

Diagnostic Study of Accounting and Auditing Practices in Sri Lanka

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

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Preface

This report was prepared under Regional Technical Assistance (RETA) 5980: *Diagnostic Study of Accounting and Auditing Practices in Selected Developing Member Countries* for the Asian Development Bank (ADB) by Francis B. Narayan, Lead Financial Management Specialist, ADB; Sarath Lakshman Athukorala, Financial Management Specialist, ADB; and Barry C. Reid, Consultant, ADB. Nihal De Silva, Partner; Lasantha Wickremasinghe, Partner; Naayila Marikkar, Manager; and Natalia Payoe, Secretary, all of B. R. De Silva & Co. (Chartered Accountants), provided excellent research guidance and assistance.

This report describes Sri Lankan accounting and auditing arrangements, identifies deficiencies in those arrangements, and presents recommendations to address those deficiencies. It is part of the ADB series of country Diagnostic Studies of Accounting and Auditing (DSAAs). In 2000, DSAAs were completed and published for Cambodia, Mongolia, Pakistan, Papua New Guinea, People's Republic of China, Uzbekistan, and Viet Nam. In 2001-02, DSAAs were prepared for five further countries, including Sri Lanka.

The contents of the draft report were discussed and debated with representatives from the Government, the private sector and international organizations at a workshop held on 19-20 July 2001 in Colombo. The issues and recommendations were further discussed at an international workshop held on 5-6 March 2002 at ADB headquarters in Manila.

This report should be read in conjunction with the Summary Report, which identifies and examines selected issues in relation to accounting and auditing.¹

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¹ ADB. 2002. *Accounting and Auditing Practices in Selected Developing Member Countries: A Diagnostic Study of Azerbaijan, Fiji Islands, Marshall Islands, Philippines and Sri Lanka*. Manila: ADB.

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Our special appreciation to Ranel T. Wijesinha, President of the Confederation of Asian and Pacific Accountants (CAPA) and former President of the Institute of Chartered Accountants of Sri Lanka (ICASL), who made his valuable time available to discuss issues, facilitate the research process and attend the Manila workshop.

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ADB Diagnostic Studies of 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.

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Accounting and Auditing Practices in Selected Developing Member Countries (DMCs): A Diagnostic Study of Azerbaijan, Fiji Islands, Marshall Islands, Philippines and Sri Lanka. 2002.

Financial Management and Governance Issues in Selected Developing Member Countries (DMCs): A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam. 2000.

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South Asia: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, **Pakistan** (2000), **Sri Lanka** (2002).

Southeast Asia: Indonesia, Malaysia, **Philippines** (2002), Singapore.

CURRENCY EQUIVALENTS

(as at 31 March 2002)

Currency Unit – Sri Lankan Rupee (SLRs)

SLRs 1.00 – \$0.01044

\$1.00 – SLRs 95.82

ABBREVIATIONS

AATSL	Association of Accounting Technicians of Sri Lanka
ACCA	Association of Certified Chartered Accountants (UK)
ADB	Asian Development Bank
ASC	Accounting Standards Committee
AusAID	Australian Agency for International Development
AuSC	Auditing Standards Committee
CAPA	Confederation of Asian and Pacific Accountants
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
CIGAS	Computerized Integrated Government Accounting System
CIMA	Chartered Institute of Management Accountants (UK)
CIMASL	Chartered Institute of Management Accountants: Sri Lanka Division
CIPFASL	Chartered Institute of Public Finance and Accountancy of Sri Lanka
CMASL	Society of Certified Management Accountants of Sri Lanka
COPA	Committee on Public Accounts
COPE	Committee on Public Enterprises
CPA	Certified Public / Practicing Accountant
CPE	Continuing Professional Education
CSP	Country Strategy and Program
DMC	Developing Member Country
DSAA	Diagnostic Studies of Accounting and Auditing
ED	Exposure Draft
FASB	Financial Accounting Standards Board
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
IAASB	International Auditing and Assurance Standards Board
IAPC	International Auditing Practices Committee
IAPS	International Auditing Practice Statement

IAS	International Accounting Standard
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICAEW	Institute of Chartered Accountants of England and Wales
ICASL	Institute of Chartered Accountants of Sri Lanka
ICSA	Institute of Chartered Secretaries and Administrators (UK)
IEG	International Education Guideline
IES	International Education Standard
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
InGAF	Institute of Government Accounts and Finance
INTOSAI	International Organization of Supreme Audit Institutions
IOSCO	International Organization of Securities Commissions
IPFDA	Institute of Public Finance and Development Accountancy
IPSAS	International Public Sector Accounting Standard
ISA	International Standard on Auditing
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting of the UNCTAD
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
LTTE	Liberation Tigers of Tamil Eelam
MOFP	Ministry of Finance and Planning
OECD	Organisation for Economic Cooperation and Development
PEIS	Public Expenditure Information System
PIP	Public Investment Program
PPBS	Planning, Programming and Budgeting System
PSC	Public Sector Committee
RETA	Regional Technical Assistance
ROSC	Report on the Observance of Standards and Codes
SAI	Supreme Audit Institution
SBE	Specified Business Enterprise
SEC	Securities and Exchange Commission
SLAASMB	Sri Lanka Accounting and Auditing Standards Monitoring Board
SLAS	Sri Lankan Accounting Standard
SLAuS	Sri Lankan Auditing Standard
SLIDA	Sri Lanka Institute of Development Studies
SLR	Sri Lankan Rupee

SME	Small and Medium-Sized Enterprise
SOE	State-Owned Enterprise
TA	Technical Assistance
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WTO	World Trade Organization

Notes

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, \$ refers to US dollars.

Contents

EXECUTIVE SUMMARY	I
I. INTRODUCTION	11
1. Study Background	11
2. Objectives	11
3. Scope	12
4. Country Case Study and Workshop	12
5. Sri Lanka	13
6. ADB Focus on Financial Governance in Sri Lanka	17
7. International Guidelines and Surveillance	18
8. Report Structure	19
II. ACCOUNTING AND AUDITING IN SRI LANKA	21
Part One. Accounting	22
1. Introduction	22
2. The ‘Sri Lankan Accounting System’	23
3. Financial Reporting and Disclosure Requirements	25
4. Quality of Sri Lankan Financial Reporting and Disclosure	28
Part Two. Auditing	29
5. Introduction	29
6. Auditor Appointment and Dismissal	30
7. Auditor Independence	31
8. Audit Reporting Requirements	33
9. Auditor Liability	34
10. Accounting and Auditing Firms	35
11. Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)	35
12. Financial Aspects of Sri Lankan Corporate Governance	39
13. Issue Synopsis: Accounting and Auditing Arrangements	41
III. PROFESSIONAL INFRASTRUCTURE	43
1. Introduction	43
2. Professional Regulation and Organization	44
3. Institute of Chartered Accountants of Sri Lanka (ICASL)	45
4. The Chartered Accountant Designation	49
5. Other Sri Lankan Accountancy Bodies	50
6. Foreign Accountancy Bodies	51

7. Quality Control and Assurance	52
8. Issue Synopsis: Professional Infrastructure	52
IV. ACCOUNTING AND AUDITING STANDARDS	53
Part One. Accounting Standards	54
1. Introduction	54
2. Accounting Standards Committee (ASC)	55
3. Accounting Standard Setting Process	56
4. Sri Lankan Accounting Standards (SLASs)	57
5. Conformity with International Accounting Standards (IAS)	61
6. Public Sector Accounting Standards	63
7. Taxation Reporting Requirements	64
Part Two. Auditing Standards	64
8. Introduction	64
9. Auditing Standards Committee (AuSC)	65
10. Auditing Standard Setting Process	65
11. Sri Lankan Auditing Standards	65
12. Comparison with International Standards on Auditing (ISA)	67
13. Issue Synopsis: Accounting and Auditing Standards	68
V. ACCOUNTING AND AUDITING TRAINING	71
1. Introduction	71
2. International Standards and Guidance on Accountancy Education	73
3. Educational Coordination	74
4. Higher Education Institutions	74
5. Sri Lanka Institute of Development Studies (SLIDA)	76
6. The Institute of Government Accounts and Finance (InGAF)	76
7. Training by Professional Bodies	77
8. Issue Synopsis: Accounting and Auditing Education and Training	77
VI. GOVERNMENT BUDGETING AND ACCOUNTING	79
1. Introduction	79
2. Legal Framework for Government Budgeting, Accounting and Auditing	81
3. Organizational Roles and Responsibilities	83
4. Budgeting, Accounting and Reporting Arrangements	83

5. Accounting Information Systems	83
6. Auditor-General's Department	84
7. Government Accounting Personnel	85
8. Fiscal Devolution to Provincial Councils	85
9. Issue Synopsis: Government Budgeting and Accounting	86
VII. DONOR ASSISTANCE	89
1. Overview	89
2. Coordination Mechanisms	89
3. Asian Development Bank (ADB)	89
4. International Monetary Fund (IMF)	92
5. The World Bank	92
6. United Nations Development Programme (UNDP)	93
7. Canada (CIDA)	93
8. Japan	93
9. United States (USAID)	93
VIII. ISSUES AND RECOMMENDATIONS	95
Part One. Where Donor Assistance Might be Appropriate	96
1. Strengthen Government Accounting and Auditing	96
2. Strengthen Public Corporation Accountability through Legislative Amendments	97
3. Appoint Accountants to Public Corporation Boards	97
4. Strengthen Public Corporation Internal Auditing and Controls	98
5. Publish a Scorecard of Public Corporation Reporting	98
Part Two. Where External Assistance is Not Required	98
6. Create Chief Financial Officer Positions in Public Corporations	98
7. Require SLAASMB Review of all Public Corporation Annual Reports	98
8. Enhance Director Accountability	99
9. Close the Emerging Gaps Between SLASs and IASs	99
10. Enhance Auditor Independence and Objectivity	99
11. Make CPE Mandatory for Continuing ICASL Membership	100
12. Enhance Institutional Support for Financial Governance	100
13. Provide Resources to ICASL for Standing-Setting	100
14. Advocate Changes to IASB Copyright and Pricing	101
15. Encourage the Development of Financial Reporting Standards for SMEs	101

IX. MAIN DEFICIENCIES AND ACTION PLAN	103
REFERENCES	105

Appendixes

Table of Appendixes	111
Appendix 1. Useful Internet Sites	113
Appendix 2. Interviewees	116
Appendix 3. RETA-5980 (Regional Study) Information	121
Appendix 4. International Accounting Standards	123
Appendix 5. International Standards on Auditing	124
Appendix 6. International Public Sector Accounting Standards (IPSASs)	126
Appendix 7. IASB Improvements Project (Potential Agenda)	129
Appendix 8. Accounting and Auditing Standards Act 1995	130
Appendix 9. Relevant Extracts from the 1990 SEC Rules	138
Appendix 10. Relevant Extracts from the Banking Act 1988	140
Appendix 11. International Standards and Guidelines on Professional Arrangements	146
Appendix 12. ICASL Examination Syllabus	152

Executive Summary

Background

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.

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 participation (e.g., a nonlevel 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, the 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, the 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.

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 the 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 intensive 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 Securities and Exchange Commission 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 arrangements 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.

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 continuing professional education 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 (CMASL), the Institute of Internal Auditors (IIA), and the Institute of Public Finance and Development Accountancy (IPFDA). Membership of the IPFDA 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 presence in Sri Lanka. 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 membership with ICASL. The two most significant bodies are the Association of Certified Chartered Accountants (ACCA)(UK) and the Chartered Institute of Management Accountants (CIMA)(UK).

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 Accounting Standards Committee (ASC) and the Auditing Standards Committee (AuSC). The ASC and the AuSC operate under the auspices of ICASL.

The ASC's accounting setting-standard process is broadly similar to that of the International Accounting Standards Board (IASB) and

focuses on reviewing International Accounting Standards (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 (SLAuSs), which are based directly upon the pronouncements of the International Auditing and Assurance Standards Board (IAASB). The promulgation process is similar to that for SLASs.

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 the 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, the 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.

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, the 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 as part of the refocusing of the technical assistance.

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 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.

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 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 million: 1994-1999). This project provided basic computing expertise and skills to a substantial number of civil servants at the national and sub-national 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 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 (AATSL) was subsequently established in 1987.

The **World Bank** is supporting modernization of the Central Bank of Sri Lanka (CBSL) through a \$30.3 million credit. The World Bank limited lending to the financial sector during the 1990s, due to the “Government’s unwillingness to privatize the two large state banks.” Technical assistance 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. The Canadian International Development Agency (**CIDA**) provided assistance to support the establishment of the Society of Certified Management Accountants of Sri Lanka (**CMA**). **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. The United States Agency for International Development (**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**.

Issues and Recommendations

This Diagnostic Study of Accounting and Auditing identifies issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. 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.

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

- In the case of **public corporations**, several recommendations are made to strengthen governance. Most can be achieved with minimal resources and effort—for instance, appointing financial specialists to public corporation boards and raising the status of Chief Financial Officers. Others are more complex and will take time, such as strengthening the legislative regime that underpins transparency and parliamentary accountability.
- 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 continuing professional education for Chartered Accountants.

I. Introduction

1. Study Background

The 1997-1998 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.²

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (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) 5877³, Diagnostic Studies of Accounting and Auditing (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 *Diagnostic Study of Accounting and Auditing Practices in Selected DMCs*⁴ 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.

2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing accounting and auditing support and standards available in the selected

² Zhuang, Juzhong, David Edwards, David Webb, and Ma. Virginita Capulong. 2000. *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines and Thailand*. Manila: ADB.

³ *Strengthening Financial Management and Governance in Selected DMCs*.

⁴ For \$230,000 approved on 20 March 2001.

DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. 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 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.

3. Scope

The RETA involved an indepth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. Sri Lanka was one of four countries that participated in the RETA.

4. Country Case Study and Workshop

The first part of the study examined the current accounting and auditing structure and systems adopted in Sri Lanka. 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 them eventually.

The second part of this 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 financial management and governance in the country.

After carrying out the assessment of Sri Lankan accounting and auditing support, the study findings and recommendations were discussed at a workshop in Colombo on 19-20 July, and at an international workshop at ADB Headquarters in Manila on 5-6 March 2002. This report incorporates feedback from both workshops. Appendix 3 provides further information on the Colombo workshop.

5. Sri Lanka

General

Sri Lanka has a land area of 65,610 km² (about the same as Ireland or Tasmania) and is located in the Indian Ocean, just off India's southern tip. In 1948, Sri Lanka's population was only seven million, but between 1963 and 1972 it increased at an annual average rate of 2.3 percent. Since then, the population growth rate has fallen substantially and averaged 1.2 percent from 1995 to 1999.

There are now about 19 million Sri Lankans of whom over one million live in the capital, Colombo. Sri Lanka's population density of 295 people per km² is among Asia's highest. The three main ethnic groups are Sinhalese (74 percent), Tamils (18 percent), and Muslims (7 percent). Sinhala and Tamil are national languages, and English is widely used as a link language, particularly in business.

Sri Lanka became a British colony in 1815, following periods of Portuguese and Dutch colonial rule. The island gained independence in 1948 and was renamed Sri Lanka on becoming a republic in 1972.⁵ Sri Lanka is a parliamentary democracy, although the President has strong powers. There is a unicameral legislature and both the President and the Parliament are elected for a maximum term of six years.

The Government had hoped to resolve a separatist Tamil insurgency in the north and east through the 1987 peace accord involving India (Indian troops were deployed but later withdrawn). But peace talks between the Government and the Liberation Tigers of Tamil Eelam (LTTE) broke down in 1995 leading to intensified military activity. The Government's priority is to bring the northern and eastern parts of the island back under its control and to negotiate a political settlement with the LTTE. Since the conflict began, over 60,000 Sri Lankans have been killed and more than 600,000

⁵ Niven, Christine, John Noble, Susan Forsyth, and Tony Wheeler. 1999. *Sri Lanka*. Lonely Planet Publications: Australia. pp. 13-14.

have lost their homes—over 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.⁶ The Central Bank of Sri Lanka estimates that the conflict reduces Gross Domestic Product (GDP) growth by 2-3 percentage points each year.⁷

Sri Lanka's major exports include garments, tea and diamonds. Major imports include textiles, machinery and transport equipment, consumer durables, food and drink, and petroleum products. Table 1 presents key indicators for Sri Lanka and for other selected countries.

Table 1. Key Indicators for Selected ADB DMCs^{8,9}

Indicator	Sri Lanka	Fiji Islands	Azerbaijan	Philippines	RMI
General					
Population (<i>thousands</i> , 2000)	19,359.0	811.0	8,049.0	78,400.0	52.0
Population density (<i>people per km²</i> , 2000)	295.0	44.0	93.0	263.0	282.0
Urban population (% of total, 2000)	23.6	42.3	57.3	58.6	71.9
Average annual population growth rate (% , 1995-2000)	1.3	1.1	1.0	2.2	1.5
Social					
Under-five mortality rate (<i>per 1000</i> , 1999)	15.0	18.0	16.0	31.0	63.0
Life expectancy at birth (<i>years</i> , 1999)	74.0	67.0	71.0	69.0	65.0
Adult literacy rate (15-yr+, %, 1999):					
– Females	89.0	90.0	97	95.0	97.0
– Males	94.0	95.0	97	95.0	97.0
Population in poverty (% , 1995-99)	26.7	25.5	68.1	40.0	...
Human Development Index (1999)	0.74	0.76	0.74	0.75	0.56
Economic					
Gross National Product (GNP)(\$million, 1999)	15,578	1,848	3,705	77,967	99
GDP per capita (\$, 2000)	842	1,978	654	959	1,890
GDP growth rate (%) – 2000	6.0	-9.3	11.4	4.0	-2.3
– 1999	4.3	9.6	7.4	3.4	0.8
– 1998	4.7	1.4	10.6	-0.6	-16.0
– 1997	6.3	-0.9	8.8	5.2	-9.4

⁶ World Bank. 2000 September. *World Bank Regional Brief: South Asia*.

⁷ Central Bank of Sri Lanka. 2000. *1999 Annual Report*. Government of Sri Lanka.

⁸ ADB. 2001. *Key Indicators of Developing Asian and Pacific Countries*. Volume XXXII. Manila: ADB.

⁹ ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. pp. 139-140.

Table 1. Key Indicators for Selected ADB DMCs (*continued*)

Indicator	Sri Lanka	Fiji Islands	Azerbaijan	Philippines	RMI
Consumer Price Index (<i>Annual % change, 2000</i>)	6.2	1.1	1.9	4.4	-1.9
Fiscal Balance / GDP (% ,2000)	-9.9	...	-1.0	-4.2	-35.5
Total External Debt / GNP (% ,1999)	60.3	9.3	30.0	64.8	...
Official Development Flows					
US\$ million (1999)	343.6	23.2	207.2	295.0	62.9
Dollars per capita (1999)	17.7	28.6	25.7	3.8	1,219.0
Percentage of GNP (1999)	2.2	1.3	5.6	0.4	63.5

In the 1960s, Sri Lanka had the same per capita income as Korea, Malaysia and Singapore. Thirty years later, these three countries have per capita incomes that are several times higher than Sri Lanka's. Several factors contributed. First, the conflict has taken a heavy social and economic toll. Second, until relatively 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 productivity in the public sector typically well below that of the private sector, this has meant foregone opportunities in terms of growth and employment.

Recent Economic Events and Future Prospects

Although the 1997-98 Asian financial crisis affected Sri Lanka's economy, GDP growth rebounded to reach 6.9 percent in the fourth quarter of 1999.¹⁰ This momentum continued and an annual growth rate of 6.0 percent was recorded in 2000. However, the intensified civil conflict since April 2000—combined with political uncertainty and the global economic slowdown—constrained growth in 2001.¹¹

¹⁰ ADB. 2001 February. *Country Economic Review: Sri Lanka*. Manila: ADB. p. 1.

¹¹ ADB. 2001. *Asian Development Outlook*. Manila: ADB. p. 125.

In 2000, the Government broadened the tax base, and rationalized the tax system and expenditure. On the expenditure side, audit and management committees were established to improve financial prudence in public enterprises and statutory agencies, and a separate unit in the Ministry of Finance and Planning was set up to evaluate government expenditure.¹² The intensified civil conflict has resulted in higher security-related expenditures (5.6 percent of GDP) that in turn have put pressure on an already weak fiscal position.¹³

Challenges

Despite the progress made in financial and corporate sector restructuring in countries affected by the Asian crisis, these efforts have not been followed through adequately. This has diminished business and investor confidence and leaves the financial and corporate sectors vulnerable to external shocks. The current global slowdown is reducing corporate profits and adding distress in the banking sectors. Without resolving bank nonperforming loans and corporate debt overhangs, these economies face the risk of prolonged slow growth.¹⁴

In the face of the current economic difficulties and the ongoing civil conflict, a stable macroeconomic environment is considered a prerequisite for sustained growth with poverty reduction. To this end, the Sri Lankan Government is implementing key reforms to promote greater private sector development, reduce the fiscal deficit, right-size the civil service, enhance labor market flexibility, restructure state enterprises, and create opportunities for the poor to participate fully in the economic growth process.¹⁵

These reforms are based upon the Government's *Framework for Poverty Reduction*. The *Framework* advocates a three-point strategy: (i) reducing poverty by creating opportunities for pro-poor growth; (ii) strengthening the social protection system; and (iii) empowering the poor and strengthening governance. With regards to (iii), institutional governance is to be strengthened by upgrading public sector management practices. Macroeconomic governance will be improved by tightening financial

¹² ADB. 2001. *2000 Annual Report*. Manila: ADB. p. 34.

¹³ ADB. 2001 June. *Country Strategy and Program Update: Sri Lanka (2002-2004)*. Manila: ADB. p. 1.

¹⁴ Kawai, Masahiro (World Bank Chief Economist for East Asia). 2001 April 18. *Replay of 1997 Not Likely if Asia Reforms Continue*. As reported in the Singapore Business Times.

¹⁵ ADB. 2001 June. *Sri Lanka: Country Strategy and Program Update (2002-2004)*. Manila: ADB. p. 2.

accountability. Decentralization is to be promoted, although regional fiscal imbalances are addressed and procedures for local government public expenditure management are improved.¹⁶

6. ADB Focus on Financial Governance in Sri Lanka

ADB's Sri Lanka Country Strategy and Program (CSP) was reformulated in June 2001. The CSP Update reflects the Government's reform priorities and provides an assistance program to achieve them.¹⁷

The Government's governance priorities include creating a policy environment conducive to private sector growth, and shifting the government's role from that of direct producer and service provider to that of regulator. ADB will assist the Government by supporting policy and institutional reforms in the sectors where ADB operations are focused (e.g. road, power, ports, education, water supply and sanitation, environmental and natural resources management and rural finance). ADB will also assist in strengthening public sector management.¹⁸ This includes supporting the implementation of new procurement practices and procedures¹⁹, and improving public expenditure management at both central and local levels.²⁰

ADB operations in finance and industry focus on policy reform and creating a favorable environment for private sector development. The Government has been active in promoting private participation in the economy. Since 1995—when the *Public Enterprise Reform Commission* commenced its work—considerable progress has been made on privatization; particularly in the plantation, telecommunications, ports, power and aviation subsectors. This contrasts with other state-controlled sectors (including roads, railways, urban transport, water supply and sanitation) that are characterized by inefficient management and service provision.²¹

Private sector participation is impeded by: (i) continued public sector involvement in commercial activities; and (ii) a weak enabling environment for private sector participation (e.g., a nonlevel playing field, labor market

¹⁶ ADB. 2001. *Asian Development Outlook*. Manila: ADB. p. 127.

¹⁷ ADB. 2001 June. *Sri Lanka: Country Strategy and Program Update (2002-2004)*. Manila: ADB. p. 2.

¹⁸ *Ibid.* p. 5.

¹⁹ TA 2950-SRI: *Establishment of the Tender Support Bureau*, for \$1.0 million, approved on 12 December 1997.

²⁰ TA 3301-SRI: *Strengthening Public Expenditure Management Systems*, for \$3.0 million, approved on 16 November 1999.

²¹ ADB. 2000 December. *Sri Lanka: Country Assistance Plan (2001-2003)*. Manila: ADB. p. 17.

rigidities, difficult access to financing and poor governance practices). Accordingly, ADB through the *Private Sector Development Program* (2001-2003), is supporting: (i) further state-owned enterprise privatization and restructuring; (ii) legislative developments to define competition policy and safeguard consumer rights; (iii) initiatives to address labor market rigidities; and (iv) the elimination of market distortions arising from regulatory barriers and the special privileges accorded to state-owned financial institutions.²²

The domestic capital market has made sound progress since liberalization began in the early 1990s—the market infrastructure compares favorably with other South Asian countries. However, the equities and private debt securities markets remain thin and underdeveloped. ADB's approach to facilitating financial sector development is to: (i) promote good financial market governance through improved understanding of governance principles and best practices, building capacity for good governance, and institutionalizing good governance principles through organizational restructuring; (ii) mobilize financial resources from commercial sources, and when necessary, with support of ADB's guarantee facility, for relending to the private sector through domestic financial institutions; and (iii) develop a network of specialized financial institutions and mainstreaming suitable credit facilities among existing financial intermediaries to target the weaker economic sectors including micro enterprises, small and medium scale industries, retail low-cost housing, and rural areas.²³

7. International Guidelines and Surveillance²⁴

The international community is supporting the development of guidelines, standards and codes to assess financial management and governance practices (see Table 2). Where appropriate, this report compares Sri Lankan arrangements and practices against these benchmarks.

These guidelines, standards and codes—to varying extents—all involve accounting and auditing arrangements. Furthermore, in an attempt to identify and avoid potential crises before they occur, the IMF and the

²² *Ibid.* p. 18.

²³ *Ibid.* p. 18.

²⁴ Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Asian Development Bank. pp. 12-13.

World Bank have together embarked on a series of *Reports on the Observance of Standards and Codes (ROSCs)*. These reports summarize the extent to which countries observe certain internationally recognized standards.²⁵ Although ROSCs are intended to be voluntary, 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.

