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**COUNTRY FINANCIAL ACCOUNTABILITY
ASSESSMENT**

REPUBLIC OF MALDIVES

DECEMBER 2000

ACRONYMS AND ABBREVIATIONS

ACB	-	Anti Corruption Board
ADB	-	Asian Development Bank
ADC	-	Atoll Development Committee
AO	-	Audit Office
CEM	-	Country Economic Memorandum
CFAA	-	Country Financial Accountability Assessment
DIR	-	Department of Inland Revenue
EMIS	-	Employment Management Information System
IDC	-	Island Development Committee
IDF	-	World Bank Institutional Development Fund
IFAD	-	International Fund for Agricultural Development
IMA	-	Institute for Management and Administration
IMF	-	International Monetary Fund
MCHE	-	Maldives College of Higher Education
MMA	-	Maldives Monetary Authority
MoFT	-	Ministry of Finance and Treasury
MPND	-	Ministry of Planning and National Development
NDP	-	National Development Plan
NGO	-	Non-Governmental Organization
PEMEB	-	Public Enterprise Monitoring and Evaluation Board
PEs	-	Public Enterprises
PSD	-	Public Service Division, President's Office
PSIP	-	Public Sector Investment Program
RDMO	-	Regional Development and Management Office
Rf	-	Rufiyaa
STO	-	State Trading Organization Limited
TA	-	Technical Assistance
TAG	-	Treasury General Account
UNDP	-	United Nations Development Program

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COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENT

REPUBLIC OF MALDIVES

EXECUTIVE SUMMARY

(1) Introduction

1. In his 1999 Independence Day address to the Nation, the President of the Maldives outlined the result of work undertaken by the Government in drawing up a vision for the Nation’s future (“National Vision 2020”). The President set forth the challenge that the Maldives should, by the year 2020, become one of the top-ranking nations amongst middle income developing countries. The vision includes the consolidation of democratic governance of the country, the development and modernization of the legal framework and the administrative structure, the establishment of the most conducive conditions for brisk commerce and economic activity, and the technical skills needed for achieving and sustaining social and economic development.

2. Good financial management and accountability, which ensures that public expenditure is effectively and efficiently managed, and which provides an enabling environment for productive economic activities in the private sector, will be an essential ingredient for the realization of this vision. Recognizing that the Maldives has not yet attained financial management and accountability capacity to a level needed to underpin its Vision 2020 goals, the Government is committed to developing this capacity.

3. A Country Financial Accountability Assessment (CFAA) has been completed to assist the Government in formulating a plan to develop this capacity, by reviewing the current financial management and accountability arrangements in the Maldives, assessing with Government the development needs in this regard, suggesting steps that should be taken in the future, and identifying areas where external capacity building technical assistance could be considered.

(2) Main conclusions and recommendations

4. The main conclusions and recommendations are set out below, according to the objectives agreed with the Government during the finalization of the concept note for this CFAA. In brief, the CFAA concludes that public financial management and accountability is still at a nascent stage in the Maldives. There is understanding and commitment within the Government to modernize in this area, and important steps have begun, but a sustained program which addresses the need for reforms in a systematic and complete fashion, and implements recommendations from past studies as well as ones underway, is needed. Support and ongoing interest for this program from the highest levels of Government will be critical.

5. A comprehensive reform program should address the following key outcomes which have not yet been achieved in the Maldives:

- Timely and efficient collection of accounting information on government revenues and expenditures, recorded against an appropriately detailed chart of accounts, that provides useful for resource management decision making, adequate budget control, and the preparation of complete financial statements for accountability purposes
- Regular reconciliations of staff numbers with the public sector salaries and wages bill, through a government-wide computerized system for employee records
- A process of annual budgeting integrated with investment plans and a medium term budget framework, with accountability for applying economic affordability to budget proposals shifting away from the Ministry of Finance and Treasury to the spending units, and effective monitoring of performance by units against clear budget targets
- Uniformly good financial governance and accountability of public enterprises, including timely preparation and publication of financial statements prepared according to International Accounting Standards
- A level of oversight by the Peoples' Majlis which promotes demand for accountability, economy and efficiency in the use of public resources, supported by comprehensive independent public sector auditing and an effectively functioning Public Accounts Committee
- An effectively regulated accounting profession, with established professional accounting and auditing standards that all local and expatriate accountants can be expected to adhere, and which takes disciplinary action for non-compliance where appropriate

- A strengthened Companies Act which provides a clear framework for corporate financial accountability, with compliance effectively monitored by the Registrar of Companies.
- Clear governance and accountability requirements for non-profit organizations which attract local and international funding for development activities.

It is suggested that the Government form a small group of key officials to prepare a Maldivian Financial Management and Accountability Improvement Plan to integrate and sequence steps necessary to achieve the above outcomes. In terms of public financial accountability, actions to strengthen the public accounting system, payroll reconciliation, budgeting processes and oversight of public enterprises should receive first priority. These steps should be closely linked with a focussed strategy to address the lack of financial management expertise in the public sector, as part of a broader civil service reform strategy.

A. The adequacy of internal controls over public expenditure in general

6. The CFAA examined the financial management and accountability environment to ensure that public funds are used properly for authorized purposes, to ensure that financial information is reliable for management purposes of Government, and to support any future program lending by donors.

7. It is important to note at the outset the significant efforts by the Government in recent years to create an effective environment for good public sector financial management and accountability. In particular:

- A number of young Maldivians have been sent under Government scholarships for overseas training in accounting and other finance-related areas, assisted by the World Bank's Education and Training Projects. The Government is also sponsoring the accounting technician and business training of a number of young civil service staff at the Institute for Management and Administration (IMA) in Male';
- A project in 1997-98 to build the capacity of the Audit Office (AO), supported by the Asian Development Bank (ADB), has established a system of government auditing which meets international standards, and includes an audit methodology, an audit manual and an audit management and review system. However, the effectiveness of the AO's systems established under the ADB technical assistance remains limited because of staff capacity constraints. The cost of time and travel for work outside Male' also hinders the extension of AO audits to the other Atolls. The development and operation of a new, computerized public accounting system will add a new challenge to the AO's capacity;
- An Anti-Corruption Board (ACB) was established in 1991 and has developed prevention and investigation functions, although it too has staff capacity constraints.

