounting Standards Board (GASB). Hence, RMI government financial statements must comply with GASB's new financial reporting model (NFRM) starting with the financial year that begins on 1 October 2002. Among other things, this will involve the introduction of full accrual accounting. It also has significant implications for budgetary documentation, accounting arrangements, accounting systems and financial reporting. However, (i) NFRM implementation activities will coincide with the introduction of new computerized information systems and changes brought about by the Fiscal and Financial Management Reform Program (FFMRP); (ii) NFRM budgetary
ACCOUNTING AND AUDITING PRACTICES IN RMI

requirements will potentially conflict with those designed as part of the FFMRP; and (iii) comparative implementation progress lags other countries and jurisdictions that have implemented accrual accounting.

RMI audits must be conducted in accordance with US generally accepted auditing standards (GAAS). This requirement is enshrined in RMI law with regards to government auditing. However, in relation to nongovernment auditing, RMI law varies and can be ambiguous or silent on auditing standards.

5. Education and Training

The Marshallese education system faces funding pressures. Moreover, RMI's 4 percent birthrate is the Pacific region's highest creating further pressures. Finally, as of 2001, nearly half RMI teachers have secondary school diplomas as their highest qualification. Consequently, basic educational attainment levels are comparatively low, particularly in mathematics and English, subjects that are vital for developing accountancy skills.

Two post-secondary educational institutions offer accountancy courses: the College of the Marshall Islands and USP. However, very few accountancy students graduate from these institutions, or from other universities. In addition, the Graduate School (US Department of Agriculture, USDA) offers training in accounting and financial management, through the Pacific Islands Training Initiative (PITI). ADB and other donors support a range of other capacity-building initiatives.

6. Government Budgeting and Accounting

The public sector dominates the RMI economy. The national and local governments not only provide an important share of formal employment, but also own and control a large number of corporations and statutory bodies. Many government holdings have been corporatized over the years, and subsidies have been successfully reduced or eliminated in many cases, but public sector dominance of the economy remains.

The ADB-supported Public Sector Reform Program (PSRP), which began in 1997, targeted several economic policy issues. Program achievements included reducing the government payroll by 30 percent, privatizing domestic shipping services, streamlining Foreign Investment Board License applications, and establishing the MIITF to stabilize budget receipts.
Despite these measures, several issues remain, including low efficiency in the public service, weak government financial management, and a slow buildup of funds in the MIITF. RMI’s fiscal problems can be directly linked to deficiencies in budgeting and financial management systems that are unable to handle the huge grants forthcoming from the CFA. The budget format provides little information on government expenditure patterns, which limits government’s ability to make informed decisions about funding priorities and the public’s ability to question these spending decisions. The budget is prepared with only the most basic projections on revenues, expenditures, and information on past expenditure trends.

The acute shortage of qualified bookkeepers and accountants in government cannot be overemphasized. Poor record keeping, inadequate internal controls and financial management are symptomatic of this underlying problem.

A new RMI government was elected in January 2000. It recognized that many current problems are linked to public financial management deficiencies. In response, government and ADB developed the FFMRP. The FFMRP, while stabilizing the immediate fiscal situation, aims primarily at longer-term issues of improving overall RMI financial management. The specific objectives are to (i) ensure a sustainable income flow for future generations, (ii) strengthen public sector financial and economic management, (iii) stabilize the fiscal position, (iv) enhance the policy environment for private sector development to maximize the benefits from future CFA assistance, and (v) increase the effectiveness of the public service. The FFMRP will also improve the annual budget format to internationally accepted practices, improve financial control mechanisms, accounting and reporting systems, and develop a medium-term framework for planning and performance evaluation.

7. Donor Assistance

RMI relies heavily on foreign assistance with US aid estimated at about $80 million per annum. This includes direct budgetary support under the CFA to the national government and to the Kwajalein Atoll Development Authority, and payments to Kwajalein landowners, as well as other forms of assistance through US Federal Government programs.

ADB plays a significant role in improving financial management arrangements. Two program loans have supported fundamental government financial management reforms. Other loans have been provided to support education reforms. Furthermore, ADB has provided around a
dozen advisory and capacity-building TA grants in the financial management field.

8. Issues and Recommendations

The study identified issues and presents recommendations associated with gaps or weaknesses in accounting and auditing arrangements. These recommendations are intended to supplement and support existing strategies and projects, particularly Vision 2018 and the FFMRP. Where actions are already planned or underway (e.g., upgrading information systems), no recommendations are made. Issues are separated into: (i) those that can be resolved without the need for external assistance; and (ii) those that can better be resolved with external assistance.

Recommendations are made regarding legal changes to remove legal ambiguities and inconsistencies, clarify the status of accountants and auditors, and clarify the application of accounting and auditing standards. The study also recommends deferring implementation of the new financial reporting model, preparing bookkeeping and accounting manuals, and strengthening the Auditor General’s independence.

But the key constraint is the shortage of qualified bookkeepers and accountants. Improving financial management arrangements is impossible without them.

- In the long term (10-30 years), this will require an education system that produces numerate, literate and technologically-skilled students. Tertiary and vocational education would supplement this foundation with specialist financial management knowledge. Vision 2018 and Ministry of Education initiatives intend to address this issue.

- In the medium term (three to 10 years), a cadre of Marshallese accountants must be established. To this end, several mutually-supporting recommendations are made regarding professional status and training, i.e., that professional bookkeeping and accountancy certifications be established, preferably as a Pacific-wide initiative.

- In the short term basic record keeping and internal control inadequacies must be addressed, and Vision 2018 and the FFMRP must be effectively implemented. This cannot be done with existing or planned resources. This report recommends that at least six suitably qualified and skilled accountants be recruited to work with the MOF and other agencies to develop counterpart capacity, resolve existing problems and support the implementation of the FFMRP and Vision 2018.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

Each study recommendation—and the issues that it is intended to address—is summarized below. The RMI DSAA report provides further detail.

Recruit Qualified Accountants to Support Financial Management Improvements

As of October 2001 there were no professionally qualified Marshallese accountants in RMI. Not surprisingly, there is an acute shortage of qualified bookkeepers and accountants in government (although government employs several qualified expatriate accountants). Issues of poor record keeping, inadequate internal controls and financial management are symptoms of this underlying problem. It is understood that two qualified accountants will be contracted for the period of the FFMRP (from counterpart funds). However, these additional resources are unlikely to be sufficient to implement Vision 2018 and FFMRP (for instance, to overhaul or implement computerized accounting information systems).

It is recommended that at least six additional expatriate qualified accountants be recruited to support the MOF and other government agencies in their efforts to improve basic record keeping and internal control arrangements, and implement Vision 2018 and the FFMRP. To this end, the expatriates should assist suitable counterparts and understudies to move towards bookkeeping and accountancy certifications.

Establish Bookkeeping and Accountancy Certifications

There are no professionally qualified Marshallese accountants in RMI; nor is there a professional accountancy body. However, RMI law regulates other professions and occupations including healthcare providers under the Health Services Act 1983, nurses under the Nursing Practices Act 1995, land surveyors under the Land Surveyors Registration Act 1970, notaries public under the Notaries Public Act 1966, and the legal profession under the Legal Profession Act 1991.

Guam’s professional accountancy body is relevant to RMI (as Guam also operates under US accounting arrangements). But becoming a Guam CPA requires a relevant graduate degree, two years’ practical experience in a supervised environment, and successful completion of the AICPA uniform CPA examination. So in the short term, very few Marshallese are likely to attain a US qualification.

In the meantime, the establishment of suitable bookkeeping and accountancy certifications would provide stepping stones to the CPA
license, measures to gauge competence to undertake bookkeeping and accountancy tasks, and professional career targets.

It is recommended that suitable RMI bookkeeping and accountancy certifications be established and that these certifications focus upon public sector accounting. These certifications should, ideally, be developed as a Pacific-wide initiative.

**Prepare and Introduce Bookkeeping and Accounting Manuals**

In the absence of suitably qualified bookkeepers and accountants, normative manuals provide a sound starting point for improving basic accounting arrangements. Such manuals have been used in the past, but not for national government accounting. The successful implementation of the FFMRP and the new financial reporting model would be supported by these manuals and associated training programs. It is recommended that assistance be provided to develop bookkeeping and accounting manuals for national government organizations along with relevant training.

**Defer Implementation of the New Government Financial Reporting Model**

The *Financial Management Act 1990* governs public sector financial management. It stipulates that RMI government financial reporting shall be in accordance with the standards promulgated by the US GASB (Sec. 104). This study supports continuing the direct use of US GAAP by RMI. Alternatives include adopting IAS or developing national accounting standards. Neither option is desirable given existing RMI knowledge and experience with US GAAP, and likelihood that the US will require financial statements to be prepared in accordance with US GAAP, as a CFA requirement.

RMI government financial statements will have to comply with GASB’s new financial reporting model, starting with the financial year beginning on 1 October 2002. Among other things, this will involve introducing full accrual accounting and will have significant implications for budgetary documentation, accounting arrangements and systems, and financial reporting. However:

- Its implementation will coincide with the introduction of new computerized information systems and changes brought about by the FFMRP.
• The budgetary requirements of the new model will potentially conflict with those designed as part of the FFMRP.

• Comparative implementation progress lags behind other countries and jurisdictions that have implemented accrual accounting.

Given the acute shortage of qualified government bookkeepers and accountants, and comparative implementation progress, it is difficult to envisage the NFRM being successfully implemented in the required timeframe. However, deferring implementation of GASB 34 and GASB 35 would provide enough time to improve fundamental accounting arrangements and prepare for the required introduction of accrual accounting.

It is recommended that a realistic plan for implementing the requirements of GASB 34 and GASB 35 be prepared in consultation with the FFMRP. Given the far-reaching nature of these requirements, it is likely that the plan will indicate a necessity to defer implementation of these requirements until at least the financial year beginning on 1 October 2003. If this is the case, it is further recommended that:

• US DOI be consulted on deferring the NFRM implementation and the relevant government plans, and

• the Financial Management Act 1990 be amended to state that implementation of GASB 34 and GASB 35 will not apply to the preparation of government financial statements until (at least) the financial year beginning on 1 October 2003.

Raise the Priority of Scholarships for Accountancy Students

Significant numbers of Marshallese accounting graduates will be required if skill shortages are to be addressed and financial management arrangements are to be sustainable (i.e., foreign accountants are to be replaced).

The Scholarship Assistance Act 1979 established the eight-member RMI Scholarship Grant and Loan Board. The Board evaluates applications for scholarships and awards scholarship grants and loans. The Scholarship Fund Account is primarily financed by CFA monies [Article 1, Sec. 216(3)(a)]. Three primary factors guide the Board in awarding scholarship grants and loans: (i) demonstrated ability and potential; (ii) inability to pay costs; and (iii) Cabinet-approved priorities. With regards to the last criterion, some interviewees questioned whether Cabinet placed sufficient priority on accountancy education.

It is recommended that Cabinet raise the priority placed on accountancy courses as a criterion for awarding scholarship grants and loans.
Strengthen the Auditor General’s Independence

The arrangements that support the Auditor General’s independence do not appear to fully meet the criteria of the Lima Declaration regarding the mechanisms for ensuring that adequate resources are provided. For example, OAG staff numbers were reduced as part of the reduction-in-force exercise during the PSRP. Furthermore, arrangements regarding the Auditor General’s annual budget do not support independence.

It is recommended that the Auditor General’s independence be strengthened through legislative and administrative changes.

Clarify Laws Regarding Auditor Qualifications

An audit opinion is meaningful only if issued by a suitably-qualified auditor. However, RMI laws are sometimes ambiguous or silent regarding auditor qualifications. For instance: (i) a range of qualifications or experience is accepted for appointment as Auditor General; (ii) the Cooperatives Act 1993 refers to an “experienced bookkeeper or accountant”; and (iii) the Banking Act 1987 refers to an “independent financial auditor.” Laws should explicitly state the acceptable qualifications of auditors.

It is recommended that all relevant RMI laws be amended so that they clearly and consistently state acceptable auditor qualifications.

Clarify Laws Regarding Accounting Standards

It is generally accepted that RMI financial statements must be prepared in accordance with US GAAP, but RMI laws are inconsistent in this respect. On one hand, some laws are absolutely clear as to the use of US accounting standards. For instance, the Financial Management Act 1990 (which governs public sector financial management) stipulates that: “RMI policy is to provide full disclosure of financial operations and adequate financial information needed in the management of operations, and shall ensure effective control over revenues, multilateral and bilateral grants-in-aid including US federal grants, income, expenditures, monies and other assets, and shall be in accordance with the standards promulgated by the US GASB” (Sec. 104). Conversely, other laws, such as the Trust Companies Act 1994 require all licensed trust companies, incorporated in RMI, to prepare annual profit and loss accounts and balance sheets (Sec. 220). No statement is made regarding the basis of preparation.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

It is recommended that all relevant RMI laws be amended so that they clearly state that financial statements must be prepared in accordance with either US GAAP or the standards promulgated by the US GASB, as the case may be.

Clarify Laws Regarding Auditing Standards

It is generally accepted that RMI financial statement audits must be conducted in conformity with US GAAS, but RMI laws are not clear in this respect. On one hand, some laws are specific as to the use of US GAAS. For instance, the Auditor General (Definition of Duties, Functions and Powers) Act 1986 stipulates that the relevant US auditing standards must be followed for public sector audits. More ambiguously, other laws, such as the Banking Act 1987 require that financial statement audits must be conducted in “conformity with generally accepted auditing standards”.

It is recommended that all relevant RMI laws be amended so that they clearly state that audits of financial statements must be conducted in accordance with the relevant US auditing standards.
VIII. Accounting and Auditing Practices in the Philippines

1. Challenges and Responses

Policies pursued over the past decade have had major positive results, but events over the past four years highlight that much remains to be done. The task is to restore the growth momentum and investor confidence of the mid-1990s through policies that prevent a return to boom-and-bust cycles.

Against this background, two imperatives are to deal with the still quite pervasive legacy of the past, such as low savings rates, widespread poverty, accommodation of rent-seeking activities (e.g., graft and corruption), and a weak public sector; and to successfully manage the challenges of globalization, allowing the country to realize the integration benefits while minimizing the associated risks of excessive leverage, currency overvaluation and sudden capital flow reversals.

In particular, this agenda includes: (i) maintaining prudent macro-economic policies, with emphasis on avoiding fundamental inconsistencies that risk disruptive shifts in capital flows; (ii) raising domestic savings and investment from the current unsustainable low levels; (iii) further leveling the playing field through domestic and external liberalization, as well as effective programs to assist the poor and to enhance the opportunities for the disadvantaged; (iv) streamlining and strengthening the public sector—the traditional economic “Achilles’ heel”; (v) further strengthening prudential, supervisory, and debt resolution frameworks in the financial and corporate sectors (including prudential-based management of foreign currency risk); (vi) accelerating rural development through agricultural modernization and by encouraging the growth of small- and medium-sized enterprises in the countryside, and (vii) improving further the investment climate, including by strengthening governance.

In 1999, government released the Medium-Term Philippine Development Plan 1999-2004, which presents initiatives to address structural economic constraints. It envisages a recovery of growth, and poverty being reduced from 32 percent in 1997 to 25-28 percent in 2004. Furthermore, President Macapagal-Arroyo has stated that her administration is looking at ways that government can address the concerns of portfolio and direct investors and is committed to reforms that will restore confidence in the country.
Whatever the case, FDI levels have fallen substantially in the past four years. The world economic slowdown is reinforcing this trend. Among a menu of options to make the Philippines a more attractive destination for FDI, one of the more effective choices is to adopt best-practice accounting and auditing standards, and to ensure that these standards are rigorously applied and enforced.