Table 2. Selected International Guidelines, Standards and Codes

Guideline, Standard or Code	Promulgated By
• Principles of Corporate Governance	Organisation for Economic Cooperation and Development (OECD)
• Code of Good Practices on Fiscal Transparency	IMF
• Code of Good Practices on Transparency of Monetary and Financial Policies	IMF
• Implementation of the Objectives and Principles for Securities Regulation assessment surveys	International Organization of Securities Commissions' (IOSCO)
• International Accounting Standards (IAS)	International Accounting Standards Board (IASB)
• International Standards on Auditing (ISA)	International Auditing and Assurance Standards Board (IAASB)
• Draft Banking Supervision guidelines	Basel Committee on Banking Supervision (BCSB) of the Bank for International Settlements (BIS)

8. Report Structure

This report examines financial management and governance issues in Sri Lanka, with a focus on accounting and auditing arrangements. In addition to this introduction, the report has the following chapters:

- Chapter II – **Accounting and Auditing in Sri Lanka** – presents an overview of accounting and auditing arrangements in Sri Lanka. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting arrangements.

²⁵ IMF. September 2000. Experimental Reports on Observance of Standards and Codes (ROSCs). www.imf.org/external/np/rosc

- Chapter III – **Professional Infrastructure** – describes the professional accountancy infrastructure in Sri Lanka, which comprises regulatory bodies and professional associations.
- Chapter IV – **Accounting and Auditing Standards** – describes the accounting and auditing standards that govern the preparation of external financial reports and their audit.
- Chapter V – **Accounting and Auditing Training** – describes accounting and auditing education and training, including coordination of accountancy education.
- Chapter VI – **Government Budgeting and Accounting** – describes government budgeting and accounting arrangements.
- Chapter VII – **Donor Assistance** – reviews donor coordination mechanisms and discusses donor activities in relation to financial management and governance arrangements.
- Chapter VIII – **Issues and Recommendations** – presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements.
- Chapter IX – **Country Action Plan** – summarizes deficiencies and actions to address these deficiencies. Recommendations are divided into actions that would be better achieved with external assistance; and actions that may be achieved without external assistance.

II. Accounting and Auditing in Sri Lanka

This chapter presents an overview of Sri Lankan accounting and auditing arrangements. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting arrangements. The chapter comprises 13 sections:

Part One: Accounting

- 1 – Introduction – identifies historical factors that have influenced accounting arrangements.
- 2 – The ‘Sri Lankan Accounting System’ – describes Sri Lankan accounting arrangements, which include the legislative and institutional framework, accounting bases and accounting information systems.
- 3 – Financial Reporting – describes financial reporting and disclosure requirements.
- 4 – Quality of Sri Lankan Financial Reporting and Disclosure – discusses evidence regarding the quality of financial reporting and disclosure practices and efforts to improve these practices.

Part Two: Auditing

- 5 – Introduction – describes the laws that govern Sri Lankan auditing practices and audit requirements.
- 6 – Auditor Appointment and Dismissal – describes auditor appointment and dismissal by comparing Sri Lankan arrangements to regional norms and international best practices.
- 7 – Auditor Independence – examines the extent of Sri Lankan auditor independence.
- 8 – Audit Reporting Requirements – describes Sri Lankan audit reporting requirements.
- 9 – Auditor Liability – examines auditor exposure to civil litigation.
- 10 – Accounting and Auditing Firms – describes the presence of domestic and international accounting firms in Sri Lanka.
- 11 – Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) – describes the establishment, authority and activities of SLAASMB.
- 12 – Financial Aspects of Sri Lankan Corporate Governance – identifies and discusses issues relating to financial aspects of corporate governance.
- 13 – Issue Synopsis: Accounting and Auditing – summarizes the issues identified in this chapter.

Part One. Accounting

1. Introduction

For a significant part of its recent history, Sri Lanka has been exposed to many foreign cultures. Of these, the British colonial period, which lasted over two centuries, was the most significant in influencing Sri Lankan accounting arrangements.

Immediately following independence from Britain in 1948, a Commission recommended that an Institute of Chartered Accountants of Ceylon be created. But it was not until 1959 that a Parliamentary Act established the Institute. Sri Lankan financial reporting requirements were primarily based upon British legislation and professional promulgations until 1970, when the Institute of Chartered Accountants of Sri Lanka (ICASL) issued the first Sri Lankan Accounting Standard (SLAS).²⁶

A number of finance companies collapsed in the late 1980s and early 1990s. Many depositors lost their savings as a result and the Government incurred significant fiscal costs through bailouts. In response, the Government established the *Presidential Commission on Finance and Banking* to investigate and strengthen financial sector arrangements. Among other things, the *Commission* recommended that international accounting and auditing standards be adopted to improve financial disclosure. It also recommended that financial reporting be monitored.²⁷

To these ends, the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995* was jointly developed by government officials, the accountancy profession and representatives from the commercial and financial sectors. Together with subsidiary regulations, the Act defines certain enterprises as Specified Business Enterprises (SBEs) and governs the preparation, presentation and audit of SBE financial statements. The Act also established the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB), which—as its name suggests—monitors accounting and auditing arrangements and practices.

Sri Lanka had reasonable accounting arrangements before these improvements were made in response to the finance company crisis. As a consequence of these improvements, Sri Lanka's accounting system

²⁶ Wickramarachchi, M. W. 1978. *Accounting Research Study No. 6: An Examination of Selected Financial Reporting Practices of Public Companies in Sri Lanka*. University of New England, Armidale: Department of Accounting and Financial Management. p. 4.

²⁷ World Bank. 1998 July 31. *Sri Lanka: Financial Sector Reforms*. p. 3.

compares very well with those of other countries: both developing and developed.

2. The ‘Sri Lankan Accounting System’

The ‘Sri Lankan Accounting System’ is strongly influenced by British and more recently international arrangements and practices. The governing legislative and institutional framework is robust and reflects a mixture of government intervention and self-regulation.

Legislative and Institutional Framework

Figure 1 depicts the legislative and institutional framework that governs Sri Lankan accounting and auditing arrangements.

Figure 1. Sri Lankan Legislative and Institutional Framework

Key Governing Laws	
Companies Act (No. 17) 1982	Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995
Public Finance Act (No. 38) 1971	
Finance Companies Act (No. 78) 1988	Securities Council Act (No. 36) 1987
Banking Act (No. 30) 1995	
Institutions and Primary Functions	
Securities and Exchange Commission (SEC) <ul style="list-style-type: none"> • Administers the Securities Act • Oversees the Stock Exchange 	Central Bank of Sri Lanka <ul style="list-style-type: none"> • Administers the Banking Act 1982 • Approves Bank auditors • Approves accounting and auditing standards for Banks • Determines disclosure requirements for financial institutions
Registrar of Companies <ul style="list-style-type: none"> • Administers the Companies Act 	
Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) <ul style="list-style-type: none"> • Monitors the application of accounting and auditing standards 	Institute of Chartered Accountants of Sri Lanka (ICASL) <ul style="list-style-type: none"> • Approves accounting and auditing standards • Supports the activities of the ASC and AuSC
Accounting Standards Committee (ASC) <ul style="list-style-type: none"> • Develops accounting standards 	Auditing Standards Committee (AuSC) <ul style="list-style-type: none"> • Develops auditing standards

The *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995* is administered by the SLAASMB and requires all SBEs to prepare and present financial statements in accordance with SLASs (see Appendix 8). It also empowers the ICASL to adopt suitable accounting and auditing standards from time to time. These standards are largely derived from IASs. Furthermore, the Act created the SLAASMB to monitor compliance with financial reporting requirements.

The Registrar of Companies administers the *Companies Act (No. 17) 1982*. The Act contains the rules, procedures, and accounting and reporting requirements for Sri Lankan incorporated or registered companies. Company registrations, and filing of accounts and annual returns are done with the Registrar. Under the Act, although the public company accounts are open for public inspection, private company accounts are not. However, private companies must file balance sheets and audited reports with the Registrar.

The Monetary Board of the Central Bank of Sri Lanka administers the *Banking Act (No. 30) 1988* (see Appendix 10). Among other things, the Act empowers the Central Bank to: (i) specify bank disclosure and reporting requirements, including the submission of annual audited statements; (ii) stipulate minimum capital requirements, and (iii) approve bank auditors. SLASs relating to banks must have the concurrence of the Banking Supervision Department of the Central Bank.

The Securities and Exchange Commission (SEC) administers the *Securities Act (No. 36) 1987*. This Act created the SEC and sets out the legal framework for the formalization and regulation of the stock market. Quoted Public Companies (on the Colombo Stock Exchange) are subject to the rules and regulations of the Colombo Stock Exchange constituted under the *Securities Act (No. 36) 1987*.²⁸ The 1990 *SEC Rules* incorporate listing requirements and specify routine and non-routine corporate disclosures (see Appendix 9).

In addition to these key laws, the *Public Finance Act (No. 38) 1971* governs the financial management, reporting and auditing arrangements for public corporations.

Accounting Bases

The financial statements of private and public sector organizations that are classified as SBEs must be prepared using the accrual accounting basis.²⁹ The financial statements of other government bodies are prepared using a cash accounting basis in accordance with Government Financial Regulations.³⁰

²⁸ As amended by the *Securities Act (No. 26) of 1991*.

²⁹ Para. 22, *SLAS Framework*.

³⁰ Government of Sri Lanka. 1992. *Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka*. Colombo: Department of Government Printing.

Accounting Information Systems

Accounting information systems range from paper-based manual systems to sophisticated, distributed internet-based systems. Many businesses and public corporations use locally-developed accounting packages.

3. Financial Reporting and Disclosure Requirements

Financial reporting and disclosure requirements are determined by mandatory rules and advisory sources. The mandatory sources were described in the previous section. Advisory sources include the promulgations of other jurisdictions and accounting societies—particularly from international organizations such as IFAC.

Under the *Accounting and Auditing Standards Act 1995*, every SBE (see Box 1) must:³¹

- prepare its financial statements in compliance with SLASs and take all necessary measures to ensure that the financial statements are audited in accordance with SLAuSs with the objective of presenting a true and fair view of the financial performance and financial position of such enterprise
- have the financial statements audited by members of the ICASL holding an Institute-issued Certificate to Practice
- submit a copy of the annual financial statements of the enterprise to the SLAASMB, to enable the Board to determine whether the financial statements have been prepared in compliance with SLASs, and
- furnish to the Board—or to any person authorized by the Board—any information pertaining to its financial statements as may be required by the Board or any person authorized by the Board within such time, as may be specified in a notice issued by the Board or any person authorized by it.

³¹ Ratnayake, Ajith S. (Director-General, SLAASMB). 2000. *Scope and Functions of the Accounting and Auditing Standards Monitoring Board*. www.sec.gov.lk

Box 1. Specified Business Enterprises (SBEs)

The following have been defined as SBEs by the Act and the regulations made under the Act:³²

- Companies licensed under the *Banking Act* (No. 30) 1988.
- Companies authorized under the *Control of Insurance Act* (No. 25) 1962 to conduct insurance business.
- Companies carrying on leasing businesses.
- Factoring companies.
- Companies registered under the *Finance Companies Act* (No. 78) 1988.
- Companies licensed under the *Securities Act* (No. 36) 1987 to operate unit trusts.
- Fund Management Companies.
- Companies licensed under the *Securities Act* (No.36) 1987 to conduct business as stockbrokers or stock dealers.
- Companies licensed under the *Securities Act* (No. 36) 1987 to operate a Stock Exchange.
- Companies listed in a stock Exchange licensed under the *Securities Act* (No. 36) 1987.
- Other Companies, which: have a turnover exceeding SLRs 500 Million; at the previous financial year-end had shareholders' equity exceeding SLRs 100 Million; at the previous financial year-end had gross assets in excess of SLRs 300 Million; at the previous financial year-end had liabilities to banks and other financial institutions exceeding SLRs 100 Million; or have a staff exceeding 1,000 employees.
- Public Corporations engaged in the sale of goods or the provision of services.
- A group of companies, any one of which falls within any of the above categories. For this purpose, a group of companies' means a holding company and its subsidiaries, the accounts of which have to be consolidated under Section 147 of the *Companies Act* (No.17) 1982.

Section 8 of the *Colombo Stock Exchange Listing Rules* stipulates quarterly, half-yearly and annual corporate disclosure requirements. In addition to the submission and publication of audited year-end financial statements, these rules require that entities listed on the main board must make unaudited income statements and balance sheets available within two months of the quarter-end; and entities listed on the secondary board must make unaudited income statements and balance sheets available within three months of the end of each half-year.³³

³² SLAASMB. 2001. *Information of Importance to Companies, Public Corporations, Directors, Managers, Secretaries and other Officers, and Auditors*. Colombo: SLAASMB.

³³ Colombo Stock Exchange. 2000 November. *Listing Rules*. Colombo: Colombo Stock Exchange.

Commercial banks incorporated or established within Sri Lanka and licensed under the *Banking Act (No. 30) 1988* must publish audited annual accounts within five months of the year-end. Sections 36 and 37 of the Act stipulate the content of balance sheets and profit and loss accounts (see Appendix 10). Regulations issued under the Act require provision of (i) monthly statements of assets, liabilities and liquidity ratios; (ii) quarterly statements on nonperforming advances in excess of SLRs 500,000, income and expense items, risk-based capital calculations; (iii) year-end cash flow statements, balance sheets, and income statements, including detailed notes on accounting procedures, commitments, transfers to reserves, depreciation on physical assets, investment values, taxes, and data related to cash reserves.³⁴

The *Public Finance Act (No. 38) 1971* governs the financial reporting of public corporations. Relevant provisions include:

- Public corporations must submit their annual accounts to the Auditor General for audit within four months after year-end. Corporations that fail to comply are liable to a fine of up to SLRs 1,000 (\$11) [Section 13(6)].
- The Auditor General must submit a report on the audit results to the public corporation Chair within eight months of year-end. Copies must be provided to the responsible Minister and the Minister of Finance [Sec 13(7)(a)].
- The Auditor General must submit a report on the audit results to the House of Representatives within ten months of year-end, where the Auditor-General considers that there are matters of interest to the House [Sec 13(7)(b)].
- Within three months of receiving the Auditor General's report, the public corporation's governing body must inform the Auditor General of the steps it proposes to take with regards to the matters raised in the report [Sec 13(8)].
- On completion of the annual audit, the public corporation must provide the following documents to the responsible Minister: the audited balance sheet, the audited operating and profit-and-loss accounts, any comments or observations made by the Auditor General that the Auditor General considers should be published, a statement of accounts and statistics, and the corporation's annual report [Sec 13(14)].
- The appropriate Minister must table these documents in the House of Representatives within ten months of year-end [Sec 14(3)].

³⁴ World Bank. 1998 July 31. *Sri Lanka: Financial Sector Reforms*. p. 29.

- The appropriate Minister may direct the public corporation's governing body to action recommendations made by the Public Accounts Committee to the House of Representatives.

4. Quality of Sri Lankan Financial Reporting and Disclosure

The quality of Sri Lankan financial reporting has improved in the past 20 years—the improvements accelerated in the past five years, in response to the actions taken to avoid a repeat of the finance company crisis. In relation to banks, one assessment concluded that:

Over the past few years, disclosure requirements for banking have substantially improved and appear to be consistent with international standards.³⁵

Furthermore, creative accounting practices include: (i) smoothing; (ii) biasing; (iii) focusing; (iv) gaming or storming; and (v) “illegal” acts.³⁶ The first four practices are common in all countries. A study of Sri Lankan creative accounting practices did not identify any “illegal acts”, thereby indicating that organizations (and their accountants and auditors) tend to work within the rules.³⁷

The ICASL provides impetus for continuous financial reporting improvements through its annual awards for the best annual reports of companies and state corporations. The awards were inaugurated in association with the *Financial Times and News of Ceylon* in 1964 and—in 2001—were available for 16 categories.³⁸

However, although private sector financial reporting and disclosure practices appear sound, this study identified concerns with financial reporting by public corporations. In relation to the 2001 awards, the ICASL President expressed concern that several public sector corporations that had participated in the past had dropped out of the competition, while

³⁵ World Bank. 1998 July 31. *Sri Lanka: Financial Sector Reforms*. p. 29.

³⁶ Birnberg, J. G., L. Turopolec and M. S. Young. 1983. The Organizational Context of Accounting. *Accounting Organizations and Society*. pp. 111-129.

³⁷ Jayasinghe, Manoja. 1998 May. *Nature and Extent of Creative Accounting in Sri Lanka*. Unpublished Manuscript: University of Sri Jayawardanapura.

³⁸ Wickramarachchi, M. W. 1978. *Accounting Research Study No. 6: An Examination of Selected Financial Reporting Practices of Public Companies in Sri Lanka*. University of New England, Armidale: Department of Accounting and Financial Management. p. 5.

others who participated and won certificates before, did not receive a Compliance Certificate.

“Even from among this small number [of public corporations], the Ceylon Electricity Board, which participated this year, did not receive a compliance certificate.

The Ceylon Petroleum Corporation, which not only participated years ago, but also won awards, has not been in the competition for many years. The CWE, which also participated in the past, does not do so now.”

– Ranel T. Wijesinha, ICASL President³⁹

Part Two. Auditing

5. Introduction

Sri Lankan auditing practices developed in line with accounting practices. Consequently, they reflect a strong British influence. SBE financial statements must be audited by ICASL members that hold practising certificates (issued by the Institute). The *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995* requires auditors to certify in their audit report that the audit has been conducted in accordance with Sri Lankan Auditing Standards (SLAuSs) and that the financial statements have been prepared and presented in accordance with SLAuSs.⁴⁰

Chapter IV describes the process by which the ICASL develops and promulgates SLAuSs—it also compares SLAuSs to ISAs. The application of SLAuSs during audits is monitored by SLAASMB (see page 35). To enable auditors to carry out and document audits in accordance with SLAuSs, the Auditing Standards Committee (AuSC) initiated a project to prepare a Tool Kit—Compendium of Audit Programs. The project was initially undertaken by United States Agency for International Development (USAID) consultants and was completed by a subcommittee of technically knowledgeable audit practitioners. The project, comprising 22 programs, was completed and sent to audit practitioners for comment in December 1999 and released in 2000.⁴¹

³⁹ Wijesinha, Ranel T. (ICASL President), quoted in *The Island Newspaper*. 2000 May 29. Non-participation of Public Corporations at ‘Annual Report’ Competitions Cause for Concern. p. 11.

⁴⁰ Ratnayake, Ajith S. (Director-General, SLAASMB). 2000. *Scope and Functions of the Accounting and Auditing Standards Monitoring Board*. www.sec.gov.lk

⁴¹ ICASL. 2000. *Institute of Chartered Accountants of Sri Lanka 1999 Annual Report*. p. 18.

The following sections examine Sri Lankan auditing practices—Singaporean arrangements are presented for comparison.⁴²

6. Auditor Appointment and Dismissal

Section 13 of the IFAC *Code of Ethics for Professional Accountants* (1996) outlines procedures for communicating between incoming and outgoing auditors.⁴³ Furthermore, ISA 315 states the requirements for communications between predecessor and successor auditors when a change of auditors occurs. It places the initiative for communication with the successor auditor who is required to make specific inquiry, after obtaining permission from the prospective client, of the predecessor auditor as to such matters as management integrity, management disagreements and the reason for change in auditor.

Table 3. Auditor Appointment and Dismissal

Factor	Sri Lanka	Singapore
Nominating party	Shareholders (see below for bank auditor nominations)	Shareholders
Appointing party	Shareholders	Shareholders
Party approving appointment	Bank audits are conducted by approved audit firms	Shareholders and the Monetary Authority of Singapore for financial institutions
Communication between outgoing and incoming auditors	Required by the Code of Conduct and Ethics, before an engagement is accepted	Required before engagement is accepted
Auditors rights to defend position on dismissal or resignation	Written or personal representation to shareholders	Written or personal representation to shareholders, filed with the Registrar of Companies
Compensation on termination	No, other than by the usual commercial practices	Fees owing to outgoing auditor must be paid before incoming auditor can accept the engagement

⁴² The analytical framework used, and the Singaporean information, is adapted from: Favere-Marchesi, Michael. 2000. Audit Quality in ASEAN. *The International Journal of Accounting*, Vol 35(1), pp. 121-149.

⁴³ IFAC. 1996. *Code of Ethics for Professional Accountants*. New York: IFAC.

The 1995 Banking Act amendments specify that banks must select auditors from a list of qualified auditors, compiled by the Banking Supervision Director of the Central Bank, to meet their auditing requirements. The Banking Supervision Director may enlarge the scope of the audit—the auditors must carry out the additional examinations and other work as required.⁴⁴

7. Auditor Independence

The *Code of Ethics for Professional Accountants* states that accountants in public practice should be, and should appear to be, free of any interest that might be regarded as being incompatible with integrity, objectivity and independence.⁴⁵ ISA 220 and the Statement of Policy by the IFAC Council (1992) support periodic peer reviews. Furthermore, Section 8 of the IFAC *Code of Ethics* (1996) relates to the objectivity of auditors with respect to their clients.

As regards auditor independence, in a recent landmark case, the US SEC brought its first successful action for fraud against an auditor in more than twenty years. The case underscored the SEC's concern that "the quality of auditing is being compromised by the amount of (more lucrative) nonaudit work that companies' auditors now perform for their clients."⁴⁶ The ICASL *Committee on Corporate Governance* did recommend that the fees paid for audit and nonaudit work should be separately shown in the annual report, however this recommendation has not been adopted.⁴⁷

Table 4. Auditor Independence

Factor	Sri Lanka	Singapore
Restrictions on relationships: personal commercial financial, or influential	Yes	Some restriction on financial relationships
Restrictions on services provided by audit firms to audit clients (other than the audit)	No (except for restrictions on the auditors providing services that effectively make them company officers or servants)	Accounting, tax advice, consulting, financial and investment advice, corporate recovery

⁴⁴ World Bank. 1998 July 31. *Sri Lanka: Financial Sector Reforms*. p. 31.

⁴⁵ IFAC. 1996. *Code of Ethics for Professional Accountants*. New York: IFAC.

⁴⁶ *The Economist*. 2001 June 23. Andersen's Fairy Tales: A \$7 million fine from the SEC again raises doubts about the independence of auditors. Magazine Article. p. 77.

⁴⁷ ICASL. 1997 December 12. *Report of the Committee to Make Recommendations on Matters Relating to Financial Aspects of Corporate Governance*. Colombo: ICASL. pp. 25-26.

Table 4. Auditor Independence (continued)

Factor	Sri Lanka	Singapore
Rules to avoid low balling	Yes. Incoming auditors are not allowed to accept fees lower than those of outgoing auditors, at least for the first year	Yes
Required rotation of audit partners	No (although the Auditor General informally rotates the private auditors of public corporations on a four-yearly basis)	Every five years for listed companies
Safeguards to objectivity:		
• Challenges to objectivity disclosed	Yes (if significant)	Yes
• Quality reviews	Recently adopted (to be implemented).	Yes
• Internal quality reviews	Yes	No
• Potential threats to objectivity monitored by third party	No	Yes
• Audit committees required	No (but recommended by Colombo Stock Exchange and encouraged by ICASL Corporate Governance Guidelines)	Yes

In other countries, the remuneration paid to auditors for performing non-audit services has to be disclosed in the accounts. Sadly there is no such requirement in Sri Lanka. In some other countries, moves are already underway to prohibit altogether the auditors from providing non-audit services.⁴⁸

In relation to audit partner rotation, the ICASL *Committee on Corporate Governance* recommended that the rotation of audit partners and teams should contribute towards the strengthening of the external audit.⁴⁹ This

⁴⁸ *The Island*. 2000 July 12. Double Standards on Setting Standards! Newspaper Article.

⁴⁹ ICASL. 1997 December 12. *Report of the Committee to Make Recommendations on Matters Relating to Financial Aspects of Corporate Governance*. Colombo: ICASL. pp. 25-26.

recommendation has not yet been adopted. However, the external auditors for state-owned commercial banks are appointed for fixed terms.⁵⁰

The ICASL *Committee on Corporate Governance* recommended that all listed companies should establish Audit Committees and suggested institutional, appointment and reporting arrangements for these committees.⁵¹ To this end, the ICASL, together with the Sri Lanka Institute of Directors and the Chartered Institute of Secretaries, recently prepared and promulgated an Exposure Draft (ED) on *Audit Committees*.⁵²

Under the ADB-sponsored *Private Sector Development Program*,⁵³ the Government will introduce a code of best practice and principles for good governance for public corporations. This code will be based upon the ICASL's guidance in this area. As preliminary implementation of these requirements, Audit and Management Committees have been appointed in public corporations, ministries and departments to review internal control processes and compliance with statutory requirements and government rules and regulations. These committees are also entrusted with reviewing and assisting with the development plans of the organization with a special emphasis on human resource development.⁵⁴

8. Audit Reporting Requirements

ISA 700 *The Auditor's Report on Financial Statements* establishes standards and provides guidance on the form and content of the auditor's report issued as a result of an audit performed by an independent auditor of the financial statements of an entity. Much of the guidance provided can be adapted to auditor reports on financial information other than financial statements.

The ICASL Committee on Corporate Governance recommended that, in view of the failure of a large number of companies, directors should include a statement in the Annual Report indicating that they are satisfied about the company being a going concern. The Committee also suggested that directors should include a specific statement in Annual Reports on

⁵⁰ World Bank. 1998 July 31. *Sri Lanka: Financial Sector Reforms*. p. 21.

⁵¹ ICASL. 1997 December 12. *Report of the Committee to Make Recommendations on Matters Relating to Financial Aspects of Corporate Governance*. Colombo: ICASL. pp. 18-21.

⁵² Ameresekere, Paneetha. 2001 May 1. Private Sector Must Also Demonstrate Good Governance. *The Island*. Newspaper Article. p. 10.

⁵³ ADB Loan No. 1800(SF)-SRI: *Private Sector Development Program*, for \$85 million, approved on 12 December 2000 and Loan No. 1801-SRI: *Private Sector Development Program*, for \$15 million, approved on 12 December 2000.

⁵⁴ MOFP. 2000 October. *Trends in Public Finance: 1999*. Colombo: MOFP. p. 66.

the effectiveness of the company's system of internal control.⁵⁵ Consequently, and in accordance with SLAuS 21 (Going Concern), Sri Lankan auditors must assess whether the entity is a going concern.