- A Public Enterprise Monitoring and Evaluation Board (PEMEB) has been established within the Ministry of Finance and Treasury (MoFT), initially as a unit in 1994 but converted to a Board in 1999, in order to provide oversight of the financial as well as other operating aspects of public enterprises. A World Bank Institutional Development Grant was used to assist establish monitoring capabilities and develop a public enterprise reform program. Once again its effectiveness is limited by staffing capacity constraints;
- The Government has recognized the need for modernization and strengthening of the government accounting systems, and will begin shortly, with technical assistance from the ADB, to prepare a project to achieve this;
- A Public Service Division (PSD) was created within the President's Office in 1999 to support the modernization and reform of the Public Service for effective and efficient delivery of services. Requirements have been instituted for Ministries and Departments to develop strategic plans and performance indicators which will, when completed, lay the foundation for value-for-money assessments. Training related to this initiative have been organized through the PSD, with support provided by the Commonwealth Fund for Technical Cooperation;
- With the opening of a new building for the People's Majlis, constructed with the assistance of the Government of Pakistan, improved office facilities are available to Members and the Secretariat to help the Majlis undertake its legislative oversight role. Further development of the Secretariat's ability to provide research support to Members will be desirable.

8. Implementation of the new public accounting system will be critical to achieve the Government's policy of good governance and improved public administration. The present manually recorded, single entry accounting system is not adequate for the Government to manage, in an increasingly complex public sector environment, the risks that (a) poor public sector resource management decisions will be made due to lack of timely and relevant financial information, and (b) public funds will not be well used due to absence of accountability. The proposed new public accounting system should be designed to:

- Give assurance that all financial transactions of the Government are promptly recorded. This should include borrowings, lending, the operation of revolving funds under the control of Government, contingency and special funds and trust funds held on behalf of non-Government entities (as anticipated in the ADB Technical Assistance proposal);
- Permit the preparation of financial reports for Ministries, Departments and other agencies, as well as the Government as a whole, that allows timely decision making by Government on public expenditures, on positions with regard to debts owed and loans made, and on the utilization of assets of significant value.
- Facilitate the timely production of annual financial statements for the Government

that reflect a true and fair view of the revenues and expenditures against budgets as well as the financial position of the Government, which can be presented to the People's Majlis.

9. There are a number of other steps that can be taken by the Government in the short to medium term to ensure the sustainability of investments already made to improve financial management and accountability, and to build on these investments:

- Update the Government's consolidated Financial Regulations, last revised in 1992 and which have since been subject to many amendments by President's Office circulars. This should desirably be in the form of Public Finance and Public Enterprise Acts and regulations, and be undertaken in parallel with the development of the new computerized, public accounting system. The MoFT should play a focal role as the Government's "financial controller" in the update of the financial policies (supporting the constitutional role of the Auditor General to prescribe the manner in which the accounts of the State should be kept), as well as the oversight of the public accounting system modernization project;
- Develop a focussed strategy to deal with the problems of lack of financial management capacity within the Ministries and Departments, including the MoFT. This should be part of a civil service reform strategy leading to a Public Service that can attract and retain qualified and experienced professional staff (including financial managers, auditors and investigators) who can be exclusively employed in public service. In considering reforms, the costs and benefits of retaining certain functions in-house or on a contracted out basis should be addressed. The capacity of the PSD needs to be built so that it can facilitate this within the Government. Studies will be needed to identify suitable reform options, drawing on lessons from other small, fast growing economies. External assistance to help fund suitably qualified consultants, who can fill in until an adequate number of civil servants complete their training, will be required for some time yet.
- Strengthen the governance of the public enterprises, particularly the oversight roles and accountability of public enterprise boards of directors.
- Implement the recommendations made by International Monetary Fund (IMF) technical assistance missions on the formulation and presentation of Government annual budgets, the control of fund flows after budget approval, and the procedures for budget adjustments during the year. In addition, implement previously agreed plans to introduce a rolling medium-term expenditure program that would integrate annual budgets and PSIPs with the National Development Plan, and which would facilitate the incorporation of recurrent expenditures from capital projects into budgets. These reforms should be reflected in the design of the new public accounting system;
- Complete the drafting of an Audit Act for submission to the People's Majlis. The CFAA team noted that an Audit Bill, drafted under the ADB technical assistance to the AO, contains many features which would enhance the AO's standing,

independence and quality. This Bill is now with the Law Commission and the CFAA team understands that review of the Bill has been accorded a high priority by the Government.

10. While these actions will vary in terms of how quickly they can be implemented, they are inter-linked. A Financial Management and Accountability Improvement Plan that ensures that action is appropriately integrated and sequenced, and which can be reflected in the Sixth National Development Plan is strongly recommended. Drawing on the results of the CFAA, the Improvement Plan should identify the actions which should be completed as essential preconditions to moving forward on any proposals for future program borrowing (budgetary support type borrowing) from international financial institutions. Strong public endorsement of the Plan from, and regular follow up of the status of implementation by, the President's Office would send a clear message about its importance and would promote timely action to implement.

B. Requirements for the preparation/appraisal of the financial management arrangements for future donor-assisted development projects;

11. Financial management risks associated with development projects are being managed through the establishment of Project Implementation Units (PIUs) or Project Management Units (PMUs) within Ministries and Departments, and the assignment of qualified staff from within the civil service, supplemented by consultants, to handle financial management functions. Separate accounting systems are developed in the PIUs to support loan disbursement applications and the preparation of project financial statements.

12. This approach has been adopted for the World Bank's Education and Training Projects and the results for the Government's compliance with financial covenants in the loan documents has been very positive – project financial statements and audit reports have been timely and satisfactory. However, the approach does have a cost – the Government must invest in systems and procedures that are parallel to the Government's own systems and procedures, and these investments are not likely to be sustained beyond the lives of the projects.