2. Accounting and Auditing in the Philippines

The Philippine accounting and auditing system is directly influenced by US and, more recently, international arrangements and practices. The Accountancy Act 1923 created the Board of Accountancy (BOA) and gave it the authority to issue CPA certificates. Six years later, the Philippine Institute of Certified Public Accountants (PICPA) was established within the private sector to represent professional interests.

Many of the larger Philippine companies were subsidiaries or branches of American companies and their accounting reflected US practices. Even after independence in 1946, the US maintained close trade and investment links. Philippine accounting and auditing moved away from US influences towards international practices in the 1990s. For instance, IAS became the basis for Philippine accounting standards in 1996.

Today’s governing legislative and institutional framework is comprehensive. In common with the US model, arrangements reflect a mixture of government intervention and self-regulation. The key legislative planks of the Philippine accounting and auditing system are the Revised Accountancy Law (No. 692) 1975, the Corporation Code, the Revised Securities Act 2000, and the National Internal Revenue Code 1999.

The Revised Accountancy Law 1975 governs the standardization of accounting education, stipulates the examination process for CPA registration, and regulates the practice of accountancy. The Professional Regulation Commission (PRC), through the BOA, administers the law. The SEC enforces the Corporation Code, which governs the creation and operations of limited liability corporations. The SEC also administers the Revised Securities Act 2000, which applies to companies listed on the Philippine Stock Exchange. Among other things, the National Internal Revenue Code 1999 requires that tax agents (including CPAs) be accredited by the Bureau of Internal Revenue (BIR).

Financial reporting disclosure requirements are governed by both mandatory and advisory sources. Mandatory sources include: (i) the legal requirements in the National Internal Revenue Code 1999; (ii) Statements of
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Financial Accounting Standards (SFASs) issued by Accounting Standards Council (ASC); and (iii) rules and regulations issued by the SEC governing the form and content of financial statements. The Bangko Sentral ng Pilipinas (Central Bank of the Philippines) prescribes disclosures for financial institutions. All companies with quarterly sales exceeding P100,000 ($2,000) must have their financial statements audited and signed by a CPA. SEC rules require listed companies to file quarterly reports within 45 days of the quarter-end.

Assessments of financial reporting quality vary. On one hand, a World Bank review of Philippine financial reporting practices favorably concluded that:

“according to users of financial statements—including banks and investment banks—accounting and disclosure regulations and standards in the Philippines compare favorably with those in many Asian countries. But the same users report that enforcement by regulators is weak and that auditors seldom issue caveats that might raise questions about the reliability of the information contained in client financial statements. In addition, there is no tradition of legal actions by investors and lenders against company officers or auditors in connection with cases of deficient or misleading financial reporting. Hence, the true financial state of companies may not be known sufficiently in advance to arrest a potentially serious deterioration in performance.”

However, other studies and surveys have been less positive.

The Revised Accountancy Law 1975 regulates the auditing profession; Only CPAs may conduct statutory audits. Recent studies have identified concerns regarding auditing practices. Professional firms are regulated by the SEC. The BOA, through the PRC, has recently begun to review and license accountancy firms. All of the large international accountancy firms are represented in the Philippines.

3. Professional Infrastructure

The origins of Philippine public accounting practice can be traced back to the 1700s. However, accountancy was not formally recognized as a profession until the enactment of the Accountancy Law 1923. This law established the CPA title for those who passed a written licensure

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examination. It also created the BOA to regulate the profession. Six years later, in 1929, CPAs organized PICPA, which makes it one of Asia’s oldest professional accountancy bodies.

In the past seven decades, PICPA has contributed immensely to the accountancy profession’s development. PICPA members have also actively contributed to the international profession (Washington Sycip was IFAC President from 1982 to 1983).

There are now over 100,000 Philippine CPAs. Each year around 14,000 candidates sit the CPA licensure examination, but less than 20 percent are successful. In the absence of empirical evidence, various reasons have been advanced to explain these low passing percentages, including poor English language skills reflecting deficient basic education, lack of training materials and inadequate facilities.

Today, the Philippines accountancy profession is one of the world’s most vibrant. It is also one of the most restricted. A mixture of regulation and private involvement characterizes professional organization. The key governing legislation is the Revised Accountancy Law 1975. BOA, under the oversight of the PRC, determines and prescribes the minimum requirements for CPA licensure. It is also responsible for supervising, controlling and regulating accountancy practices. The Board administers the CPA examination and issues certificates to successful candidates. Among other things, Philippine CPAs must hold an undergraduate accounting degree and pass a multiple-choice professional examination. In contrast to international guidelines, practical experience is not required and CPE is not mandatory. BOA also investigates violations of the Revised Accountancy Law 1975 and may suspend, revoke, or reissue registration certificates.

By December 2000, 103,340 CPAs were registered with the PRC, but only about 20 percent were active (i.e., fee-paying) members of professional organizations. Furthermore, it is estimated that there are at least 400,000 accounting graduates who are not CPAs. In 1999, PICPA launched a concerted push for professional integration (i.e., compulsory CPA membership). These efforts increased membership significantly.

As of December 2000, PICPA had 20,323 active members (those who pay membership dues and receive information and services). PICPA regularly organizes seminars on technical subjects such as auditing, taxation, management services, accountancy education, accounting principles, and information technology.

Sectoral PICPA bodies include the Government Association of Certified Public Accountants (GACPA), the Association of Certified Public
Accountants in Public Practice (ACPAPP), the Association of Certified Public Accountants in Commerce and Industry (ACPACI) and the Association of Certified Public Accountants in Education (ACPAE). Furthermore, the National Federation of Junior Philippine Institute of Accountants (NFJPIA) links accountancy students with their professional counterparts. Other professional bodies include the Philippine chapter of the US-based IIA and the Association of Government Internal Auditors (AGIA). AGIA represents internal auditors in government and promotes their professional development. It had 1,177 members in 1999.

In recent years, globalization has focused attention on raising standards to meet the challenge of increased competition. Meanwhile, concerns about CPA licensure procedures and apparently soft disciplinary procedures have undermined the profession's reputation. For example, the BOA has the power to suspend or revoke CPA titles. However, these powers are seldom exercised and when they are, the reasons are usually related to unprofessional conduct rather than the failure to properly execute the duties and responsibilities of an auditor.

"Big auditing firms do not get sued because their interest is always protected through the influence they have on BOA. The presence of representatives from the big auditing firms on the BOA serves the personal interest of those firms. ... If cases of big auditing firms are filed with the Board, then it is just like saying that they are putting themselves on trial—which really negates the purposes of the Board. This is where the law has a loose end."

– Former PRC Commissioner (1998) 62

In 1979–1997, 170 cases were filed against individual CPAs and one against an accounting firm. No cases were filed against CPAs on the grounds of gross negligence or incompetence in the practice of their profession, issuing an accountant’s certificate covering the examination of client accounts without observing the necessary auditing standards, or conduct discreditable to the accounting profession. But, the SEC has investigated prima facie malpractice cases. Two examples involve Engineering Equipment Incorporated (EEI) and Victorias Milling Company (Vicmico). Both cases centered on material misstatements in the companies’ certified financial statements. In relation to EEI, the SEC wrote “the auditors may have been

involved or professionally negligent” and recommended a one-year suspension of the firm’s accreditation to appear for clients before the SEC. This recommendation was later overturned and the auditors reportedly fined P50,000 ($1,000). The penalty was not reported in the media. Nor did the PRC or the BOA investigate the auditing firm. As for Vicmico, neither the PRC nor the BOA took action, while the SEC pursued the case. Moreover, in the Vicmico case, the auditing firm later withdrew its audit reports for the financial statements in question.

In 2000, PICPA focused on: (i) amending the Accountancy Law 1975 to support membership growth; (ii) fully computerizing operations; (iii) reviewing and amending the Institute’s by-laws; (iv) refining a proposal for PICPA to administer examinations to accounting graduates and unsuccessful CPA examinees to make them Registered Accountants to be accredited with the BIR, SEC and BOA; and (v) promoting the field of environmental accounting. In 2001, PICPA is concentrating on three areas. First, undertaking policy reforms including: (i) improving policy formulation, deliberation, and implementation through the use of sectoral clusters and feedback loops; (ii) strengthening development and training policies; and (iii) preparing structural and organizational changes that require changes in by-laws, the Revised Accountancy Law 1975, and the Code of Ethics. Second, strengthening professional development by: (i) continuing progress on establishing the Power Knowledge Institute; (ii) establishing a technical resource pool; (iii) improving library facilities and resources; (iv) extending development forums to Luzon, Visayas, and Mindanao; (v) improving the curriculum and re-tooling CPAs; (vi) enhancing the Institute’s Internet site; (vii) updating publications; and (viii) mandating the inclusion of professional development issues in the agendas of chapter meetings. Third, increasing the Institute’s focus on social responsibility.

4. Accounting and Auditing Standards

In 1949, PICPA began issuing accounting standards in the form of accounting bulletins, compliance was voluntary. In response to a 1979 PICPA committee report on the state of Philippine financial accounting standards and standard setting, the Institute established the ASC in November 1981.

The ASC issued the first Philippine SFAS in 1983. Until 1996, the ASC based most SFASs upon US accounting standards. Starting in 1996, the ASC issued IAS-based SFASs. The Council’s mechanism for standard setting is similar to that of the IASB and FASB. Once approved by the BOA,
the PRC’s final concurrence gives legal authority to the SFAS and CPA compliance is mandatory.

SFASs are broadly consistent with their equivalent IASs, but there are differences in detailed accounting and disclosure requirements. Subject to any modifications that may be required by Philippine regulatory requirements or deemed necessary by the ASC, the final SFASs will be the same as IASs. Furthermore, the Philippines will fully adopt IAS by 2005.

Philippine enterprises are not required to adopt tax rules for financial accounting purposes, for instance, Section 43 of the Tax Code 1997 provides that “taxable income shall be computed ... in accordance with the method of accounting regularly employed in keeping the [taxpayer’s] books.” Most enterprises, however, adopt the prescribed tax reporting guidelines for expediency so long as these practices do not contravene prescribed accounting standards. Furthermore, in the absence of a specific SFAS or tax ruling, the BIR will refer to authoritative accounting sources, such as IASs.

PICPA formerly issued auditing guidance as bulletins. In response to the 1979 PICPA committee report that influenced ASC’s establishment, PICPA and the ACPAPP established the Auditing Standards and Practices Council (ASPC) in 1986. The ASPC promulgates the Statements of Auditing Standards of the Philippines (SASPs) and other guidance on auditing practices and procedures. SASPs are significantly influenced by US auditing standards and IAPC pronouncements. All ASPC-approved SASPs are submitted to the PRC through the BOA and, once approved, CPA compliance is mandatory.

The ASPC was inactive for several years but resumed activities in 2001 under a new chairperson. The rejuvenated ASPC has will complete direct adoption of IAASB pronouncements by 2005.

5. Education and Training

The American colonial period substantially influenced Philippine accountancy education arrangements. Business schools were initially established across the country to provide a skilled labor pool for government and business organizations. Eventually business education progressed to the point where the University of Philippines began to offer accounting courses in 1916.

Today, the Philippine education system, and its graduates, is internationally and regionally recognized as being of a high standard. The top Philippine accountancy faculties are also recognized for the caliber of their graduates and research publications.
Several laws and regulations govern accountancy education and coordination. These include the Revised Accountancy Act 1975. BOA recently established an Accounting Education Task Force to help it examine developments in the accountancy profession as they affect accountancy education. The Higher Education Act 1994 created the Commission on Higher Education (CHED). Among other things, CHED is responsible for: (i) formulating and recommending development plans, policies, priorities, and programs on higher education; (ii) setting minimum standards for programs and institutes of higher education; (iii) monitoring and evaluating the performance of programs and institutions; and (iv) imposing sanctions for poor performance. PICPA is also involved in educational coordination through its representation on CHED’s advisory board and in the BOA.

Driven by concerns over educational quality and the issuance of updated international guidance, BOA and PICPA began developing proposals for a revised accountancy curriculum in 1998. CHED approved the revised curriculum in August 2001, which reflects relevant UNCTAD and IFAC guidance.

The Philippines had 164 public and 1,189 private higher education institutions at September 2000. Of these institutions, 367 offered accredited BSA programs. The quality of these programs differs substantially when assessed on the basis of graduate success in the CPA licensure examination. Zero-performing schools—those that had no successful candidates in the CPA licensure examination—comprise around 50 percent of accredited institutions. Students at these schools are predominantly drawn from less wealthy families.

In the 1999-2000 academic year, CHED acted to phase out the accountancy programs of 54 schools. In addition, one school was warned and one school was referred to the Technical Panel for further action. The CHED process is continuing and should reduce the number of substandard schools offering accountancy programs.

As a condition of offering accountancy programs, institutions must have a formal faculty development program. However, in some schools, continuing training for accountancy lecturers and professors is very limited. The absence of relevant materials is perceived as a constraint to staff development (most materials are local adaptations or reprints of US books). These books are based on US GAAP rather than international standards and practices. Furthermore, case studies based on local practices and conditions are rare.
6. Government Budgeting and Accounting

Government accounting and auditing arrangements were formulated in 1947. They have many strengths including the use of double-entry bookkeeping, a mixed cash-accrual accounting base, a cadre of well-trained accountants, and potential access to a large external pool of trained accountants.

Wider public management arrangements are characterized by institutional and regulatory rigidities. Efforts to modernize the public sector have gathered pace in recent years. Among other things, the Government intends to: (i) develop an MTEF; (ii) introduce output and outcome performance measures and targets; (iii) overhaul procurement practices; (iv) introduce three-year baseline budgeting; (v) modernize auditing practices; (vi) introduce computerized financial management information systems; and (vii) prepare for the introduction of full accrual accounting.

The *Constitution 1987* mandates the keeping of government accounts, the promulgation of accounting rules, the audit of financial reports, and the submission of reports covering government’s financial operations and position. A raft of laws and decrees are subsidiary to the Constitution and include the *State Audit Code 1978* that specifies the powers and responsibilities of the Commission on Audit (COA). COA audits the general accounts of government, promulgates accounting rules and regulations, and submits the annual government financial report (including government-owned or controlled corporations).

In accordance with the *Constitution 1987*, fund, obligation and cash-disbursement-ceiling accounting methods are used in government. These methods are based on those used in the US government (before it began its move to accrual accounting). Organizations are required to use a COA-prescribed standard chart of accounts. A variety of accounting standards are applied in the preparation of financial reports. These include the prescriptions set out by the GFS system, and COA’s accounting rules and chart of accounts. COA is planning the move to full accrual accounting and is considering the appropriateness of IPSAS as the basis for government accounting standards.

The financial reports of government organizations include: (i) current assets; (ii) contingent assets; (iii) fixed assets; (iv) current liabilities; (v) contingent liabilities; (vi) allotted appropriations; (vii) income; (viii) invested surplus; (ix) contingent surplus; (x) national clearing account; (xi) the total surplus; and (xii) assorted notes to the accounts. However, these reports are generally not provided in a timely manner.
The entry salaries and conditions for government accountants compare very favorably with the private sector. Indeed, government agencies have no difficulty attracting high-quality accounting personnel. However, as the government salary structure is flatter than that of the private sector, these personnel are difficult to retain once they have gained experience. Moreover, these comparatively low salaries for senior personnel provide a supportive environment for graft and corruption. In response, several legislative measures have been prepared to raise the remuneration and status of government accounting personnel. However, in the view of a recent study:

“While the ... study did not allow an examination of the actual performance of government accountants, the consultants engaged in this project were impressed with the professionalism of the accountants they encountered. Provided that they receive adequate technical direction and training, we have no reason to believe that the general competence of accountants is an issue.”