Table 5. Audit Reporting

Issue	Sri Lanka	Singapore
In Auditor's Report:		
• Fraud or irregularities	Yes	Yes
• Illegal acts	Yes	Yes
• Internal controls and systems	Yes	Yes
• Maintenance of proper records	Yes	Yes
Reporting to Other Parties:		
• Fraud or irregularities	Yes	Yes
• Illegal acts	Yes	Yes
• Internal controls and systems	No	No
• Maintenance of proper records	Yes	Yes
Standard forms of audit reports required by law	Yes	Yes
Matters to be included in reports specified by law	Yes	Yes
Standard forms of audit reports established by professional bodies	Yes	Yes
Qualified audit reports due to uncertainties	Yes	Yes

9. Auditor Liability

Exposing auditors to civil liability creates strong incentives to raise quality and maintain independence. But there must be a balance between providing this incentive and avoiding a decline in audit services due to excessive litigation costs.⁵⁶

Table 6. Auditor Liability

Issue	Sri Lanka	Singapore
Professional Sanctions:		
• Warning	Yes	Yes
• Reprimand	Yes	Yes
• Fine	Yes	Yes
• Temporary suspension	Yes	Yes
• Permanent exclusion	Yes	Yes
Legal liability cap between contract parties	No	No
Contractual liability cap between contract parties	No	No
Legal liability caps between contract parties and third parties	No	No

⁵⁵ ICASL. 1997 December 12. *Report of the Committee to Make Recommendations on Matters Relating to Financial Aspects of Corporate Governance*. Colombo: ICASL. pp. 23, 25-27.

⁵⁶ Palmrose, Zoe-Vonna. 1988. An Analysis of Auditor Litigation and Audit Service Quality. *The Accounting Review*. (63). pp. 55-73.

10. Accounting and Auditing Firms

Sri Lanka has a developed accountancy profession. All 'Big Five' international accountancy firms are represented together with most of the second-tier international firms. Moreover, there are significant numbers of sole practitioners and partnered firms.

11. Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)⁵⁷

Introduction

The SLAASMB was established by the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995*. The Board has 13 members, including representatives from accountancy bodies, academia, capital regulators, and industry and commerce (see Table 7).

Table 7. SLAASMB Members

Member Type	Number	Nomination and Appointment
Ex Officio Members	1	Registrar of Companies.
	1	Commissioner-General of Inland Revenue.
	1	Director-General of the SEC.
Ministerial Appointees (Appointed Members)	1	An officer of the Central Bank nominated by the Governor of the Central Bank.
	3	Three members of the ICASL selected from among persons nominated by the Institute.
	1	A member of the Sri Lanka Division of the Chartered Institute of Management Accountants (CIMA) of the United Kingdom selected from among three members nominated by the Institute.
	1	A senior lawyer selected from among three senior lawyers nominated by the Bar Association of Sri Lanka.

⁵⁷ The information provided in this section is drawn from the informative article by: Ratnayake, Ajith S. (Director-General, SLAASMB). 2000. *Scope and Functions of the Accounting and Auditing Standards Monitoring Board*. www.sec.gov.lk

Table 7. SLAASMB Members (*continued*)

Member Type	Number	Nomination and Appointment
	2	Company directors or other persons with extensive managerial experience at senior level in a specified business enterprise one of whom shall be selected from a panel of three names submitted by the Ceylon Chamber of Commerce, and the other from a panel of three names submitted by the Federation of Chambers of Commerce and Industry of Sri Lanka.
	1	A Senior Banker selected from a panel of three bankers nominated by the Sri Lanka Banks' Association.
	1	A person selected from a panel of three persons nominated by the University Grants Commission established by the <i>Universities Act (No.16) 1978</i> to represent the Departments Faculties and Post-graduate Institutes of Accounts or Business Management or Business Administration in Universities coming within its purview.

Membership and Independence

All Board members are either *ex-officio* members (i.e., they hold a specified public office), or are selected from a list of nominees. This appointment process is intended to distance the Board from political influence. The Board takes additional measures to safeguard its independence, which include: (i) Board members must provide a list of SBEs to which they, or their firm, has a connection with either as an auditor, accountant, director or professional advisor; (ii) portions of Board papers relating to these SBEs are omitted from the papers sent to the relevant Board members; (iii) the concerned Board members do not participate in discussions and decisions on the relevant SBEs, and are required to withdraw from the meeting when such issues are taken up; (iv) concerned Board members shall not represent the relevant SBE or the relevant SBE's auditors when SBE representative are invited for a discussion—unless the SBE auditor practices as a sole proprietor; and (v) concerned Board members must not communicate with the Board Chair or the Board Secretariat on issues relating to any matter subject to inquiry or investigation (unless as a sole audit practitioner).

Authority

The Act gives the SLAASMB the authority to: (i) require an SBE or its auditors to provide any information relating to its financial statements; (ii) summon and question any SBE director, officer or auditor on any matter relating to the preparation or presentation of its financial statements; and (iii) conduct investigations or inquiries it considers necessary to perform its duties under the Act. For this purpose, it may call upon any SBE director, officer or auditor to appear at the investigation or inquiry or to produce books or documents as are required for the purpose of the investigation or inquiry.

Activities and Investigations

All SBEs must submit their annual accounts to the Board. The Board reviews annual accounts to identify any apparent non-compliance with SLASs. Investigations are undertaken when doubts arise—the nature of investigations depends on the particular circumstances. Investigations into non-compliance with SLASs may lead to investigations into non-compliance with SLAuSs.

Issues brought to the Board's attention may be concluded: (i) without any further action; (ii) by agreement; (iii) with a direction issued by the Board; or (iv) through legal action. The following actions may result from Board investigations: a direction that the SBE's annual accounts comply with requirements in the future; the requirement that the published accounts be corrected and redistributed; the imposition of a fine by the Board; a court-imposed fine; a court-imposed imprisonment term; or other implications. Box 2 sets out the penalties that can be imposed for non-compliance with the Act.

The year ending 31 December 2000 was the first that the Board had been in active operation. Up until 31 December 2000, it had received financial statements from 341 specific businesses. To date, the SLAASMB has reviewed all financial statements that it received. However, in the future—as the number of received financial statements grows—it intends to adopt a selective sampling approach. As of July 2001, the Board had received very few financial statements from public corporations.

Box 2. Penalties and Other Implications Resulting from Violations

- Every person who fails to comply with the requirements of the Act shall be guilty of an offence under this Act, and shall on conviction after a summary trial ... be liable to a fine not exceeding SLRs 500,000 (\$5,366).
- Where a person is convicted of an offence under this Act and the court holds that the act constituting such offence was done with intention of misleading the shareholders of a specified business enterprise or any financial institution dealing with such specified business enterprise or the Inland Revenue Department or where a licensed commercial bank is convicted of an offence under this Act and the court holds that the act constituting the offence was done with the intention of misleading the depositors of such bank the court may sentence the offender to imprisonment of either description for a term not exceeding five years.
- Where an offence under this Act is committed by a body corporate, any person who is at the time of the commission of the offence, a director, manager, secretary or other similar officer of that body corporate shall be deemed to be guilty of that offence unless he proves that the offence was committed without his knowledge or connivance and that he exercised all such diligence to prevent the commission of that offence as he ought to have exercised having regard to the nature of his functions and all the circumstances of the case.
- Where any accountant of any SBE violates any provision of this Act, it shall be duty of the Board to bring such violation to the notice of any professional body of which such accountant is a member for the purpose of enabling such body to take appropriate action against such accountant.
- Where any SBE has failed to act in compliance with provisions of this Act, it shall be the duty of the Board to bring such fact to the notice of:
 - any authority which is empowered by law to regulate or supervise the activities of such SBEs; and
 - the Inland Revenue Department if the Board considers that such non-compliance has resulted in a substantial reduction of the tax liabilities of such SBEs.

Although the Board identified a large number of deviations from SLASs in the financial statements it had received to 31 December 2000, most were minor disclosure and presentation deviations.

Where significant deviations—which substantially altered an organization’s financial position or financial performance—were detected, the Board took appropriate steps to ensure that the organization took corrective action. Where other departures from SLASs were detected—which were not so significant as to require the use of statutory corrective procedures—letters were sent to the organizations so that the organizations could take corrective action on their own. These letters were not Board directives but were intended to be of assistance. The Board approached financial statement reviews in such a manner as to achieve maximum effectiveness with a minimum of inconvenience to the organizations.

Amalgamation of Monitoring and Regulatory Bodies

In response to complaints from businesses regarding compliance requirements, a Core Group of Business Development was established. The Group includes representatives from: (i) SLAASMB; (ii) the Registrar of Companies; (iii) the SEC; (iv) the Central Bank of Sri Lanka; and (v) the Insurance Regulation Body. The Group recently reported to the Secretary to the Treasury on possibilities for reducing compliance requirements on businesses.

SLAASMB Salary Structure and Staffing Arrangements

The SLAASMB is subject to civil service employment regulations. These limit the Board's ability to pay market salaries to staff, in the absence of a case-by-case dispensation from the Secretary to the Treasury. The issuance of dispensations can take up to two months, during which time the potential employee may find alternative employment.

12. Financial Aspects of Sri Lankan Corporate Governance

In 1999, Sri Lanka's private sector comprised about 36,000 registered private companies and about 2,160 registered public companies; about 75 percent of these were small or medium size companies. After a slow start, privatizations of public corporations accelerated in 1992. ADB supported the Government's privatization program under its *Financial Sector Program* loan in 1990.⁵⁸ By the end of 1999, 75 commercial enterprises and 115 statutory boards and agencies, were still wholly government-owned and employed about 181,000 people (about 3 percent of total employment), with a net asset value close to SLRs 295 billion (\$3.2 billion).

In 1996, the ICASL established a Committee on Corporate Governance to make recommendations on matters relating to financial aspects of corporate governance. The 10-person Committee comprised high-level representatives from ICASL, Registrar of Companies, Colombo Stock Exchange, SEC, Central Bank of Sri Lanka, President's Office, CIMA, Ceylon Chamber of Commerce, and business organizations.⁵⁹

⁵⁸ ADB Loan No. 1051-SRI: *Financial Sector Program*, for \$80 million, approved on 20 November 1990.

⁵⁹ Hussein, Asiff. 1996 March 17. Committee to Study Corporate Governance. *Sri Lanka Sunday Times*.

The Committee finalized its report in December 1997. Among other things, the report recommended that: (i) all listed companies should establish Audit Committees and suggested institutional, appointment and reporting arrangements for these committees; (ii) finance functions be made the responsibility of a specific board director; (iii) company annual reports should include a statement regarding directors' responsibilities for the financial statements in the annual report; (iv) directors should include a specific statement in the Annual Report on the effectiveness of the company's system of internal control; (v) fees paid for audit and non-audit work should be separately shown in the annual report; (vi) the rotation of audit partners and teams would contribute towards the strengthening of the external audit, and (vii) in view of the failure of a large number of companies, directors should include a statement in the Annual Report indicating that they are satisfied about the company being a going concern.⁶⁰

In response to these recommendations:

- ICASL, together with the Sri Lanka Institute of Directors and the Institute of Chartered Secretaries and Administrators (ICSA), recently prepared and promulgated Exposure Drafts (EDs) on *Boardroom Governance and Audit Committees*.⁶¹
- ICSA has published a handbook on *Corporate Governance and Guidelines to Best Practice in Sri Lanka*.^{62, 63}
- SLAS 3 *Presentation of Financial Statements* now requires Directors to sign a responsibility clause as part of the Financial Statements.

However, the corporate governance regime for public institutions remains weak as reflected in: (i) lack of management autonomy, commercial orientation and corporate vision; (ii) inflexibility in pricing goods and services; (iii) poor procurement practices; and (iv) non-transparent operations owing to weak disclosure standards and enforcement as exemplified in the often delayed or failed submission of audited annual reports. In April 1999, the Department of Public Finance reported that a number of audited public corporation accounts for 1996 were still

⁶⁰ ICASL. 1997 December 12. *Report of the Committee to Make Recommendations on Matters Relating to Financial Aspects of Corporate Governance*. Colombo: ICASL.

⁶¹ Ameresekere, Paneetha. 2001 May 1. Private Sector Must Also Demonstrate Good Governance. *The Island*. Newspaper Article. p. 10.

⁶² *Sunday Observer*. 2001 July 15. Principles and Guidelines to Good Practice. p. 42.

⁶³ Institute of Chartered Secretaries and Administrators (ICSA). 2001 *Corporate Governance and Guidelines to Best Practice in Sri Lanka*. Colombo: ICSA.

outstanding. Meanwhile, some of the 1997 reports and none of the 1998 reports had been received.⁶⁴

13. Issue Synopsis: Accounting and Auditing Arrangements

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues from this chapter:

- The Boards of public corporations could be strengthened considerably through the inclusion of at least one Chartered Accountant, or similarly qualified person.
- To strengthen financial management within public corporations, all public corporations should have suitably qualified Chief Financial Officers with senior manager status.
- To improve the financial reporting and disclosure practices of public corporations, the SLAASMB should be required to review the annual reports of all public corporations as a matter of course.
- The *Public Finance Act (No. 38) 1971* sets out reporting and auditing requirements for public corporations. However: (i) public corporations have up to four months after year-end to submit their annual reports to the Auditor-General; (ii) public corporation annual reports can be tabled in parliament as long as 10 months after year-end; (iii) in any case, the time to prepare and audit public corporation annual reports exceeds these deadlines (in practice); (iv) the incentive mechanisms under the Act (e.g., a fine of up to SLRs 1,000) do not encourage compliance; and (v) public corporations do not address issues identified during audits.
- Accountability for financial management could be strengthened by requiring directors to include specific statements in the Annual Report on: (i) the effectiveness of the organization's internal control systems; and (ii) their satisfaction that the company is a going concern.
- Auditor independence is undermined by not requiring separate disclosure of the fees paid for audit and nonaudit work in annual reports.
- The irregular rotation of audit partners and teams would strengthen external audits.

⁶⁴ ADB. 2000 November 21. *Report and Recommendation of the President: Private Sector Development Program (Sri Lanka)*—Proposed Program Cluster, Loans, and Technical Assistance Grant. Manila: ADB. p. 6.

- Allowing the reappointment of external auditors for more than one year would strengthen external audits of state-owned banks.
- The SLAASMB is a key institutional support to good financial governance. But its effectiveness is compromised by staff remuneration arrangements.

III. Professional Infrastructure

This chapter describes the professional accountancy infrastructure in Sri Lanka. It is structured as follows:

- 1 – Introduction – describes the development of Sri Lanka’s accountancy profession.
- 2 – Professional Regulation and Organization – describes the laws and organizations that regulate the profession and the professional bodies that represent accountants.
- 3 – Institute of Chartered Accountants of Sri Lanka (ICASL) – describes the framework, and activities of the ICASL, the national professional accountancy body.
- 4 – The Chartered Accountant Designation – sets out the requirements for the Chartered Accountant designation and compares these against international guidelines.
- 5 – Other Sri Lankan Accountancy Bodies – describes the membership of other Sri Lankan professional accountancy bodies.
- 6 – Foreign Accountancy Bodies – describes the presence and activities of foreign accountancy organizations within Sri Lanka.
- 7 – Quality Control and Assurance – describes and examines international guidelines on quality assurance.
- 8 – Issue Synopsis: Professional Infrastructure – summarizes the issues identified in this chapter.

1. Introduction

The first (British) professional accountancy examinations were held in Colombo in 1920. However, it was not until 1941 that the colonial government established the Accountancy Board to prescribe regulations and conduct examinations for selecting suitable candidates for the government accounting service. Those selected by the Accountancy Board through its examinations were called ‘Ceylon Registered Accountants’.⁶⁵

In 1950, following independence, the *L.M.D. de Silva Commission on Company Law* recommended that a professional accounting body—the Institute of Chartered Accountants of Ceylon (ICAC)—be created. Due to an unstable political situation, this was only achieved nine years later

⁶⁵ Yapa, P.W. Senarath. 2001. *Empowering the Accounting Profession in Sri Lanka*. Paper presented to the Second Accounting History International Conference (Osaka, Japan): 8-10 August.

when the *Institute of Chartered Accountants Act (No. 23) 1959* provided for the establishment of ICASL as the national professional accountancy body.^{66,67}

ICASL had 121 founder members at establishment. The need for more accountants (among other technicians and professionals) was a pressing national issue following independence. In 1963, the *Commission of Inquiry on Technical Education* observed that there were just 271 financial accountants and 15 cost accountants employed in Sri Lanka by 1961. In 1973, the Government directed ICASL to establish a special committee to investigate the Future Training of Accountants (FTA).

One of the FTA Committee's main findings was that ICASL's system of education and training—based largely on the traditional British articleship practice—could not meet Sri Lanka's emerging economic and social needs. As a response, ICASL introduced new examination structures in 1976 and membership increased to about 500 by 1980.⁶⁸

In common with the United Kingdom, Sri Lanka's professional accountancy infrastructure is largely self-regulated and characterized by a plethora of competing professional bodies. Where relevant, this chapter compares Sri Lankan professional arrangements with international standards and guidelines (see Appendix II).

2. Professional Regulation and Organization

The Sri Lankan accountancy profession is largely self-regulated and comprises a range of professional bodies (see Table 8). However, ICASL membership is required in order to conduct audits of SBEs (see page 25).

Table 8. Organization and Regulation of the Sri Lankan Accountancy Profession

Governing Laws	The <i>Institute of Chartered Accountants Act (No.23) 1959</i> governs the Sri Lankan accountancy profession. ICASL Members are also recognized in several other laws (for instance, the <i>Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995</i>).
Regulatory Bodies	The profession is largely self-regulated (i.e., no regulatory bodies have been established in relation to professional regulation).

⁶⁶ ICASL. 2000. *Institute of Chartered Accountants of Sri Lanka 1999 Annual Report*. p. 40.

⁶⁷ The Institute of Chartered Accountants of Sri Lanka (ICASL) was originally called the Institute of Chartered Accountants of Ceylon (ICAC).

⁶⁸ Yapa, P.W. Senarath. 2001. *Empowering the Accounting Profession in Sri Lanka*. Paper presented to the Second Accounting History International Conference (Osaka, Japan): 8-10 August.

Table 8. Organization and Regulation of the Sri Lankan Accountancy Profession *(continued)*

Professional Organizations		Members ⁶⁹
	Sri Lankan bodies:	
	▪ ICASL	2,170
	▪ Association of Accounting Technicians of Sri Lanka (AATSL)	2,738
	▪ Society of Certified Management Accountants of Sri Lanka (CMASL)	638
	▪ Institute of Internal Auditors (IIA)	50
	▪ Institute of Public Finance and Development Accountancy (IPFDA)	1,754
	Foreign bodies:	
	▪ Chartered Institute of Management Accountants Sri Lanka Division (CIMASL)	1,434

3. Institute of Chartered Accountants of Sri Lanka (ICASL)

Introduction

In 1950, the *L.M.D. de Silva Commission on Company Law* recommended to government that an Institute of Chartered Accountants of Ceylon be established. This recommendation was acted upon only in 1959, when the Minister for Commerce presented a Bill in Parliament to incorporate the Institute of Chartered Accountants of Ceylon. The *Institute of Chartered Accountants Act (No.23) 1959* came into operation in December 1959.⁷⁰

The Institute Council

The Council of the Institute is responsible for the administration and management of the Institute. The Council also conducts qualifying examinations, supervises and regulates student education and training, secures the maintenance of professional standards among members and promotes the profession's advancement.

⁶⁹ Many members hold multiple memberships (e.g., an ICASL member may also be a member of CMASL and CIMA). Moreover, substantial numbers of members practice overseas (for instance, 42 percent of ICASL members).

⁷⁰ ICASL. 2000. *Institute of Chartered Accountants of Sri Lanka 1999 Annual Report*. Colombo: ICASL. p. 40.

The Institute Council initially comprised the President and 11 ministerial appointees. However, with the *Institute of Chartered Accountants (Amendment) Act (No. 15) 1998*—the Council now comprises the President, Vice-President, six members selected by the general membership and eight ministerial nominees.

The Council's main duties are to: (i) conduct qualifying examinations and to prescribe courses of study therefore; (ii) supervise and regulate student education and training; (iii) maintain professional standards, and acquaint members with the methods and practices necessary to maintain standards; (iv) encourage research in accountancy and related subjects; and (v) secure the profession's well-being and advancement.

Affiliations

The Institute is a member of the following bodies:

- Asia-Oceania Tax Consultants' Association (AOTCA).
- Confederation of Asian and Pacific Accountants (CAPA).
- IFAC.
- International Accounting Standards Committee (IASC).
- International Auditing and Assurance Standards Board (IAASB).
- South Asian Federation of Accountants (SAFA).
- Organization of Professional Associations (OPA).

The Institute is also represented in the following bodies:

- Computer and Information Technology Council (CINTEC).
- Company Law Advisory Committee.
- SEC.
- Postgraduate Institute of Management.
- National Institute of Business Management (NIBM).
- SLAASMB.
- Sri Lanka Institute of Advanced Technical Education.

Memberships

Institute members are either Associates or Fellows:

- People who have completed the Final Examination and have satisfied the practical training requirements are eligible to apply for admission as a Member (Associate Chartered Accountant, ACA).
- Associate Members who have satisfied the Council that they have acquired the required Continuing Professional Education (CPE)

credits, thus successfully completing the Fellowship Examination may apply for admission as a Fellow Member (Fellow Chartered Accountant, FCA).

Certificate to Practice

Associate or Fellow Members, with at least two years practical training in a firm of practising Chartered Accountants after obtaining the Final Certificate, may apply for a Certificate to Practice. Once the Certificate is issued, they may practice as accountants or auditors.

Educational Requirements and Examinations⁷¹

The Institute provides training and administers examinations to Registered Students—it had over 14,000 Registered Students in 2001. A new examination scheme was introduced in 1999.

The qualifications accepted for Registered Student enrolment include: (i) an approved university degree; (ii) Sri Lanka or London University GCE Advanced Level passes; (iii) successful completion of certain examinations from the Sri Lanka Technical College; (iv) completion of certain professional examinations from CIMA, ACCA, ICSA, Institute of Financial Accountants (IFA, UK), Association of International Accountants (AIA, UK), AATSL, AAT (UK), Institute of Bankers (Sri Lanka or UK); (v) Attorney-at-Law of the Supreme Court of Sri Lanka; (vi) membership of the Chartered Institute of Marketing; (vii) membership of the Sri Lanka Government Accountants' Service; and (viii) membership of the Sri Lanka Government Audit Service.

The Institute's qualification structure comprises four levels: Foundation, Intermediate, Final I and Final II (see Table 9). Appendix 12 provides further details on these courses.

The Institute provides related education and training programs to its Registered Students through correspondence courses and lectures. Study halls are available to students and the Institute maintains a library for the benefit of students and members.

⁷¹ Primary Sources:

- ICASL. 2000. *Students' Guide*. Colombo: ICASL.
- ICASL. 1999 December. *Practical Training Guide*. Colombo: ICASL.

Table 9. ICASL Examination Structure⁷²

Level	Languages	Component Papers
Foundation	Sinhala, Tamil or English	<ul style="list-style-type: none"> ▪ Introduction to Financial Accounting (including systems and procedures) ▪ Introduction to Decision-making Techniques (Financial Mathematics, Statistics and Elements of Operations Research) ▪ Introduction to Business ▪ Business Communication I
Intermediate	Sinhala, Tamil or English	<ul style="list-style-type: none"> ▪ Auditing ▪ Commercial Law and Tax ▪ Financial Accounting ▪ Business Finance and Decisions ▪ Business Communication II
Final I	English only	<ul style="list-style-type: none"> ▪ Advanced Financial Accounting and Reporting ▪ Corporate Law ▪ Management Information Systems and Information Technology ▪ Management Accounting
Final II	English only	<ul style="list-style-type: none"> ▪ Financial Management ▪ Advanced Auditing ▪ Advanced Taxation ▪ Strategic Planning and Management

Practical Training and Experience⁷³

Training requirements with respect to duration, commencement and scope are being reviewed at present. Currently, at least three years of practical training under the supervision of an Institute Member are required for Institute admission. At the Intermediate level—the two-year training period starts only after passing (or being exempted from) the Foundation examination. However, a one-year reduction is allowed in certain circumstances (e.g., for university degree holders). A further two years of approved practical training is required at the Final level before admission to Associate Membership.

The practical experience must be gained with approved practical training organizations, classified into the following categories: (i) the Audit Sector, which includes firms of practising Chartered Accountants and the Auditor-General's Department; (ii) the Non-Audit Sector which includes organizations that employ Chartered Accountants; and (iii) Both Sectors.

⁷² ICASL. 2000. *Students' Guide*. Colombo: ICASL.

⁷³ ICASL. 1999 December. *Practical Training Guide*. Colombo: ICASL.

Each year of approved practical training must comprise a minimum of 1,250 hours. Student trainees are required to sign training agreements and submit training records and quarterly summaries.

Training Activities

The Institute organizes regular seminars and training on technical subjects such as auditing, taxation, management services, accountancy education, accounting principles, and information technology.

Professional Ethics

IFAC pronouncements on professional ethics include: the *Code of Ethics for Professional Accountants*, the *Statement of Policy of Council: Implementation and Enforcement of Ethical Requirements*, and IEG 10: *Professional Ethics for Accountants: The Educational Challenge and Practical Application*. The ICASL Council approved the Institute's *Code of Professional Conduct and Ethics* in November 1975—the Code was most recently updated in 1993.⁷⁴

4. The Chartered Accountant Designation

Table 10 sets out the ICASL membership requirements—international and selected regional requirements are presented for comparison. IFAC recommends that the appraisal process be founded upon the key components of a professional qualification, falling into: (i) education – entry standards/body of knowledge; (ii) examinations – tests of professional competence; and (iii) experience – relevant to the practice function.⁷⁵ Furthermore, IFAC requires that CPE be a requirement for practising accountants.

A recognized university degree is not a prerequisite for the Chartered Accountant qualification. Although unusual, this arrangement does accord with IFAC requirements. Justifications include: (i) with a few exceptions, Sri Lankan university standards are generally recognized as inferior to ICASL's education program; and (ii) Sri Lankan universities are subject to frequent strikes and other disruptions, which limit educational quality and can substantially extend a student's program of study.

⁷⁴ ICASL. 1993 February 12. *Institute of Chartered Accountants of Sri Lanka—Code of Professional Conduct and Ethics*. Colombo: ICASL.

⁷⁵ IFAC. 1995 June. *Statement of Policy of Council: Recognition of Professional Accountancy Qualifications*. New York: IFAC.