13 The approach will continue to be necessary until such time as an adequate number of qualified staff exist in the civil service, and a new public accounting system is functioning effectively that permits the mainstreaming of project accounting. Therefore, the new public accounting system should have the necessary project accounting capabilities to ensure that donor and international lending agency reporting requirements can be met.

14. Donors have requested private audit firms to carry out audits of development projects that they are funding, because of limits on the capacity of the AO to carry these out. Although this remains the case, in order to reinforce the AO's mandate, it will be desirable to have the audits by these firms overseen by the AO, either through formal contracting out procedures as proposed for the ADB-financed Regional Development Project, or equivalent arrangements for technical oversight by the AO as has been

adopted for the World Bank-financed Education and Training Projects.

15. The AO's capacity will require further strengthening before it can be in a position to provide the level of auditing across the public sector that would give reasonable assurance to international financial institutions offering program lending.

C. The reliability of the public expenditure figures, coming from Government accounting systems, which will be used in Public Expenditure Reviews;

16. The chart of accounts (coding system) used in the current public accounting systems does not allow for the ready accumulation of expenditure information beyond broad, functional categories of expenditures (budget spending heads). The lack of transaction data by programs and projects produced by a double entry system that promotes completeness and accuracy of data hinders the Government's monitoring of expenditures to ensure they reflect approved development plans and programs. It also makes the production of reliable data for use in the analysis of public expenditures by funding agencies difficult and costly.

17. In order to manage these risks the Government should ensure that the new public accounting system is designed with a chart of accounts that allows the aggregation of expenditures by approved programs and projects.

D. The accounting and auditing environment related to private sector business enterprises and non-profit entities

18. In recent years, the Government has submitted and the People's Majlis has enacted a number of commercial laws to establish a conducive environment for private sector business in the Maldives. Accounting and auditing requirements are referred to in the Companies Act 1996, but the Act is not very specific. There are no local accounting standards which can be applied as a benchmark. There is no local professional accounting body, and the qualifications for company auditors specified in the Companies Act are that auditors of public companies and companies with share capital over Rf1 million must be accountants ("chartered accountants or CPAs") approved by the Auditor General.

19. Companies are required to deliver to the Registrar of Companies copies of their financial statements and audit reports. However, there are insufficient qualified staff in the Registrar's office to adequately review these reports, consequently the Registrar is not well positioned to perform his role as a protector in relation to shareholders and potential investors of public companies, and to lenders and creditors of companies, particularly the smaller ones that cannot expect to get their own special purpose financial statements from the companies.

20. The lack of local qualified accountants also hinders the implementation of the reporting requirements. Many companies must hire expatriate accountants and rely on these accountants to observe the professional codes of ethics of the accounting bodies

from which they have been qualified. In the absence of a local professional body there is no scope for local enforcement of professional standards and ethics.

21. General legislation governing non-profit entities are not clear regarding financial reporting and auditing requirements. Within the broad range of non-profit entities which includes clubs and associations, a new class of non-profit charitable societies (non-governmental organizations) is emerging which is attracting local and international funding. While donors implementing development activities through these organizations may be getting special purpose financial reports to satisfy the accountability requirements in relation to their funds, the accountability requirements for the entity as a whole are not clear.

22. The Government has begun steps to address some of the issues identified above, in particular:

- The Fifth National Development Plan 1997-2000 provides that by 2020 the Nation will be self-sufficient in accountants. The World Bank's Education and Training Projects are providing support through the financing of scholarships for staff to receive overseas accounting training;
- An Accounting and Auditing Standards Committee has been constituted under the Auditor General to look into the development of a local accounting profession that can supervise the professional ethics of its members and which has the capacity to issue local accounting and auditing standards;

23. Further action will be necessary, possibly with the help of donor assistance, in the areas of:

- Developing a strategy for establishing a local professional body for accountants;
- Designing appropriate revisions to the Companies Act to clarify accounting and auditing requirements for companies (by linking these requirements to accounting and auditing standards);
- Clarify the laws relating to the requirements for financial reporting and auditing of non-profit entities.

E. The status of current external assistance in support of improved financial management and accountability, and the potential for further support from development partners.

24. The status of current external assistance related to public sector financial management and accountability, and areas where Government has indicated that further external support may be sought, is summarized in the matrix below:

<i>Areas identified</i>	<i>External assistance underway or planned</i>	<i>No External Assistance currently identified, but may be necessary</i>
1. Increasing the number of qualified Maldivian accountants	✓ World Bank Third Education and Training Project	
2. Modernize the public accounting system. Ensure this permits accounting for expenditures by programs and projects as well as functional categories	✓ ADB Technical Assistance Project to prepare a Public Accounting System modernization project is currently underway, and ADB may provide support for later phases	

<i>Areas identified</i>	<i>External assistance underway or planned</i>	<i>No External Assistance currently identified, but may be necessary</i>
3. Develop a Government financial statement which can be audited by the Auditor General and presented to the People's Majlis		✓ (preferably in conjunction with ADB TA on public accounting system)
4. Update the consolidated Government's Financial Regulations, under new Public Finance and Public Enterprises Acts		✓ (same comments as above)
5. Develop a focussed strategy to deal with the problems of lack of financial management capacity within the Ministries and Departments, including the MoFT.		✓
6. Strengthen governance capacity in public enterprises		✓
7. Implement previously recommended reforms of Government budget procedures		
8. Develop capacity of Public Service Division to formulate and help implement civil service reforms needed to promote better public administration, including financial management and accountability initiatives		✓
9. Complete the drafting of an Audit Bill		

10. Build the capacity of the Secretariat of the People's Majlis to undertake research activities for Members		✓
11. Arrange for all audits in the public sector to be undertaken under the authority of the Auditor General, with provision for contracting out the audits to private firms or introducing equivalent supervising arrangements.		