Government accounting personnel must hold CPA licenses, but their role is largely limited to bookkeeping, due to the complicated legal accounting framework and the absence of computerized systems. Minimal time is available for financial analysis and providing financial advice to management.

7. Donor Assistance

ADB is supporting broad governance activities through technical assistance and loans. Directly relevant activities include:

• Loan 1858: Nonbank Financial Governance Program ($75 million: 2001–2003). The Philippines DSAA provided input into this program’s development, which is intended to support the development of stronger financial sector and institutions. Its key pillars are (i) strengthening the governance and enforcement capacity of the regulators, Bangko Sentral ng Pilipinas and SEC; (ii) introducing more transparency in the market; and (iii) encouraging equal enforcement of rules and regulations. Loan implementation is supported by TA 3773: Strengthening Regulatory Market Governance.

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- **Loan 1363: Capital Market Development Program** ($150 million: 1995). The program objectives were to support financial and corporate governance reforms, particularly the development of capital market institutions with a view to enhancing transparency and predictability in the marketplace.

- **AOTA TA 31656-02: Strengthening Public Finance and Planning of LGUs-II** ($0.100 million: 2002). This proposed TA is intended to assist the Government to conduct more detailed analysis of its budget processing and project-monitoring mechanism.

- **TA No. 3310: Capacity Building for Procurement** ($0.400 million: 2000). This project strengthened institutions with procurement responsibilities.

- **TA No. 3245: Nonbank Financial Sector Development** ($2.0 million: 2000–2001). Among other things, this TA has focused on reorganizing and strengthening the SEC.

- **TA No. 3145: Strengthening Public Finance and Planning of Local Government Units** ($0.870 million: 1999–2000). This TA focused on strengthening LGU budgeting and finance capabilities.

**World Bank** assistance is primarily for tax administration, financial market development, and supervision of financial institutions. In 1998, the World Bank approved a Banking System Reform Project, which aimed to strengthen banking sector regulation and supervision and develop a resolution framework for troubled banks. The release of the second tranche of this loan has been delayed due to the lack of agreement between the Government and the major shareholders on the pricing of government shares in Philippines National Bank (PNB). As a result, the Government has not been able to divest its PNB shares, which is a second tranche loan condition. Furthermore, a proposed loan for $100 million to support public sector reforms was abandoned in 2000. The Local Government Finance and Development Project ($100 million) is assisting participating LGUs to expand and upgrade their basic infrastructure, services, and facilities and to strengthen their capacities in municipal governance, investment planning, revenue generation, and project development and implementation.

**UNDP** intends to provide support to strengthen the role of the Department of Budget and Management in the public sector reform process. **AusAID** is providing the majority of financing for a UNDP-managed project to strengthen the COA. The Canadian International Development Agency (CIDA) is providing technical assistance and training to assist government departments and agencies to further develop their internal mechanisms and structure for increased efficiency in policy formulation, planning,
implementation, monitoring and evaluation. CIDA is also providing assistance to enhance the structures and mechanisms of local governments.

Japan does not directly support financial management and governance activities, but provides indirect assistance through Japan-based education and training on financial management and public management. USAID is implementing a TA project to (i) develop the capacity of the Philippines Stock Exchange (PSE), (ii) assist in drafting rules for implementing the newly-enacted Securities Regulation Code 2000, (iii) review the corporate code, and (iv) facilitate company registration procedures within the SEC. USAID is also supporting improvements to government procurement, local government finance and budget information systems. Furthermore, USAID has supported environmental accounting training initiatives.

8. Issues and Recommendations

This part presents the issues and recommendations that are associated with gaps or weaknesses in Philippine accounting and auditing arrangements. These issues and associated recommendations are consistent with those identified by the subsequent World Bank review of Philippine Corporate Sector Accounting and Auditing Practices, which is not surprising as the World Bank consultants were provided with the final draft of the Philippines DSAA report, before commencing their work.

The Philippines was less affected by the Asian financial crisis than some other countries in the region, largely due to better financial management arrangements. Moreover, accountancy is an elite and respected profession. However, the study revealed a range of issues that need attention if accountancy is to maintain its high status and if the Philippines is to successfully attract investment.

• In the case of accounting and auditing standards and practices, the study identifies deficiencies in the standards and in standard-setting arrangements. Several recommendations are made to enhance these arrangements so that the Philippines can have world-class accounting and auditing standards.

• The quality of financial reporting is undermined by a lack of compliance monitoring. To this end, the study recommends that financial disclosure monitoring be strengthened.

• Regarding professional arrangements the study identifies significant weaknesses in CPA licensure standards and quality assurance arrangements. The Philippines accountancy profession was once among the region’s strongest. However, in the meantime, international
standards and practices were continuously enhanced and neighboring countries developed their professions accordingly. The recommendations are intended to support the return of the Philippines accountancy profession to its former status.

- Standards of accountancy education and training might also be raised. To this end, recommendations are made to improve course quality and ensure that accountancy teachers keep up-to-date with international developments.

Some constraints can be addressed with minimal resources and effort. For instance, strengthening the profession by making PICPA membership compulsory for all CPAs. Others are more complex and will take time, such as enhancing CPA licensure standards (examination, practical experience and continuing professional education).

The Philippines DSAA was undertaken before the other country studies. The study recommendations were first discussed and debated with representatives from government, the private sector and international organizations at a workshop held at ADB’s Manila Headquarters on 12–13 March 2001.

Some of the recommendations were the subject of intense debate. For instance, Philippine accountants could be licensed as CPAs—and could conduct audits—without ever having worked in accountancy. Some study participants disputed the need for a practical experience component in the CPA qualification. They contended that this requirement would be unworkable in the Philippine environment.

Moreover, some study participants disagreed with the study’s general conclusion that Philippine financial disclosure and auditing practices were not consistent with international best practice:

“There have been instances of fraudulent reporting and audit failures in the US, United Kingdom, Singapore, Hong Kong and other supposedly best practice countries mentioned in the report. On the average, the Philippine accounting and auditing profession, at least those in the top tier, are comparable, if not better, than some of these countries.” 64

Although these countries have had financial reporting and auditing failures—like those in the Philippines—there is a stark contrast in reactions. For instance, in response to recent US financial reporting scandals, stricter controls have been introduced; civil actions have been

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filed against the offending companies, their officers and their auditors; criminal charges have been laid against involved parties; and there has been intense scrutiny through the media and by the US Congress.

In contrast, following the Philippine scandals involving Engineering Equipment Incorporated (EEI) and Victorias Milling Company (Vicmico), neither PRC nor BOA investigated the auditors, the auditors were reportedly fined minimal amounts and these penalties were never reported in the media.

Whatever the case, the Philippines DSAA provided input into the development of the ADB-supported nonbank financial governance program. Some of the government-agreed policy conditions of that program reflect the study recommendations. Furthermore, ADB is providing technical assistance to strengthen the SEC’s monitoring capacity in line with the study recommendations.

Significant efforts have already been made to implement the study recommendations. The Philippines country action presented in Chapter X (pp. 117–121) identifies these efforts.

Each study recommendation—and the issues that it is intended to address—is summarized below. The Philippines DSAA report provides further detail.

Advocate Changes to IASB Copyright and Pricing Policies

IASB promulgates IAS and associated guidance materials. The IASC holds the copyright to these materials. Many developing countries, including the Philippines, are moving towards IAS. Investors, lenders, academics, practitioners and regulators should have access to the IAS and associated materials. However, IASC’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.

Directly Adopt International Accounting Standards

The ASC has recently begun basing IAS-based SFASs. However, (i) SFASs are not being issued as quickly as IASs, (ii) old SFASs are not always modi-
fied to reflect the impacts of new SFASs, (iii) IASs are not necessarily fully adopted as a whole, and (iv) a range of accounting policy choices continues to be available to financial statement preparers.

The direct adoption of IASs offers benefits through: (i) reducing the costs and efforts associated with standard setting, (ii) improving the credibility of Philippine financial reporting, (iii) providing access to a greater range of training materials, (iv) making Philippine CPA skills more transferable on the international market, and (v) enabling Philippine financial reporting standards to be current with international pronouncements and practices. Where an IAS does not address a certain country-specific arrangement, there is a case for promulgating a national accounting standard. For instance, Papua New Guinea uses IASs directly but has released a national accounting standard on Plantation accounting.66 A Philippine case might possibly be argued for Dacion en Pago arrangements.67

To accommodate diverse international views, IASs offer a range of accounting policy choices. While the available choices have been significantly reduced since 1996, IASs are still criticized for being too flexible. For instance, IAS 2 Inventories allows for several valuation methods. Many countries who have adopted, or who are adopting, IASs limit the available choices to improve the consistency and comparability of financial reporting in their country. In many cases, accounting choices are limited to those allowed for taxation purposes.

It is recommended that: (i) the Philippines adopt IASs directly and completely on 1 January 2004, and that existing SFASs be invalidated at that date; (ii) assistance be provided to prepare training and guidance materials on the differences between IAS and existing Philippines GAAP; and (iii) training programs for practitioners, academics, and regulators in this respect be supported. It is further recommended that amendments to IAS be: (i) allowed only to remove multiple accounting policy choices, and (ii) effected through overlay regulations rather than a direct amendment to an IAS.

Alter Accounting Standard Setting Arrangements

The ASC’s accounting standard-setting processes align with international practice, but its structure is heavily weighted in favor of financial statement preparers and auditors. This imbalance is arguably reflected in the wide range of accounting policy choices that SFASs allow. In comparison, the US FASB and IASB reflect users’ interests alongside those of preparers. Furthermore, the imprimatur of the PRC, through BOA, is required before accounting standards have legal authority. The BOA, like the ASC, is balanced strongly in favor of the accountancy profession.

The FASB and the IASB are, like the ASC, private sector organizations. The issue of whether accounting standard setting should be a government or private-sector function is a common one faced by many countries—it is influenced by a range of factors. Assigning this role to a government agency can be counterproductive. Research has found that government regulation stifles the profession and that accounting standard setting can become a taxation policy instrument, thereby significantly reducing the value of financial statements to other users.

In the Philippines, the members of the ASC, and in particular the Chair, have devoted enormous amounts of voluntary time over the past 18 years to develop accounting standards. If the preceding recommendation on direct acceptance of IASs is implemented, the balance of the Council’s membership re-weighted, and approval responsibility assigned away from the BOA, there seems no reason why the accounting standard setting process should not continue to remain in the private sector.

It is recommended that the Revised Accountancy Law 1975 be amended to reflect the following improvements to accounting standard setting arrangements: (i) accord legal status to the ASC; (ii) prescribe the Council’s composition and appointment processes—the composition should reflect a balance of constituency views; and (iii) define the ASC’s role as being limited to reviewing IASs and identifying policy choice exclusions in IASs.

Strengthen Financial Disclosure Monitoring

There is evidence that financial statements do not comply with financial disclosure requirements. It is recommended that assistance be provided to the Office of the General Accountant (OGA) of the SEC to develop and implement; (i) a strict monitoring regime over financial disclosures; and (ii) an automatic system of penalties for corporations who breach financial disclosure requirements and for auditing firms that do not qualify audit opinions where financial disclosure requirements are substandard.

Directly Adopt IAASB Auditing Pronouncements

The ASPC promulgates SASPs, but is inactive. Consequently, SASPs have a narrow coverage and are behind IAASB pronouncements.

It is recommended that: (i) the Philippines adopt ISAs, IAPSs and all other IAASB pronouncements directly on 1 January 2004, and that existing SASPs be invalidated at that date; (ii) assistance be provided to prepare training and guidance materials on the differences between these pronouncements and SASPs; and (iii) training programs for practitioners, academics, and regulators in this respect be supported. It is further recommended that the Revised Accountancy Law 1975 amended to require that audits be conducted in accordance with the pronouncements of the IAASB.

Strengthen Compliance with Auditing Practices

It appears that Philippine auditing practices differ substantially from international and regional guidelines and norms in four areas: (i) auditor appointment and dismissal; (ii) auditor independence; (iii) audit reporting procedures; and (iv) exposure of auditors to liability. It is recommended that assistance be provided to develop and implement regulations covering the following areas: (i) auditor appointment and dismissal (e.g., appointments made by shareholders, automatic resignation at AGM, and mandatory requirement for communications between incoming and outgoing auditors); (ii) auditor independence (e.g., restrictions on interests, restrictions on services, antilow-balling rules, mandatory rotation of audit firms or audit partners, mandatory disclosures of challenges to objectivity); (iii) audit reporting procedures (e.g., mandatory disclosure of fraud, illegal acts and internal control weaknesses in audit reports); and (iv) exposure of auditors to liability (e.g., remove legal liability caps). It is further recommended...
that assistance be provided to the OGA of the SEC so that it can develop the capacity and procedures to ensure compliance with these requirements.

Amend the Accountancy Law so that Licensure Standards can be Raised

Qualifying as a CPA has four stages: academic, experience, examination and CPE. The Philippine CPA title meets international standards and regional norms on the first stage. It falls short on the others. There are three possible implications. First, the recently established IFAC Compliance Committee will be reviewing member body compliance with IFAC guidelines and standards in the next few years. PICPA will have to explain deviations. The IFAC Compliance Committee is responsible for recommending actions to IFAC’s Board and Council when member bodies fail to comply with guidelines and standards. Second, ISAR is embarking on a project to benchmark CPA qualifications from around the world. The “grade” given to a country CPA qualification will be based on compliance with international guidelines and practices. This grade will directly affect the international standing and transferability of CPA titles. Third, as a condition of membership, IFAC member bodies are required to comply with guidelines and standards. In this respect, IFAC has issued guidance on the procedures to be followed when agreeing mutual recognition of qualifications. It appears that the Philippine WTO-GATS and Asia Pacific Economic Cooperation negotiation strategy, in relation to accountancy services, is to conclude Mutual Recognition Agreements (MRAs). Under IFAC guidelines, member bodies must take education, examination and experience requirements into account when negotiating MRAs. As a significant exporter of accountancy services, the Philippines appears to be at a negotiating advantage. The legality of any MRAs which the Philippines concludes with other ASEAN countries might be open to challenge, from other Asia Pacific Economic Cooperation and WTO members, based on the quality of CPA licensure procedures.

The accountancy profession is attempting to raise standards—for instance, requiring mandatory CPE—but is hamstrung by the regulatory environment. A particular impediment is the uniform regulation approach applied through the PRC—which oversees 43 diverse professions. The story of CPE over the past decade has been one of endless legal proposals, reversals and court challenges. It is difficult to see how CPA licensure standards can be raised in the existing environment, without enabling legislative changes.
In order to create an environment that will enable CPA licensure standards to be raised, it is recommended that the Revised Accountancy Law 1975 and other laws and regulations be amended to enable the introduction of: (i) practical experience requirements for CPA licensure, (ii) a written component to the CPA licensure examination, and (iii) mandatory CPE as a condition of license renewal.

Address CPA Licensure Examination Issues

International guidelines recommend that a significant component of a CPA exam should be written, but the Philippine CPA licensure examination is entirely multiple choice. This approach was taken deliberately to minimize serious “leakage” problems in the examination process—it has been extremely effective in this sense. The tension between minimizing leakage and preparing high quality examinations is also reflected in the quality of examination questions. Examiners individually prepare one section each, but the other examiners do not review their efforts. The Microsoft certification approach provides a successful example of how technology can be employed to ensure that integrity is maintained while examinees are practically tested. This represents an updated approach to that used for the computerized CPA licensure examination. It is recommended that options for restructuring the CPA licensure examination be investigated with the objective of; (i) introducing a written component into the examination, and (ii) implementing quality reviews over examination question setting.