Table 10. Professional Accountancy Qualifications⁷⁶

Requirement	International	Sri Lanka (ICASL)	Philippines
Education	Recognized education program (IFAC: IEG 9, Para 26).	✓ A range of entry qualifications are accepted—a university degree is not necessarily required.	✓ Four-year bachelor degree, majoring in accountancy.
Examination	Yes (IFAC: IEG 9, Para 44).	✓ Yes.	✓ ✗ Yes, multiple-choice questions.
Practical Experience	Minimum of three years practical experience in an appropriate, supervised environment (IFAC: IEG 9, Para 49).	✓ At least three years for university degree holders and four years for others.	✗ None, a CPA with no practical experience can conduct audits and issue audit opinions. Although the introduction of practical experience is being considered.
Continuing professional education (CPE)	Annual minimum of 30 hours, or 90 hours over each three-year period, of structured learning activities (IFAC, ISAR).	✗ Recommended but not mandatory. Follows the practice of ICAEW.	✗ None. Although the introduction of mandatory CPE is being considered.

5. Other Sri Lankan Accountancy Bodies

There are four other Sri Lankan accountancy bodies in addition to ICASL.

Association of Accounting Technicians of Sri Lanka (AATSL)

In 1986, the Government worked with ADB to prepare a *Master Plan for Accounting and Auditing Education*. Among other things, the Plan revealed a shortage of accounting personnel at the technician level. In a move to address this shortage, AATSL was established in December 1987 at the initiative of the ICASL.

The objective of AATSL is to produce technician-level accounting support staff. The AATSL had 2,738 members at 31 March 2001. AATSL is an associate member of IFAC and CAPA.

⁷⁶ Table adapted from: Favere-Marchesi, Michael. 2000. Audit Quality in ASEAN. *The International Journal of Accounting*. Vol 35(1). pp. 121-149.

Society of Certified Management Accountants of Sri Lanka (CMASL)

The CMASL was registered in June 1998 and launched in June 2001—it had 638 members and 873 registered students as of June 2001. It is based upon the guidelines of international accounting bodies such as the Society of Management Accountants of Canada, the Institute of Management Accountants of the United States, IFAC and other regional management accounting bodies. CMASL was established with technical assistance from CMA Canada, funded by the Canadian International Development Agency (CIDA).

The Institute of Internal Auditors

The Association of Internal Auditors was formed in February 1991 and changed its name to the Institute of Internal Auditors in July 1994. The Institute had 50 members as of June 2001.

The Institute of Public Finance and Development Accountancy (IPFDA)

IPFDA was established in March 1980 and represents public sector accountants and auditors. It had 1,750 members as of March 2001.

Membership of the Institute is attained by virtue of career experience and position. Membership does not require specified academic qualifications, professional examinations, practical experience or CPE. The Institute has recently prepared a Bill to create the Chartered Institute of Public Finance and Accountancy of Sri Lanka (CIPFASL).

6. Foreign Accountancy Bodies

Foreign professional accountancy bodies have a strong and growing presence in Sri Lanka. Their success in establishing operations reflects strong historical connections with Britain and a desire by many Sri Lankans to have exportable qualifications. However, many members of these foreign bodies hold concurrent membership with ICASL. An outpost of ACCA (UK) is being established in Sri Lanka.

The largest and most active of the foreign accountancy bodies is CIMASL. The parent body, the Chartered Institute of Management Accountants (CIMA), was founded in the United Kingdom by Royal Charter in 1919. There are two membership levels: Fellow (FCMA) and

Associate (ACMA). In 2001, CIMA Worldwide had around 50,000 members in over 100 countries. CIMASL was originally formed in 1965 under the name “Ceylon Association of Cost and Works Accountants UK”. In 1973 it was made a branch of the UK body and in 1988 was elevated to the status of a Division. The Division had 1,434 resident members as of May 2001—many of whom are also ICASL members.

7. Quality Control and Assurance

In comparison to international guidelines and norms (see Appendix 11), the Sri Lankan accountancy profession does not currently emphasize quality control assurance over professional practices. However, ICASL has recently initiated moves to investigate and implement quality control arrangements.

8. Issue Synopsis: Professional Infrastructure

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding Sri Lanka’ professional accountancy infrastructure:

- ICASL membership is a requirement in order to conduct audits and discharge other statutory duties in Sri Lanka. However, in contrast to international guidelines, CPE is not a mandatory requirement for continued membership. This is consistent with the current UK practice (ICAEW).
- Public sector accountants and auditors lack adequate professional representation and qualifications.

IV. Accounting and Auditing Standards

This chapter describes the accounting and auditing standards that govern the preparation of external financial reports and their audit. It comprises 13 sections as follows:

Part One: Accounting Standards

- 1 – Introduction – reviews the historical development of Sri Lankan accounting standards.
- 2 – Accounting Standards Committee (ASC) – outlines the role, composition and activities of ASC, the primary accounting standard-setting body.
- 3 – Accounting Standard Setting Process – describes the accounting standard-setting process.
- 4 – Sri Lankan Accounting Standards – describes Sri Lankan accounting standards.
- 5 – Conformity with International Accounting Standards (IAS) – examines differences between Sri Lankan accounting standards and IASs.
- 6 – Public Sector Accounting Standards – describes the standards that govern public sector reporting.
- 7 – Taxation Reporting Requirements – reviews the relationship between financial reporting and taxation reporting practices.

Part Two: Auditing Standards

- 8 – Introduction – describes the historical development of Sri Lankan auditing standards.
- 9 – Auditing Standards Committee (AuSC) – outlines the role, composition and activities of the AuSC, which is the auditing standard-setting body.
- 10 – Auditing Standard Setting Process – discusses the audit standard-setting process.
- 11 – Sri Lankan Auditing Standards – describes Sri Lankan auditing standards.
- 12 – Comparison with International Standards on Auditing (ISA) – examines differences between Sri Lankan auditing standards and ISAs.
- 13 – Issue Synopsis: Accounting and Auditing Standards – summarizes the issues identified in this chapter.

Part One. Accounting Standards

1. Introduction

Before 1970, Sri Lankan financial reporting requirements were based upon the prescriptions of the *Companies' Ordinance of Ceylon*, contemporary UK legislation and the recommendations of ICAEW. On 1 April 1970, ICASL issued the first SLAS, SLAS I: *The treatment of dividends duly grossed in the balance sheets and appropriation statements of companies*.⁷⁷ However, the use of SLASs was not legally mandated, other than for publicly quoted companies, financial institutions and insurance companies.⁷⁸

A number of Sri Lankan finance companies collapsed in the late 1980s and early 1990s. Many small depositors lost their savings and significant fiscal costs were incurred in bailouts. In response, the Government established the *Presidential Commission on Finance and Banking* to investigate and strengthen financial sector arrangements. Among other things, the *Commission* recommended that international accounting and auditing standards be adopted to improve financial disclosure.⁷⁹

To this end, the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995* was developed by government officials, the accountancy profession, and representatives from the commercial and financial sectors. Together with subsidiary regulations, the Act defines certain enterprises as SBEs and governs the preparation, presentation and audit of financial statements of SBEs for periods commencing on or after 1 January 1999.

The Act requires all SBEs to prepare and present financial statements in accordance with SLASs. It also empowers ICASL to adopt suitable accounting standards from time to time. These standards have legal effect once they have been published in the *Gazette*. SLASs relating to banks must have the concurrence of the Banking Supervision Department of the Central Bank. The ASC, an ICASL committee, was established to undertake the accounting-standard-setting process. The Act also established the independent SLAASMB to monitor SBE compliance with SLASs.

The Sri Lankan regime for promulgating accounting standards, and monitoring compliance with these standards, is a world leader. It is particularly appropriate for application in developing and transitional

⁷⁷ Wickramarachchi, M. W. 1978. *Accounting Research Study No. 6: An Examination of Selected Financial Reporting Practices of Public Companies in Sri Lanka*. University of New England, Armidale: Department of Accounting and Financial Management. p. 4.

⁷⁸ US State Department. 1999. *Country Commercial Guides for FY 2000: Sri Lanka*.

⁷⁹ World Bank. 1998, July 31. *Sri Lanka: Financial Sector Reforms*. p. 3.

markets, which tend to lack effective investor monitoring. In this respect, other developing and transitional countries should be encouraged to examine the Sri Lankan model with a view to strengthening their financial reporting and disclosure practices.

2. Accounting Standards Committee (ASC)

ICASL established the ASC in accordance with the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995*. This Committee is responsible for making recommendations and assisting the Institute to develop and promulgate SLASs.

The ICASL promulgates SLASs in accordance with Sections 2(1) and 8(1) of the Act. In keeping with the recommendations of the *Presidential Commission on Finance and Banking*, SLASs are directly based on the IASs promulgated by the IASB. It is a condition of ICASL's IFAC membership that the Institute works towards implementation of IASs.

The first Committee under the Act was established in June 1996. Within six months it had reviewed the IAS Framework and all IASs (up to IAS 27), and published a book of Sri Lankan Accounting Standards.⁸⁰

The ASC comprises 12 members, who are drawn from professional accountancy bodies, regulatory bodies, and user groups (see Table 11). Members are appointed for four-year terms under Section 10(2) of the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995*. 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 and the ASC's activities are funded entirely by ICASL (In contrast to the SLAASMB).

Table 11. Membership of the Accounting Standards Committee⁸¹

Organization	Members	Nomination and Appointment
ICASL	1	President.
	5	Five other members nominated by the Institute's Council.
CIMASL	1	Nominated by CIMASL.
Registrar of Companies.	1	Registrar of Companies.

⁸⁰ ICASL. 1999. *Sri Lanka Accounting Standards 1999*. President's Message to 1999 Edition. Colombo: ICASL.

⁸¹ Ratnayake, Ajith S. (Director-General, SLAASMB). 2000. *Scope and Functions of the Accounting and Auditing Standards Monitoring Board*. www.sec.gov.lk

Table 11. Membership of the Accounting Standards Committee *(continued)*

Organization	Members	Nomination and Appointment
Central Bank of Sri Lanka	1	Nominated by the Governor of the Central Bank.
SEC	1	SEC Director-General.
Ceylon Chamber of Commerce.	1	Company director or other person with extensive senior management experience in a specified business enterprise, nominated by the Ceylon Chamber of Commerce.
Federation of Chambers of Commerce and Industry of Sri Lanka	1	Company director or other person with extensive senior management experience in a specified business enterprise, nominated by the Federation of Chambers of Commerce and Industry of Sri Lanka.

3. Accounting Standard Setting Process⁸²

The ASC's standard-setting process is broadly similar to that of the IASB and the US Financial Accounting Standards Board (FASB), except that the process focuses on reviewing IASs for adoption in Sri Lanka. Although the Committee aims to achieve complete consistency between SLAs and IASs, modifications are sometimes made to reflect country-specific factors. The ASC's standard-setting process is as follows:

- The ASC invites interested parties to comment on the targeted IAS.
- The ASC appoints a subcommittee, chaired by an ASC member, to study the IAS.
- The subcommittee studies the IAS, taking into consideration any comments from interested parties.
- The subcommittee prepares a draft SLAS, modified as necessary, and presents it to the ASC.
- The ASC conducts a public seminar, to explain the proposed SLAS, and to obtain further public comments.
- The subcommittee reviews the draft SLAS, taking into consideration any further public comments, and recommends the SLAS for adoption to the ASC.
- The ASC discusses the proposed standard with the subcommittee Chair and determines the nature and contents of the final standard

⁸² Primary Source: Ratnayake, Ajith S. (Director-General, SLAASMB). 2000. *Scope and Functions of the Accounting and Auditing Standards Monitoring Board*. www.sec.gov.lk

that it will recommend to the ICASL Council for adoption. Under ASC rules, at least three-quarters of members must support a standard, before it is recommended to the ICASL Council for adoption.

- The ICASL Council then adopts the SLAS in accordance with Section 2 of the *Sri Lanka Accounting and Auditing Standards Act (No.15) 1995*.
- The adopted SLAS must be published in the *Gazette*. It becomes effective from the date of publication, or from a later date as specified in the SLAS.
- In order to be gazetted, the SLAS must be translated into Sinhala and Tamil. The first batch of 28 SLASs was translated with ADB assistance under the Financial Management Training Project.

The first set of SLASs promulgated through this process was published in *Gazette Extraordinary No.1056/19* (2 December 1998). These standards applied to financial reporting on financial periods commencing on, or after, 1 January 1999.

4. Sri Lankan Accounting Standards (SLASs)

Twenty-eight SLASs were effective as of 30 June 2001. Table 12 lists the effective SLASs and identifies divergences with IASs. Differences between SLASs and IASs are examined more closely in the following section.

Table 12. Sri Lankan SLASs as at 30 June 2001⁸³

No. Title	Parentage	Effective
... Framework for the Preparation and Presentation of Financial Statements	IAS Framework	
3 Presentation of Financial Statements	IAS 1	Apr 2000
5 Inventories	IAS 2	Jan 1996
8 Depreciation Accounting	IAS 4	Apr 1986
9 Cash Flow Statements	IAS 7	Jan 1996
10 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	IAS 8	Jan 1996
11 Research and Development Costs	IAS 9 (superseded by IAS 38)	Jan 1996
12 Contingencies and Events Occurring After the Balance Sheet Date	IAS 10 (superseded by revised IAS 10 and IAS 37)	Jan 1980

⁸³ Sources:

- ICASL. 1999. *Sri Lanka Accounting Standards 1999*. Colombo: ICASL.
- SLAAMSB. 2001. *Status of Sri Lankan Accounting Standards in Relation to International Standards*. www.slaasmb.org

Table 12. Sri Lankan SLAs as at 30 June 2001 *(continued)*

No.	Title	Parentage	Effective
13	Construction Contracts	IAS 11	Jan 1996
14	Accounting for Taxes on Income	IAS 12 (superseded by revised IAS 12)	Jan 1984
16	Retirement Benefits Costs	IAS 19 (superseded by revised IAS 19)	Jan 1996
18	Property, Plant and Equipment	IAS 16 (superseded by revised IAS 1, 22, 26 and 37)	Jan 1996
19	Accounting for Leases	IAS 17	Jan 2001
20	Borrowing Costs	IAS 23	Jan 1996
21	The Effects of Changes in Foreign Exchange Rates	IAS 21	Jan 1996
22	Accounting for Investments	IAS 25	Apr 1991
23	Revenue Recognition and Disclosures in the Financial Statements of Banks	IAS 30	Jan 1992
24	Accounting for Government Grants and Disclosure of Government Assistance	IAS 20	Apr 1991
25	Business Combinations	IAS 22 (superseded by revised IAS 12, 36, 37 & 38)	Jan 1996
26	Consolidated Financial Statements and Accounting for Investments in Subsidiaries	IAS 27	Jan 1992
27	Accounting for Investments in Associates	IAS 28 (superseded by revised IAS 36)	Jan 1992
28	Segment Reporting	IAS 14	Apr 2000
29	Revenue	IAS 18	Jan 1996
30	Related Party Disclosures	IAS 24	Apr 1992
31	Financial Reporting of Interests in Joint Ventures	IAS 31 (superseded by revised IAS 36)	Jan 1993
32	Plantations	IAS 41 (Agriculture) subsequently issued in 2000	Jan 1994
33	Revenue Recognition and Disclosures in the Financial Statements of Finance Companies	IAS 30	Apr 1995
34	Earnings per Share	IAS 33	Apr 2000

Five issues warrant attention in relation to SLAs. First, the IASB holds exclusive copyright over IASs. In this respect, the ICASL has obtained permission from the IASB to use its materials, including IASs. Other DMCs should be encouraged to follow Sri Lanka's approach.

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Second, IAS and IAS-related materials are highly priced—a copy of IAS 1 is available from the IASB for \$48—this is cheap compared to IAS 39 at \$71. To effectively adopt IAS-compliant accounting standards, developing countries must have affordable access to IAS explanatory and training materials—every accountancy teacher and accountant should have copies of these materials. IASB's pricing policy is inconsistent with its objectives. Moreover, it fails to recognize that the international community has funded the development of these materials (IASB's activities are financed by professional accountancy bodies and other organizations on its Board, by IFAC, and by contributions from companies, financial institutions, accounting firms, and other organizations).

Third, SLASs include a section that compares the SLAS to the equivalent IAS. Once again, other DMCs should be encouraged to follow Sri Lanka's approach.

SLAS 5 *Inventories*: Compliance with IAS⁸⁵

Compliance with this SLAS ensures compliance in all material respects with International Accounting Standard IAS 2, *Inventories*.

⁸⁴ Source: www.iasc.org.uk

⁸⁵ ICASL. 1999. *Sri Lanka Accounting Standards 1999*. Colombo: ICASL. p. 112.

Fourth, the IASB came into being in April 2001 and intends to undertake an *Improvements Project* (see Appendix 7) focusing on: (i) eliminating explicit or implicit choices; (ii) eliminating conceptual inconsistencies between IASs; (iii) providing additional guidance; (iv) identifying additional disclosures; (v) making drafting improvements; and (vi) improving the structure of standards. The *Improvements Project* is additional to the issuance of further EDs and standards. Consequently, as there will be many changes to IASs in the next five years, it will be difficult for Sri Lankan SLASs to keep abreast of these changes. In this respect, SLASs are already slightly out-of-step with certain IASs that have been recently revised or issued (see, for instance, IAS 16 and IAS 36).

Fifth, IASs are particularly intended for financial reporting by publicly listed companies. Small and medium-sized enterprises generally do not have the capacity to correctly apply the provisions of certain standards, such as IAS 39 *Financial Instruments, recognition and measurement* and IAS 19 *Employee Benefits* (see Box 3).

**Box 3. Practical Problems Meeting the Requirements of IAS 19
*Employee Benefits***

Sri Lankan organizations must provide employee retirement benefits at a rate of one-half month's salary for every year of completed service. SLAS 16 *Retirement Benefits Costs* (largely equivalent to IAS 19 *Employee Benefits*) effectively requires an actuarial valuation to calculate the value of such benefits for financial disclosure purposes.

Given the dearth of Sri Lankan actuaries—and the potential costs for SMEs—ASC opted to suspend the actuarial valuation requirement for a period of three years commencing 1 January 1999 (Gazette Extraordinary No.1103/18 of 28 October 1999). Instead, Sri Lankan companies are required to calculate the liability at its undiscounted face value. Although significantly overstating employee benefit liabilities—in comparison to the IAS 19 treatment—the calculation is simple to apply and audit.

In April 1998, a project to examine the reporting requirements for SMEs was added to the IASB agenda—however no progress has been made to date and further activity has yet to be determined by IASB. Possible issues that relate to this, include: (i) whether IASB should develop a basic accounting system for developing countries, comprising procedural standards and guidelines similar to the French *Plan Comptable*; (ii) whether there should be different accounting standards or different disclosure standards for enterprises in developing countries and economies in transition; and (iii) whether there are special problems with applying existing IASs in developing or transition countries.

In July 2000, IASB staff attended the most recent session of the UN Intergovernmental Working Group of Experts on International Standards

of Accounting and Reporting (ISAR), which discussed SME accounting and reporting, and suggested that a 'progressive' system of reporting formats be developed. At the session, ISAR specified that the proposed framework should: (i) be simple, understandable and user-friendly; (ii) produce useful management information; (iii) be as standardized as possible; (iv) be flexible enough to accommodate the business growth and increase the potential of some SMEs as they expand to use IASs; (v) be easily reconcilable for tax purposes; and (vi) recognize the environment in which SMEs operate

ISAR mandated an *ad hoc* working party to prepare a set of voluntary guidelines as to how those countries that wished to review their accounting regulatory structure might install a system that was both coherent throughout, adapted to the needs of SMEs at the entry level and permitted a logical progression in line with company growth.

IASB staff attended an ISAR working party meeting in May 2001 to discuss the proposals that were later put before the annual ISAR conference in September 2001. The proposals aimed to provide a model framework for national accounting regulators that will cover the whole range of accounting entities from the one-person business through to the listed company.⁸⁶

At the September 2001 meeting, ISAR agreed a categorization methodology for entities and requested that the *ad hoc* working party further refine the proposals for SME reporting.

However, although the use of IAS-compliant accounting policies by Sri Lankan organizations currently creates difficulties in the absence of a differential reporting regime, the ICASL has initiated a project to develop an SME reporting standard on the lines taken by the United Kingdom.

5. Conformity with International Accounting Standards (IAS)

As a consequence of the ASC's decision to make SLASs IAS-compliant, there are few material differences, except for the following variances that this study identified.

IASs not adopted (yet) by Sri Lanka:

IAS 15	Information reflecting the effects of changing prices (SLAS17 was withdrawn).
IAS 26	Accounting and reporting by retirement benefit plans.
IAS 29	Accounting and reporting in hyperinflationary economies.

⁸⁶ Source: www.iasc.org.uk

IAS 32	Financial instruments, disclosure and presentation.
IAS 35	Discontinued operations (partly dealt with in SLAS 10).
IAS 36	Impairment of assets.
IAS 38	Intangible assets (partly dealt with in SLAS 25).
IAS 39	Financial instruments, recognition and measurement.
IAS 40	Investment property.
IAS 41	Agriculture.

SLASs which have been drafted or adopted, but have not been issued:

SLAS 12	Events after the balance sheet date (draft standard based on IAS 10).
SLAS 35	Interim financial reporting (draft standard based on IAS 34).
SLAS 36	Provisions and contingent assets and liabilities (Adopted but not yet issued, based on IAS 37).

Sri Lankan standards based upon *IASs that have been withdrawn*:

SLAS 8	Depreciation accounting IAS 4 (superseded by IAS 16, 22 and 38).
SLAS 11	Research and development costs IAS 9 (superseded by IAS 38 Intangible Assets).
SLAS 15	Presentation of current assets and current liabilities.
SLAS 22	Accounting for investments IAS 25 (superseded by IAS 39 & 40).

***Country-specific national standards* that have been developed:**

SLAS 32	Plantations.
SLAS 33	Revenue recognition and disclosure in the financial statements of financial companies.

***Non-comparable SLASs* (due to significant differences):**

IAS 12	Income taxes (SLAS 14 Accounting for taxes on income).
IAS 19	Employee benefits (SLAS 16 Defined contribution plans).

There are the following ***content differences with IASs***:

IAS		Differences
16	Property, plant and equipment	The SLAS is completely consistent with the pre-1998 IAS 16. However, IAS 16 was revised in 1998 and, as part of the revision process, IAS 36 (Impairment losses) was issued. SLASs have not been updated to reflect these revisions.
31	Financial reporting of interest in joint ventures	Revisions made to the IAS regarding Impairment Losses have not been adopted. Instead, declines other than temporary in the carrying value of long-term assets should be recognized.

6. Public Sector Accounting Standards

Sri Lankan government organizations can be categorized into: (i) ministries, departments and constitutional bodies, such as the Auditor-General's Office; (ii) nonrevenue-earning statutory bodies and public enterprises; and (iii) revenue-earning statutory bodies and public enterprises. The *Sri Lankan Accounting and Auditing Standards Act (No. 15) 1995* requires that the latter group report in accordance with SLASs.

Groups (i) and (ii) are required to report in accordance with the *Financial Regulations 1992* issued by MOFP's Public Finance Department Planning.⁸⁷ These groups prepare cash-based budgets and financial reports. The *Financial Regulations* do not prescribe accounting standards in this respect. The Government is considering introducing accrual budgeting and accounting as part of the Public Expenditure Management Reform Program.

In 1996, the Public Sector Committee (PSC) of IFAC initiated a project to prepare a set of International Public Sector Accounting Standards (IPSASs). The benefits of improved governmental financial reporting and the corresponding improvement in transparency were recognized by international and regional organizations, including ADB, the World Bank, the IMF and the United Nations Development Programme (UNDP), all of which provided funding for the public sector accounting standards project.

On 24 May 2000, IFAC formally released the first IPSASs (see Appendix 6). They are the first set of accounting standards applicable to public sector reporting and are intended to meet the needs of governments, ministers, taxpayers and credit-rating agencies. The standards apply to all levels of government and will provide governments with a platform on which to base improvements in their financial management and reporting practices. Further IPSASs are currently being developed.

The PSC recognizes that many governments may not yet be in a position to adopt the accrual-based IPSASs. To assist these governments, the PSC has also developed ED-9 *Financial Reporting under the Cash Basis of Accounting*. ED-9 sets out the requirements for the presentation of the primary financial statement under the cash basis of accounting, as well as the statement's structure and minimum content requirements. The requirements that are likely to emerge in this standard should lead to transparency where governments remain on the cash basis of reporting.

⁸⁷ Government of Sri Lanka. 1992. *Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka*. Department of Government Printing: Colombo.

Although public corporations report largely in accordance with SLASs, there are no accounting standards for Sri Lankan public sector budgeting and reporting. Although the Government has stated its intention to adopt the accrual-based IPSASs as the basis for government budgeting and accounting, this is likely to take some years to achieve. In the interim, the requirements of ED-9, which calls for preparation of a standard cash flow statement (i.e., where flows are categorized into cash flows from operating, investing and financing) could be met by the existing Computerized Integrated Government Accounting System (CIGAS), with few modifications.

7. Taxation Reporting Requirements

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.

Part Two. Auditing Standards

8. Introduction

As already described (see page 54), the findings and recommendations of the *Presidential Commission on Finance and Banking* foreshadowed the passage of the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995*. The Act empowers the ICASL to adopt from time to time, appropriate SLAuSs.

To assist the Institute in promulgating SLAuSs, the Act provides for the AuSC, which was established in June 1996. The AuSC promulgates SLAuSs, which are based directly upon IAASB pronouncements. The ICASL is obliged, as a member of IFAC, to work towards implementation of ISAs. The AuSC issued a new set of SLAuSs in May 1997. These replaced the auditing standards that had been issued in the mid-1970s and had only been subjected to minor modifications in the interim.⁸⁸

The Act stipulates that only a professionally qualified auditor, who is an ICASL member holding a Certificate to Practice, may audit SBE accounts. The Act makes the SLAASMB responsible for monitoring the application of SLAuSs in the conduct of SBE audits.

⁸⁸ ICASL. 1997. *Sri Lanka Auditing Standards 1997*. President's Foreword. Colombo: ICASL.

9. Auditing Standards Committee (AuSC)

The Committee comprises eight members are appointed under Section 9(1) of the *Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995*. Four Committee members must also be ASC members. As with the ASC, and in contrast to the SLAASMB, the AuSC's activities are funded entirely by the ICASL.

10. Auditing Standard Setting Process

The promulgation process for SLAuSs is similar to that for SLASs (see page 56). SLAuSs are based on the ISAs published by the IAASB.