25. Actions to improve the financial management and accountability environment of the private for profit and non profit sectors, and areas where Government has indicated that further external assistance may be required, are summarized below:

<i>Areas identified</i>	<i>External assistance underway or planned</i>	<i>No External Assistance currently identified, but may be necessary</i>
12. Develop a strategy for the establishment of local professional body for accountants		✓
13. Revise Companies Act to clarify accounting and auditing requirements for companies (link to accounting and auditing standards)		
14. Clarify laws relating to the financial reporting and auditing requirements of non-profit entities		✓

Items 5, 6, 8, 10, 12 and 14 are areas which could be considered by the World Bank for capacity building support in its country assistance program. Some exposure to lessons from other modernizing small countries, where informal social controls have traditionally played a more significant role in accountability than formal mechanisms, would be a useful ingredient in any capacity building efforts.

26. The CFAA does not cover public sector procurement policies and practices. However, the Government also identified this as an area requiring further development. This could examine the Government's tendering practices to ensure that they produce fair and economical procurement, and assess capacity development needs. A Country Procurement Assessment, carried out by World Bank procurement specialists, is recommended.

DETAILED REPORT

INTRODUCTION

Brief description of country characteristics

1. The Republic of Maldives comprises some 1,200 coral islands within 29 natural atolls in a north-south chain 820 kilometers long and up to 130 kilometers wide. Almost one quarter of the islands are inhabited. The atolls are divided into 20 administrative regions also known as Atolls. These administrative Atolls are divided into 200 administrative Islands. In addition there are about 60 islands set aside for tourist resorts and special uses. The population (excluding foreign nationals) is, according to the 2000 census results, just under 270,000 with about one quarter living in the Male' Capital Atoll. The rest of the population is spread fairly uniformly among the other administrative Atolls.

2. Maldives is a homogeneous nation with a shared history, culture and religion, and a common language, Dhivehi. The 1998 Constitution defines the Maldives as an Islamic state with the seat of government in Male'. Maldives has been an independent nation throughout its recorded history, and after a period from 1887 to 1965 under British protection with regard to its defense and foreign affairs, it became a fully independent state. After many centuries of sultanate form of government, the Maldives adopted a republican form of government which has been evolving since the final abolition of the sultanate in 1968.

3. The public sector is a significant segment of the Maldivian economy, with expenditures amounting to about 50% of GDP. Of those segments of the economy with major private sector activity, tourism and commercial fisheries are the most important, accounting for almost 30% of GDP¹.

4. In recent years, official development assistance to the Maldives has averaged about \$35 million per year. This assistance – about evenly split between grants and concessional loans – amounts to around 12 percent of GDP and is critical for supporting Maldives' development efforts. The World Bank, ADB, the Islamic Development Bank, the United Nations agencies, the OPEC Fund, the Kuwait Fund, the Saudi Fund, Japan, AusAid, India and DANIDA are the principal donors. Development investment projects and balance of payment support funded with concessional loans are executed by the Government. Grant funded projects may or may not be executed by the Government depending on the donor and project - where grant funds remain under donor control, procurement and payments are handled by the donors themselves rather than through Government systems. The UN agencies are moving towards full country execution of their grant aid to the Maldives.

¹ Maldives Country Economic Memorandum: Policies for Sustaining Economic Growth (CEM), World Bank, April 19, 1999, Executive Summary, page 1

Description of the political structure of the country:

Constitutional arrangements in general

5. The present Constitution came into force on January 1, 1998. This provides that the Maldives is a democratic, unitary state with a republican form of government. The governing powers of the state comprise the Executive (President), Legislature (People's Majlis and People's Special Majlis) and Judiciary.

6. Under Section 92 of the Constitution, the power to make and amend the Constitution is vested in the People's Special Majlis, consisting of the Cabinet of Ministers, members of the People's Majlis, members elected from Male' and the Atolls equal to the members elected to the People's Majlis from each constituency, and eight members appointed by the President.

7. Sections 144-146 provide that the President may issue a Proclamation of Emergency for an initial period of three months. Rights and laws which in the opinion of the President impede the maintenance of national security and public order may be suspended. A Proclamation of Emergency may be extended beyond three months by the People's Majlis. Within one month of expiration of the Proclamation of Emergency, the President shall submit a written report on the emergency to the People's Majlis.

Executive, Legislature and Judiciary

8. Section 4 of the Constitution vests executive power in the President and the Cabinet of Ministers appointed by the President; legislative power is vested in the People's Majlis and the People's Special Majlis, and power to administer justice is vested in the President and the courts of the Maldives.

9. The President is Head of State and Head of Government and Commander-in-Chief of the Armed Forces and of the Police (Section 33). He is elected by a general public vote in secret ballot, after having been selected for candidature by the People's Majlis in secret ballot from among candidates who have applied to the Commissioner of Elections and who are determined by the Commissioner of Elections, in public announcement, to meet the qualifying criteria (Section 35). The President will govern with a Cabinet of Ministers appointed by him, and over which he will preside (Section 54). The President is currently also the Minister for Finance and Treasury, and Minister of Defence and National Security. The Constitution provides for a Presidentially appointed Vice President (Section 51) but to date the President has not made such an appointment.

10. The People's Majlis consists of 50 members of which 8 are appointed by the President, 2 are elected from Male' and 2 are elected from each Atoll (Section 64). The duration of the Majlis is 5 years from the date of the first meeting after its election (Section 65). The Speaker is appointed and removed by the President, and is not a member of the Majlis (Sections 68). No taxation may be levied except by legislation passed by the Majlis (Section 76). Prior to the commencement of every financial year, the Minister of Finance shall submit the budget to the Majlis and the budget so proposed

will be passed by the Majlis. No supplementary or excess funds shall be added to an already passed budget unless it has been submitted to and passed by the Majlis (Section 78). Bills passed by the Majlis require the assent of the President to become law, but a Presidential veto may be overridden by a two-thirds majority of the Majlis (Section 79). Bills which have received assent become law and enter into force when published in the Government Gazette (Section 80). The Majlis is supported by a Secretariat headed by a Secretary-General.