Introduce an Experience Prerequisite for the CPA Title

The absence of a practical-experience prerequisite for CPA licensure does not accord with international standards or regional norms. Philippine accountants can be licensed as CPAs and conduct audits, without ever having worked in accountancy. An analogy would be issuing a pilot’s license, based on an examination, to a person who has never flown an aircraft. IFAC has published two documents to guide member bodies on how to meet the requirements of IEG 9.\textsuperscript{71,72} The effective and fair implementation of these requirements in the Philippine environment poses

\textsuperscript{71} IFAC. Study I: An Advisory on Examination Administration Based on the Practices of Selected IFAC Member Bodies. New York: IFAC.

\textsuperscript{72} IFAC. Discussion Paper on Work Experience. New York: IFAC.
some clear challenges; implementation and monitoring arrangements will need to be very carefully designed. It is recommended that specified practical experience be introduced as a prerequisite requirement for the CPA title.

Introduce Mandatory Continuing Professional Education

PICPA supports the introduction of mandatory CPE requirements—which international guidelines require. It is recommended that: (i) mandatory CPE requirements be introduced through enabling legislative changes, and (ii) assistance be provided to design and implement appropriate procedures for monitoring CPE compliance.

Reassign Responsibilities for Monitoring and Investigating Certain Ethical Matters

BOA and PICPA are unwilling to investigate cases involving: (i) gross negligence or incompetence, (ii) issuance of an accountant’s certificate covering the examination of the client’s accounts without observing the necessary auditing standards, or (iii) conduct discreditable to the accounting profession. This is perhaps because accounting firms have a strong representation in these bodies. In contrast, the SEC has shown willingness to investigate these types of ethical matters. Furthermore, the SEC is being restructured so that it can meet its responsibilities under the Revised Securities Code 2000. The restructure involves the creation of the OGA. This position was unfilled at February 2001.

It is recommended that responsibility for investigating cases involving: (i) gross negligence or incompetence, (ii) issuance of an accountant’s certificate covering the examination of the client’s accounts without observing the necessary auditing standards, or (iii) conduct discreditable to the accounting profession; be assigned to the Office of the General Accountant of the SEC. It is further recommended that assistance be provided to: (i) identify and draft the necessary legislative amendments to effect this reassignment; (ii) identify OGA requirements for implementing these responsibilities; and (iii) support the development of OGA capacity to meet these responsibilities.

Implement Quality Control and Assurance Arrangements

The accountancy profession places minimal emphasis on quality control assurance over professional practices—a recent limited initiative has been
for the BOA to recognize accounting firms, based on their internal review processes. In contrast, IFAC recommends that member bodies, including PICPA: (i) adopt quality control standards and require individual accounting firms to implement these, (ii) develop and implement programs to review compliance with these standards, (iii) establish programs to review compliance with relevant professional standards for assurance engagements, and (iv) require accounting firms to make appropriate improvements in quality arrangements and procedures when these fail to meet standards. Neighboring countries have adopted robust programs of this nature.

It is recommended that assistance be provided for a project to improve professional supervision. The project would involve: (i) studying the existing structures and processes of CPA firms, (ii) examining, and drawing useful lessons from international experience with regards to supervisory regimes (including peer review regimes); (iii) designing a supervisory system for the Philippines that reflects local conditions and provides sufficient flexibility to deal with environmental changes; (iv) implementing the supervisory system and associated reporting systems; (v) reviewing and, where necessary, revising CPA legal responsibilities and associated disciplinary regulations; and (vi) improving the capacity of managers with supervisory responsibilities through training.

**Introduce Provisional CPA Title**

International practice is for CPA titles to be issued, only after candidates have completely met academic, practical experience, and licensure examination requirements. In the period between meeting the academic requirements and receiving the full CPA license, accountants are accorded provisional status. They are not, however, allowed to sign audit reports or undertake certain other activities. It is recommended that PICPA and BOA establish a provisional CPA title for those who met academic requirements and are gaining prescribed practical experience.

**Introduce Accounting Technician Membership Category**

PICPA essentially has one individual membership category—that of the CPA. It has been estimated that the Philippines has a further 400,000 accountants. It is common international practice for professional bodies to have a range of membership categories with differing qualification criteria—particularly that of Accounting Technician. The establishment of at least one subsidiary membership category within PICPA would
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provide a transitional route for aspiring CPAs and professional representation for nonCPAs. It would also improve their societal status, and improve their knowledge and competence. Furthermore, this initiative would strengthen PICPA's membership and revenue base. It is recommended that PICPA and BOA consider establishing a professional membership category for accounting technicians.

Develop Annual Financial Management Scorecard

The establishment and systematic monitoring of financial management indicators, would provide a impetus for raising standards. The BOA’s initiative, of preparing examination result analyses and distributing these to under-performing academies, is an excellent example. It is recommended that assistance be provided to the OGA to: (i) design a financial management scorecard; (ii) design and develop the data-collection methods to support the annual preparation of the scorecard; and (iii) prepare a scorecard for the 2001 calendar year.

Improve Monitoring of Accountancy Courses

There is a wide disparity in the quality of accountancy courses. Students from poorer families attend institutions with poor educational records in the hope that they will pass the CPA board examination. The BOA has initiated an excellent program to provide feedback to educational institutions on the quality of their courses. It is recommended that assistance be provided to the BOA to broaden its educational monitoring initiative.

Provide Continuing Training to Professors and Lecturers

There is a wide disparity in the quality of professors and lecturers. Anecdotal evidence contends that professors and lecturers, who teach accountancy courses to less-wealthy students, are not conversant with modern accounting and auditing practices. It is recommended that assistance be provided to design and implement a continuing education program for accounting lecturers and professors.

Define Accounting Information System Requirements

COA aims to increase the computerization of government accounting and auditing. Before further progress can be made, several policy issues must
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first be examined and a position agreed. Among others, these include: (i) the accounting policy basis, (ii) consolidation policies and methodologies, (iii) the respective emphasis on financial and management accounting, (iv) the desirability of the Canadian practice of modified accrual accounting, and (v) the future of obligation and fund accounting. It is recommended that assistance be provided to COA to analyze these issues and develop agreed policies and plans to implement these policies.

Directly Adopt IFAC Pronouncements on Ethics

The BOA and PICPA Code of Professional Ethics, and procedures for dealing with potential ethical breaches, do not accord with international guidelines. Two examples follow. First, the Board and the Institute should have the authority to investigate potential ethical breaches, even when no complaint has been made. Second, the Board and the Institute should publicize potential breaches and investigative actions as a matter of course, rather than as a matter of exception. It is recommended that the Revised Accountancy Law 1975 be amended so that: (i) the IFAC Code of Professional Ethics and other IFAC promulgations on ethical matters be accorded legal status, (ii) existing pronouncements and procedures on ethics be revoked, and (iii) the procedures of BOA and PICPA be amended to accord with IFAC promulgations.

Limit Proxy Voting in PICPA Meetings and Elections

Proxy voting is employed in PICPA elections. It has been contended that large accounting firms collect proxies and cast block votes. It is recommended that PICPA’s by-laws be amended to limit the number of proxy votes that individual members can exercise at meetings or during elections.

Make PICPA Membership Compulsory for CPAs

Despite efforts to make it so, membership of the Accredited Professional Body—PICPA—is not compulsory—only about 20 percent of CPAs are members. This limits quality control and educational efforts. It also undermines the financial position of the professional accountancy bodies. It is recommended that the Accountancy Law be amended to require membership of PICPA, a requirement for retaining the CPA title.
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Exempt CPAs from Tax Agent Accreditation

In 1999, under the National Internal Revenue Code, the BIR required that tax agents be accredited. This requirement took legal effect from 1 January 2001, but has yet to be implemented in practice. It has been suggested that accreditation will encourage rent-seeking behavior. Moreover, as attorneys are exempt from accreditation, it has also been contended that this exemption should also apply to CPAs. It is recommended that the BIR treat CPAs in the same manner as attorneys for the purpose of tax agent accreditation.

Limit Accountancy Degree Courses to Four Years

PICPA proposes that a five-year accountancy curriculum be introduced. In contrast, the BOA recommends that a four-year curriculum be continued and that focus be directed towards improving curriculum quality and teaching quality. This study supports the BOA’s stand for two reasons. First, IFAC recommends a minimum three-year curriculum—a longer education program will not necessarily address quality issues. Second, a five-year curriculum will limit opportunities for less wealthy students. It is recommended that a four-year course limit be placed upon accountancy degree courses.

Separate Accounting and Auditing Responsibilities

The Commission on Audit is exclusively responsible, for promulgating accounting and auditing rules—per Article IX of the Constitution 1987. Their coexistence is inconsistent with the concept of auditor objectivity and independence. Moves are already underway to address this issue—for instance, Senate Bill No 439 (2000) seeks to create a government accounting office under the DBM—this could be constitutionally troublesome unless carefully designed. However, a proposed ADB TA will examine COA’s structure and responsibilities with the intention of recommending a solution that is in keeping with the Constitution. This study supports efforts to separate government accounting and auditing responsibilities. But, it is recommended that initiatives to separate government accounting and auditing functions, be planned in full acknowledgement of Constitutional requirements.
Adopt International Public Sector Accounting Standards

There is no consistent set of accounting standards for budgeting and reporting. Major reporting differences result. COA is considering what accounting standards might be appropriate as it prepares for the introduction of accrual accounting. There are three sets of international standards available: (i) IMF GFS; (ii) UN SNA; and (iii) IPSAS. ADB, World Bank, IMF and UNDP have funded the development of IPSASs and are represented on the PSC. The International Organization of Supreme Audit Institutions (INTOSAI) is also represented on the PSC.

Most countries use the cash-based GFS and SNA standards. Furthermore—given that IPSASs are entirely grounded in IASs—a number of governments indirectly use them for preparing financial statements on the accrual accounting basis. While differences remain between GFS, SNA and IPSASs, significant progress has been made towards harmonization. As demonstrated by several governments, the IPSAS basis provides the necessary information to prepare GFS and SNA financial statements. Three advantages would accrue through the adoption of the IPSASs. First, government and private sector accounting practices would be the same. This would enable direct transferability of accounting skills between the two sectors. Second, training and guidance materials are available from governments that have already moved to an IPSAS-compatible accrual basis (e.g., Australia and New Zealand, among others). Third, as IPSASs are essentially IASs under another name, choices in computerized accounting systems are not limited to those with special functionality.

It is recommended that IPSASs be adopted if the Government moves to full accrual accounting.

Minimize Compliance (Transaction) and VFM Auditing

Auditors spend the majority of their time on compliance auditing (checking transactions). Minimal time is spent on financial attest auditing as more effort is applied to value-for-money (VFM) audits. A proposed ADB TA will focus on strengthening financial attest auditing and VFM capacities. While this study strongly supports resources being redirected from compliance auditing to financial attest auditing, it cautions against similar redirection to VFM auditing, for three reasons. First, VFM audits are essentially policy evaluations but generally take place long after policies have been implemented. Strengthening the policy-making function, through policy evaluations, is more effective in this sense. Second,
contrast to a well-designed policy evaluation function, VFM audits are generally targeted on the basis of questionable criteria. A review of VFM reports from SAIs around the world would reveal, in keeping with public choice theory, that issues are targeted for their media worthiness—not necessarily for their impact on significant public policy outcomes. Third, the skills required to conduct a policy evaluation or a VFM audit are generally not those of a CPA. This requires that organization capacity be established. Fourth, even if VFM audits do represent value for money, they inevitably divert resources away from financial attest auditing—a key tool in reducing graft and corruption. For instance, COA already devotes more resources to VFM auditing than it does to financial attest auditing. The SAIs of developed countries, which have a strong financial attest auditing capacity, can afford to divert resources to VFM auditing. It is questionable whether the same is true of developing countries.

It is recommended that COA: (i) continues to reduce the resources that are directed towards compliance (transaction) audits; (ii) continues to strengthen financial attest auditing capacity; and (iii) consider the appropriateness of directing scarce resources towards VFM auditing in the absence of a strong financial attest auditing capability.
IX. Accounting and Auditing Practices in Sri Lanka

1. Challenges and Responses

Sri Lanka’s overriding challenge is to resolve the ongoing conflict (security-related expenditures consume 5.6 percent of GDP). Financial governance issues and challenges are centered on the public sector: private sector participation is impeded by: (i) continued public sector involvement in commercial activities; and (ii) a weak enabling environment for private sector activity (e.g., a non-level playing field, labor market rigidities, difficult access to financing and poor governance practices).

Particular challenges include: (i) improving the financial governance arrangements for public corporations; (ii) improving the financial reporting of public corporations; and (iii) improving public expenditure management practices. These challenges all involve accounting and auditing arrangements.

In response to these challenges, government has been taking a number of initiatives. First, the Public Enterprise Reform Commission commenced work in 1995 and has made significant progress on privatizations. The ADB-supported Private Sector Development Program is supporting this work and, among others things, will focus on improving corporate governance arrangements amongst public enterprises. Second, government has embarked on a program of public expenditure management reform. Among other things, the program’s objectives are to improve public sector accounting arrangements and procurement practices.

2. Accounting and Auditing in Sri Lanka

Sri Lankan accounting and auditing systems are directly influenced by British, and more recently, international arrangements and practices. In 1948, the newly independent country did not automatically accept the inherited arrangements as adequate; a post-independence commission recommended the creation of a professional accountancy body and improved financial reporting requirements. The professional body was established in 1959 and began issuing accounting standards in 1970.

Confidence in Sri Lanka’s accounting and auditing arrangements was severely shaken following the collapse of a number of finance companies
in the late 1980s and early 1990s. Many depositors lost their savings and
government incurred significant fiscal costs through bailouts. In response,
the Presidential Commission on Finance and Banking was established to
investigate and strengthen financial sector arrangements. It recommended
that international accounting and auditing standards be adopted to
improve financial disclosure and that financial reporting be monitored.

The Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995 was
developed in response to the Commission’s recommendations. It governs
the preparation, presentation and audit of financial statements. The Act
also established the Sri Lanka Accounting and Auditing Standards
Monitoring Board (SLAASMB).

The private sector comprises about 36,000 registered private
companies and about 2,160 registered public companies. Despite an intense
privatization program, 75 commercial enterprises and 115 statutory bodies
remain wholly government-owned.

Today’s governing legislative and institutional framework is robust
and reflects a mixture of government intervention and self-regulation. Key
institutions include: the Registrar of Companies who administers the
Companies Act 1982; the Central Bank of Sri Lanka which administers the
Banking Act 1995, approves bank auditors, approves accounting and auditing
standards for banks, and determines disclosure requirements for financial
institutions; the SEC which administers the Securities Act 1987 and oversees
the Stock Exchange; and the SLAASMB which administers the Sri Lanka
Accounting and Auditing Standards Act 1995 and monitors the application
of accounting and auditing standards. In addition, the Public Finance Act
1971 governs the financial management, reporting and auditing arrange-
ments for public corporations.

Commentators have concluded that the quality of Sri Lankan private
financial reporting is sound. SLAASMB’s activities underpin ongoing
improvements to financial reporting. The accountancy profession’s annual
awards for the best annual reports of companies and state corporations
reinforce these activities. Furthermore, the profession is pushing for further
improvements, including the establishment of audit committees and the
introduction of audit partner rotation. Indeed, Sri Lanka’s accounting and
auditing arrangements compare very well with those of other countries—
both developing and developed—at least for the private sector.