The first 28 new SLAuSs were published in all three languages in the Gazette Extraordinary No. 1056/19 of 2 December 1998. ADB supported the translation process under the Financial Management Training Project.⁸⁹

11. Sri Lankan Auditing Standards

Twenty-eight SLAuSs were effective as of 30 June 2001 (Table 13 refers).

Table 13. Sri Lankan SLAuSs as at 30 June 2001⁹⁰

No. Title	Parentage	Effective
... Framework of SLAuSs	ISA 120	
Responsibilities:		
1 Objective and General Principles Governing an Audit of Financial Statements	ISA 200	Jan 1998
2 Terms of Audit Engagements	ISA 210	Jan 1998
3 Quality Control for Audit Work	ISA 220	Jan 1998
4 Documentation	ISA 230	Jan 1998
5 Fraud and Error	ISA 240	Jan 1998
6 Consideration of Laws and Regulations in an Audit of Financial Statements	ISA 250	Jan 1998
Planning:		
7 Planning	ISA 300	Jan 1998
8 Knowledge of the Business	ISA 310	Jan 1998
9 Audit Materiality	ISA 320	Jan 1998

⁸⁹ ICASL. 2000. *Institute of Chartered Accountants of Sri Lanka 1999 Annual Report*. p. 18.

⁹⁰ ICASL. 1997. *Sri Lanka Auditing Standards 1997*. Colombo: ICASL.

Table 13. Sri Lankan SLAuSs as at 30 June 2001 (*continued*)

No. Title	Parentage	Effective
Internal Control:		
10 Risk Assessment and Internal Control	ISA 400	Jan 1998
11 Auditing in a Computer Information System (CIS) Environment	ISA 401	Jan 1998
12 Audit Considerations Relating to Entities Using Service Organizations	ISA 402	Jan 1998
Audit Evidence:		
13 Audit Evidence	ISA 500	Jan 1998
14 Audit Evidence: additional considerations for specific items	ISA 501	Jan 1998
15 Initial Engagements - Opening Balances	ISA 510	Jan 1998
16 Analytical Procedures	ISA 520	Jan 1998
17 Audit Sampling	ISA 530	Jan 1998
18 Audit of Accounting Estimates	ISA 540	Jan 1998
19 Related Parties	ISA 550	Jan 1998
20 Subsequent Events	ISA 560	Jan 1998
21 Going Concerns	ISA 570	Jan 1998
22 Management Representations	ISA 580	Jan 1998
Using the Work of Others:		
23 Using the Work of Another Auditor	ISA 600	Jan 1998
24 Considering the Work of Internal Auditing	ISA 610	Jan 1998
25 Using the Work of an Expert	ISA 620	Jan 1998
Audit Conclusions and Reporting:		
26 The Auditor's Report on Financial Statements	ISA 700	Jan 1998
27 Corresponding Figures	ISA 710	Jan 1998
28 Other Information in Documents Containing Audited Financial Statements	ISA 720	Jan 1998

Four issues deserve attention in relation to SLAuSs. First, the IFAC holds exclusive copyright over ISAs. In this respect, the ICASL has obtained permission from IFAC to use its materials, including ISAs. Other DMCs should be encouraged to follow Sri Lanka's approach. Second, ISAs and ISA-related materials are much more reasonably priced than IASs. They are also available via the Internet (www.ifac.org). Third, SLAuSs include a section that compares the SLAuS to the equivalent ISA. Once again, other DMCs should be encouraged to follow Sri Lanka's approach.

SLAuS 13 *Audit Evidence*: Compliance with ISAs⁹¹

Compliance with this SLAuS ensures compliance in all material respects with International Standard on Auditing ISA 500.

⁹¹ ICASL. 1997. *Sri Lanka Auditing Standards 1997*. ICASL: Colombo. p. 119.

Fourth, in keeping with ISAs, SLAuSs include a section that provides a public sector perspective on the standard. Once again, other DMCs should be encouraged to follow Sri Lanka's approach.

SLAuS 2 *Terms of Audit Engagements*: Public Sector Perspective⁹²

The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagement letters when undertaking an audit.

12. Comparison with International Standards on Auditing (ISA)

The IAASB works to improve the uniformity of auditing practices by issuing pronouncements on auditing issues and promoting their acceptance. Its key pronouncements are ISAs and International Auditing Practice Statements (IAPs). The list of ISAs and IAPs that were effective at 30 June 2001 is provided as Appendix 5.

National standards on auditing and related services that have been published in many countries differ in form and content. The IAASB recognizes these documents and differences and, in the light of this knowledge, issues ISAs that are intended for international acceptance. ISAs are to be applied in the audit of financial statements. ISAs are also to be applied, adapted as necessary, to the audit of other information and to related services. These standards outline basic responsibilities for auditors, help them cope with increased and changing demands for financial statement information, and provide guidance in specialized areas, such as auditing computerized information systems. They are codified and available in a bound volume or through an electronic subscription service. IAPs provide practical assistance to auditors in implementing the standards or on related subjects and promote good practice. These statements are not intended to have the authority of standards.

As a consequence of the AuSC's decision to make SLAuSs ISA-compliant, there are few material differences, except for the following variances that this study identified.

⁹² *Ibid.* p. 26.

ISAs not adopted by Sri Lanka:

ISA 505 External confirmations

ISAs adopted as Sri Lankan Auditing Practice Statements:

ISA 800 The auditors report on special purpose audit engagements.

ISA 810 The examination of prospective financial information.

ISA 910 Engagements to review financial statements.

ISA 920 Engagements to perform agreed upon procedures regarding financial information.

ISA 930 Engagements to compile financial information.

IAPs not adopted by Sri Lanka:

IAPS 1000* Inter-bank confirmation procedures.

IAPS 1001* Computer Information System (CIS) environments: standalone microcomputers.

IAPS 1002* CIS environments: online computer systems.

IAPS 1003* CIS environments: database systems.

IAPS 1004* The relationship between bank supervisors and external auditors.

IAPS 1005 Particular considerations in the audit of small business.

IAPS 1006 The audit of international commercial banks.

IAPS 1007* Communications with management.

IAPS 1008 Risk assessments and internal control: CIS characteristics and considerations.

IAPS 1009* Computer assisted techniques.

IAPS 1010 The consideration of environmental matters in the audit of financial statements.

IAPS 1012 Auditing Derivative Financial Instruments

IAPS 1013 Electronic Commerce: Effect on the Audit of Financial Statements

* under consideration for adoption as of March 2002.

There are *no content differences with ISAs*. However, in addition to the provisions of ISA 700 (The Auditor's Reports on Financial Statements), a Sri Lankan audit report must also cover whether: (i) the books of account agree with the financial statements; (ii) the company maintained proper books of account; (iii) the financial statements were prepared according to accounting standards; (iv) the financial statements provide information required by the Companies Act; and (v) any directors' interests in contracts have been disclosed.

13. Issue Synopsis: Accounting and Auditing Standards

Other countries should consider the following aspects of Sri Lanka's arrangements regarding accounting and auditing standards. First, the ICASL has obtained permission from the IASB to use its materials, including IASs. Second, SLASs include a section that compares the

SLAS to the equivalent IAS. Third, the ICASL has obtained permission from IFAC to use its materials, including ISAs. Fourth, SLAuSs include a section that compares the SLAuS to the equivalent ISA. Fifth, SLAuSs include a section that provides a public sector perspective on the standard.

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding Sri Lankan accounting and auditing standards:

- In contrast to SLAASMB activities, the standing-setting activities of the ASC and the AuSC are entirely reliant on voluntary efforts. This potentially constrains Sri Lanka's ability to maintain country standards in line with international standards.
- IASs are particularly intended for financial reporting by publicly listed companies. SMEs generally do not have the capacity to correctly apply the provisions of certain standards, such as IAS 39 (Financial instruments, recognition, and measurement) and IAS 19 (Employee benefits). In this respect, the application of IAS-compliant accounting policies by Sri Lankan organizations creates difficulties in the absence of a differential reporting regime.
- A gap has emerged between SLASs and IASs. In the absence of corrective actions or arrangements, this gap will widen as the IASB reviews existing IASs and issues new standards.

V. Accounting and Auditing Training

This chapter describes accounting and auditing education and training. It is structured as follows:

- 1 – Introduction – describes the development of accountancy education in Sri Lanka and introduces some of the key issues.
- 2 – Educational Coordination – discusses the coordination of accountancy education within Sri Lanka.
- 3 – International Standards and Guidance on Accountancy Education – describes international standards and guidance in relation to accountancy education and training.
- 4 – Higher Education Institutions – describes the providers of tertiary accountancy education.
- 5 – Sri Lanka Institute of Development Studies (SLIDA) – describes the activities of SLIDA.
- 6 – The Institute of Government Accounts and Finance (InGAF) – describes the activities of InGAF.
- 7 – Training by Professional Bodies – briefly describes the training activities of professional accountancy bodies.
- 8 – Issue Synopsis: Accounting and Auditing Education and Training – summarizes the issues identified in this chapter.

1. Introduction

The origins of Sri Lankan technical education go back to 1883 when the Government Technical School (Ceylon Technical College) was established with 25 students. This institution offered the country's first commerce course in 1908.

Following independence, the Government recognized that technicians and professionals were necessary for economic development—to this end it established the *Commission of Inquiry on Technical Education* in 1963.⁹³ The *Commission* found that there were only 271 financial accountants and 15 cost accountants employed in Sri Lanka in 1961. Most of these had obtained their professional accounting qualifications from the UK. The *Commission* estimated that a further 120 qualified accountants would be required by 1970.⁹⁴

⁹³ Yapa, P.W. Senarath. 2001. *Empowering the Accounting Profession in Sri Lanka*. Paper presented to the Second Accounting History International Conference (Osaka, Japan): 8-10 August.

⁹⁴ Commission of Inquiry on Technical Education. 1963. Sessional Paper X-1963: Government Press Ceylon.

The *Commission's* findings put pressure on ICASL to increase the numbers of qualified accountants—the Institute responded by changing its training and qualification methods in the mid-1970s (see pages 43-44)—ICASL's membership subsequently increased to about 500 by 1980. However, these numbers were apparently still inadequate to meet Sri Lanka's social and economic needs. Although it has been contended that a major reason for the chartered accountant shortage is the excessively high failure rates in ICASL examinations, this reflects the Institute's efforts to (at least) match international best practices.

“Mainly due to high examination failure rates of ICASL, many prospective accountants have continued to depend on British professional bodies (such as CIMA, ACCA) for becoming professionally qualified accountants. Even today, students enroll in large numbers for locally conducted professional examinations of these British professional bodies. For example, the student enrolments for CIMA examinations have been about 5,110 in the year 1999. It is evident that these foreign professional examinations are based on the subject matter applicable to British economy. They are apparently not suitable to Sri Lanka. Some subjects covered in these exams such as British taxation, and British company law, are almost totally irrelevant to Sri Lankan environment. Moreover, a sizeable amount of foreign exchange has been flowing out of the country annually as subscriptions and examinations fees for these British professional bodies and associated correspondence colleges.”

– P.W. Senarath Yapa (p. 6)⁹⁵

Sri Lanka has primarily relied on professional bodies, rather than universities, for accountancy training—it was not until 1992 that the Sri Jayewardenepura University (USJ) 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.⁹⁶

In 1993, ADB concluded that certain key reform programs were being impeded by the severe shortage of financial management personnel. It

⁹⁵ Yapa, P.W. Senarath. 2001. *Empowering the Accounting Profession in Sri Lanka*. Paper presented to the second Accounting History International Conference (Osaka, Japan): 8-10 August.

⁹⁶ ADB. 1993 November 8. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Financial Management Training Project*. p. 5.

estimated that there was a shortfall of 500-1,000 professional accountants and 1,000-3,000 accounting technicians. Furthermore, ADB identified fundamental flaws in degree, diploma and certificate course structures—specifically mismatches between curricula and job slots (course content was not relevant to the needs of employers).⁹⁷ In response, the ADB-supported *Financial Management Training Project*⁹⁸ (1994-1999) supported improvements to accountancy education and training in: (i) universities; (ii) technical institutions; (iii) professional bodies; and (iv) specialist institutions (particularly InGAF).

The *Financial Management Training Project* addressed some of the 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.

This diagnostic study did not involve a quantitative analysis of accountancy skill shortages. However, there was 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 these shortages.

2. International Standards and Guidance on Accountancy Education

The international community has issued a variety of guidance on accountancy education. This guidance is relevant to Sri Lanka and includes:

- *Quality Issues For Internet and Distributed Learning in Accounting Education*. This IFAC Education Committee discussion paper discusses the environment that encourages the design, development and delivery of high-quality Internet and distributed learning in global accounting education. It offers recommendations for assessing the quality of Internet education and distributed learning.⁹⁹
- *Discussion Paper on Assistance Projects in Accountancy Education and Development*. This IFAC Education Committee discussion paper, which is based on the experiences of 15 IFAC member organizations, looks at some of the common aspects of successful aid and assistance projects and the impediments that can derail the process. It is meant to be of

⁹⁷ *Ibid.* p. 5.

⁹⁸ ADB Loan No. 1275-SRI: *Financial Management Training Project*, for \$13 million, approved on 29 November 1993.

⁹⁹ IFAC. 2000. *Quality Issues For Internet and Distributed Learning in Accounting Education*. New York: IFAC Education Committee. www.ifac.org

assistance to accountancy organizations and consultants involved in aid projects for the development of accountancy education, as well as potential donors.¹⁰⁰

- *International Education Guideline 9: Accounting Education and Experience*. This IFAC guideline sets out high-level curriculum expectations.¹⁰¹
- *Guideline for a Global Accounting Curriculum and Other Qualification Requirements*. This UNCTAD report sets out (i) requirements for the qualifications of professional accountants; and (ii) a guideline for national systems for the qualifications of professional qualifications.¹⁰²
- *Global Curriculum for the Professional Education of Professional Accountants*. This UNCTAD report sets out curriculum requirements including: (i) organizational and business knowledge; (ii) information technology; and (iii) accounting and accounting-related knowledge.¹⁰³

3. Educational Coordination

The *University Act (No. 3) 1989* and the *Sri Lanka Institute of Advanced Technical Education (SIATE) Act (No. 29) 1995* govern Sri Lankan higher education arrangements.

The University Grants Commission, a separate legal body operating under the Ministry of Education and Higher Education, administers overall policy making, resource allocation, university admission and other common functions.

4. Higher Education Institutions

Some of the issues regarding higher education were described in the chapter introduction. As of 31 December 2000, Sri Lanka had 13 universities (69,007 enrolled students), five postgraduate institutes (2,553 enrolled students), and six 'other' institutes (2,695 enrolled students).¹⁰⁴ Ten universities offer accountancy courses (see Table 14) and 14 technical colleges offer vocational accountancy training.

¹⁰⁰ IFAC. 2000. *Discussion Paper on Assistance Projects in Accountancy Education and Development*. New York: IFAC Education Committee. www.ifac.org

¹⁰¹ IFAC. 1996. *Guideline 9: Accounting Education and Experience*. New York: IFAC.

¹⁰² UNCTAD. 1999. *International Accounting and Reporting Issues: 1999 Review*. New York: UN.

¹⁰³ *Ibid.*

¹⁰⁴ Sri Lanka University Grants Commission (UGC). 2000 December. *University Statistics 2000*. Colombo: UGC.

Table 14. Students Enrolled in University Programs involving Accountancy (31 December 2000)¹⁰⁵

University	Bachelor of Commerce	Bachelor of Management	Total
Colombo	860	534	1,394
Peradeniya	2,356	...	2,356
Sri Jayewardenepura (USJ)	1,034	3,796	4,830
Kelaniya	799	1,080	1,879
Jaffna	327	399	726
Ruhuna	705	78	783
Babaragamuwa	...	387	387
Rajarata	...	326	326
Eastern	403	195	598
South-Eastern	138	148	286
Open	...	214	214
Total	6,622	7,157	13,779

Enrolments of females and males in accountancy programs are evenly balanced—the language of instruction varies by university and includes Sinhala, English and Tamil. There is high demand for entry to accountancy and related courses—only the very best students are able to meet the requisite entrance grades.

USJ offered the first Sri Lankan specialist undergraduate accountancy program in the early 1990s—the program was designed in collaboration with the ICASL and the medium of instruction is English. As part of the four-year program of accountancy studies, undergraduates are required to complete a 60-week program of practical training in a selected organization during the third and fourth years of the degree program. However, this accounting degree is yet to be recognized by ICASL as a sufficient qualification for meeting the examination requirement for membership.¹⁰⁶

The quality of facilities and academic staff varies significantly across institutions. However, despite staff retention issues and resource constraints, the best of these institutions are broadly comparable to academic institutions in developed countries.

¹⁰⁵ *Ibid.*

¹⁰⁶ Yapa, P.W. Senarath. 2001. *Empowering the Accounting Profession in Sri Lanka*. Paper presented to the second Accounting History International Conference (Osaka, Japan): 8-10 August.

5. Sri Lanka Institute of Development Studies (SLIDA)

SLIDA is a government training institution that provides courses for middle and senior levels of management. It is situated in Colombo and has substantial teaching facilities and residential accommodation. SLIDA offers a one-year Diploma in Public Finance Management (DPFM), which is open to all public sector employees.

6. The Institute of Government Accounts and Finance (InGAF)

InGAF offers a range of training programs for government accounting and auditing personnel. These training programs, and supporting materials, were developed through the ADB-supported *Financial Management Training Project*.¹⁰⁷ The project also supported InGAF equipment purchases and facilities upgrading.

InGAF training programs are conducted by academics and personnel from government organizations and cover: (i) computer systems; (ii) tender and procurement procedures; (iii) project administration and accounting; (iv) government accounting practices; (v) communication; (vi) modern management practices; and (vii) accounting theory and practice.

Around 500 public sector employees per month attend InGAF training courses. In July 2001, InGAF was offering courses on:

- How to Compare a Corporate Plan (two days)
- Presentation Skills (three days)
- Introduction to Computers (two days)
- Public Corporation Audits (two days)
- Training Program for Accounts Clerks in Public Enterprises (four days)
- Public Officers: Advance Account Activities (two days)
- Situational Leadership and Conflict Management (three days)
- Training Program for Accounts Clerks in Government Departments and Ministries (four days)
- Microsoft Excel (two days)
- Training of Accounts Assistants (two days)
- Tender Procedures (two days)
- Microsoft Word (two days)
- Accounting Fundamentals (three days)
- Foreign Aid Accounting (two days)

¹⁰⁷ ADB Loan No. 1275-SRI: *Financial Management Training Project*, for \$13 million, approved on 29 November 1993.

7. Training by Professional Bodies

The professional accountancy bodies (see Chapter III) conduct extensive training for prospective members, members and external parties. This training covers technical subjects such as auditing, taxation, management services, accountancy education, accounting principles, and information technology.

In the case of ICASL, over 14,000 Registered Students are studying for the Institute's examinations. The Institute provides education and training programs to its Registered Students through correspondence courses and lectures. Study halls are available to students and the Institute maintains a library for the benefit of students and members.

Furthermore, the Institute administers the practical training programs for its Registered Students. These programs are of at least three years duration, must be supervised by an Institute Member and must be with an approved practical training organization.

8. Issue Synopsis: Accounting and Auditing Education and Training

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding Sri Lankan accounting and auditing education and training:

- Sri Lanka has an historical shortage of qualified accountants. There have been initiatives to address this shortage—notably in the past decade through the ADB-supported *Financial Management Training Project*.
- These initiatives have had a significant impact, but there was 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 these shortages.
- Universities have only recently introduced accountancy programs. However—with a few exceptions—the content of these programs does not appear to meet employers' needs.
- The accountancy profession—particularly ICASL—could play a more positive role in encouraging improvements in the country's general educational standards.

VI. Government Budgeting and Accounting

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

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

1. Introduction

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

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

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

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

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

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

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

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

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

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

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

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

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

2. Legal Framework for Government Budgeting, Accounting and Auditing

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

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

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

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

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

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

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

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

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

3. Organizational Roles and Responsibilities

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

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

4. Budgeting, Accounting and Reporting Arrangements

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

5. Accounting Information Systems

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

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

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

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

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

6. Auditor-General's Department

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

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

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

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

7. Government Accounting Personnel

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

– Sanderatne, Nimal (pp. 18-19)¹¹⁸

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

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

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

8. Fiscal Devolution to Provincial Councils

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

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

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

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

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

9. Issue Synopsis: Government Budgeting and Accounting

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

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

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

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

VII. Donor Assistance

This chapter describes donor coordination mechanisms and discusses donor activities in relation to financial management and governance arrangements. It is structured as follows:

- 1 – Overview
- 2 – Coordination Mechanisms
- 3 – Asian Development Bank (ADB)
- 4 – International Monetary Fund (IMF)
- 5 – The World Bank
- 6 – United Nations Development Programme (UNDP)
- 7 – Canada (CIDA)
- 8 – Japan
- 9 – United States (USAID)

1. Overview

Japan, ADB and the World Bank are the largest donors to Sri Lanka. Significant assistance also continues to be provided by bilateral funding agencies (see Table 16).

2. Coordination Mechanisms

The External Resources Department of the Treasury is responsible for coordinating external assistance. The principal donor coordination mechanism in Sri Lanka is the Development Forum, chaired by the World Bank. The Development Forum is held every one to two years. ADB actively participates in the Development Forum, and since the opening of the Resident Mission in Colombo in October 1997, has been prominent in local donor coordination, particularly in the sectors where ADB has a major role, such as water, roads, energy, urban development, and natural resources and environment.

3. Asian Development Bank (ADB)

To 30 June 2000, ADB had provided 150 loans totaling \$7,549 million, since Sri Lanka joined ADB in 1966. Technical Assistance (TA) grants totaling \$113 million for 268 projects were provided in the same period.¹²¹

¹²¹ ADB. 2000 June. *Loan and Private Sector Operations Approvals for the Period Ending 30 June 2000*.

Table 16. Overall External Assistance to Sri Lanka¹²²

External Source (US\$ million)	1994 – 1998 (annual average)		1999 Approvals	
	Loan	Grant	Loan	Grant
Multilateral				
ADB	131.5	3.7	148.8	7.2
European Union (EU)	2.3	2.2	..	..
Nordic Development Fund	..	..	14.0	..
UN Group	..	14.0	..	5.3
World Bank Group	75.4	2.3	57.4	0.4
Other	2.8	0.2	11.1	0.3
Subtotal	211.9	22.4	231.3	13.2
Bilateral				
Australia	..	4.4	..	1.5
Canada	..	2.2	..	..
China, People's Republic of	1.0	1.0	..	..
Finland	3.7	..	..	..
France	2.9	..	..	..
Germany	28.5	11.7	37.5	10.6
India	5.3	..	..	..
Japan	331.0	58.2	206.7	23.1
Korea, Republic of	24.0	1.0	12.0	..
Kuwait	16.8	..	..	..
Netherlands	8.5	8.8	..	..
New Zealand	..	..	..	0.3
Norway	11.3	8.2	..	..
Sweden	8.6	0.2	..	2.6
United Kingdom	5.0	5.5	..	..
United States	45.5	32.9	..	9.9
Subtotal	492.1	134.1	256.2	48.0
Total	704.0	156.5	487.5	61.2

A country portfolio review was most recently undertaken in October 2000. Portfolio performance was characterized by delays in start-up and project implementation, caused by cumbersome and time-consuming contracting and procurement rules and procedures, and noncompliance with some major financial loan covenants.¹²³ As of 30 June 2000, audited accounts and financial statements were due for 34 loans, of which 26 complied, seven complied late and one did not comply.¹²⁴

¹²² ADB. 2000 December. *Country Assistance Plan (2001-2003): Sri Lanka*. p. 32.

¹²³ ADB. 2001. *ADB Annual Report for 2000*. Manila: ADB. p. 34.

¹²⁴ ADB. 2000 September. *Semi-Annual Report on Loan and Technical Assistance Portfolio Performance for the Period Ending 30 June 2000*. Manila: ADB. p. 70.

Loan Projects

The following loans are directly related to improving financial management and governance arrangements.

Loans 1800 and 1801: Private Sector Development Program (2001-2004)

ADB's Private Sector Development Program¹²⁵ is the latest attempt to promote private initiative and enhance the performance of financial markets. The first component of this loan aims at privatizing a number of large (and loss-incurring) public enterprises. The second component aims to encourage private sector investment in infrastructure. The third component focuses on strengthening competition policy and consumer protection. The fourth component seeks to reduce labor market rigidities, and the fifth to liberalize access to non-bank financial services.

Loan 1275: Financial Management Training (1994-1999)

This loan for \$13 million, approved on 29 November 1993, provided basic computing expertise and skills to a substantial number of civil servants at the national and sub-national levels. The project 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.

Technical Assistance

Along with assistance provided to executing agencies to strengthen their financial management capacity, assistance has been provided to coordinating agencies to improve their loan administration and accounting procedures (in relation to ADB projects). The relevant initiatives that ADB has supported, or is supporting, in relation to accounting and auditing include:

TA No. 3301-SRI: Public Expenditure Management Systems (2000-2002)

This TA for \$3 million, approved on 16 November 1999, aimed to support

¹²⁵ ADB Loan No. 1800(SF)-SRI: *Private Sector Development Program*, for \$85 million, approved on 12 December 2000 and Loan No. 1801-SRI: *Private Sector Development Program*, for \$15 million, approved on 12 December 2000.

the country in improving public expenditure management by addressing five closely related subprojects. These were: (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. The TA is intended to initiate a comprehensive program of reform in public expenditure management in the medium to long term. During 2002-2004, two loans and one project preparatory TA are included in ADB's country program for Sri Lanka. The planned assistance covers the implementation of a modern public expenditure management system and the decentralization of expenditure management at the provincial and local levels.

TA No. 2616-SRI: Public Administration Reform (1996)

This TA for \$275,000, approved on 24 July 1996, 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 (1986)

This TA for \$158,000, approved on 13 September 1985, assisted the government to develop an accounting and auditing education master plan. The Government noted the master plan recommendations regarding the need for middle-level financial personnel, and the AATSL was established in 1987.

4. International Monetary Fund (IMF)

The IMF has provided technical assistance to the Central Bank for modernization and training.

5. The World Bank

The World Bank is supporting modernization of the Central Bank of Sri Lanka (CBSL) through a \$30.3 million credit. The World Bank limited lending to the financial sector during the 1990s, due to the "Government's unwillingness to privatize the two large state banks."¹²⁶

¹²⁶ World Bank. 1998. *Country Assistance Strategy: Sri Lanka*. World Bank. p. 9.