11. The Judiciary comprises the High Court and other courts as decided by the President. The President has the power to appoint and remove judges of the High Court or other courts (Sections 117 and 123).

Local government institutions

12. While the Maldives is established as a unitary state, and there are no other elected governing powers in addition to the Government, there are institutions for delivering municipal services.

13. Section 106 of the Constitution provides that there shall be an Atoll Chief appointed by the President for each Atoll. Each Atoll is administered by the Atoll Chief and the President may issue directions to the Atoll Chief through Ministers (Section 109). Atoll Chiefs usually remain in post until retirement. The Ministry of Atolls Administration advises the President on the selection of Atoll Chief and once appointed the Atoll Chief is under the administrative oversight of the Minister of Atolls Administration.

14. All activities conducted in the Atolls by the Government Ministries and Departments are conducted according to directives issued by them, but under the supervision of the Atoll Chief and the Atoll Office which provides administrative support to the Atoll Chief. No Ministry or Department currently maintains its own offices in the Atolls independent of the Atoll Office (but see comments on Regional Development and Management Offices in paragraph 17 below).

15. Each inhabited island has an Island Chief, supported by an Island Office, and they are directly subordinate to the Atoll Chief. The Island Chief is appointed by the Minister of Atoll Administration and usually remains in post until retirement or until transfer to another post. The CFAA mission was advised that the post of Island Chief is advertised and any qualified person may apply for the post.

16. In addition to the Government administrative structures, there are Atoll Development Committees (ADCs) and Island Development Committees (IDCs). These are elected by the local communities and the Atoll Chief is president of the ADC and patron of the IDCs in the Atoll. These committees identify, fund and manage local development activities.

17. Under the Regional Development Project, the Government proposes to establish permanent Regional Development and Management Offices (RDMOs), which will have responsibilities to coordinate and manage regional development projects. The first phase

of this project, supported by a recently approved ADB loan, will focus on the northern and southern development regions and RDMOs will be established in these regions. Planning activities of the RDMOs will be guided by a regional advisory committee consisting of participating Atoll Chiefs, the RDMO chief executive officer, one community representative from each participating Atoll and a planner seconded to each RDMO.

18. Various municipal services for the capital city, such as allotments and leasing of land, birth registrations, street maintenance, parks and gardens and local markets, are carried out by Male' Municipality, an office of the Ministry of Home Affairs, Housing and Environment. The Municipality is headed by an appointed Chairman who reports to the Minister of Home Affairs, Housing and Environment.

Scope of functions carried out by the public sector

19. A full range of functions is carried out by the Maldives public sector, including:

(a) policy and regulatory functions that are the responsibility of Ministries and Departments;

(b) various administrative activities and services provided by Ministries and Departments, Public Enterprises (utilities), and Atoll and Island Offices; and

(c) profit-making activities carried out (mainly) by Public Enterprises.

Non-profit and private sectors

20. There is an active private sector and the Government has been undertaking measures to improve the business environment for private investment. Major areas of activity for the private sector are tourism, fisheries, construction and trade. There is a Companies Act, which was passed in 1996 and a number of other commercial laws including ones on contracts, negotiable instruments, foreign investment and environmental protection. The Government plans to review certain these laws to address certain identified gaps, and is planning to strengthen the judicial system with the help of the ADB, to ensure the application of commercial laws to international standards.

21. Within the broad range of non-profit entities which includes clubs and associations, a new class of non-profit charitable societies (non-governmental organizations) is emerging which is attracting local and international funding.

Areas of coverage of the CFAA

22. The scope of the CFAA encompasses the following core aspects of the public financial management and accountability environment:

- the effectiveness of **legislative and other oversight functions** and **public financial reporting** to promote accountability for efficient and effective use of public resources;
- the **accounting, auditing and related legal frameworks**, to determine their compatibility with the needs of the country as well as with international accounting and auditing standards – in particular International Accounting Standards (IAS), International Standards of Auditing (ISA) and INTOSAI auditing standards;
- **public sector accounting and financial control processes** including, inter alia, aspects of planning, budgeting, treasury operations, disbursement, accounting systems, internal control, and related practices at the national and local government levels. This includes the identification of key financial risk areas in disbursement mechanisms and channels currently in place, including those related to funds flows to local government bodies, community based organizations and NGOs for development projects;
- the **audit capacity** in the country, including the independence and capacity of the Audit Office (AO) and private audit firms, and efforts to upgrade this capacity; the status of the **accounting and auditing profession**; and the scope and quality of financial management training;
- the financial management and accountability dimensions of the country's **anti-corruption** standards, practices, and other measures.

23. The results of the CFAA are set out in this report according to the following modules:

1. PUBLIC SECTOR

- Tone at the Top
- Legislative Oversight and Public Financial Reporting
- Budgeting, accounting, reporting and internal controls
 - ◊ Control environment
 - ◊ Legitimization of public revenues and expenditure
 - ◊ Disbursements, receipts and accounting
 - ◊ Payroll
 - ◊ Internal audit
- Funds flows
- Local Government Institutions
- Public Enterprises and Undertakings
- Government Auditing
- Anti-corruption and Civil Service Reform Initiatives

2. ACCOUNTING/AUDITING PROFESSION AND EDUCATION

3. ACCOUNTING/AUDITING REGULATORY FRAMEWORK FOR THE PUBLIC SECTOR

MODULE 1 - PUBLIC SECTOR

CONTEXT

24. The Maldives public sector is a relatively large part of the nation's economy – for the period 1996-98, Government expenditure-to-GDP ratio was 48-50% (though lower than the 1991-93 period when it was 56-61%)². In the 2000 budget, Government recurrent expenditure amounted to just over 33% of GDP and Government capital expenditure amounted to just under 17%. The public sector (including state-owned enterprises) employs over 22% of the labor force³.