In contrast, public corporation financial reporting and governance
practices are poor. In particular, disclosure standards are deficient and
compliance with these standards is weak as evidenced by delayed or failed
submission of audited annual reports.
3. Professional Infrastructure

The colonial government established Sri Lanka’s first accountancy body—the Accountancy Board—in 1941. Those who passed the Accountancy Board’s examinations were called ‘Ceylon Registered Accountants’. The enactment of the Institute of Chartered Accountants Act (No. 23) 1959 established the Institute of Chartered Accountants of Sri Lanka (ICASL) as the national professional accountancy body.

Today, the ICASL has 2,170 members, comprising associate and fellow chartered accountants. The Institute’s qualification criteria meet international guidelines, with the exception of CPE requirements (which conform to UK practices). However, these criteria have been criticized as unnecessarily high in that they restrict the availability of qualified accountants in the face of pressing national needs and emigration.

Other Sri Lankan accountancy bodies include the Association of Accounting Technicians of Sri Lanka (AATSL), the Society of Certified Management Accountants of Sri Lanka, the Institute of Internal Auditors (IIA), and the Institute of Public Finance and Development Accountancy (IPFDA). IPFDA membership is by virtue of career experience and position. Specific academic qualifications, professional examinations and practical experience are not required.

Foreign professional accountancy bodies have a strong and growing Sri Lankan presence. Their success in establishing operations reflects strong historical connections with Britain and a desire by many Sri Lankans to have exportable qualifications; many of their members hold concurrent ICASL memberships. The two most significant bodies are the Association of Certified Chartered Accountants (ACCA)(UK) and the Chartered Institute of Management Accountants (CIMA)(UK).

4. Accounting and Auditing Standards

Before 1970, Sri Lankan financial reporting requirements were primarily based upon the prescriptions of the Companies’ Ordinance of Ceylon, UK legislation and the recommendations of the Institute of Chartered Accountants of England and Wales (ICAEW). In 1970, the ICASL issued the first Sri Lankan Accounting Standard (SLAS). But the use of SLASs was not legally mandated until 1995, other than for publicly quoted companies, financial institutions and insurance companies.

In addition to tightening financial disclosures, the Sri Lanka Accounting and Auditing Standards Act 1995 provided for the establishment of the Statutory
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Accounting Standards Committee (ASC) and the Auditing Standards Committee (AuSC). The ASC and the AuSC operate under ICASL auspices.

The ASC’s accounting setting-standard process is broadly similar to that of IASB and focuses on reviewing IASs for adoption in Sri Lanka. Twenty-eight SLASs were effective as of 30 June 2001. These include only minor divergences from IASs which, when they do occur, are disclosed as part of the SLAS. All Sri Lankan companies must prepare SLAS-compliant financial reports. Adjustments are then applied to these financial reports to derive corporate income for taxation purposes.

The AuSC promulgates Sri Lankan Auditing Standards, which are based directly upon IAASB pronouncements. The promulgation process is similar to that for SLASs.

5. Education and Training

The Government Technical School (Ceylon Technical College) offered Sri Lanka’s first commerce course in 1908. Sri Lanka has primarily relied on professional bodies—rather than universities—for accountancy training. It was not until 1992 that Sri Jayewardenepura University established a comprehensive Bachelor Degree program in accountancy. This situation reflects an historical reluctance on the part of the universities to provide accountancy courses, which is mirrored by the profession’s reluctance to recognize university qualifications.

Following independence, government recognized that technicians and professionals were necessary for economic development. To this end it established the Commission of Inquiry on Technical Education in 1963. The Commission identified shortages in the availability of financial and cost accountants. ICASL responded by reviewing its admission procedures and membership subsequently increased.

In 1993, a study concluded that certain key reform programs were being impeded by the severe shortage of financial management personnel. It estimated that there was a shortfall of 500-1,000 professional accountants and 1,000-3,000 accounting technicians. Moreover, the study identified fundamental flaws in degree, diploma and certificate course structures. Specifically, there were mismatches between curricula and job slots. In response, the ADB-supported Financial Management Training Project supported improvements to accountancy education and training in: (i) universities; (ii) technical institutions; (iii) professional bodies; and (iv) specialist institutions (particularly the Institute of Government Accounts and Finance: InGAF). The Financial Management Training Project addressed some
supply-side issues in accountancy education and training. Meanwhile, demand for accountancy education remains high (only the very best students are able to meet the requisite entrance grades).

There is no evidence that skills shortages have abated, particularly in the public sector. If anything, emigration and attempts to improve public sector accountability and transparency have exacerbated the effects of these shortages.

6. Government Budgeting and Accounting

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.

In the absence of fundamental civil service reforms or a curtailment of the conflict, government has minimal room for pursuing fiscal savings. Attempts to initiate civil service reforms in the early 1990s were unsuccessful. Government efforts have subsequently 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 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.

The legal framework for government finance comprises: Chapter XVII of the 1978 Constitution; the Public Finance Act (No. 38) 1971; and the Financial Regulations promulgated by the Ministry of Finance and Planning. A primary objective of the ADB-supported Public Expenditure Management Project was to develop a new Public Finance Act. However, this activity has been postponed.

In the 1970s, the Sri Lankan Government adopted the Planning, Programming and Budgeting System (PPBS) approach to public expenditure management. However, the system has changed little since its implementation. A series of detailed rules and input controls have developed in the meantime. Budgeting and reporting are conducted on a cash accounting basis. Two computerized systems have been developed to manage public expenditure. A primary objective of the ADB-supported
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Public Expenditure Management Project was to identify user requirements, and develop specifications, for a new public expenditure information system (PEIS). This activity has been de-emphasized as part of the refocusing of the technical assistance. Activities now focus on upgrading the capacity of existing systems.

Existing public management arrangements impede 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. This is not currently the case.

7. Donor Assistance

ADB is supporting broad governance activities through technical assistance and loans. Directly relevant activities include:

- Loans 1800-SRI and 1801-SRI: Private Sector Development Program ($100.0 million: 2001-2004). This program is intended to promote private initiative and enhance the performance of financial markets.
- Loan 1275-SRI: Financial Management Training Project ($13.0 million: 1994-1999). This project provided basic computing expertise and skills to a substantial number of civil servants at the national and subnational levels. It had had three components: (i) development of the Sri Lanka Accountants Service and associated accountancy training; (ii) specialized training in financial management, auditing and computers; and (iii) professional development and training. The project supported the development of InGAF and the preparation and delivery of a variety of training materials.
- TA No. 3301-SRI: Public Expenditure Management Systems ($3.0 million: 2000-2002). This TA was originally intended to support improvements to public expenditure management through five closely related subprojects: (i) public expenditure information system, (ii) public investment program, (iii) medium-term expenditure framework, (iv) human resource management, and (v) revised Public Finance Act and internal audit. However, in 2001 the TA was refocused in terms of both scope and objectives.
- TA No. 2616-SRI: Public Administration Reform ($0.275 million: 1996). This TA assisted the government to review public administration structures, identify key issues and problems, and formulate a number of strategic design alternatives based on the identified problems.
- TA No. 705-SRI: Accounting and Auditing Education Master Plan ($0.158 million: 1986). This TA assisted the government to develop an accounting
and auditing education master plan. The recommendations of the master plan—regarding the need for middle-level financial personnel—were noted by the Government and the Association for Accounting Technicians of Sri Lanka was subsequently established in 1987.

The World Bank is supporting modernization of the Central Bank of Sri Lanka through a $30.3 million credit. TA to strengthen government auditing and accountability processes is also planned for 2002. The objectives of the assistance are to: (i) strengthen and reorganize the department, and (ii) develop a separate Audit Act to underpin these activities.

Although a UNDP-funded project supported activities to initiate broad-based civil service reforms, other considerations—including the attention and resources absorbed by the civil conflict—limited the effectiveness of these activities. CIDA provided assistance to support the establishment of the Society of Certified Management Accountants of Sri Lanka. Japan is the largest donor to Sri Lanka. It does not directly support financial management and governance activities, but provides indirect support through Japan-based education and training on financial and public management. USAID has provided support for the development of financial markets and technical assistance to ICASL to enhance the accounting and auditing standards of large and small audit firms, and improve the compliance and monitoring activities of the SEC.

8. Issues and Recommendations

This study concludes that, while 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.

- Regarding 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 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 CPE for chartered accountants.

Each study recommendation—and the issues that it is intended to address—is summarized below. The Sri Lankan DSAA report provides further detail.

**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. However, government accountants and auditors still do not have adequate or appropriate professional qualifications or representation. For instance, IPFDA membership is attained by virtue of career experience and position. Membership does not require specified academic qualifications, professional examinations, practical experience or CPE requirements. The establishment of suitable bookkeeping and accountancy certifications would provide: (i) stepping stones to higher professional qualifications; (ii) measures to gauge competence to undertake bookkeeping and accountancy tasks; and (iii) professional career targets. It is recommended that assistance be provided to support: (i) the establishment of strong professional body for public sector accountants and auditors—while 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. Given this proven success, ICASL would be the ideal parent or partner for this public sector professional organization; (ii) the design and establishment of an appropriate

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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.

**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 SLRs1,000 ($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.

**Appoint Financial Specialists 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 appointment and removal processes. Furthermore, nominees for board appointment should be selected from an ICASL-provided shortlist.

**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.

Publish a Quarterly 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, 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 process; and (iii) highlight where deadlines have been exceeded.

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 should have suitably qualified Chief Financial Officers with senior manager status.

Require SLAASMB Review of all Public Corporation Annual Reports

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.

Enhance Director Accountability

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.

Close the Emerging Gaps Between SLASs and IASs

A gap has begun to emerge between SLASs and IASs. In the absence of corrective actions or arrangements, this gap will widen during the coming four years as the 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.

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. 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 nonaudit services by auditors; and (iii) regular rotation of audit partners and teams be mandated.

Make CPE Mandatory for Continuing ICASL Membership

IFAC and ISAR recommend a minimum of 30 hours CPE per year, or a minimum of 90 hours in every three-year period of structured learning activity.\(^\text{74}\) 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.


III
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

Enhance Institutional Support for Good 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.

Provide Resources to the ICASL for Standing-Setting Activities

There is a significant public good component to the standing-setting activities of ASC and AuSC, which are supported entirely by the 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. It is recommended that funding be appropriated to ICASL to support accounting and auditing standard-setting activities.

Advocate Changes to IASB Copyright and Pricing Policies

The IASCF copyrights IAS and associated guidance materials. Many developing countries, including Sri Lanka, are moving towards IASs. Investors, lenders, academics, practitioners, and regulators should have access to IASs and associated materials. The IASCF’s copyrighting and pricing policies effectively limit this access. 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.

Encourage the Development of Financial Reporting Standards for SMEs

IAS has been developed on a one-size-fits-all basis. For instance, IAS 19 Employee Benefits requires that actuarial valuations be undertaken of certain employee benefits. It is recommended that ADB, together with other multilateral development banks, should encourage efforts to develop a financial reporting regime for SMEs.
X. Regional Issues and Country Action Plans

1. Introduction

The study identified a range of gaps and weaknesses. Section two examines issues that are common across the Asia Pacific region. Sections three to seven present the individual country action plans. Each action plan was agreed-in-principle with the country representatives during the Manila workshop in March 2002. The action plans classify issues into those deficiencies that are: (i) better able to be resolved with external assistance; and (ii) able to be resolved without the need for external assistance.

2. Regional Issues

Several issues identified in the individual studies were common across countries. Chapter IV examines certain regional issues including: (i) the benefits and challenges of IAS adoption; (ii) problems with IAS copyright and pricing; (iii) SME financial reporting; (iv) mechanisms to strengthen auditing standards and practices; (v) the importance of strong country accountancy professions; and (vi) public sector reporting challenges.

Four additional regional issues are described below. The first three remain valid from the 2000 DSAA Summary Report and have been repeated.\(^\text{75}\) In some cases, for instance the training of lecturers and professors, ADB is implementing regional responses.\(^\text{76}\)

Public–Private Pay Disparities

There is a general lack of skilled accounting and auditing personnel in the public sectors of DMCs. The private sector—because it pays better—is able to attract the qualified personnel that are available in the market. There is no simple answer for this very serious constraint.


\(^\text{76}\) ADB TA No. 6028-REG: Small-scale Technical Assistance for Upgrading Accounting Education (Training the Trainers), for $100,000, approved on 11 April 2002.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

Two recommendations made for individual countries offer a partial response. First, recommendations have been made to support training for public sector accountants. Second, recommendations have been made to create professional membership categories for public sector accountants. The intent of these recommendations is to raise the competence and status of public sector accountants, thereby making this a more attractive career choice for potential employees.

Training of Accountancy Lecturers and Professors

The training of accountancy lecturers and professors needs urgent attention. It was revealed that accountancy trainers at universities and colleges are not up to date in the latest international best practices. If the quality of accounting and auditing support is to be improved in countries, then investments must be made to train trainers on the implementation and use of international accounting and auditing standards.

Availability of Training Materials

The availability of textbooks in local languages is another major constraint that has been brought to light. Urgent attention is needed to provide assistance to prepare textbooks in local languages.

Legislative Impediments

In many DMCs, country laws and regulations impede sound accounting and auditing practices. First, few countries have legislation that clearly stipulates accounting and auditing requirements, and plainly sets out processes for developing and promulgating standards. Second, laws and regulations often override accounting standards and conflict with sound financial disclosure practices.


Azerbaijan’s financial management reforms lag behind those of most other Former Soviet Union countries. However, it is now positioned to closely examine other countries’ efforts and, by doing so, to develop a comprehensive strategy for effective reform.
### REGIONAL ISSUES AND COUNTRY ACTION PLAN

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<tbody>
<tr>
<td>Establish Coordination Group, Develop Strategic Plan and Review Framework</td>
<td>High</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amend Laws and Regulations</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Clarify Accounting Standard Setting Arrangements</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Clarify Legal Status of Auditing Standards</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Clarify Auditing Standard-Setting Arrangements</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Broaden and Strengthen Accounting Qualifications</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
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<tr>
<td>Develop Training Materials</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
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<tr>
<td>Develop Accounting Curriculum and Materials</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Provide Continuing Training to Professors and Lecturers</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Establish Government Accountant and Auditor Certifications</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Strengthen Accounting Standards and Financial Disclosure Requirements</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Enhance Financial Disclosure Monitoring</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

77 This recommendation was strongly supported by all Baku workshop participants (5-6 December 2001), but there was mixed support at the Manila workshop (5-6 March 2002).

### 4. Action Plan: Fiji Islands

Despite its small numbers and limited resources, the Fiji Islands accountancy profession compares favorably with those of most other countries. This is attributable to the efforts of a hardcore of dedicated professionals supported by the larger accountancy firms.
5. **Action Plan: Marshall Islands**

While RMI has made some progress in improving financial management arrangements over the past decade, basic record keeping systems and internal control systems remain inadequate. Moreover, future improvements are unlikely given the critical shortage of suitably qualified bookkeepers and accountants.

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<tbody>
<tr>
<td>Recruit Qualified Accountants to Support Financial Management Improvements</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td>...</td>
</tr>
<tr>
<td>Establish Bookkeeping and Accountancy Certifications</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td>...</td>
</tr>
</tbody>
</table>

78 There was mixed support for this recommendation.
6. Action Plan: Philippines

The Philippines was less affected by the Asian financial crisis than some other countries in the region, largely due to better financial management arrangements. Moreover, accountancy is an elite and respected profession. However, the study revealed a range of issues that need attention if accountancy is to maintain its high status and if the Philippines is to attract investment.