Assistance 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.

6. United Nations Development Programme (UNDP)

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.¹²⁷

7. Canada (CIDA)

The CMASL was registered in June 1998 and launched in June 2001—it had 638 members as of June 2001. The Society was established with technical assistance from CMA Canada, funded by the Canadian International Development Agency (CIDA).

8. Japan

Japan is the largest donor to Sri Lanka. It provides official development loans and untied loans through the Japan Bank for International Cooperation (JBIC), and grants and technical assistance through the Japan International Cooperation Agency (JICA). Japan's country strategy for official development assistance emphasizes (i) strengthening economic infrastructure, especially in power, transport and industry, (ii) poverty reduction and regional development through promoting rural development and improving basic social services, (iii) environmental conservation and disaster management, and (iv) human resource development. Although Japan does not directly support financial management and governance activities, it provides indirect support through Japan-based education and training on financial and public management.

9. United States (USAID)

The United States Agency for International Development (USAID) provided support for the development of financial markets through the

¹²⁷ SRL/97/201: Public Sector Improvement.

Financial Markets Project (FMP)(1992–1997). Among other things, the FMP provided 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.

VIII. Issues and Recommendations

This chapter presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. These recommendations are intended to supplement and support existing strategies and projects, for instance the *Private Sector Development Program*.¹²⁸ Furthermore, the World Bank is currently undertaking a Country Financial Accountability Assessment (CFAA) of Sri Lanka. The CFAA is focused on the public sector and involves a detailed review of public sector arrangements and reform efforts to date—it will identify a comprehensive set of reform actions. These actions are likely to include some of the postponed parts of the refocused Public Expenditure Management Systems project (e.g., revision of the *Public Finance Act (No. 38) 1971* and development of internal auditing).¹²⁹ However, this study does not attempt to pre-empt the findings of the CFAA study.

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

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

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

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

qualifications for public sector accountants and establishing associated retraining courses.

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

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

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

Part One. Where Donor Assistance Might be Appropriate

1. Strengthen Government Accounting and Auditing

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

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

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

2. Strengthen Public Corporation Accountability through Legislative Amendments

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

3. Appoint Accountants to Public Corporation Boards

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

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

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

4. Strengthen Public Corporation Internal Auditing and Controls

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

5. Publish a Scorecard of Public Corporation Reporting

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

Part Two. Where External Assistance is Not Required

6. Create Chief Financial Officer Positions in Public Corporations

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

7. Require SLAASMB Review of all Public Corporation Annual Reports

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

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

8. Enhance Director Accountability

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

9. Close the Emerging Gaps Between SLASs and IASs

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

10. Enhance Auditor Independence and Objectivity

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

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

11. Make CPE Mandatory for Continuing ICASL Membership

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

12. Enhance Institutional Support for Financial Governance

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

13. Provide Resources to ICASL for Standing-Setting

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

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

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

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

14. Advocate Changes to IASB Copyright and Pricing

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

15. Encourage the Development of Financial Reporting Standards for SMEs

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

IX. Main Deficiencies and Action Plan

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. This study has identified several gaps and weaknesses that may be categorized as follows:

- Those deficiencies that are better able to be resolved with external assistance; and
- Those deficiencies that are able to be resolved without external assistance.

Issue	Priority	Donor Assistance?	Country Support?	2002 - 2006
1. Strengthen Government Accounting and Auditing (page 96).	High	✓	✓	■ ■ ■ ■
2. Strengthen Public Corporation Accountability through Legislative Amendments (page 97).	High	✓	✓	■ ■
3. Appoint Accountants to Public Corporation Boards (page 97).	High	✓	✓	■
4. Strengthen Public Corporation Internal Auditing and Controls (page 98).	High	✓	✓	■
5. Publish a Scorecard of Public Corporation Reporting (page 98).	High	✓	✓	■
6. Create Chief Financial Officer Positions in Public Corporations (page 98).	High	✗	✓	■
7. Require SLAASMB Review of all Public Corporation Annual Reports (page 98).	High	✗	✓	■
8. Enhance Director Accountability (page 99).	Med	✗	✓	■

Issue	Priority	Donor Assistance?	Country Support?	2002 - 2006
9. Close the Emerging Gaps Between SLASs and IASs (page 99).	Med	✗	✓	■ ■
10. Enhance Auditor Independence and Objectivity (page 99).	Med	✗	✓	■
11. Make CPE Mandatory for Continuing ICASL Membership (page 100).	Low	✗	... ¹³⁴	■ ■ ■ ■
12. Enhance Institutional Support for Financial Governance (page 100).	Low	✗	✓	■ ■
13. Provide Resources to ICASL for Standing-Setting (page 100).	Low	✗	✓	■
14. Advocate Changes to IASB Copyright and Pricing Policies (page 101).	Low	✗	✓	■ ■ ■ ■ ■
15. Encourage the Development of Financial Reporting Standards for SMEs (page 101).	Low	✗	✓	■ ■ ■ ■ ■

¹³⁴ Although an IFAC requirement, there was mixed support for this recommendation.

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Appendixes

Appendix 1.	Useful Internet Sites	113
	1. Regulatory and Standard-Setting Bodies	113
	2. Professional Bodies	113
	3. International Organizations	113
	4. Government Organizations	114
	5. Accounting Firms	114
	6. Financial Institutions	114
	7. Donor Organizations	115
Appendix 2.	Interviewees	116
Appendix 3.	RETA-5980 (Regional Study) Information	121
	1. Study Phases	121
	2. Phase I: Case Study On Accounting and Auditing	121
	3. Phase II: Colombo Workshop	121
	4. Phase III: Manila Workshop and Formulation of Action Plan	122
Appendix 4.	International Accounting Standards	123
Appendix 5.	International Standards on Auditing	124
	1. International Standards on Auditing (ISAs)	124
	2. International Auditing Practice Statements (IAPs)	125
Appendix 6.	International Public Sector Accounting Standards (IPSASs)	126
Appendix 7.	IASB Improvements Project (Potential Agenda)	129
Appendix 8.	Accounting and Auditing Standards Act 1995	130
Appendix 9.	Relevant Extracts from the 1990 SEC Rules	138
Appendix 10.	Relevant Extracts from the Banking Act 1988	140
Appendix 11.	International Standards and Guidelines on Professional Arrangements	146
	1. Overview	146
	2. Membership Requirements	148
	3. Quality Control and Assurance	149
Appendix 12.	ICASL Examination Syllabus	152
	1. Introduction	152
	2. Foundation Examination Syllabus	152
	3. Intermediate Examination Syllabus	153
	4. Final I Examination Syllabus	155
	5. Final II Examination Syllabus	157

Appendix 1. Useful Internet Sites

1. Regulatory and Standard-Setting Bodies

Central Bank of Sri Lanka	www.lanka.net/centralbank/
Financial Accounting Standards Board (FASB – United States)	www.fasb.org
International Accounting Standards Committee (IASC)	www.iasc.org.uk
International Federation of Accountants (IFAC)	www.ifac.org
Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)	www.slaasmb.org

2. Professional Bodies

Association of Chartered Certified Accountants (ACCA)	www.acca.co.org.uk
Canadian Institute of Chartered Accountants (CICA)	www.cica.ca
Ceylon Chamber of Commerce	www.lanka.net/chamber
Chartered Institute of Management Accountants (CIMA)	www.cima.org.uk
Confederation of Asian and Pacific Accountants (CAPA)	www.capa.com.my
Federation of Chambers of Commerce and Industry of Sri Lanka	www.fccisl.org
Institute of Certified Public Accountants of Singapore	www.acco.org.sg
Institute of Chartered Accountants in England and Wales (ICAEW)	www.icaew.co.uk
Institute of Chartered Accountants of Sri Lanka (ICASL)	www.icasrilanka.com
Institute of Internal Auditors (IIA) (United States)	www.theiia.org

3. International Organizations

Asia Pacific Economic Cooperation (APEC)	www.apecsec.org.sg
Association of Southeast Asian Nations (ASEAN)	www.asean.or.id

International Federation of Accountants
(IFAC) www.ifac.org

International Organization of Securities
Commissions (IOSCO) www.iosco.org

World Trade Organization (WTO) www.wto.org

4. Government Organizations

Board of Investment of Sri Lanka www.boisrilanka.org
Central Bank of Sri Lanka www.lanka.net/centralbank/

Securities and Exchange Commission
(SEC) www.sec.gov.lk

Sri Lanka Accounting and Auditing
Standards Monitoring Board (SLAASMB) www.slaasmb.org

Sri Lankan Government (information) www.lk/Government.html

University Grants Commission www.lk/ugc

5. Accounting Firms

Andersen www.andersen.com
Deloitte Touche Tohmatsu www.deloitteap.com
Ernst & Young www.ey.com
KPMG www.kpmg.com
PricewaterhouseCoopers www.pwcglobal.com

6. Financial Institutions

Banks and Financial Institutions

Bank of Ceylon www.lanka.net/boc
Commercial Bank www.combank.net

Development Finance Corporation of
Ceylon (DFCC) www.dffccbank.com

Hatton National Bank www.hnb.net

Hong Kong & Shanghai Banking
Corporation www.hsbc.lk/lk

Merchant Bank of Sri Lanka Ltd www.lanka.net/mbsl

National Development Bank (NDB) www.lanka.net/ndb/

National Savings Bank www.nsb.lk

Pan Asia Bank www.pabank.lk

People's Bank www.is.lk/is/peoples/

Pramuka Bank www.pramukabank.com

Sampath Bank	www.sampath.lk
Seylan Bank	www.seylan.lk
Standard Chartered Bank	www.standardchartered.com.lk
State Mortgage Bank	www.lanka.net/smib
Union Bank	www.unionb.com
Vanik Incorporation Ltd	www.vanik.lk
<i>Insurance Companies</i>	
Ceylinco Insurance	www.ccom.lk/ceylife/
The Finance Company Ltd	www.ccom.lk/thefinace
<i>Other</i>	
Colombo Stock Exchange	www.lanka.net/stocks

7. Donor Organizations

Asian Development Bank (ADB)	www.adb.org
International Monetary Fund (IMF)	www.imf.org
Japan Bank for International Cooperation (JBIC)	www.jbic.go.jp
Japan International Cooperation Agency (JICA)	www.jica.lk
United Nations Development Programme (UNDP)	www.undp.org
United States Agency for International Development (USAID)	www.usaid.gov
World Bank	www.worldbank.org

Appendix 2. Interviewees

Aspects of financial management and governance were discussed with the following people.

Sultan H. Rahman	Director	ADB, South Asia Department
Richard Allen	Advisor for Governance	ADB, Strategy and Policy Department
John R. Cooney	Resident Representative	ADB, Sri Lanka Resident Mission
Hua Du	Senior Programs Officer	ADB
Joseph E. Zveglic, Jr.	Deputy Resident Representative / Economist	ADB, Sri Lanka Resident Mission
Renato M. Limjoco	Lead Financial Sector Specialist	ADB
Shenuka Chanmugam	Project Analyst	ADB, Sri Lanka Resident Mission
A. R. W. M. M. A. Bandara	Senior Economist	Central Bank of Sri Lanka, Economic Research Department
C. J. P. Siriwardena	Senior Economist	Central Bank of Sri Lanka, Economic Research Department
Ranel T. Wijesinha	President	Institute of Chartered Accountants of Sri Lanka (ICASL)
	President	Confederation of Asian and Pacific Accountants (CAPA)
	Partner	PricewaterhouseCoopers, Lanka (Pvt) Ltd.

APPENDIXES

Asite Talwatte	President	ICASL
	Partner	Ernst & Young
Lakshman Perera	Secretary / Chief Executive	ICASL
Ranjith Ramanayake	Technical Director	ICASL
Dayanande Anderawawe	Director, Legal and Corporate Affairs	ICASL
Tissa Marusinghe	Director	Institute of Government Accounts and Finance (InGAF)
M. W. D. Ariyasena	President	Institute of Internal Auditors (IIA)
	Senior Partner	Ariyasena Millewa & Co. (Chartered Accountants)
N. Sri Pragasa	Chair of Education Committee	IIA
Gammacharige Jinnadasa	President	Institute of Public Finance Development Association (IPFDA)
Sinniah Sivagnanasuntharam	Secretary	IPFDA
Dr. P. B. Jayasundera	Secretary to the Treasury	Ministry of Finance and Planning (MOFP)
S. B. Divaratne	Deputy Secretary to the Treasury	MOFP
Faiz Mohideen	Deputy Secretary to the Treasury and Director-General, External Resources Department	MOFP
A. Abeygunasekera	Director	MOFP, External Resources Department
A. Kumarasiri	Deputy Director	MOFP, External Resources Department

W. Perera	Deputy Director	MOFP, External Resources Department
S. Abeysinghe	Director-General	MOFP, National Budget Department
W. D. Jayasinghe	Additional Director-General Project Director	MOFP, National Budget Department Public Expenditure Management Project
C. S. Kumarasinghe	Director	MOFP, National Budget Department
Mr. Abeysooriya	Director	MOFP, National Budget Department
R. Senanayake	Director	MOFP, National Budget Department
P. Algama	Deputy Director	MOFP, National Budget Department
R. Cooray	Director-General	MOFP, Fiscal Policy and Economic Affairs Department
P. Alailima	Director-General	MOFP, National Planning Department
M. Vamadevan	Additional Director-General	MOFP, National Planning Department
U. Dahanayake	Director	MOFP, National Planning Department
Ms Gangadaran	Assistant Director	MOFP, National Planning Department
M. V. P. Silva	Director-General	MOFP, Public Finance Department
M. M. B. Navaratna	Assistant Director	MOFP, Public Finance Department
N. Warusawitharana	Director-General	MOFP, State Accounts Department
P. Fernando	Director	MOFP, State Accounts Department

APPENDIXES

L. R. De Silva	Additional Director-General	MOFP, State Accounts Department
A. M. S. K. Chandrasena	Director	MOFP, Accounting Services
P. Ekanayake	Director	MOFP, Debt Management and Financial Analysis
Susantha De Silva	Director	MOFP, Management Services Department
K. Fernando	Deputy General Manager (Finance)	National Water Supply and Drainage Board (NWSDB)
K. L. J. Basil Perera	Director	Post Graduate Institute of Management (PIM), University of Sri Jayewardenepura (USJ)
Gunapala Nanayakkara	Professor	PIM, USJ
H. Amerasekera	Director	Public Expenditure Management Project / PricewaterhouseCoopers, Lanka (Pvt) Ltd.
Ravi Corea	Director	Public Expenditure Management Project / PricewaterhouseCoopers, Lanka (Pvt) Ltd.
Sarah Holloway	Project Manager	Public Expenditure Management Project / PricewaterhouseCoopers, Lanka (Pvt) Ltd.
Ursula Blackshaw	Consultant	Public Expenditure Management Project / PricewaterhouseCoopers, Lanka (Pvt) Ltd.
Caroline Stanforth	Consultant	Public Expenditure Management Project / PricewaterhouseCoopers, Lanka (Pvt) Ltd.

Ajith S. Rathnayake	Director-General	Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)
W. D. Perera	Director-General	Sri Lanka Customs
Mr. Weerantunga	Chief Accountant	Sri Lanka Customs
Mr. Tissera	Director, Policy Planning	Sri Lanka Customs
M. Reyaz Mihular	Chairperson	Statutory Accounting Standards Committee, ICASL
	President	Association of Accounting Technicians of Sri Lanka (AATSL)
	Partner	KPMG Ford, Rhodes, Thornton & Co.
Lal Nanayakkara	Chairperson	Statutory Auditing Standards Committee, ICASL
Athula S. P. G. Manawadu	Head	USJ, Department of Accountancy and Financial Management
M. W. Wickramaarachci	Lecturer	USJ, Department of Accountancy and Financial Management
W. G. S. Kelum	Lecturer	USJ, Department of Accountancy and Financial Management
Bob Saum	Senior Financial Management Specialist	World Bank
Julitta Rasiah	Financial Management Officer	World Bank, Sri Lanka Resident Mission

Appendix 3. RETA-5980 (Regional Study) Information

1. Study Phases

The study had three broad phases as follows:

Phase I – Sri Lankan Case Study on Accounting and Auditing Support and Structures.

Phase II – Colombo Workshop (19-20 July 2001).

Phase III – Manila Workshop (5-6 March 2002) and Formulation of Action Plan.

2. Phase I: Case Study On Accounting and Auditing

This phase involved the examination of Sri Lanka's current accounting and auditing structure and systems. It also (i) analyzed Sri Lanka's 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 eliminating them eventually.

Barry Reid conducted the fieldwork for the study from 21 June to 23 July 2001. Nihal De Silva, Partner; Lasantha Wickremasinghe, Partner; Naayila Marikkar, Manager; and Natalia Payoe, Secretary, all of B. R. De Silva & Co. (Chartered Accountants), provided excellent research guidance and assistance. Financial management and governance arrangements were discussed with representatives from: the MOFP, the Auditor-General's Office, other government organizations, professional organizations, private sector businesses and educational institutions. A list of interviewees is attached as Appendix 2.

3. Phase II: Colombo Workshop

Issues arising from the study were discussed and debated at a workshop held in Colombo on 19-20 July 2001. Joseph E. Zveglic, Jr (Deputy Resident Representative, ADB) and A. Abeygunasekera (Director, External Resources Department MOFP) chaired session of the workshop. Francis B. Narayan, Lead Financial Management Specialist, ADB, participated in the workshop as a resource person and provided overall guidance with respect to the objectives of the study. Forty participants, representing the following organizations, attended the workshop:

- AATSL
- ACCA
- Auditor-General's Department
- BDH Burah Hathy
- Central Bank of Sri Lanka
- CIMASL
- Colombo Stock Exchange
- Ernst & Young
- Inland Revenue Department
- Institute of Bankers
- ICASL
- InGAF
- IIA
- IPFDA
- KPMG Ford Rhodes Thornton & Co
- MOFP
- Ministry of Higher Education and Information Technology Development
- Ministry of Internal and International Commerce and Food
- PIM (USJ)
- PricewaterhouseCoopers
- SEC
- CMASL
- SLAASMB
- University of Colombo
- University of Sri Jayawardenapura

4. Phase III: Manila Workshop and Formulation of Action Plan

Phase III assessed the roles that ADB and other funding agencies could play in improving the current situation in the selected DMCs. The roles included policy intervention, projects and program assistance, and mobilization of cofinancing resources to address the identified problems and weaknesses. This activity was undertaken in close consultation with the Government, regulatory authorities, representatives of the accounting and auditing professions, and other local interest groups and funding agencies. At this stage of the RETA, the commitment-in-principle of each selected country to implement the findings and recommendations of the study was agreed. The findings of the RETA were disseminated and debated at a workshop in Manila on 5-6 March 2002 and the developed action plan was finalized for implementation.

Appendix 4. International Accounting Standards

The following IASs were in effect at 28 February 2002.^{135, 136}

IAS 1	Presentation of Financial Statements	IAS 27	Consolidated Financial Statements and Accounting for Investments in Subsidiaries
IAS 2	Inventories	IAS 28	Accounting for Investments in Associates
IAS 7	Cash Flow Statements	IAS 29	Financial Reporting in Hyper-inflationary Economies
IAS 8	Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 10	Events After the Balance Sheet Date	IAS 31	Financial Reporting of Interests in Joint Ventures
IAS 11	Construction Contracts	IAS 32	Financial Instruments: Disclosures and Presentation
IAS 12	Income Taxes	IAS 33	Earnings Per Share
IAS 14	Segment Reporting	IAS 34	Interim Financial Reporting
IAS 15	Information Reflecting the Effects of Changing Prices	IAS 35	Discontinuing Operations
IAS 16	Property, Plant and Equipment	IAS 36	Impairment of Assets
IAS 17	Leases	IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 18	Revenue	IAS 38	Intangible Assets
IAS 19	Employee Benefits	IAS 39	Financial Instruments: Recognition and Measurement
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	IAS 40	Investment Property
IAS 21	The Effects of Changes in Foreign Exchange Rates	IAS 41	Agriculture
IAS 22	Business Combinations		
IAS 23	Borrowing Costs		
IAS 24	Related Party Disclosures		
IAS 26	Accounting and Reporting by Retirement Benefit Plans		

¹³⁵ Source: IASC Website: www.iasc.org.uk

¹³⁶ The following IASs have been withdrawn:

- IAS 3 was replaced by IAS 27 and IAS 28.
- IAS 4 was replaced by IASs 16, 22, and 38.
- IAS 5 was replaced by IAS 1.
- IAS 6 was replaced by IAS 15.
- IAS 9 was superseded by IAS 38.
- IAS 13 was replaced by IAS 1.
- IAS 25 was replaced by IAS 39 and IAS 40.

Appendix 5. International Standards on Auditing

The following ISAs and IAPs were in effect at 31 March 2002.

1. International Standards on Auditing (ISAs)

100	Assurance Engagements	520	Analytical Procedures
120	Framework of ISAs	530	Audit Sampling and other Selective Testing Procedures
200	Objective and General Principles Governing an Audit of Financial Statements	540	Audit of Accounting Estimates
210	Terms of Audit Engagements	550	Related Parties
220	Quality Control for Audit Work	560	Subsequent Events
230	Documentation	570	Going Concerns
240	The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements	580	Management Representations
240A	Fraud and Error	600	Using the Work of Another Auditor
250	Consideration of Laws and Regulations in an Audit of Financial Statements	610	Considering the Work of Internal Auditing
260	Communications of Audit Matters with those Charged with Governance	620	Using the Work of an Expert
300	Planning	700	The Auditor's Report on Financial Statements
310	Knowledge of the Business	710	Comparatives
320	Audit Materiality	720	Other information in documents containing Audited Financial statements
400	Risk Assessments and Internal Control	800	The Auditor's Report on Special Purpose Audit Engagement
401	Auditing in a Computer Informa- tion Systems Environment	810	The Examination of Prospective Financial Information
402	Audit Considerations Relating to Entities Using Service Organiza- tions	910	Engagements to Review Financial Statements
500	Audit Evidence	920	Engagements to Perform Agreed Procedures Regarding Financial Information
501	Audit Evidence: Additional Considerations for Specific Items	930	Engagements to Compile Financial Information
505	External Confirmations		Glossary of Terms
510	Initial Engagements - Opening Balances		Preface to ISAs and RSs

2. International Auditing Practice Statements (IAPSS)

1000	Inter-Bank Confirmation Procedures	1006	Audits of the Financial Statements of Banks
1001	Computer Information System (CIS) Environments: Standalone Microcomputer Systems	1007	[withdrawn]
1002	CIS Environments: Online Computer Systems	1008	Risk Assessments and Internal CIS Characteristics and Considerations
1003	CIS Environments: Database Systems	1009	Computer-Assisted Audit Techniques (CAATs)
1004	The Relationship Between Banking Supervisors and External Auditors	1010	The Consideration of Environmental Matters in the Audit of Financial Statements
1005	Special Consideration in Audits of Small Entities	1011	[withdrawn]
		1012	Auditing Derivative Financial Instruments
		1013	Electronic Commerce: Effect on the Audit of Financial Statements

Appendix 6. International Public Sector Accounting Standards (IPSASs)

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, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.
- IPSAS 14 *Events After the Reporting Date* prescribes when an entity should adjust its financial statements for events after the reporting date; and the disclosures that an entity 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 7. IASB Improvements Project (Potential Agenda)¹³⁷

This project covers issues relating to problems with implementing existing IASs. The issues addressed are those that have been identified by various sources as narrow issues of substance whose resolution could improve the quality of the IASC standard and/or increase convergence of national and international standards. Also included are issues for which an IASC standard allows explicit or implicit alternative treatments. The issues could be addressed in a large single project or group of subprojects. Sources of issues include IOSCO, national standard setters, international accounting firms and the Standards Interpretation Committee (SIC).

The Preface to IASB Standards and transition to IAS (including possible amendment to SIC 8) were identified early by the IASB as matters needing improvement. A project on the Preface is already under way.

Potential topics for improvements are broadly of six types: (i) elimination of choices (explicit or implicit); (ii) elimination of conceptual inconsistencies between IASs; (iii) additional guidance; (iv) additional disclosure; (v) drafting improvements; and (vi) structural improvements. Regarding elimination of choices, IASB has identified the following nine choices as areas for possible change:

Issue	Choices
Inventory valuations	First-in First-out (FIFO) / Average or Last-in First-out (LIFO)
Correction of fundamental errors relating to prior periods	Restate or cumulative effect in earnings
Adjustments resulting from changes in accounting policies	If impracticable to restate, adjust retained earnings or cumulative effect in earnings
Foreign exchange losses from a severe devaluation or depreciation	Expense or capitalize
Translation of goodwill and fair value adjustments on acquisition of a foreign entity	Closing rate or rate at transaction date
Measurement of minority's portion of identifiable assets and liabilities acquired	Fair value or carrying amount
Borrowing costs	Expense or capitalize
Investments in associates/subsidiaries in parent entity accounts	Cost or equity method or IAS 39
Reporting a venturer's interest in jointly controlled entities	Proportionate consolidation or equity method

¹³⁷ Source: www.iasplus.com

Appendix 8. Accounting and Auditing Standards Act 1995

Parliament of the Democratic Socialist Republic of Sri Lanka
Accounting and Auditing Standards Act (No.15) of 1995
[Certified on 5th August 1995]

Published as a Supplement to Part II of the Gazette of the Democratic Socialist Republic of Sri Lanka of 25 August 1996

An Act to provide for the establishment of Sri Lanka Accounting Standards and Sri Lanka Auditing Standards; to establish the Sri Lanka Accounting and Auditing Standards Monitoring Board; and to provide for matters connected therewith or incidental thereto.

1. This Act may be cited as the Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995.

2. (1) The Institute of Chartered Accountants of Sri Lanka (hereinafter referred to as the "Institute") shall, from time to time, adopt such accounting standards (hereinafter referred to as "Sri Lanka Accounting Standards") as may be necessary for the purpose of maintaining a uniform and high standard in the preparation and presentation of accounts of business enterprise.

(2) The Sri Lanka Accounting Standards adopted under subsection (1) shall be published in the Gazette and shall become effective from and after the date of such publication or such later date as may be applied therein.

3. (1) The Institute shall from time to time, adopt appropriate auditing standards (hereinafter referred to as "Sri Lanka Auditing Standards") as may be necessary to govern the conduct of the audit of accounts of business enterprises.

(2) The Sri Lanka Auditing Standards, adopted under subsection (1) shall be published in the Gazette and shall become

effective from and after the date of such publication or such later date as may be specified therein.