TONE AT THE TOP

Public speeches and pronouncements on public financial management and accountability by Government leaders

25. The Fifth National Development Plan 1997-2000 puts on record the Government's commitment to improved financial accountability in the public sector. The Plan states that "Public sector improvements in the Plan period will be centered on accountability". Among the policies, strategies and measures set out in the Plan⁴, pertinent ones in terms of financial management and accountability are:

- Maintain *clear mandates and responsibilities* for Government agencies;
- Foster a *culture of accountability* for performance within agencies;
- Examine ways of expanding Ministerial responsibility in accordance with *clearly specified and written delegation* of financial and administrative authority;
- Strengthen the *role of the Citizens' Majlis (now People's Majlis) to scrutinize* Ministry and public enterprise performance by questioning public sector conduct of Government business and performance against targets in their programs;
- Require annual *preparation of agency programs* by agencies as part of their budget bidding exercise and *assessment of program performance* in their annual reports. Relating to this are the formulation of quantifiable and measurable *targets* for agency programs and establish related *evaluation processes*;
- Establish and implement a comprehensive and fully costed public sector training plan to meet the needs of a *self-sufficient and qualified public administration*;
- Strengthen MCMA (now Institute for Management and Administration) to provide *training courses to civil servants* on public sector financial and recording procedures and approval requirements, budget processes, service excellence, project formulation and program development and evaluation

² CEM,

³ CEM, Chapter 1, page 2 (see Box 1.1)

⁴ Fifth National Development Plan 1997-2000 (Fifth NDP), Ministry of Planning, Human Resources and Environment, 1988, Volume II, pages 75-78.

As indicated in this report, the Government has undertaken a number of steps to implement these challenging goals, but much work is yet to be done. The CFAA assesses that there is genuine commitment within the Government for improved financial management and accountability, and it is acknowledged that the speed of reform will be dependent on the absorptive capacity of the public sector and the pace of political development. However, clear signals of priority for a Financial Management and Accountability Improvement Plan, and ongoing review of progress, by the President's Office would ensure that reforms are pursued in a timely manner.

Oaths of office of public office holders

26. Public office holders are required to take an oath of office in which they swear to discharge the responsibilities and duties of their office honestly and faithfully. This includes the President, Acting President, Vice President, Ministers, Attorney General, Members of the People's Majlis and People's Special Majlis, Speaker, Atoll Chiefs, Chief Justice and Judges, Commissioner of Elections and Auditor General. The forms of the oaths are set out in a Schedule to the Constitution.

Codes of ethical conduct for public office holders and civil servants

27. There are no specific codes of ethical conduct for public office holders and civil servants.

28. Section 45 of the Constitution provides that the President shall not engage in any private business or be in the employment of any commercial enterprise or hold any office for profit.. However Ministers, other public office holders and civil servants are not so restricted, in that they may engage in their own private businesses but are not allowed to be employed by private businesses or work for any other party, and it quite the norm for them to have their own private businesses. Ministers are required to submit details of their income and assets to the President.

29. The practice of allowing outside business or employment originated to meet the demands of economic development of the country at a time when there were few Maldivians trained and experienced in managing large enterprises. However, significant increase in the quality of public administration, including financial management and accountability, will require a move to a system whereby public office holders and civil servants can be engaged full time in their public responsibilities. This will not only contribute to more effective government but also reduce the potential for any conflicts of interest concerning the execution of their public duties and their private interests. It will also, together with the development of a code of ethical conduct for public office holders and civil servants, establish a firmer base on which a culture of accountability can be developed.

30. It would be unrealistic to implement a change in public sector employment policy along these lines under current remuneration packages. The Government first needs to develop a focussed strategy for civil service reform that will allow it to attract and retain qualified and experienced professional staff who can be exclusively employed in public

service. The Public Service Division of the President's Office will need strengthened capacity to facilitate, within the Government, the development of this strategy. Studies will be needed to identify suitable reform options, drawing on lessons from other small, fast growing economies. The development of codes of ethical conduct can go hand in hand with this. External technical assistance would be useful in these areas.

Review, ruling and publication of disciplinary actions with regard to alleged unethical conduct by public office holders

31. The ACB, established in 1991, is responsible for investigating breaches of oaths in terms of financial misbehavior. The functions of the Board and its current capacity to carry out these functions effectively are discussed in paragraphs 199-209 of this report. As indicated in these paragraphs, the Board does have limited capacity.

32. The ACB does not publish any reports or statistics of results of cases under its investigation. Details of disciplinary actions taken are not publicized. As a way of building public awareness of the importance given to transparent and accountable government, it would be desirable for the Government to develop with the ACB a suitable reporting mechanism to inform the public, in general terms, of the activities and outcomes of the Board.

LEGISLATIVE OVERSIGHT AND PUBLIC FINANCIAL REPORTING

Overview of national traditions and attitudes towards the citizen's monitoring of government and public officials

33. The smallness of the Maldives means that family, friendship and business ties significantly affect relationships between the public and their Government and relationships within the Government. Informal, social controls relying heavily on personal relationships have taken on a relatively larger degree of importance in comparison with formal accountability mechanisms. The latter have not historically been well developed. Unlike many other countries in the region, the Maldives has never been colonized by another power that has transplanted accountability structures and institutions. Only in the last two decades has the Government nurtured indigenous accountability mechanisms within the public sector as part of its program to modernize the state, but these are still evolving. The Maldives has not had a tradition of non-governmental institutions playing a role in public accountability.

34. Many officials and others met by the CFAA mission indicated that, because the scale of government and the amount of public revenue and expenditure has rapidly increased over the last two decades, there is a need to build further awareness and consciousness in the community and among Government officials about the requirements for accountability of Government. Efforts to build accountability mechanisms face special challenges posed by their implementation in a small, closely connected society without long traditions of public accountability. This was an area that many officials thought access to information on experiences in other small countries would be helpful, and the CFAA mission believes that exposure to such experiences would be a useful

ingredient in any public accountability capacity building initiatives contemplated by the World Bank .

Public financial and performance reporting

35. Full financial statements of the Government are not currently prepared and published. The annual budget document (in Dhivehi only), which is presented to the People's Majlis for approval, is available to the public on request to the Ministry of Finance and Treasury (MoFT) – there is no Government bookshop as such. An English language budget booklet providing budget statistics is also prepared. Auditor General's reports are not published.