In contrast to the other country actions presented in this chapter, explanatory comments are included in the Philippine country action plan for two reasons. First, the study recommendations were initially discussed at the March 2001 Manila workshop. In the intervening period, efforts have already been made to implement the recommendations—the action plan describes these efforts. Second, Philippine study participants were less unified—when compared to other country participants—in agreeing study issues and recommendations. Accordingly, the action plan describes discordant views.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

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<tr>
<td>Directly adopt IAS in 2004</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
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<tr>
<td>• The Philippines will complete direct IAS adoption by 2005.</td>
<td></td>
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<tr>
<td>Strengthen financial disclosure monitoring and impose strict penalties on erring corporations and auditors</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
</tr>
<tr>
<td>• ADB is providing TA to implement this recommendation.</td>
<td></td>
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<tr>
<td>Directly adopt IAASB pronouncements (International Standards on Auditing) in 2004</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
</tr>
<tr>
<td>• The Philippines will complete direct adoption of IAASB pronouncements by 2005</td>
<td></td>
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<td></td>
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<tr>
<td>Strengthen auditing practices and monitor compliance with auditing requirements</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
</tr>
<tr>
<td>• Although one auditing firm strongly disagreed with this recommenda-</td>
<td></td>
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<tr>
<td>tion, other study participants were supportive. Moreover, Bangko Sentral ng Pilipinas has recently introduced five-yearly mandatory rotation of bank auditors.</td>
<td></td>
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<tr>
<td>Amend the Accountancy Law so that licensure standards can be raised</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
</tr>
<tr>
<td>• In keeping with the recommendation, the accountancy profession is pre-</td>
<td></td>
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<tr>
<td>paring amendments to the Accountancy Law to support, among other</td>
<td></td>
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<tr>
<td>things: (i) mandatory CPE; (ii) quality assurance improvements; and</td>
<td></td>
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<tr>
<td>(iii) the introduction of practical experience requirements for auditors.</td>
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<tr>
<td>Introduce practical experience prerequisite for the CPA title</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
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<tr>
<td>• The PRC is working to address this important international requirement.</td>
<td></td>
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<tr>
<td>In particular, auditors are now required to have three years' practical experience before they may sign audit reports.</td>
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<tr>
<td>Introduce mandatory CPE</td>
<td>High</td>
<td>☑</td>
<td>☑</td>
<td></td>
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<tr>
<td>• The Philippines will introduce this international requirement through an amendment to the Accountancy Law.</td>
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</table>
### REGIONAL ISSUES AND COUNTRY ACTION PLAN

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<tbody>
<tr>
<td>Reassign responsibility for investigating certain ethical matters from BOA and PICPA to the SEC</td>
<td>High</td>
<td>✔</td>
<td>Mixed</td>
<td></td>
</tr>
<tr>
<td>• Although there was general agreement that BOA and PICPA had not effectively discharged their responsibilities in this area, there was no clear support for the recommendation on the basis that the SEC would also be ineffective. ADB is providing TA to SEC to strengthen its capacity in this area.</td>
<td></td>
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<tr>
<td>Design and implement quality control and quality assurance arrangements over the profession</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>• In keeping with the recommendation, amendments are being prepared to the Accountancy Law to strengthen quality assurance arrangements.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Introduce provisional CPA title</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>• Participants in the March 2001 Manila workshop supported this recommendation, as did all associated written comments. However, PRC subsequently disagreed with the recommendation (March 2002).</td>
<td></td>
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<tr>
<td>Improve monitoring of accountancy courses</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td></td>
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<tr>
<td>• In August 2001, the Commission on Higher Education approved a new accountancy curriculum. BOA would appreciate support to implement the new curriculum and associated monitoring arrangements.</td>
<td></td>
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<tr>
<td>Provide continuing training to professors and lecturers</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>• ADB is supporting a regional response to this important issue.(^7^9)</td>
<td></td>
<td></td>
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<tr>
<td>Define accounting information system requirements</td>
<td>High</td>
<td>✔</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>• COA has acted to define requirements.</td>
<td></td>
<td></td>
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<tr>
<td>Directly adopt IFAC pronouncements on professional ethics</td>
<td>High</td>
<td>☒</td>
<td>✔</td>
<td></td>
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<tr>
<td>• BOA has prepared a revised code of ethics that is directly based on the IFAC code of ethics.</td>
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</table>

\(^7^9\) ADB TA No. 6028-REG: Small-scale Technical Assistance for Upgrading Accounting Education (Training the Trainers), for $100,000, approved on 11 April 2002.
## ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

|--------|----------|-------------------|-----------------|-------------|
| Make PICPA membership compulsory for CPAs  
- On the basis that this would probably delay congressional approval of the Accountancy Law amendments, PRC has not included this requirement in proposed Accountancy Law amendments, but intends to pursue this as a longer term objective. | High | ✗ | ✓ | |
| Minimize compliance (transaction) and value-for-money (VFM) audits  
- With the important exception of COA, all participants agreed with this recommendation. COA intends to maintain its VFM auditing focus. | High | ✗ | Mixed | |
| Alter accounting standard setting arrangements by giving the ASC legal status, altering ASC representation, and tightly defining the ASC role  
- There was mixed support for this recommendation. In particular, the PRC intends to maintain ASC's existing composition. However, this recommendation is now less important, given the decision to directly adopt IAS. | Medium | ✓ | Mixed | |
| Address CPA licensure examination issues  
- PRC have already addressed some of these issues, and intend to improve quality reviews of examination question setting. Regarding the introduction of a written examination component (in accordance with international standards), PRC supports the introduction of this requirement before auditors may issue audit opinions. | Medium | ✓ | ✓ | |
| Introduce Accounting Technician membership category to PICPA  
- Although all written comments received prior to the March 2001 Manila workshop supported this recommendation, one view was expressed in the workshop that the Accounting Technician designation is a very low level qualification intended for countries with poorly developed accountancy professions. | Medium | ✓ | ✓ | |
| Develop annual financial management scorecard for the private sector  
- Although supported by study participants, this recommendation has yet to be implemented. | Medium | ✓ | ✓ | |
### Regional Issues and Country Action Plan

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<tr>
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<tbody>
<tr>
<td>Limit the use of proxy voting in PICPA meetings and elections</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>• With exception of current and former partners from a particular auditing firm, there was general agreement with this recommendation. However, as a nonstock corporation PICPA is required to allow proxy voting. Furthermore, it was suggested that the potential misuse of proxy votes could be addressed by limiting the number of proxies that can be assigned to an individual. For instance, the California Society of CPAs limits proxy assignments to 10.</td>
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<tr>
<td>Exempt CPAs from BIR tax agent accreditation requirement</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>• PRC/BOA subsequently met with the BIR Commissioner and officials to discuss this issue; a memorandum of agreement is being developed to give effect to this recommendation.</td>
<td></td>
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<tr>
<td>Limit accountancy degree courses to four years</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>• This issue has since been resolved. In August 2001, the Commission on Higher Education approved a new accountancy curriculum. It requires a minimum of 177 units, which can be completed within four years.</td>
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<tr>
<td>Carefully separate accounting and auditing responsibilities</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Adopt international public sector accounting standards (IPSASs), if accrual accounting is implemented</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Advocate changes to IASB copyright and pricing policies</td>
<td>Low</td>
<td>✓</td>
<td>✓</td>
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Sri Lanka’s financial management arrangements 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.

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<tbody>
<tr>
<td>Strengthen Government Accounting and Auditing</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Strengthen Public Corporation Accountability through Legislative Amendments</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
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<tr>
<td>Appoint Financial Specialists to Public Corporation Boards</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Strengthen Public Corporation Internal Auditing and Controls</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Publish a Scorecard of Public Corporation Reporting</td>
<td>High</td>
<td>✓</td>
<td>✓</td>
<td></td>
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<tr>
<td>Create Chief Financial Officer Positions in Public Corporations</td>
<td>High</td>
<td>✗</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Require SLAASMB Review of all Public Corporation Annual Reports</td>
<td>High</td>
<td>✗</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Enhance Director Accountability</td>
<td>Medium</td>
<td>✗</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Close the Emerging Gaps Between SLASs and IAS</td>
<td>Medium</td>
<td>✗</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Enhance Auditor Independence and Objectivity</td>
<td>Medium</td>
<td>✗</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Make CPE Mandatory for Continuing ICASL Membership</td>
<td>Low</td>
<td>✗</td>
<td>✗</td>
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Although an IFAC requirement, there was mixed support for this recommendation.
## Regional Issues and Country Action Plan

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<tbody>
<tr>
<td>Enhance Institutional Support for Good Financial Governance</td>
<td>Low</td>
<td>×</td>
<td>✓</td>
<td>✧</td>
</tr>
<tr>
<td>Provide Resources to the ICASL for Standards-Setting Activities</td>
<td>Low</td>
<td>×</td>
<td>✓</td>
<td>✧</td>
</tr>
<tr>
<td>Advocate Changes to IASB Copyright and Pricing Policies</td>
<td>Low</td>
<td>×</td>
<td>✓</td>
<td>✧</td>
</tr>
<tr>
<td>Encourage the Development of Financial Reporting Standards for SMEs</td>
<td>Low</td>
<td>×</td>
<td>✓</td>
<td>✧</td>
</tr>
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ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs


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<td>1. Proposed International Education Standards (IESs) for Professional Accountants</td>
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<td>2. Proposed International Education Guideline (IEG) for Professional Accountants</td>
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<td>7.</td>
<td>International Public Sector Accounting Standards (IPSAS)</td>
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<td>1. International Public Sector Studies</td>
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<td>2. Occasional Papers</td>
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## Appendix 1. Useful Internet Sites

### Regulatory and Standard-Setting Bodies
- Financial Accounting Standards Board (US) [FASB](www.fasb.org)
- Government Accounting Standards Board (US) [GASB](www.gasb.org)
- Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting of the UNCTAD [ISAR](www.unctad.org/isar/)
- International Accounting Standards Board [IASB](www.iasc.org.uk)
- International Auditing and Assurance Standards Board [IAASB](www.ifac.org/IAASB/)
- International Federation of Accountants [IFAC](www.ifac.org)
- International Organization of Supreme Audit Institutions [INTOSAI](www.intosai.org)
- International Valuation Standards Committee [IVSC](www.ivsc.org)

### Professional Organizations and Bodies
- American Institute of Certified Public Accountants [AICPA](www.aicpa.org)
- ASEAN Federation of Accountants [AFA](www.afa-central.com)
- Association of Accounting Technicians [AAT](www.aat.co.uk)
- Association of Chartered Certified Accountants [ACCA](www.accaglobal.com)
- Canadian Institute of Chartered Accountants [CICA](www.cica.ca)
- Chartered Institute of Management Accountants [CIMA](www.cimaglobal.com)
- Confederation of Asian and Pacific Accountants [CAPA](www.capa.com.my)
- CPA Australia [CPA](www.cpaonline.com.au)
- Fiji Institute of Accountants [FIA](www.cpaonline.com.au)
- Hong Kong Society of Accountants [HKSA](www.hksa.org.hk)
- Institute of Certified Public Accountants of Singapore [ICPAS](www.icpas.org.sg)
- Institute of Chartered Accountants in Australia [ICAA](www.icaa.org.au)
# ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

<table>
<thead>
<tr>
<th>Organization</th>
<th>Website</th>
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</thead>
<tbody>
<tr>
<td>Institute of Chartered Accountants of New Zealand</td>
<td>ICANZ <a href="http://www.icanz.co.nz">www.icanz.co.nz</a></td>
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<tr>
<td>Institute of Chartered Accountants of Sri Lanka</td>
<td>ICASL <a href="http://www.icasrilanka.com">www.icasrilanka.com</a></td>
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<tr>
<td>Institute of Internal Auditors</td>
<td>IIA <a href="http://www.theiia.org">www.theiia.org</a></td>
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<tr>
<td>Accounting and Reporting of the UNCTAD</td>
<td>IFAC <a href="http://www.ifac.org">www.ifac.org</a></td>
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<td>International Federation of Accountants</td>
<td>INTOSAI <a href="http://www.intosai.org">www.intosai.org</a></td>
</tr>
<tr>
<td>International Organization of Supreme Audit Institutions</td>
<td>JICPA <a href="http://www.jicpa.or.jp">www.jicpa.or.jp</a></td>
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<tr>
<td>Japanese Institute of Certified Public Accountants</td>
<td>KICPA <a href="http://kicpa.or.kr">http://kicpa.or.kr</a></td>
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<td>Korean Institute of Certified Public Accountants</td>
<td>MIA <a href="http://www.mia.org.my">www.mia.org.my</a></td>
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<td>Malaysian Institute of Accountants</td>
<td>MICPA <a href="http://www.micpa.com.my">www.micpa.com.my</a></td>
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<td>Malaysian Institute of Certified Public Accountants</td>
<td>PICPA <a href="http://www.picpa.org.ph">www.picpa.org.ph</a></td>
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<td>Philippine Institute of Certified Public Accountants</td>
<td>SAFA <a href="http://www.citechco.net/safa/">www.citechco.net/safa/</a></td>
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<td>South Asian Federation of Accountants</td>
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**International and Regional Organizations**

<table>
<thead>
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<th>Organization</th>
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<tr>
<td>Asia Pacific Economic Cooperation</td>
<td>APEC <a href="http://www.apecsec.org.sg">www.apecsec.org.sg</a></td>
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<tr>
<td>Association of Southeast Asian Nations</td>
<td>ASEAN <a href="http://www.aseansec.org">www.aseansec.org</a></td>
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<tr>
<td>Bank for International Settlements</td>
<td>BIS <a href="http://www.bis.org">www.bis.org</a></td>
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<tr>
<td>International Federation of Accountants</td>
<td>IFAC <a href="http://www.ifac.org">www.ifac.org</a></td>
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<tr>
<td>International Organization of Securities Commissions</td>
<td>IOSCO <a href="http://www.iosco.org">www.iosco.org</a></td>
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<td>International Organization of Supreme Audit Institutions</td>
<td>INTOSAI <a href="http://www.intosai.org">www.intosai.org</a></td>
</tr>
<tr>
<td>Organisation for Economic Cooperation and Development</td>
<td>OECD <a href="http://www.oecd.org">www.oecd.org</a></td>
</tr>
<tr>
<td>World Trade Organization</td>
<td>WTO <a href="http://www.wto.org">www.wto.org</a></td>
</tr>
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</table>
## Development Organizations

### Multilateral

- **Asian Development Bank** (ADB) - www.adb.org
- **International Monetary Fund** (IMF) - www.imf.org
- **Islamic Development Bank** (IsDB) - www.isdb.org
- **United Nations Development Programme** (UNDP) - www.undp.org
- **World Bank** - www.worldbank.org

### Bilateral

- **Australian Agency for International Development** (AusAID) - www.ausaid.gov.au
- **Danish International Development Agency** (DANIDA) - www.um.dk/danida
- **Gesellschaft für Technische Zusammenarbeit** (GTZ) - www.gtz.de
- **Japan Bank for International Cooperation** (JBIC) - www.jbic.go.jp
- **Japan International Cooperation Agency** (JICA) - www.jica.go.jp
- **New Zealand Agency for International Development** (NZAID) - www.nzaid.govt.nz
- **Swedish International Development Agency** (SIDA) - www.sida.se
- **United Kingdom Department for International Development** (DFID) - www.dfid.gov.uk
- **United States Agency for International Development** (USAID) - www.usaid.gov
Appendix 2. International Accounting Standards (IAS)

The following IAS analysis was valid at 20 July 2002.