4. (1) The Institute shall, whenever necessary revise, alter and amend the Sri Lanka Accounting Standards and Sri Lanka Auditing Standards adopted by it under this Act and shall cause such revised, altered or amended standards to be published in the Gazette, and such revisions, alterations and amendments shall become effective from and after the date of such publication or such later date as may be specified therein.

(2) The Institute shall notify the public of the Sri Lanka Accounting Standards and the Sri Lanka Auditing Standards and of the revisions, alterations and amendments made thereto, be notice published in the Gazette or in such other manner as is calculated to give publicity thereto.

5. The standards adopted by the Institute under sections 2 and 3 of this Act shall be applicable to all business enterprises specified in the Schedule to this Act (hereinafter referred to as "specified business enterprises").

6. (1) It shall be the duty of every specified business enterprise to prepare its accounts

in compliance with the Sri Lanka Accounting Standards and take all necessary measures to ensure that its accounts are audited in accordance with the Sri Lanka Auditing Standards with the object of presenting a true and fair view of the financial performance and financial condition of such enterprise.

(2) Any specified business enterprise, which acts in contravention of the provision of subsection (1), shall be guilty of an offense under this Act.

7. (1) The accounts of every specified business enterprise shall be audited by professionally qualified auditors who shall be members of the Institute holding a certificate to practice, issued by the Institute, and it shall be the duty of such auditors to certify in their audit report that the audit has been conducted in accordance with the Sri Lanka Auditing Standards and that accounts have been prepared and presented in accordance with the Sri Lanka Accounting Standards.

(2) Where any qualified auditor fails to comply with the Sri Lanka Accounting Standards and the Sri Lanka Auditing Standards as required by subsection (1), he shall specify clearly the deviations made and give reasons for such deviations.

8. (1) An Accounting Standards Committee consisting of such members as are specified in subsection (2) is hereby established and such Committee shall make recommendation and otherwise assist the Institute in the adoption of accounting standards under section 2 of this Act.

(2) The Accounting Standards Committee shall consist of: (a) the President of the Institute and five other members of the Institute nominated by the Council of such Institute; (b) one member nominated by the Sri Lanka Division of the Chartered Insti-

tute of Management Accountant of the United Kingdom; (c) the Registrar of Companies; (d) the Director-General of the Securities and Exchange Commission of Sri Lanka; (e) one member to represent the Central Bank nominated by the Governor of the Central Bank; (f) one member who shall be a director of a company or person having extensive experience at senior managerial level in a specified business enterprise, nominated by the Ceylon Chamber of Commerce; and (g) one member who shall be a director of a company or a person having extensive experience at a senior level in a specified business enterprise, nominated by the Federation of Chambers of Commerce and Industry of Sri Lanka.

(3) Notwithstanding the provisions of subsection (1), the Accounting Standards Committee shall, where it is called upon to make recommendations regarding accounting standards to be adopted in respect of licensed commercial banks or other financial institutions coming within the supervisory control of the Central Bank, consult the Central Bank and obtain its concurrence, before making such recommendations.

9. (1) An Auditing Standards Committee consisting of such members as are specified in subsection (2) is hereby established and such Committee shall make recommendations and otherwise assist the Institute in the adoption of Auditing Standards under section 3 of this Act.

(2) The Auditing Standards Committee shall consist of eight members of the Institute nominated by the Council of such Institute, at least four of whom shall be members of the Accounting Standards Committee nominated under paragraph (a) of subsection (2) of section 8.

(3) Notwithstanding the provisions of subsection (2), the Institute may, as and

when it considers necessary, co-opt any person with special experience in the field of auditing to serve in the Auditing Standards Committee.

10. (1) A member nominated to the Accounting Standards Committee or the Auditing Standards Committee (in this section referred to as “a nominated member”) may resign from such Committee by a letter addressed to the person nominating him.

(2) A nominated member of the Accounting Standards Committee or the Auditing Standards Committee shall serve on such Committee for a period of four years and shall be eligible for re-nomination.

(3) A person nominated to the Accounting Standards Committee or Auditing Standards Committee in place of a nominated member, who dies or resigns from such Committee, shall serve on such Committee for the unexpired period of the term of the nominated member whom he succeeds.

11. (1) There shall be established a board which shall be called and known as the “Sri Lanka Accounting and Auditing Standards Monitoring Board” (hereinafter referred to as “the Board”).

(2) The Board shall by the name assigned to it by subsection (1) be a body corporate with perpetual succession and a common seal and may sue and be sued in its corporate name.

12. (1) The Board shall consist of the following members:

(a) three members (hereinafter referred to as “ex officio members”) who shall be the persons holding office as (i) the Registrar of Companies; (ii) the Commissioner-General of Inland Revenue; and (iii) the Director-General of the Securities and Exchange Commission of Sri Lanka;

(b) ten members appointed by the Minister (hereinafter referred to as “appointed members”) and consisting of (i) an officer of the Central Bank nominated by the Governor of the Central Bank; (ii) three members of the Institute selected from among persons nominated by the Institute; (iii) a member of the Chartered Institute of Management Accountants of the United Kingdom selected from among three members nominated by the Sri Lanka Division of the Institute; (iv) one senior lawyer selected from among three senior lawyers nominated by the Bar Association of Sri Lanka; (v) two company directors or other persons with extensive managerial experience at senior level in a specified business enterprise one of whom shall be selected from a panel of three names submitted by the Ceylon Chamber of Commerce, and the other from a panel of three names submitted by the Federation of Chambers of Commerce and Industry of Sri Lanka; (vi) one senior banker selected from a panel of three bankers nominated by the Sri Lanka Bank’s Association; and (vii) one person selected from a panel of three persons nominated by the University Grants Commission established by the Universities Act No. 16 of 1978, to represent the Departments Faculties and Postgraduate Institutes of Accounts or Business Management or Business Administration in Universities coming within its purview.

(2) The Minister shall appoint one of the appointed members of the Board to be the Chairman of the Board.

13. (1) Every appointed member of the Board shall, unless he vacates office earlier by death, resignation or removal, hold office for a period of four years.

14. (1) The Minister may, by Order published in the Gazette remove any appointed member of the Board from office without assigning any reason therefore.

(2) A member, in respect of whom an Order under subsection (1) is made, shall be deemed to have vacated office on the date of publication of such Order in the Gazette.

15. An appointed member may at any time resign his office by letter to that effect addressed to the Minister and such resignation shall take effect upon it being accepted by the Minister.

16. An appointed member who vacates office, otherwise than by removal, shall be eligible for reappointment.

17. In the event of vacation of office by death, resignation or removal of any appointed member of the Board, the Minister may having regard to the provisions of paragraph (b) of subsection (1) of section 12, appoint any other person to succeed such member. Any member so appointed in place of such member shall hold office for the unexpired period of the term of office of the member whom he succeeds.

18. (1) The Chairman of the Board shall preside at every meeting of the Board. In the absence of the Chairman from any such meeting, the members present shall elect one of the members to preside at such meeting.

(2) The quorum for any meeting of the Board shall be not less than six members of the Board.

(3) Subject to the provisions of this section the Board may regulate the procedure in regard to the meetings and the transaction of business at such meetings.

(4) No act, decision or proceeding of the Board shall be deemed to be invalid by reason only of the existence of any vacancy among its members or any defect in the appointment of any member thereof.

(5) The Chairman of any meeting of the Board shall, in addition to his own vote, have a casting vote.

19. The members of the Board shall be remunerated in such manner and at such rates as may be determined by the Minister with the concurrence of the Minister in charge of the subject of Finance.

20. (1) If the Chairman of the Board becomes by reason of illness or other infirmity or absence from Sri Lanka, temporarily unable to perform the duties of his office, the Minister may appoint another member of the Board to act in his place.

(2) The Minister may, without assigning any reason therefore, remove the Chairman from the office of Chairman.

(3) The Chairman may at any time resign from the office of Chairman by letter addressed to the Minister.

(4) Subject to the provisions of subsection (2) and (3), the term of office of the Chairman shall be his period of membership of the Board.

21. (1) The seal of the Board shall be in the custody of the Chairman of the Board.

(2) The seal of the Board may be altered to such manner as may be determined by the Board.

(3) The seal of the Board shall not be affixed to any instrument or document except in the presence of three members of the Board all of whom shall sign the instrument in token of their presence.

22. The Board shall, subject to the provisions of this act (a) appoint such officers and servants as it may consider necessary for the performance or discharge of its

duties and functions and may exercise disciplinary control over them; (b) fix the amounts to be paid as remuneration to the officers and servants so appointed; (c) determine the terms and conditions of service of such officers and servants; (d) establish and regulate provident funds or schemes for the benefit of such officers and servants and make contributions to any such fund or scheme.

23. The function of the Board shall be to monitor the compliance with Sri Lanka Accounting standards and the Sri Lanka Auditing Standards, by specified business enterprises.

24. The Board shall have power (a) to acquire and hold, any property, movable or immovable, which may become vested in it by virtue of any purchase, grant, gift, testamentary disposition or otherwise and to sell, mortgage, assign, exchange or otherwise dispose of the same; (b) to enter into such contracts and agreements as may be necessary for the discharge of its functions; (c) to do all such acts or things as may be necessary in the opinion of the Board for the proper discharge of its functions.

25. (1) It shall be duty of every specified business enterprise to submit to the Board a copy of the annual accounts of such enterprise to enable the Board to determine whether the accounts have been prepared in compliance with the Sri Lanka Accounting Standards.

(2) For the purpose of enabling the Board to perform its duty under subsection (1), the Board or any person authorized in that behalf by the Board may by notice in writing issued not later than one year after a specified business enterprise has submitted its relevant accounts to the Board, require such specified business enterprise or its auditors to furnish to the Board or to the

person authorized by the Board, within such time, as shall be specified in the notice, any information pertaining to its accounts and it shall be the duty of such specified business enterprise or its auditors, as the case may be, to comply with such requirement within the time specified in the notice.

(3) The Board shall have the power for the purpose of performing its duties under subsection (1) to summon and question any director, officer or auditor of any specified business enterprise on any matter pertaining to the preparation or presentation of its accounts.

26. The Board or any person duly authorized in that behalf may carry out such investigations or hold such inquiries as it may by notice in writing consider necessary or expedient for the performance of its duties under this Act, and for such purpose may summon and call upon any director, officer or auditor of any specified business enterprise to appear before it at any such investigation or inquiry or to produce any such books or documents in the possession or control of such director, officer or auditor as are required for the purpose of such investigation or inquiry.

27. (1) Every (a) person who fails to comply with, or contravene, the provisions of section 6 or section 7 or subsection (1) of section 25; (b) person who fails to comply with any requirement imposed on him under subsection (2) of section 25 or knowingly furnishes any false information in compliance with any such requirement; (c) director, officer or auditor of a specified business enterprise who fails to appear before the Board when required to do so under subsection (3) of section 25 or section 26, or who refuses to answer any question put to him by the Board or a person duly authorized by the Board or who refuses to produce any book or document in his

possession or control when required to do so by the Board or knowingly gives any false answer to any question put to him by the Board or a person duly authorized by the Board, shall be guilty of an offense under this Act, and shall on conviction after summary trial before a Magistrate be liable to a fine not exceeding five hundred thousand rupees.

(2) Where a person is convicted of an offense under this Act and the court holds that the act constituting such offense was done with the intention of misleading the shareholders of a specified business enterprise or any financial institution dealing with such specified business enterprise or where a licensed commercial bank is convicted of an offense under this Act and the court holds that the act constituting the offense was done with the intention of misleading the depositors of such bank, the court may sentence the offender to imprisonment of either description for a term not exceeding five years.

(3) Where an offense under this Act, is committed by a body corporate, any person who is at the time of the commission of the offense, a director, manager, secretary or other similar officer of that body corporate shall be deemed to be guilty of that offense unless he proves that the offense was committed without his knowledge or connivance and that he exercised all such diligence to prevent the commission of that offense as he ought to have exercised having regard to the nature of his functions and all the circumstances of the case.

28. (1) The Board may, having regard to the circumstances in which offense under this Act is committed compound such offense for a sum of money not exceeding one-third of the fine imposable for such offense and all prior sums of money received by the

Board in the compounding of an offense under this section shall be credited to the Fund of the Board.

(2) Where the Board is satisfied that a specified business enterprise or an auditor has contravened any provision of this Act and that such contravention is not of a serious nature it may (a) direct such specific business enterprise to have its accounts reaudited or where such accounts have been published, to republish them or to include suitable correction in its accounts for the following year; or (b) where such specified business enterprise is a public company, direct such public company to send a notification in writing to all its shareholders explaining the reason for such non-compliance on the accounts of such public company and where such specified business enterprise is a public company listed in a stock exchange licensed by the Securities and Exchange Commission of Sri Lanka, to send in addition, a copy of such notification to such Commission and such stock exchanges.

29. Where any document of any specified business enterprise violates any provision of this Act, it shall be duty of the Board to bring such violation to the notice of any professional body of which such accountant is a member for the purpose of enabling such body to take appropriate action against such accountant.

30. Where any specified business enterprise has failed to act in compliance with provisions of this Act, it shall be the duty of the Board to bring such fact to the notice (a) of any authority which is empowered by law to regulate or supervise the activities of such specified business enterprise; and (b) of the Inland Revenue Department. If the Board considers that such non-compliance has resulted in a substantial reduction of the tax liabilities of

31. (1) There shall be charged, levied and paid by every specified business enterprise, a cess of such amount as may be determined by the Minister from time to time, by Order published in the Gazette, and which shall consist of a percentage of the shareholders equity as shown in the balance sheet of such enterprises for the previous year or a percentage of its after tax profits as shown in the profit and loss account of such enterprise for the previous year, whichever is higher.

(2) Every Order made under this section shall come into force on the date of its publication in the Gazette or such later date as may be specified therein and shall be brought before Parliament for its approval within two months of its publication. Any Order, which is not so approved, shall be deemed to be revoked from the date of disapproval but without prejudice to the validity of any thing previously done thereunder. Notification of the date on which an Order is so disapproved shall be published in the Gazette.

32. (1) The Board shall have its own Fund. There shall be credited to the fund of the Board (a) all such sums of money as may be voted from time to time by Parliament for the use of the Board; (b) all such sums of money received by the Board as proceeds of the cess imposed under section 31; and (c) all such sums of money as may be received by the Board in the exercise and performance of its powers and duties under the Act.

(2) There shall be paid out of the Fund of the Board all sums of money as are required to defray the expenditure incurred by the Board in the exercise, discharge and performance of its powers duties and functions under this Act or any other written law.

33. (1) The financial year of the Board shall be the calendar year.

(2) The provisions of Article 154 of the Constitution relating to the audit of the accounts of public corporations shall apply to the audit of the accounts of the Board.

34. The Board shall, at the end of each financial year publish a report of its activities during the year and it shall be submitted to the Minister for approval. On being approved by the Minister, the Minister shall cause such report to be laid before Parliament.

35. (1) No suit or prosecution shall lie (a) against the Board for any act which in good faith is done, or purported to be done, by the Board under this Act; or (b) against any member, officer or servant of the Board for any act which is done, or purported to be done by him in good faith under this Act or on the direction of the Board.

(2) Any expense incurred by the Board in any suit or prosecution brought by or against the Board before any court shall be paid out of the Fund of the Board, and any costs paid to or recovered by, the Board in any such suit or prosecution shall be credited to the Fund of the Board.

(3) Any expense incurred by any such person as is referred to in paragraph (b) of subsection (1) in any suit or prosecution brought against him before any court in respect of any act which is done or is purported to be done by him under this Act or on the direction of the Board shall, if the court holds that such act was done in good faith, be paid out of the Fund of the Board, unless such expense is recovered by him in such suit or prosecution.

36. All members, officers and servants of the Board shall be deemed to be public servants within the meaning and for the purpose of the Penal Code.

37. The Board shall be deemed to be a scheduled institution within the meaning of the Bribery Act and the provision of that Act shall be construed accordingly.

38. (1) The Minister may make regulations in respect of any matter required by this Act to be prescribed or in respect of which regulations are authorized by this Act to be made.

(2) Every regulation made by this Act shall be published in the Gazette and shall come into operation on the date of its publication or on such later date as may be specified in the regulation.

(3) Every regulation made by the Minister shall as soon as convenient after its publication be laid before Parliament for approval. Any regulation, which is not approved, shall be deemed to be rescinded from the date of such approval but without prejudice to anything previously done thereunder.

(4) Notification of the date on which any regulation made by the Minister is deemed to be rescinded shall be published in the Gazette.

39. In the event of any inconsistency between the Sinhala and Tamil texts of this Act, the Sinhala text shall prevail.

40. In this Act, unless the context otherwise requires

“Central Bank” means the Central Bank of Sri Lanka established under the Monetary Law Act;

“company” shall have the same meaning as in the Companies Act No. 17 of 1982;

“Ceylon Chamber of Commerce” means the Ceylon Chamber of Commerce incorporated by the Chamber of Commerce Ordinance;

“Factoring Company” means a company which (a) assumes responsibility for the trade debts of a client company; (b) assumes responsibility for the trade debts due to the client company, thereby relieving the client of the risk of loss; (c) takes over client’s trade debts and in certain circumstances, advances a portion of their value immediately, and the balance on maturity of debts; (d) purchase a debt or a number of debts from a client, usually in order to improve the client’s cash flow; or (e) underwrites a client’s trade debt with or without recourse.

“Fund Management Company” means a company which manages portfolios of their clients in investing in range of assets to suit the clients preferences and needs;

“Institute of Chartered Accountants” means the Institute of Chartered Accountants established by the Institute of Chartered Accountants Act No. 23 of 1959;

“licensed commercial bank” means a public company licensed to carry on banking business under the Banking Act No 30 of 1988;

“prescribed” means prescribed by regulation made by the Minister;

“public corporation” means any corporation, board or other body which was or is established by or under any written law other than the Companies Act, with funds or capital wholly or partly provided by the Government by way of grant, loan or otherwise;

“Securities and Exchange Commission” means the Securities and Exchange established by the Securities and Exchange Commission Act, No. 36 of 1987;

“share-holders’ equity” when used in relation to a public company, means the issued capital of that company and its reserves.

Appendix 9. Relevant Extracts from the 1990 SEC Rules

1990 Rules made by the Securities and Exchange Commission of Sri Lanka under section 53 of the Securities and Exchange Commission Act, No. 36 of 1987, read with Paragraph (g) of Section 13 of that Act.

Books of accounts 8. (1) Every licensed stock exchange shall records and other maintain and preserve the following documents to be books of accounts and documents, or maintained by a such other acceptable alternative stock exchange, accounting records for a period of stock broker and five years - stock dealer (a) Minute Books of the meetings of- (i) Members, (ii) Governing Body, (iii) Any standing committee or committees of the Governing body or of the General Body of members. (b) A register of members containing their full names and addresses. Where any member of stock exchange is a company, the full names and addresses of all the Directors, and where any member is a partnership, the full names and addresses of the partners shall be shown; (c) Register of accredited representatives and authorised assistants; (d) Record of Security deposits and bank guarantees; (e) Ledgers; (f) Journals; (g) Cash Books; (h) Bank statements and bank reconciliation account; (i) List of names and addresses of Secretaries/ Registrars of companies listed with the stock exchange.

(2) Every licensed stockbroker stock dealer shall maintain and preserve the following books of account and documents, or such other acceptable alternative accounting records in their place, for a period of five years- (a) Register of Transactions - contract-wise; (b) Register of Transactions - company-wise; (c) Register of Transactions - Client-wise; (d) Client's Ledger;

(e) General Ledger; (f) Cash Book; (g) Bank Statements and Bank Reconciliation

Account; (h) Members' contract books, showing details of all contracts entered into by him with other members of the same stock exchange, or counter foils or duplicates of memos of confirmation issued to such other members; (i) Duplicates of contract notes issued to clients; (j) Written consent of clients in respect of contracts entered into as members, where available.

10. (1) Every stock exchange shall, before the 31st day of March in each year, or where the Commission grants an extension of time, within such time, furnish to the Commission annually, - report of its activities during the preceding calendar year which shall, inter alia, contain information on the following matters - (a) Amendments, if any, made to the Rules and by-laws of the stock exchange; (b) Changes in the composition of the Governing Body; (c) Any new sub-committees set up and changes in the position of existing ones; (d) Admission, re-admission, deaths or resignation of members; (e) Disciplinary action taken against members; (f) Arbitration of disputes (nature and number) between members; (g) Defaults; (h) Action taken to combat any emergency in trade; (i) Securities listed and de-listed; (j) Securities brought on, or removed from the forward list, where applicable.

(2) Every stock exchange shall hold its Annual General Meeting within four months from the end of the financial year, at which meeting there shall be presented an Annual report and duly audited accounts. Such report and audited accounts should be submitted to the Commission within two weeks thereafter.

11. Every licensed stock exchange shall furnish to the Commission, quarterly returns relating to - (a) Purchases and sales during the preceding quarter; (b) Names of companies which have not submitted annual and bi-annual reports; (c) The number of securities listed and delisted during the previous three months.

12. (1) In addition to any other existing requirements of members for an audit, every member shall, if directed by the Commission, have its accounts audited by a firm of Chartered Accountants who are registered as Auditors.

(2) The Commission where it deems necessary may appoint an independent auditor to conduct an audit at any time, without prior notice on a member, and it may fix the remuneration to be paid by the member to such auditor.

18. (1) Every issuer of listed securities shall file with by listed public companies the stock exchange, Annual Reports certified by their Auditors. Such Reports shall be made available to the public. (2) Listed public companies shall report to their shareholders on a regular and consistent basis, as required by the rules of the stock exchange.

(3) Listed public companies' financial year end provisional results shall be announced within four months of the end of each companies' financial year.

(4) (a) Every listed public company shall prepare and furnish to the Commission accounts in accordance with the provisions of the companies Act No. 17 of 1982 in

respect of each financial year: (b) The Auditors shall certify that such accounts are presented in accordance with accounting standards as laid down by the Institute of Chartered Accountants of Sri Lanka.

(5) The reports of a listed public company shall disclose an occurrence or events which in the view of the Directors may materially affect the following- (a) Nature of business; (b) Objectives; (c) Consideration as a going concern; (d) Valuation of assets; (e) Assessment of liabilities including contingent liabilities; (f) Profits and/or losses; and the extent to which provision had been made in the accounts in respect of such occurrence or event.

(6) The Directors of a holding company shall ensure that, except where in their opinion there are good reasons to the contrary, the financial year of each of its subsidiaries shall coincide with the Company's own financial year.

(7) (a) A listed public company shall submit to the shareholders, as well as to the stock exchange of which it is a member, an interim financial statement within ninety days from the end of six months of the financial year, in such format as may be prescribed by the stock exchange. The interim statement shall be signed by any two Directors of the company and any two Directors of the company and certified as to whether such accounts are audited or unaudited. (b) The stock exchange upon receipt of the interim financial statement, shall, if such statement conforms to prescribed standards forward such statement to the members of such stock exchange.

Appendix 10. Relevant Extracts from the Banking Act 1988

Incorporating amendments to 31 December 1999.

Part I – Licensing of Persons Carrying on Banking Business

14. (1) Where the Governor of the Central Bank has reasonable grounds to believe that any person or any commercial bank is carrying on banking business without a licence, the Governor may direct the Director of Bank Supervision or any other officer of the Central Bank to examine the books, accounts and records for the purpose of ascertaining whether such person or bank has contravened, or is contravening any of the provisions of this Act.

(2) The Director of Bank Supervision or such other officer so authorised by the Governor in terms of subsection (1) may require such person or the bank to furnish to him such information or to produce for inspection any books, minutes, accounts, cash, securities, vouchers, other documents and records as he may consider necessary to obtain for the purpose of such examination, and it shall be the duty of such person or bank to furnish such information and to submit to such officer for examination such books, minutes, accounts, cash, securities, vouchers, other documents and records, as the case may be, when so required.

(3) Any person who fails to furnish such information or to produce any books, minutes, accounts, cash, securities, vouchers, other documents and records when required to do so under subsection (2) shall be guilty of an offence under this Act.

(4) Any refusal by any person or commercial bank to furnish such information or to submit such books, minutes, accounts, cash, securities, vouchers, other documents

and records in contravention of the provisions of subsection (2) shall be prima facie evidence of such person or bank carrying on banking business without a licence.

Part II – Banking Names and Descriptions

Part III – Capital Requirements, Reserve Funds and Maintenance of Liquid Assets

Part IV – Offshore Banking Business

27. Every licensed commercial bank shall, in respect of its off-shore unit, prepare—
(a) a balance sheet as at the last working day of each financial year of such licensed commercial bank; (b) a profit and loss account in respect of such year.

28. The Monetary Board may specify the form of the balance sheet and profit and loss account referred to in section 27 and the balance sheet and profit and loss account shall be prepared in such form as is specified.

30. (1) Every commercial bank engaged in off-shore banking business, shall appoint annually, a qualified auditor to audit the accounts of its off-shore unit and such auditor shall submit a report to such licensed commercial bank in respect of the accounts, balance sheet and profit and loss account of such off-shore unit. The auditor shall state in his report whether in his opinion, the balance sheet and profit and loss account are full and fair and properly drawn up and whether they exhibit a true and correct statement of affairs of the licensed commercial bank.

(2) A certified copy of the report shall be sent to the Monetary Board, and if the Monetary Board is of the opinion that the auditor has not discharged his duty to the best of his ability the Board may, order the licensed commercial bank to appoint another auditor for the purpose of preparing a fresh report.

31. The Monetary Board may cause an examination of any off-shore unit to be made by officers duly, authorised by it, in that behalf, in consequence of the auditor's report, or the auditor's failure to submit a report, or because of other relevant information that affords the Monetary Board reasonable grounds to believe that the off-shore unit is not in a sound financial condition or that it is engaging in fraudulent, unsafe or unsound banking practices or that the requirements of this Part have not been complied with in the carrying on of its business.

32. Every off-shore banking unit shall maintain the books, minutes, accounts, cash securities, vouchers, other documents and records as may be determined by the Monetary Board, having regard to the nature of the business carried on by such off-shore unit.

33. (1) It shall be lawful for the Director of Bank Supervision or any officer of the Department of Bank Supervision or any officer authorised under section 31 — (a) to require any director, officer or employee of any off-shore unit to furnish him with such information as he may consider necessary to obtain, for the purpose of ascertaining the true condition of the affairs of any off-shore unit; (b) to require any such director, officer, or employee to produce for inspection by him at such time as he may specify any books, minutes, accounts, cash securities, vouchers, other documents and records in the possession of such director, officer or

employee containing or likely to contain any such information.