36. The preparation of annual financial statements of the Government will be an essential element of any further development of public accountability in the Maldives. These financial statements should:

- compare actual and budgeted revenues and expenditure of Government for the year;
- analyze revenues by various sources;
- show expenditures according to programs as well as traditional budget heads (salaries, supplies, travel etc);
- show assets and liabilities as at the end of the year, including details of contingent liabilities;
- encompass not just the Treasury General Account but also any revolving funds outside this account, and any trust funds held on behalf of other entities or persons; and
- include development activities funded by donor grants and loans.

The design of the financial statements should be undertaken in parallel with the development of the new public accounting system which is being planned with ADB assistance (see paragraphs 111-112 for further information on this).

37. The development of annual reporting by Government on achievement of program objectives should be a medium term objective. These reports should outline, for all major government programs, the key performance indicators and targets versus actual results for the year in terms of these indicators. The introduction of annual reporting should be linked with the recently initiated development of strategic plans and performance indicators for Government ministries and departments.

Role of People's Majlis

38. There are three regular sessions of the People's Majlis each year (Section 72 of the Constitution). Governments are not made and unmade on the floor of the Majlis, and there is no political party system. However, in a number of aspects, the Majlis has the power to play a key oversight role over the affairs of government. Annual and supplementary budgets are passed by the Majlis (Section 78) – this is discussed in more detail in paragraphs 61-62 of this report. Also, every member of the Cabinet of Ministers

and every Minister may be questioned, after a period of notice, in the Majlis concerning any act done or committed in his official capacity (Section 81).

39. The People's Majlis also has standing and select committees which can look into questions of government. Among existing standing committees is a Fiscal, Monetary and Economic Affairs Committee. These committees have the power to call witnesses and will submit reports of their deliberations to the Majlis. A resolution of the Majlis would be binding on the Ministers. However, at present there is no Public Accounts Committee whereby the Majlis receives and reviews Auditor General reports, including annual financial statements of the Government, public enterprises and development projects. Oversight from the point of view of financial accountability is therefore not as well developed as in many other countries.

40. A well functioning Public Accounts or similar committee of parliament is an internationally well recognized feature of good public financial accountability. It enhances the role of the Auditor General and generates a demand for good financial control within governments. It can also provide advice and pressure on the Government and the civil service with respect to improving services and making more efficient use of resources. The ADB consultants providing technical assistance to the Audit Office (AO) recommended the establishment of a Public Accounts Committee and made proposals in this regard. These proposals have been submitted for consideration to the Government but no steps have yet been taken in this regard.

41. Decisions regarding the expansion of the role of Fiscal, Monetary and Economic Affairs Committee, or establishing a separate Public Accounts Committee must, of course, involve the People's Majlis itself, and have regard to the Members' and Secretariat's capacities. The CFAA team was advised that interest among Members to exercise more effective oversight of Government financial activities is growing. With the opening of a new building for the People's Majlis, constructed with the assistance of the Government of Pakistan, improved office facilities are available for Members and the Secretariat to help the Majlis undertake its legislative oversight role. Members have rooms to meet with constituents, and space for library and research is available. There are exchanges with other parliaments in the region which are exposing Members and Secretariat staff to practices in other countries, and the recent joining of the Commonwealth Parliamentary Association will broaden these opportunities and provide access to further technical resources.

42. Developing Members' knowledge of practices elsewhere and capacity building in the Secretariat, to ensure it can keep pace with the demands of Members for related research support, are areas of where further external technical assistance could be effective. Assistance to the Majlis to study how Public Accounts Committees function in other countries, and how such a Committee might be constituted and operate in the Maldives, might best be included as part a broader package of capacity building assistance that includes help with research methods, modernizing the legislation database, translating laws and publishing both Dhivehi and English versions on the internet, and establishing a library of subsidiary regulations which are not currently consolidated in any form.

BUDGETING, ACCOUNTING, REPORTING AND INTERNAL CONTROLS

43. Basic controls over budgeting, disbursements, receipts, accounting and reporting exist. These have been established over the years in financial regulations and circulars, and are subject to independent audit by the AO. Key aspects include controls over operation of bank accounts, a budget appropriation and release process overseen by MoFT, requirements for basic accounting records, certification and authorization controls over Government payroll and other expenditures, and preparation of monthly accounting reports for MoFT. However, there is considerable scope for improvement in a number of aspects as indicated in this section of the report.

I. Control Environment

44. The control environment for budgeting, accounting, reporting and internal controls would be enhanced by the development and publication of a code of ethics for civil servants. This could be done as part of civil service reforms overseen by the Public Service Division of the President's Office.

Roles and responsibilities of public agencies

45. The roles and responsibilities of public agencies, in relation to budgeting, accounting, reporting and internal controls are defined, although the absence of a Public Finance Act or equivalent legislation means that much is not codified in law. Consolidated financial regulations are out of date, having been amended by various circulars, and are not comprehensive. The key roles and responsibilities are summarized below:

- The Auditor General is responsible, under section 127 of the Constitution, for prescribing the form and manner in which the accounts of the State shall be maintained, and under section 126 for audit of these accounts and the preparation of reports thereon.
- The MoFT is responsible for coordination of budget preparation, monitoring of actual revenues and expenditures against budgets during the year and has an oversight responsibility for the operation of the internal controls over financial management in the Government.
- The Maldives Monetary Authority (MMA), the nation's central bank, maintains the Government's bank accounts and lends to the Government through Ways and Means Advances and other mechanisms.
- Spending units in each Ministry and Department are responsible for adhering the Government's policies and procedures with respect to budgeting, receipt and expenditure of public funds, and maintenance of the related accounting records.

Roles and responsibilities of civil servants concerned with financial management of public funds

46. Each Ministry and Department has an accounts cell which is responsible for the maintenance of accounting registers and ledgers, filing of supporting documentation (purchase orders, invoices, receipts, and other records), bank account statements, copies of accounting reports to MoFT and security of accountable documents (cheques, receipt books, purchase order books). Ministries and Departments which collect payments also have cashiers who are responsible for custody of cash and cheques received pending their bank deposit, and maintenance of receipt books and registers. In some Departments, staff will be designated as petty cash custodians and will be responsible for security of cash and petty cash vouchers pending submission for replenishment of the cash floats.