<table>
<thead>
<tr>
<th>No.</th>
<th>Title</th>
<th>Revised</th>
<th>Abridged⁸¹</th>
<th>Options⁸²</th>
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</thead>
<tbody>
<tr>
<td>...</td>
<td>Preface to International Financial Reporting Standards (IFRSs)</td>
<td>2002</td>
<td>...</td>
<td>...</td>
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<tr>
<td>1</td>
<td>Presentation of Financial Statements</td>
<td>1997</td>
<td>✓</td>
<td>...</td>
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<tr>
<td>2</td>
<td>Inventories</td>
<td>1993</td>
<td>✓</td>
<td>First-in First-out and weighted-average cost flow valuations (Last-in Last-out as alternative)</td>
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<tr>
<td>3</td>
<td>Consolidated Financial Statements. Originally issued 1976, effective 1Jan 1977. No longer effective. Superseded in 1989 by IAS 27 and IAS 28.</td>
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<td>...</td>
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<tr>
<td>4</td>
<td>Depreciation Accounting. Withdrawn in 1999, replaced by IAS 16, 22 and 38, all of which were issued or revised in 1998.</td>
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<td>...</td>
<td>...</td>
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<tr>
<td>5</td>
<td>Information to Be Disclosed in Financial Statements. Originally issued October 1976, effective 1 January 1997. No longer effective. Superseded by IAS 1 in 1997.</td>
<td>...</td>
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</tr>
<tr>
<td>6</td>
<td>Accounting Responses to Changing Prices. Superseded by IAS 15.</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>7</td>
<td>Cash Flow Statements</td>
<td>1992</td>
<td>✓</td>
<td>...</td>
</tr>
<tr>
<td>8</td>
<td>Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies</td>
<td>1993</td>
<td>✓</td>
<td>Alternative treatments for the correction of fundamental errors</td>
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<tr>
<td>9</td>
<td>Accounting for Research and Development Activities. Superseded by IAS 38 effective 1 July 1999.</td>
<td>...</td>
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⁸¹ Abridged IASs for SME Accounting and Reporting recommended by the UNCTAD ISAR:

⁸² Identifies key options for accounting treatments.
<table>
<thead>
<tr>
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<th>Options&lt;sup&gt;52&lt;/sup&gt;</th>
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<td>10</td>
<td>Events After the Balance Sheet Date</td>
<td>1999</td>
<td>✓</td>
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<td>11</td>
<td>Construction Contracts</td>
<td>1993</td>
<td>...</td>
<td>...</td>
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<tr>
<td>12</td>
<td>Income Taxes</td>
<td>2000</td>
<td>✓</td>
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<tr>
<td>13</td>
<td>Presentation of Current Assets and Current Liabilities. Superseded by IAS 1.</td>
<td>...</td>
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<td>14</td>
<td>Segment Reporting</td>
<td>1997</td>
<td>...</td>
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<td>15</td>
<td>Information Reflecting the Effects of Changing Prices</td>
<td>1981</td>
<td>...</td>
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<td>16</td>
<td>Property, Plant and Equipment</td>
<td>1998</td>
<td>✓</td>
<td>Historical cost (Revaluation as alternative)</td>
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<td>17</td>
<td>Leases</td>
<td>1997</td>
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<td>18</td>
<td>Revenue</td>
<td>1993</td>
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<td>...</td>
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<td>19</td>
<td>Employee Benefits</td>
<td>2002</td>
<td>...</td>
<td>Accrued benefit valuation method (Projected benefit method as alternative)</td>
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<tr>
<td>20</td>
<td>Accounting for Government Grants and Disclosure of Government Assistance</td>
<td>1983</td>
<td>✓</td>
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<tr>
<td>21</td>
<td>The Effects of Changes in Foreign Exchange Rates</td>
<td>1993</td>
<td>✓</td>
<td>Some choices</td>
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<tr>
<td>22</td>
<td>Business Combinations</td>
<td>1998</td>
<td>...</td>
<td>Allowed alternatives: (i) acquisition accounting on either Purchase Method or Pooling of Interests method basis; and (ii) measurement of minority interest and accounting for negative goodwill.</td>
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<tr>
<td>23</td>
<td>Borrowing Costs</td>
<td>1993</td>
<td>✓</td>
<td>Expensing (capitalization as alternative)</td>
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<td>24</td>
<td>Related Party Disclosures</td>
<td>1984</td>
<td>✓</td>
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<td>25</td>
<td>Accounting for Investments. Superseded by IAS 39 and IAS 40 effective 2001.</td>
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<td>26</td>
<td>Accounting and Reporting by Retirement Benefit Plans</td>
<td>1987</td>
<td>...</td>
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<td>27</td>
<td>Consolidated Financial Statements and Accounting for Investments in Subsidiaries</td>
<td>1989</td>
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# Accounting and Auditing Practices in Selected DMCs

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<th>Options&lt;sup&gt;82&lt;/sup&gt;</th>
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<td>29</td>
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<td>1989</td>
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<td>30</td>
<td>Disclosures in the Financial Statements of Banks and Similar Financial Institutions</td>
<td>1990</td>
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<td>31</td>
<td>Financial Reporting of Interests in Joint Ventures</td>
<td>2000</td>
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<td>32</td>
<td>Financial Instruments: Disclosures and Presentation</td>
<td>1998</td>
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<td>Earnings Per Share</td>
<td>1997</td>
<td>...</td>
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<td>Interim Financial Reporting</td>
<td>1998</td>
<td>...</td>
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<td>Discontinuing Operations</td>
<td>1998</td>
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<td>36</td>
<td>Impairment of Assets</td>
<td>1998</td>
<td>✓</td>
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<tr>
<td>37</td>
<td>Provisions, Contingent Liabilities and Contingent Assets</td>
<td>1998</td>
<td>...</td>
<td>...</td>
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<tr>
<td>38</td>
<td>Intangible Assets</td>
<td>1997</td>
<td>✓</td>
<td>...</td>
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<tr>
<td>39</td>
<td>Financial Instruments: Recognition and Measurement</td>
<td>2000</td>
<td>...</td>
<td>...</td>
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<td>Investment Property</td>
<td>2000</td>
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<td>...</td>
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<td>41</td>
<td>Agriculture</td>
<td>2001</td>
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</table>
Appendix 3. IAS Interpretations (SICs)

As of 20 July 2002, the IASB Standing Interpretations Committee (SIC) had issued the following SICs.

SIC 1  Consistency - Different Cost Formulas for Inventories
SIC 2  Consistency - Capitalization of Borrowing Costs
SIC 3  Elimination of Unrealized Profits and Losses on Transactions with Associates
SIC 5  Classification of Financial Instruments – Contingent Settlement Provisions
SIC 6  Costs of Modifying Existing Software
SIC 7  Introduction of the Euro
SIC 8  First-Time Application of IASs as the Primary Basis of Accounting
SIC 9  Business Combinations – Classification either as Acquisitions or Unitings of Interests
SIC 10 Government Assistance - No Specific Relation to Operating Activities
SIC 11 Foreign Exchange - Capitalization of Losses Resulting from Severe Currency Devaluations
SIC 12 Consolidation - Special Purpose Entities
SIC 13 Jointly Controlled Entities - Non-Monetary Contributions by Venturers
SIC 14 Property, Plant and Equipment – Compensation for the Impairment or Loss of Items
SIC 15 Operating Leases – Incentives
SIC 16 Share Capital - Reacquired Own Equity Instruments (Treasury Shares)
SIC 17 Equity - Costs of an Equity Transaction
SIC 18 Consistency - Alternative Methods
SIC 19 Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29
SIC 20 Equity Accounting Method – Recognition of Losses
SIC 21 Income Taxes - Recovery of Revalued Non-Depreciable Assets
SIC 22 Business Combinations – Subsequent Adjustment of Fair Values and Goodwill Initially Reported
SIC 23 Property, Plant and Equipment - Major Inspection or Overhaul Costs
SIC 24 Earnings Per Share - Financial Instruments that May Be Settled in Shares
SIC 25 Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders
SIC 27 Evaluating the Substance of Transactions in the Legal Form of a Lease
SIC 28 Business Combinations - 'Date of Exchange' and Fair Value of Equity Instruments
SIC 29 Disclosure - Service Concession Arrangements
SIC 30 Reporting Currency - Translation from Measurement Currency to Presentation Currency
SIC 31 Revenue - Barter Transactions Involving Advertising Services
SIC 32 Intangible Assets - Web Site Costs
SIC 33 Consolidation and Equity Method - Potential Voting Rights and Allocation of Ownership Interests
# Appendix 4. International Standards on Auditing

The following International Standards on Auditing (ISAs) and International Auditing Practice Statements (IAPSs) were in effect at 31 March 2002.

## 1. International Standards on Auditing (ISAs)

<table>
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<th>ISA Code</th>
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<tr>
<td>100</td>
<td>Assurance Engagements</td>
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<tr>
<td>120</td>
<td>Framework of ISAs</td>
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<td>200</td>
<td>Objective and General Principles Governing an Audit of Financial Statements</td>
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<td>210</td>
<td>Terms of Audit Engagements</td>
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<td>220</td>
<td>Quality Control for Audit Work</td>
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<td>230</td>
<td>Documentation</td>
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<tr>
<td>240</td>
<td>The Auditor’s Responsibility to Consider Fraud and Error in an Audit of Financial Statements</td>
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<tr>
<td>240A</td>
<td>Fraud and Error</td>
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<tr>
<td>250</td>
<td>Consideration of Laws and Regulations in an Audit of Financial Statements</td>
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<td>260</td>
<td>Communications of Audit Matters with those Charged with Governance</td>
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<tr>
<td>300</td>
<td>Planning</td>
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<td>310</td>
<td>Knowledge of the Business</td>
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<tr>
<td>320</td>
<td>Audit Materiality</td>
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<tr>
<td>400</td>
<td>Risk Assessments and Internal Control</td>
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<tr>
<td>401</td>
<td>Auditing in a Computer Information Systems Environment</td>
</tr>
<tr>
<td>402</td>
<td>Audit Considerations Relating to Entities Using Service Organizations</td>
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<tr>
<td>500</td>
<td>Audit Evidence</td>
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<tr>
<td>501</td>
<td>Audit Evidence: Additional Considerations for Specific Items</td>
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<tr>
<td>505</td>
<td>External Confirmations</td>
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<tr>
<td>510</td>
<td>Initial Engagements - Opening Balances</td>
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<td>520</td>
<td>Analytical Procedures</td>
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<td>530</td>
<td>Audit Sampling and other Selective Testing Procedures</td>
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<td>540</td>
<td>Audit of Accounting Estimates</td>
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<td>Related Parties</td>
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<td>560</td>
<td>Subsequent Events</td>
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<td>Going Concerns</td>
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<td>580</td>
<td>Management Representations</td>
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<td>600</td>
<td>Using the Work of Another Auditor</td>
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<tr>
<td>610</td>
<td>Considering the Work of Internal Auditing</td>
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<tr>
<td>620</td>
<td>Using the Work of an Expert</td>
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<tr>
<td>700</td>
<td>The Auditor’s Report on Financial Statements</td>
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<td>710</td>
<td>Comparatives</td>
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<tr>
<td>720</td>
<td>Other information in documents containing Audited Financial statements</td>
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<tr>
<td>800</td>
<td>The Auditor’s Report on Special Purpose Audit Engagement</td>
</tr>
<tr>
<td>810</td>
<td>The Examination of Prospective Financial Information</td>
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<tr>
<td>910</td>
<td>Engagements to Review Financial Statements</td>
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<td>920</td>
<td>Engagements to Perform Agreed Procedures Regarding Financial Information</td>
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<td>930</td>
<td>Engagements to Compile Financial Information</td>
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</table>

Glossary of Terms

Preface to ISAs and RSs
## 2. International Auditing Practice Statements

<table>
<thead>
<tr>
<th>Appendix No.</th>
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<tr>
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<td>Inter-Bank Confirmation Procedures</td>
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<td>1001</td>
<td>Computer Information System (CIS) Environments: Standalone Microcomputer Systems</td>
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<tr>
<td>1002</td>
<td>CIS Environments: Online Computer Systems</td>
</tr>
<tr>
<td>1003</td>
<td>CIS Environments: Database Systems</td>
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<tr>
<td>1004</td>
<td>The Relationship Between Banking Supervisors and External Auditors</td>
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<tr>
<td>1005</td>
<td>Special Consideration in Audits of Small Entities</td>
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<tr>
<td>1006</td>
<td>Audits of the Financial Statements of Banks</td>
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<td>1007</td>
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<td>1008</td>
<td>Risk Assessments and Internal CIS Characteristics and Considerations</td>
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<td>1009</td>
<td>Computer - Assisted Audit Techniques (CAATs)</td>
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<td>1010</td>
<td>The Consideration of Environmental Matters in the Audit of Financial Statements</td>
</tr>
<tr>
<td>1011</td>
<td>[withdrawn]</td>
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<tr>
<td>1012</td>
<td>Auditing Derivative Financial Instruments</td>
</tr>
<tr>
<td>1013</td>
<td>Electronic Commerce: Effect on the Audit of Financial Statements</td>
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Appendix 5. International Standards and Guidelines on Professional Arrangements

1. Overview

IFAC created a Compliance Committee in May 2000. The Committee is one of several initiatives designed to strengthen IFAC and the international profession. Its primary responsibilities are: (i) monitoring the relevance, sufficiency, and efficacy of IFAC membership obligations; (ii) monitoring member body compliance with these obligations; (iii) recommending actions to the IFAC Board and Council in respect of membership obligations; (iv) reviewing the investigative and disciplinary processes of member bodies, and reporting and making recommendations on these to the IFAC Board and Council; (v) considering how member bodies might best be encouraged, or if necessary, required to comply more closely with such obligations; (vi) devising schemes to assist member bodies to comply more closely and to considering whether additional powers are required to enforce compliance with membership obligations; and (vii) implementing agreed policy in this area. The Compliance Committee will also work closely with members of the Transnational Audit Committee (TAC) in its monitoring of the members of the IFAC Forum of Firms (FOF).

Table 9 sets out relevant international guidelines with respect to the accountancy profession. IFAC has also established a Money Laundering Task Force.