(2) It shall be the duty of every director, officer or employee of any off-shore unit to afford to the Director of Bank Supervision or to any officer of his department or any officer authorised under section 31 whenever required so to do, in terms of subsection (1), the fullest opportunity to examine books, minutes, accounts, cash securities, vouchers, other documents and records in his possession containing or likely to contain any such information.

(3) If any books, minutes, accounts, cash securities, vouchers, other documents and records are not produced or information not furnished in accordance with the provisions of subsection (2), the officer so defaulting shall be guilty of an offence under this Act.

34. Subject to the provisions of this Part, the Monetary Board may, from time to time, call for information, reports and returns as it may deem necessary for the purposes of this Part and may publish information and data extracted therefrom which does not disclose particulars of individual transactions.

Part V – Accounts, Audit, Information and Inspection

35. Every licensed commercial bank shall prepare at the expiration of each financial year— (a) a balance sheet as at the last working day of such financial year; and (b) a profit and loss account in respect of such year.

36. (1) The balance sheet of a licensed commercial bank shall set out the state of affairs of such bank as at the end of the financial year to which such balance sheet relates.

(2) There shall be shown in the balance sheet or in any statement annexed

thereto— (a) capitalised expenses not represented by tangible assets under separate headings, so far as they are not written off; (b) the market value of investments; (c) the method adopted to value fixed assets if there had been any valuation of such assets during the financial year; (d) the aggregate amounts of advances after the provisions for bad and doubtful debts; (e) any increase or decrease in the provision for depreciation, renewals or diminution in the value of fixed assets; (f) the sources and applications of funds; (g) reserves, provisions and liabilities distinguishable from each other; (h) except in the case of the first balance sheet after the coming into force of this Part of this Act the corresponding amounts at the end of the immediately preceding financial year for all items shown in the balance sheet.

37. There shall be shown in the profit and loss account or in any statement annexed thereto—(a) the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets; (b) the amount charged to revenue for Sri Lanka income tax and other Sri Lanka taxation on profits and distinguishable from such accounts, the amounts, of material, set aside or proposed to be set aside for liabilities in respect of tax due in the current year of taxation or a succeeding year; (c) the aggregate amount of dividends paid or proposed to be paid; (d) the amount of remuneration of auditors; (e) the amount charged to revenue representing the aggregate amount of the emoluments of directors; (f) the amount set aside or proposed to be set aside to, or withdrawn from, reserves; (g) under separate headings, the profit or loss or the income and expenses arising from transactions such as are not usually carried on by banking companies and are carried on owing to circumstances of an exceptional or non-recurrent nature or by a change in the basis of accounting;

(h) except in the case of the first profit and loss account after the coming into force of this Part of this Act, the corresponding amount at the end of the immediately preceding financial year for all items shown in the profit and loss account.

38. (1) Every licensed commercial bank incorporated or established within Sri Lanka by or under any written law shall transmit to the Director of Bank Supervision, and publish within five months after the close of the financial year its audited balance sheet as at the close of the financial year, and exhibit them in a conspicuous place of each of its places of business until the balance sheet and profit and loss account for the succeeding financial year are prepared and exhibited.

(2) Every licensed commercial bank incorporated outside Sri Lanka shall transmit to the Director of Bank Supervision within five months of the close of each financial year its audited balance sheet as at the close of the financial year and its profit and loss account for such financial year in respect of its business in Sri Lanka.

(3) The Monetary Board may specify the form of the balance sheet and profit and loss account referred to in this Part and where such form is specified, the balance sheet and profit and loss account of every licensed commercial bank shall be prepared in such form as may be specified.

(4) Every commercial bank licensed to carry on banking business in Sri Lanka shall within six months of the close of the financial year, exhibit in a conspicuous place within the place of business of such commercial bank— (a) the profit and loss account for such financial year in respect of its business within Sri Lanka including the business of its off-shore unit; and (b) the consolidated balance sheet as at the end

of such financial year setting out the state of affairs of such commercial bank and of its affiliates and subsidiaries, until its next profit and loss account and balance sheet are exhibited.

38A. (1) The Monetary Board may having regard to the need to ensure that experienced and competent qualified auditors are engaged in auditing the accounts of licensed commercial banks, issue guidelines to the Director of Bank Supervision who shall select from time to time in accordance with such guidelines, such number of qualified auditors to audit the accounts of licensed commercial banks and transmit a list of such selected qualified auditors to all licensed commercial banks.

(2) It shall be the duty of all licensed commercial banks to select their auditors for purpose of auditing its accounts from and out of the list transmitted under subsection (1).

39. (1) Every licensed commercial bank shall appoint annually from and out of the list issued by the Director of Bank Supervision under section 38 A, a qualified auditor to audit the accounts of such bank. The duties of such auditor shall be— (a) in the case of a licensed commercial bank incorporated or established within Sri Lanka by or under any written law, to prepare a report in respect of the accounts, balance sheet and profit and loss account examined by him, to be submitted to each of its shareholders; and (b) in the case of a licensed commercial bank incorporated outside Sri Lanka, to submit a report to its head office in respect of the accounts, balance sheet and the profit and loss account examined by him.

(2) Every such report, which shall be completed within three months of the end of the financial year, shall contain a statement by the auditor as to whether in his

opinion the balance sheet and profit and loss account contain a full and fair and properly drawn up statement and whether they represent a true and correct statement of the bank's affairs, and if the auditor has called for an explanation or any information from the officers or agents of such licensed commercial bank whether such explanation or information is satisfactory.

(3) The report of the auditor made in accordance with subsections (1) and (2) shall, in the case of a licensed commercial bank incorporated or established within Sri Lanka by or under any written law, be read together with the report of the Board of Directors of the licensed commercial bank at the annual general meeting of its shareholders, and, in the case of a licensed commercial bank incorporated outside Sri Lanka, be transmitted to the head office of such licensed commercial bank. A copy of such report shall be transmitted to the Director of Bank Supervision. Where the Director of Bank Supervision is not satisfied with the report of the auditor, he may make a request to the Monetary Board for the appointment of a new auditor to submit a fresh report.

(3A) Notwithstanding the provisions of subsection (3), the Director of Bank Supervision may, on receipt of the report referred to in that subsection, call upon the auditors to— (a) submit such additional information in relation to the audit, as the Monetary Board considers necessary; (b) enlarge or extend the scope of the audit of the business and affairs of the bank; (c) carry out such other examination required by him or recommend to the licensed commercial bank any procedure in respect of a particular matter; and (d) submit a report on any of the matters referred to in paragraphs (b) and (c), and the cost of such additional audit or such other work shall be met by the Central Bank.

(4) If a licensed commercial bank fails to appoint an auditor under subsection (1) or the Director of Bank Supervision has made a request to the Monetary Board in terms of subsection (3), the Monetary Board shall have the power to appoint an auditor for such licensed commercial bank.

(5) Every auditor appointed under subsection (1) or (4) shall have a right of access at all times to the books, accounts and vouchers and all documents and records belonging to the licensed commercial bank, which he considers necessary for the performance of his duties, and he shall be entitled to require from the officers of such bank such information and explanations as he thinks necessary for the performance and proper discharge of his duties and functions as auditor.

(6) The remuneration of the auditor, whether appointed by the licensed commercial bank or by the Monetary Board, shall be paid by the licensed commercial bank and, in the case of an auditor appointed by the Monetary Board under subsection (4), he shall be paid such amount as may be determined by the Monetary Board.

(7) No person having an interest in any licensed commercial bank or any director, officer, employee, agent of such licensed commercial bank shall be eligible for appointment as auditor for that licensed commercial bank. Any person appointed as auditor who shall after such appointment acquire any interest in or become a director, officer, employee or agent of such licensed commercial bank shall forthwith cease to act as such auditor.

(8) Nothing contained in this section shall apply to the audit of the accounts of any licensed commercial bank which is a public corporation.

40. Where any licensed commercial bank has, due to circumstances beyond its control, failed to comply with the provisions of section 35, or where an auditor appointed by such licensed commercial bank has, due to reasons beyond his control, failed to complete the audit report as specified, the Monetary Board may, on an application made by such licensed commercial bank, grant a reasonable period of time for compliance with the preceding provisions of this Part.

41. (1) The Monetary Board shall, from time to time, cause an examination of any licensed commercial bank or any of its subsidiaries, to be made by an officer duly authorised by it, whenever it appears to the Board that such examination is necessary or expedient in order to examine whether such licensed commercial bank is in a sound financial condition and whether the carrying on of business by the licensed commercial bank has been in accordance with the provisions of this Act or any other written law.

(2) Every licensed commercial bank and any subsidiary of such licensed commercial bank referred to in subsection (1) shall permit the officer authorised by the Monetary Board, to inspect at any time as requested by such officer all books, minutes, accounts, cash securities, vouchers, other documents and records relating to its business and shall be required to furnish such information concerning its business as may be requested by such officer.

(3) If any books, minutes, accounts, cash, securities, vouchers, other documents and records are not produced or information not furnished in accordance with the provisions of subsection (2) or if any information furnished or item produced is false in any material particular the defaulting licensed commercial bank or subsidiary or both, as

the case may be, shall be guilty of an offence under this Act.

Part VI – Disqualification for Appointment as Director, Secretary, Manager of licensed commercial banks

Part VII – Control Over Licensed Commercial Banks

Part VIIA – Vesting the Banking Business of a Licensed Commercial Bank

49F. (1) For the purpose of ascertaining the value of the vested business of the defaulting bank on the day immediately preceding the relevant date, the Director of Bank Supervision shall cause an audit of such vested business to be conducted by a qualified auditor appointed by him with the approval of the Monetary Board.

(2) The auditor appointed under subsection (1) shall submit a report to the Director of Bank Supervision within three months from the date of his appointment and the Director of Bank Supervision shall forward such report to the Monetary Board and the Monetary Board shall consider the report and if necessary, require the Auditor to furnish any further information, or explanations as it may consider necessary.

(3) The auditor appointed under subsection (1) shall examine the accounts of the defaulting bank and ascertain the correctness of the balance sheet and furnish a report stating— (a) whether he has or has

not obtained all the information and explanations required by him; (b) whether the balance sheet and accounts referred to in the report are properly drawn up so as to exhibit a true and fair view of the defaulting bank's affairs; and (c) the value of the assets and liabilities of the vested business.

Part VIII – Liquidation of Licensed Commercial Banks Incorporated Within Sri Lanka and Closure of Branches of Licensed Commercial Banks Incorporated Outside Sri Lanka

Part IX – Abandoned Property

Part IXA – Licensed Specialised Banks

Part X – General

Part XII – Interpretation

“ qualified auditor ” means—

(a) an individual who, being a member of the Institute of Chartered Accountants of Sri Lanka or of any other Institute established by law, possesses a certificate to practise as an Accountant, issued by the Council of such Institute;

(b) a firm of Accountants each of the resident partners of which, being a member of the Institute of Chartered Accountants of Sri Lanka or of any other Institute established by law, possesses a certificate to practise as an Accountant, issued by the Council of such Institute;

Appendix 11. International Standards and Guidelines on Professional Arrangements

1. Overview

The IFAC Board 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 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) once these entities are fully established.

As an IFAC member body, the IFAC Compliance Committee will monitor the ICASL. Table 17 sets out relevant international guidelines with respect to the accountancy profession. IFAC has also established a *Money Laundering Task Force*. The task force has obtained information from around the world on what other professional bodies are doing and is currently analyzing these activities. This is a first step in determining its scope of activities. Included in the work of the task force will be consideration of whether standards will be developed to help member bodies and their members to address money laundering and related issues.

Table 17. International Guidelines for the Accountancy Profession

World Trade Organization (WTO): General Agreement on Trade in Services (GATS)	The criteria for recognizing professional qualifications may not exceed what is necessary to ensure the quality of service. Each country is expected to have a methodology for comparing professional qualifications and this must be applied in a fair and consistent manner to all applicants.
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Table 17. International Guidelines for the Accountancy Profession (*continued*)

IFAC	<p>IFAC pronouncements cover several areas:</p> <ul style="list-style-type: none"> • Education Guidelines and Standards. IFAC's Education Committee issues International Education Standards (IESs) and International Education Guidelines (IEGs). The IESs are intended to establish the essential elements on which education and training programs, both pre-qualification and post-qualification, 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. • Code of Ethics for Professional Accountants. 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. • Statement of Policy of Council: Implementation and Enforcement of Ethical Requirements.¹³⁸ This statement sets expectations and provides guidance on disciplinary action, including punishment and publicity. • Assuring the Quality of Professional Services. This statement sets expectations on quality control policies and procedures for member bodies and professional firms.¹³⁹
Confederation of Asian and Pacific Accountants (CAPA)	<p>CAPA's Guide on the Essential Components of a Professional Accountancy Body¹⁴⁰ 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.¹⁴¹</p>

¹³⁸ IFAC. 1998 January. *Statement of Policy of Council: Implementation and Enforcement of Ethical Requirements*. New York: IFAC.

¹³⁹ IFAC. 1999 August. *Assuring the Quality of Professional Services*. New York: IFAC.

¹⁴⁰ CAPA. 1998. *Guide on the Essential Components of a Professional Accountancy Body*. Kuala Lumpur: CAPA.

¹⁴¹ Further details are provided in: Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Manila: ADB. p. 27.

Table 17. International Guidelines for the Accountancy Profession (*continued*)

UNCTAD ISAR	<p>In February 1999, UNCTAD issued a report on accounting education and qualifications.¹⁴² The report provides a useful set of benchmarks in respect of these issues, in particular:</p> <ul style="list-style-type: none"> • 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. • 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.
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Furthermore, ISAR has initiated a project to assess the competence of accountants. The objective of the project is to rate professional accounting qualifications from around the world and, in doing so, create impetus for improvements and support international skill transferability.¹⁴³

2. Membership Requirements

Education

IFAC and ISAR have published guidelines on education requirements. The IFAC guidelines, such as IEG 9, provide an overview of what is expected. The ISAR guidelines are more useful in a practical sense as they suggest a detailed curriculum structure and contents.¹⁴⁴

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 pre-qualification

¹⁴² UNCTAD. 1999. International Accounting and Reporting Issues: 1999 Review. United Nations.

¹⁴³ Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Manila: ADB. p 29.

¹⁴⁴ UNCTAD. 1999. International Accounting and Reporting Issues: 1999 Review. United Nations.

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.

Paragraph 49—IEG 9.

Moreover, IFAC recommends that practical experience requirements must be considered when professional bodies seek mutual recognition of qualifications.¹⁴⁵

Continuing Professional Education (CPE)

IFAC and ISAR recommend a minimum of 30 hours of CPE per year, or a minimum of 90 hours in every three-year period, of structured learning activity.¹⁴⁶

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)¹⁴⁷

In relation to quality control and assurance, IFAC suggests that:¹⁴⁸

- 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

¹⁴⁵ IFAC. 1995 June. *Statement of Policy of Council: Recognition of Professional Accountancy Qualifications*. New York: IFAC. Paras. 22-25.

¹⁴⁶ IFAC. 1998 May. *International Education Guideline (IEG) 2: Continuing Profession Education*. New York: IFAC.

¹⁴⁷ IFAC. 1999 August. *Assuring the Quality of Professional Services*. New York: IFAC.

¹⁴⁸ *Ibid.*

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.

- 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, its ISAs and the IASs issued by the IASB all provide guidance for such standards.

Box 4. 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.¹⁴⁹ 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.
- Reexamination. From November 1998 to March 1999, CICPA reexamined the qualifications and status of qualified accountants and 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.¹⁵⁰ 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.

¹⁴⁹ Narayan, Francis, B. and Barry Reid. 2000. *Financial Management and Governance Issues in the People's Republic of China*. Manila: ADB. pp. 35–39.

¹⁵⁰ Yong, Li. 1999. The Reform, Regulation and Opening-up of China's Accounting Market. *Contemporary Issues in China Accounting and Finance: Policy and Practise*. Oxford University Press. p. 282–283.

Appendix 12. ICASL Examination Syllabus

1. Introduction

The ICASL provides training and administers examinations to Registered Students. The Institute's qualification structure comprises four levels: Foundation, Intermediate, Final I and Final II. Educational arrangements regarding these courses are described on page 2. The following subsections provide curriculum details.

2. Foundation Examination Syllabus

The Foundation examinations can be answered in Sinhala, Tamil or English.

Paper	Objectives and Coverage
Introduction to Financial Accounting (including Systems and Procedures)	<p>Aim: To assess ability to: (i) appreciate theory and basic assumptions and concepts in financial accounting and their applications in recording transactions; (ii) understand the operation of financial accounting systems; (iii) prepare financial statements of business entities; and (iv) appreciate systems, procedures and controls.</p> <p>Contents:</p> <ul style="list-style-type: none">▪ General principles of financial accounting▪ Understanding of preliminary accounting records and their functions.▪ Assets and liabilities▪ Stocks and methods of valuation▪ Control accounts and self-balancing ledgers▪ Accounting for sole proprietorships and partnerships▪ Manufacturing accounts▪ Income and expenditure accounts▪ Accounting for specialized transactions▪ Systems and procedures
Introduction to Business	<p>Aim: To assess ability to appreciate the manner in which a business is operated in its external environment.</p> <p>Contents:</p> <ul style="list-style-type: none">▪ Basic economic problems of society▪ Elementary theory of price▪ National income and its computation▪ Money and price level▪ Principles of public finance▪ International trade▪ Documents, practices and elementary legal environment in commerce.

Paper	Objectives and Coverage
Introduction to Decision Making Techniques (Financial Mathematics, Statistics and Elements of Operations Research)	<p>Aim: To ensure that the candidates have acquired an understanding of decision-making techniques.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Basic mathematical tools such as logarithms, arithmetic and geometric progressions, binomial theorem, differentiation etc. used in financial decision making processes. ▪ Collection and grouping of numerical data. ▪ Measures of central tendency and dispersion ▪ Probability, and probability distributions ▪ Sampling distribution of the mean and proportion, correlation and regression. ▪ Time series analysis - additive and proportional models, index numbers ▪ Statistical quality control ▪ Elements of Operations Research Basics of linear programming (graphical and simplex methods). ▪ Conditional and expected values. ▪ Basics of transportation and assignment problems ▪ Basics of inventory control
Business Communication I	<p>Aim: To assess ability to use English language for business communication</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Basic English skills ▪ Vocabulary ▪ Writing skills ▪ Comprehension

3. Intermediate Examination Syllabus

The Intermediate examinations can be answered in Sinhala, Tamil or English.

Paper	Objectives and Coverage
Business Communication II (English)	<p>Aim: To assess the ability to communicate in the English Language (oral and written) and to comprehend information.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Grammar and vocabulary ▪ Writing skills ▪ Reading for comprehension

Paper	Objectives and Coverage
Auditing	<p>Aim: To assess knowledge of the principles, techniques and procedures involved in a limited company audit.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ General ▪ Accounting and auditing concepts ▪ Auditor's position ▪ Audit planning and control ▪ Quality control ▪ Performance of an audit ▪ Assessment of accounting systems and internal controls ▪ Techniques and procedures ▪ Reporting ▪ Miscellaneous (including: (i) differences between internal and external audit; and (ii) audit and internal control implications of computerized business environments).
Commercial Law and Tax	<p>Aim: To assess the extent to which candidates: (i) understand the branches of commercial law and labor law with which they will be concerned in the normal course of their professional work; and (ii) possess a knowledge of the law of taxation and its application to individuals at an elementary level.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Commercial law ▪ Law of contract ▪ Negotiable instruments ▪ Special situations (i.e., application of the basic principles of contract law) ▪ Labor law ▪ Income tax ▪ Special cases (i.e., application of income tax principles to the taxation of partnerships and definition of a child according to the Inland Revenue Act). ▪ Government and Provincial Council Turnover Tax and GST
Business Finance and Decisions	<p>Aim: To assess the extent to which candidates understand costing principles and their application: financing methods and decisions: information technology systems and use of the computer as a tool for information analysis.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Systems of costing ▪ Standard costing and variance analyses ▪ Other costing techniques in budgeting and budgetary control ▪ Introduction to finance and decisions ▪ Management information systems

Paper	Objectives and Coverage
Financial Accounting	<p>Aim: To assess the extent to which candidates: (i) understand the theory and basic assumptions and concepts in financial accounting and their application in recording transactions; and (ii) are able to prepare and interpret financial statements of business entities.</p> <p>The financial accounting syllabus is designed to extend the conceptual understanding and knowledge of accounting acquired at Foundation level so that underlying principles can be applied to practical accounting problems. Specifically this syllabus expects: (i) full knowledge of SLAS 3, 5, 8, 9, 10, 11, 12, 15 and 18; and (ii) awareness of SLAS 21, 25, 26 and 27.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Company accounts and group accounts (Candidates should be able to: (i) prepare and present financial statements for limited companies in conformity with legal requirements and generally accepted accounting practice; and (ii) identify the circumstances in which group accounts are required and prepare and present them in conformity with legal requirements and generally accepted accounting practice) ▪ Partnerships and sole traders ▪ Special cases (special features of accounting for a range of special entities) ▪ Miscellaneous accounting (bookkeeping and accounting relating to a range of specialized business activities) ▪ Analysis of limited company financial statements

4. Final I Examination Syllabus

The Final I examinations can only be taken in English.

Paper	Objectives and Coverage
Corporate Law	<p>Aim: To assess the extent to which candidates understand the provisions governing the formation, financing, accounting, auditing, administration and liquidation of companies.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Corporate forms of business ▪ Formation of a company and commencement of business ▪ Share and loan capital ▪ Management and administration ▪ Inspection and investigation ▪ Winding up ▪ Other legislation

Paper	Objectives and Coverage
Advanced Financial Accounting and Reporting	<p>Aim: To assess the extent to which candidates are able to: (i) prepare financial statements in compliance with applicable laws, Sri Lanka Accounting Standards, and generally accepted accounting practices; (ii) analyze and interpret financial statements.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Company accounts and group accounts (including: (i) preparing limited company financial statements; (ii) recommending accounting treatments for items in the financial statements of limited companies and groups; (iii) preparing and presenting financial statements in accordance with SLASs, legal requirements and generally accepted accounting practices; (iv) identifying when group accounts are required and preparing and presenting them in conformity with SLASs, legal requirements and generally accepted accounting practices). ▪ Partnerships ▪ Special cases ▪ Miscellaneous accounting ▪ Alternative Bases for accounting ▪ Analysis of limited company financial statements
Management Accounting	<p>Aim: To assess the extent to which candidates have acquired a sound knowledge in decision-making techniques and their application in management accounting, and are able to analyze the position and performance of a business.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Business decisions ▪ Decisions under uncertainty ▪ Operations research techniques used in decision making ▪ Internal performance measurement and transfer pricing ▪ Performance measures ▪ Ratio analysis ▪ Working capital management ▪ Stock management ▪ Debtor/creditor management ▪ Cash management ▪ Costing and variance analysis - activity based costing ▪ Use of variance analysis

Paper	Objectives and Coverage
Management Information Systems and Information Technology	<p>Aim: To assess the extent to which candidates understand and are able to apply management information systems requirements.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Management information ▪ Controls and standards ▪ Systems development ▪ Application systems and end-user systems ▪ Tools and techniques ▪ Security

5. Final II Examination Syllabus

The Final II examinations can only be taken in English.

Paper	Objectives and Coverage
Financial Management	<p>Aim: To assess understanding of theory and practice of financial management, knowledge of the financial environment and ability to apply analytical techniques in decision-making.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Financial evaluation ▪ Investment decisions (provide advice and evaluate information for the management of a Sri Lankan business on the likely financial consequences of taking specified investment decisions). ▪ Decisions under uncertainty ▪ Valuation ▪ Sources of finance ▪ The financing decision ▪ The dividend decision ▪ Financial and capital markets ▪ Treasury management ▪ Management of working capital ▪ Public finance (Candidates should be able to explain briefly the government budgeting process and the role of foreign aid and describe project appraisal in the public sector in terms of the differences from private sector project appraisal).

Paper	Objectives and Coverage
Advanced Auditing	<p>Aim: Assess knowledge of audit principles, techniques and procedures.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ General ▪ Accounting and auditing concepts ▪ Auditor's position ▪ Planning and control of an audit ▪ Planning an audit ▪ Controlling and recording audit work ▪ Quality control ▪ Performance of an audit ▪ Assessment of accounting systems and internal controls ▪ Techniques and procedures ▪ Reporting ▪ Special audits ▪ Miscellaneous
Advanced Taxation	<p>Aim: To assess knowledge of the principles of Income Tax, Surcharge on Income Tax, Turnover Tax, Defense Levy and Stamp Duty and ability to apply this knowledge to practical situations.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Income tax ▪ Special cases ▪ Tax administration ▪ Case law ▪ Government and Provincial Council Turnover Tax, GST and Defense Levy ▪ Stamp duty ▪ Tax planning (ability to provide advice on tax matters, including situations where more than one tax is involved)
Strategic Planning and Management	<p>Aim: To assess understanding of the: (i) processes and techniques of strategic management, the impact of the environment on organizational goal setting and strategy formulation, and the importance of the role of the chief executive of an organization; and (ii) importance of marketing and human resources development in achieving organizational goals and objectives.</p> <p>Contents:</p> <ul style="list-style-type: none"> ▪ Strategic planning and management ▪ Strategic management ▪ Business analysis ▪ Business planning ▪ Marketing management ▪ Human resources development

APPENDIXES

Paper	Objectives and Coverage
Advanced Financial Accounting and Reporting	<p>Aim: To assess the extent to which candidates are able to: (i) prepare financial statements in compliance with applicable laws, SLASs and generally accepted accounting practices; (ii) analyze and interpret financial statements.</p> <p>Contents:</p> <ul style="list-style-type: none">▪ Company accounts and group accounts (including: (i) preparing limited company financial statements; (ii) recommending accounting treatments for items in the financial statements of limited companies and groups; (iii) preparing and presenting financial statements in accordance with all existing SLASs, legal requirements and generally accepted accounting practices; (iv) identifying the circumstances in which group accounts are required and preparing and presenting them in conformity with all existing SLASs, legal requirements and generally accepted accounting practices).▪ Partnerships▪ Special cases▪ Miscellaneous accounting▪ Alternative bases for accounting▪ Analysis of limited company financial statements