Table 9: International Guidelines for the Accountancy Profession

| Confederation of Asian and Pacific Accountants (CAPA) | CAPA’s Guide on the Essential Components of a Professional Accountancy Body\(^1\) covers: (i) admission/advancement standards; (ii) full membership requirements; (iii) CPE; (iv) technical standards; (v) quality assurance/peer review program; (vi) registration as accountant/auditor; (vii) disciplinary rules; (viii) management and administrative structures; (ix) governance; and (x) external affiliations/memberships.\(^2\) |

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## Table 9: International Guidelines for the Accountancy Profession (continued)

<table>
<thead>
<tr>
<th>World Trade Organization (WTO): General Agreement on Trade in Services (GATS)</th>
<th>The criteria for recognizing professional qualifications may not exceed what is necessary to ensure service quality. Each country is expected to have a methodology for comparing professional qualifications, which must be applied in a fair and consistent manner to all applicants.</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Federation of Accountants (IFAC)</td>
<td>IFAC pronouncements cover several areas:</td>
</tr>
<tr>
<td></td>
<td>• <em>Education Guidelines and Standards</em>. IFAC's Education Committee issues IESs and IEGs. The IESs are intended to establish the essential elements on which education and training programs, both prequalification and postqualification, for all accountants should be founded. The IEGs promote good practice and or provide good advice. They are based on careful study of the best practices and most effective methods for dealing with the issues being addressed.</td>
</tr>
<tr>
<td></td>
<td>• <em>Code of Ethics for Professional Accountants</em>. This is intended to serve as a model on which to base national ethical guidance. It sets standards of conduct for professional accountants and states the fundamental principles that should be observed by professional accountants in order to achieve common objectives.</td>
</tr>
<tr>
<td></td>
<td>• <em>Statement of Policy of Council: Implementation and Enforcement of Ethical Requirements</em>. This statement sets expectations and provides guidance on disciplinary action, including punishment and publicity.</td>
</tr>
<tr>
<td></td>
<td>• <em>Assuring the Quality of Professional Services</em>. This statement sets expectations on quality control policies and procedures for member bodies and professional firms.</td>
</tr>
<tr>
<td>Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) of the UNCTAD</td>
<td>In February 1999, UNCTAD issued a report on accounting education and qualifications. The report provides a useful set of benchmarks in respect of these issues, in particular:</td>
</tr>
<tr>
<td></td>
<td>• Guideline for a Global Accounting Curriculum and Other Qualification Requirements (including (i) requirements for the qualifications of professional accountants; and (ii) a guideline for national systems for the qualifications of professional qualifications.</td>
</tr>
<tr>
<td></td>
<td>• Global Curriculum for the Professional Education of Professional Accountants (including: (i) organizational and business knowledge; (ii) information technology; and (iii) accounting and accounting-related knowledge.</td>
</tr>
</tbody>
</table>

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86 IFAC. 1999 August. *Assuring the Quality of Professional Services*. New York: IFAC.  
2. Qualification Requirements

Introduction

International Education Standards (IESs) address prequalification education of professional accountants and continuing professional development. In mid-2002, the IFAC Education Committee released exposure drafts of seven standards and one guideline for public comment. The overall goal of the proposed standards is to support efforts to produce competent professional accountants. The exposure drafts are summarized in Appendix 6.

Education

IFAC and ISAR have published guidelines on education requirements. The IFAC guidelines, such as IEG 9, provide an overview as to what is expected. The ISAR guidelines are more useful in a practical sense as they suggest a detailed curriculum structure and contents.

Experience

With regards to practical experience, international guidelines state that:

An appropriate period of relevant experience in performing the work of professional accountants must be a component of a prequalification program. The period of experience may vary due to differences in the environment in which professional accountants offer their services. However, this period should be long enough to permit prospective accountants to demonstrate they have gained the knowledge, skills and professional values sufficient for performing with professional competence and for continuing to grow throughout their careers. This objective cannot normally be met in a period of less than three years.

Para. 49, IEG 9.

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Moreover, IFAC recommends that practical experience requirements must be considered when professional bodies seek mutual recognition of qualifications.90

Continuing Professional Education (CPE)

IFAC and ISAR recommend a minimum of 30 hours CPE per year, or a minimum of 90 hours in every three-year period, of structured learning activity.91

3. Quality Control and Assurance

“In the case of professional accountants in public practice, the implementation of appropriate quality control policies and procedures is the responsibility of each firm of practicing accountants. The task of encouraging and assisting firms of practicing accountants to maintain and improve the quality of professional services is primarily that of the member bodies in each country. IFAC believes that the member bodies have the responsibility to take appropriate steps to achieve that objective in the legal, social, business, and regulatory environment prevailing within their countries.”

– IFAC (August 1999)92

In relation to quality control and assurance, IFAC suggests that:93

- Member bodies should adopt or develop quality control standards and relevant guidance that require firms of practicing accountants to establish the quality control policies and procedures necessary to provide reasonable assurance of conforming with professional standards in performing services. The nature and extent of a firm’s quality control policies and procedures depend on a number of factors, such as the size and nature of its practice, its geographic dispersion, its organization and appropriate cost/benefit considerations. Accordingly, the policies and procedures adopted by individual firms will vary, as will the manner in which the policies and procedures themselves and compliance with them are documented.

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92 IFAC. 1999 August. Assuring the Quality of Professional Services. New York: IFAC.
93 Ibid.
ACCOUNTING AND AUDITING PRACTICES IN SELECTED DMCs

- Member bodies should develop quality review programs designed to evaluate whether firms of practicing accountants have established appropriate quality control policies and procedures and are complying with those policies.
- Member bodies should establish quality review programs designed to evaluate whether firms of practicing accountants have complied with relevant professional standards for assurance engagements.
- Member bodies should require firms of practicing accountants to make appropriate improvements in their quality control policies and procedures, or in their compliance with those policies and procedures, when the need for such improvement is identified. Where firms fail to comply with relevant professional standards, the member body should take appropriate corrective action. Member bodies should also take such educational or disciplinary measures as indicated by the circumstances.

As a basic condition, IFAC emphasizes that implementation of an adequate self-regulatory program cannot be effected until firms of practicing accountants in a country are bound by an appropriate code of ethics and also by adequate standards governing accounting principles and engagements to provide professional services. The IFAC Code of Ethics for Professional Accountants, ISAs and IAS all provide guidance for such standards. Box 7 describes a rigorous approach to strengthening professional quality assurance.

Box 7: Professional Quality Assurance in the People’s Republic of China

The People’s Republic of China provides one example of how a quality assurance program can be implemented.94 From July 1997 to March 1999, China conducted a nationwide rectification campaign of the accounting market. The campaign had four stages:

- Self-inspection. In the six months to December 1997, around 6,700 accounting firms conducted self-inspections. The self-inspections covered around 50 percent of their 1996–1997 activities. Just under 1.5 million business reports were inspected, of these, 26 percent were considered to be either defective or in need of correction.
- Focus Groups and Field Inspections. In January 1998, local CPA Institutes established working groups. In the following six months, these working groups conducted field inspections of 5,800 firms.
- Inspection Reviews. From July to the end of October 1998, 192 people selected by the Chinese Institute of Certified Public Accountants (CICPA) reviewed the inspections conducted in stages I and II. The reviews focused on 405 accounting firms.

As a consequence of the campaign almost 12,700 individual CPAs were either forced to withdraw from the profession or were disciplined (25 percent of CPAs). Many of these were older members who had not passed the uniform accounting examination, and around 580 accounting firms withdrew from the profession or had their licenses cancelled. Warnings and punishments were issued to a further 2,000 accounting firms (43 percent of firms).

CICPA judged the campaign to be a success based on the following evidence. First, during the period of the campaign, 6,300 newly qualified accountants joined the profession. The net effect was to substantially improve the profession's age structure and knowledge. Second, to address problems that were identified in the inspections, 85 percent of accounting firms substantially improved their internal-management practices; improved professional rules; implemented or improved quality-control systems; increased training; and in doing so, effectively eliminated the problems that had been identified. Third, in 1998, the level of “non-clean” audit opinions given on listed companies rose dramatically (to around 12 percent of audit reports) which (arguably) indicated improved professional quality and ethics. Fourth, the credibility of CPAs in the eyes of the public, as measured by a media survey, climbed from 45 percent in 1996, to 81 percent in June 1998.

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Appendix 6. Proposed International Education Standards

The deadline for comments on these documents is 31 December 2002.

1. Proposed International Education Standards (IESs) for Professional Accountants

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry Requirements</td>
<td>Prescribes entry requirements for candidates beginning the qualifying process for becoming professional accountants.</td>
</tr>
<tr>
<td>Content of Professional Education Programs</td>
<td>Prescribes the professional education candidates require to qualify as professional accountants.</td>
</tr>
<tr>
<td>Professional Skills and General Education</td>
<td>Prescribes the personal and professional skills candidates must have to qualify as professional accountants.</td>
</tr>
<tr>
<td>Professional Values and Ethics</td>
<td>Prescribes the professional values and ethics that professional accountants need to acquire during their programs of education and practical experience. The aim of this standard is to ensure that candidates for membership of an IFAC member body are equipped with the appropriate professional values and ethics to function as professional accountants.</td>
</tr>
<tr>
<td>Experience Requirements</td>
<td>Prescribes the practical experience and training IFAC member bodies should require their members to obtain to qualify as professional accountants. The aim of this standard is to ensure that candidates for members of an IFAC member body have acquired the practical experience considered appropriate at the time of qualification to function as competent professional accountants.</td>
</tr>
<tr>
<td>Assessment of Professional Competence</td>
<td>Prescribes the requirement for a process of assessment of a candidate's professional competence before admission to the profession.</td>
</tr>
<tr>
<td>Continuing Professional Education and Development</td>
<td>Prescribes that member bodies establish a continuing professional education and development (or CPD) requirement for all accountants. This is an important aspect of serving the public interest and fosters values of continuous learning and greater professional competence among professional accountants to better meet client and employer needs.</td>
</tr>
</tbody>
</table>

2. Proposed International Education Guideline (IEG) for Professional Accountants

Continuing Professional Education and Development

Provides guidance to assist member bodies in establishing a requirement for an effective program of continuing professional education and development for members, as prescribed in the proposed IES on Continuing Professional Education and Development.
Appendix 7. International Public Sector Accounting Standards (IPSAS)

As of June 2002, the IFAC Public Sector Committee (PSC) had issued the following IPSASs:

- **IPSAS 1 Presentation of Financial Statements** prescribes the overall considerations for the presentation of financial statements, guidance for the structure and minimum requirements for the content of financial statements prepared under the accrual accounting basis.

- **IPSAS 2 Cash Flow Statements** requires the provision of information about the historical changes in cash and cash equivalents of an entity by means of a cash flow statement that classifies cash flows during the period from operating, investing and financing activities. Cash flow information allows users to ascertain how a public sector entity raised the cash it required to fund its activities and the manner in which that cash was used.

- **IPSAS 3 Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies** requires the classification and disclosure of extraordinary items and the separate disclosure of certain items in the financial statements. It also specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors.

- **IPSAS 4 The Effect of Changes in Foreign Exchange Rates** deals with accounting for foreign currency transactions and foreign operations. IPSAS 4 sets out the requirements for deciding which exchange rate to use and how to recognize in the financial statements the financial effect of changes in exchange rates.

- **IPSAS 5 Borrowing Costs** prescribes the accounting treatment for borrowing costs and generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

- **IPSAS 6 Consolidated Financial Statements and Accounting for Controlled Entities** requires all controlling entities to prepare consolidated financial statements, which consolidate all controlled entities on a line-by-line basis. The Standard also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes.
• IPSAS 7 Accounting for Investments in Associates requires all investments in associates to be accounted for in the consolidated financial statements using the equity method of accounting, except when the investment is acquired and held exclusively with a view to its disposal in the near future in which case the cost method is required.
• IPSAS 8 Financial Reporting of Interests in Joint Ventures specifies proportionate consolidation as the benchmark treatment for accounting for such joint ventures entered into by public sector entities. IPSAS 8 also permits—as an allowed alternative—joint ventures to be accounted for using the equity method of accounting.
• IPSAS 9 Revenue from Exchange Transactions establishes the conditions for the recognition of revenue arising from exchange transactions, requires such revenue to be measured at the fair value of the consideration received or receivable and includes disclosure requirements.
• IPSAS 10 Financial Reporting in Hyperinflationary Economies describes the characteristics of a hyperinflationary economy and requires financial statements of entities that operate in such economies to be restated.
• IPSAS 11 Construction Contracts defines construction contracts, establishes requirements for the recognition of revenues and expenses arising from such contracts and identifies certain disclosure requirements.
• IPSAS 12 Inventories defines inventories, establishes measurement requirements for inventories (including those inventories which are held for distribution at no or nominal charge) under the historical cost system and includes disclosure requirements.
• IPSAS 13 Leases prescribes the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.
• IPSAS 14 Events After the Reporting Date prescribes when entities should adjust their financial statements for events after the reporting date; and disclosures that entities should give about the date when the financial statements were authorized for issue and about events after the reporting date.
• IPSAS 15 Financial Instruments: Disclosure and Presentation provides guidance on the significance of on-balance-sheet and off-balance-sheet financial instruments to a government’s or other public sector entity’s financial position, performance and cash flows.
• IPSAS 16 Investment Property prescribes the accounting treatment for investment property and related disclosure requirements.
• IPSAS 17 Property, Plant and Equipment describes the principal issues in
accounting for property, plant and equipment, including the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognized in relation to them.

- IPSAS 18 Segment Reporting establishes principles for reporting financial information about distinguishable activities of a government or other public sector entity.
- Glossary of Defined Terms (IPSAS 1-IPSAS 18) identifies the terms defined in IPSASs on issue at 30 June 2002.
Appendix 8. International Public Sector Material

As of June 2002, the IFAC Public Sector Committee had released the following studies and guidance materials.

1. International Public Sector Studies

- Study 1 *Financial Reporting by National Governments* addresses the fundamental underpinnings of governmental financial reporting.
- Study 2 *Elements of the Financial Statements of National Governments* considers the elements (types or classes of financial information) to be reported in financial statements prepared under the different bases of accounting that may be employed by national governments and their major units and the way in which those elements may be defined.
- Study 3 *Auditing for Compliance with Authorities: A Public Sector Perspective* addresses aspects of the audit for compliance in the public sector that, in many countries, is subject to very different mandates and objectives than in the private sector.
- Study 4 *Using the Work of Other Auditors: A Public Sector Perspective* addresses using the work of other auditors, including both other external and internal auditors, in financial attest and compliance audits.
- Study 5 *Definition and Recognition of Assets* identifies and describes the variety of views which exist about whether, when and how specific assets should be measured and reported in the public sector.
- Study 6 *Accounting for and Reporting Liabilities* provides a public sector perspective on the definition and recognition of liabilities.
- Study 7 *Performance Reporting by Government Business Enterprises* identifies principal users of performance information, considers the needs of those users and outlines forms of reporting that could be available to meet those needs.
- Study 8 *The Government Financial Reporting Entity* considers the implications of different approaches to the definition of the government financial reporting entity and different techniques for the construction of government financial reports to the achievement of objectives of financial reports.
- Study 9 *Definition and Recognition of Revenues* examines concepts, principles and issues related to the definition and recognition of revenues in the general purpose financial statements of national governments and other nonbusiness public sector entities.
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- Study 10 Definition and Recognition of Expenses and Expenditures examines the concepts, principles and issues related to the treatment of expenses/expenditures in general purpose financial statements of governments and other nonbusiness public sector entities.
- Study 11 Government Financial Reporting: Accounting Issues and Practices aims to assist governments at all levels in the identification of issues associated with financial reporting (on both the cash and accrual accounting bases).
- Study 12 Perspectives on Cost Accounting for Governments is intended to assist government financial aid officers and other government accountants in their efforts to develop and implement cost accounting.
- Study 13 Governance in the Public Sector examines public sector governance issues.
- Study 14 Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities is intended to help entities intending to move to the accrual basis of accounting and comply with the accrual-based IPSASs.

2. Occasional Papers

- No. 1 Implementing Accrual Accounting in Government: The New Zealand Experience
- No. 2 Auditing Whole of Government Financial Statements - The New Zealand Experience
- No. 3 Perspectives on Accrual Accounting aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing accounting reform in the public sector or who have observed its progress.
- No. 4 The Delegation of Public Services in France - An Original Method of Public Administration: Delegated Public Service describes the specific framework designed in France to manage the relationship between a government entity and a private sector entity contracted to deliver a certain service, and to ensure an adequate level of information and accountability.
- No. 5 Resource Accounting: Framework of Accounting Standard Setting in the United Kingdom Central Government Sector considers the experiences of the United Kingdom, which decided to move to an accrual basis for both budgeting and financial reporting in 1995.