Arrangements for control over operation of bank accounts

47. Control is exercised through the requirement that all bank accounts of Government must be kept with the MMA. There is a system of delegations for signatories to the accounts. Each spending unit keeps one or more accounts with the MMA. The MMA maintains bank account records on a computerized system and issues monthly bank statements to the spending units, and the MMA's records provide an independent source for verification of Government transactions by the AO.

48. Funds are released by the MMA to the spending units' bank accounts in accordance with authorizations from the MoFT. These will be based on annual budget appropriations of the People's Majlis, subject to a certain amount (the "unspent balance") withheld at the beginning of the fiscal year by the MoFT – see paragraphs 66-67 for more details on this. Further funds releases from the "unspent balance" may be advised by MoFT to MMA during the fiscal year.

II. Legitimization of Public Revenues and Expenditure

49. Annual budgetary formulation and presentation requires reform to reduce inefficiency, improve transparency and accountability, and support better financial management of the budget. The introduction of an annual Public Sector Investment Program (PSIP) will help integrate Government investment plans with the annual budget, but more work is needed to better integrate these instruments with the National Development Plans. The new public accounting system to be developed with the assistance of the ADB should incorporate accounting requirements to support budget reforms.

Recent Reviews

50. In 1994, an International Monetary Fund (IMF) team reviewed public expenditure management and made certain recommendations (in a report known as the "Potter Report") concerning the budget preparation and presentation process, as well as monitoring of budget execution. This was followed up in 1995 with the assignment of a

Fiscal Advisor (Mr. David Webber) to assist with the implementation of the recommendations. The current status of findings and recommendations from the IMF technical missions are incorporated in this section.

Laws defining public funds and their management

51. Section 78 of the Constitution provides that, prior to the commencement of every financial year, the Minister of Finance shall submit to the People’s Majlis the estimated expenditure and income of the State for the year, and the expenditure and the income of the State for the preceding year and the budget so proposed shall be passed by the People’s Majlis. No supplementary or excess funds shall be added to an already passed budget unless it has been submitted to and passed by the People’s Majlis.

52. Section 127 provides that the accounts of the State shall be kept and maintained in such form and manner prescribed by the Auditor General on the advice of the President.

53. There are Financial Regulations, last consolidated in 1992, which set out the requirements for the internal controls and recording of public revenue; government expenditure including payroll; government assets including cash in custody, property and equipment, consumable items and items printed for sale; procurement and contract management⁵. The Financial Regulations have been amended over the years by President’s Circulars, which must be filed and read together with the Regulations in order to ascertain current requirements. The Regulations reflect the manual accounting systems of the Government are not comprehensive, and will need to be updated as part of the modernization and computerization of the public accounting system.

54. There is currently no Finance Act or Public Enterprises Act.

Government budget (revenues and expenditures) formulation and expenditure authorization process

55. The Government’s fiscal year runs from January 1 to December 31. The current budget formulation and expenditure authorization process is documented in broad terms in the Government’s published English language annual budget summary “Government Budget in Statistics”.

56. The Government budget is based on cash accounting principles, i.e. it is formulated on the basis of determining a ceiling for cash expenditures in the year after taking into account cash revenue received during the year.

57. The budget consists of the “regular budget” and “extra-budgetary operations”. The regular budget presents estimates of domestic revenue, and domestically financed current and capital expenditure. The extra-budgetary operations are made up of two parts, one comprising expenses for development projects financed by foreign grants and the other

⁵ The Government’s Financial Regulations and amending President’s Circulars are in Dhivehi. An unofficial translation of the 1992 consolidation is available.

comprising projects financed by foreign loans. The budgets for extra-budgetary operations are now included (separately) in the budget document that is presented to the People's Majlis⁶.

58. The annual budget formulation process begins in late July when the MoFT requests, by Budget Circular, individual spending units to provide the information for the preparation of the next year's budget: A set of standard forms is used to capture revenue and expenditure for the previous year (actual), current year (budgeted, actual and revised) and next year (estimated). The main purpose of the Budget Circular is to ensure that spending units follow consistent procedures when preparing budget estimates.

59. This information is supplied over the August-November period, and the CFAA team was advised that MoFT staff must work intensively with spending units to get timely information on the forms in a manner that will permit MoFT to consolidate the budget document. The first draft of the annual budget for the coming year is in early December. The budget is reviewed and cleared first by a Budget Committee comprising Ministers and MMA representative, before submission to the President's Office. Once approval is given by the President's Office, the budget is presented in late December to the People's Majlis by the Minister for Finance and Treasury (currently the President). Members of the Majlis receive the budget document for review a few days before the budget sessions.

60. The main thrust of budget scrutiny is carried out by MoFT rather than the People's Majlis, although some members of the Budget Committee will be Members of the Majlis. While the State Minister of Finance and Treasury will answer questions in the Majlis on the budget, the Majlis does not meet as a "Committee of the Whole" to change budget figures. In the event that the Majlis would seek amendment of the budget, the whole budget would have to be referred back to the Government for change and resubmission. The wording of section 78 of the Constitution, which states that "the budget so proposed shall be passed by the Majlis", indicates that the Majlis can not formally reject a budget, although it is clearer that the Majlis can decline to pass a request to subsequently increase the budget.

61. The budget is passed by the People's Majlis on a vote, like other legislation. The Speaker will inform the President of approval of the budget and the President will inform the Speaker of his assent. Once this is received the Speaker will inform the Minister of Finance and Treasury that the budget may be implemented. MoFT will then advise the MMA of the funds which may be transferred from the Government's budget account to the bank accounts of the spending units.

62. As indicated below, some of the IMF technical mission's key recommendations on budget processes have not yet been implemented, though they remain relevant:

⁶ The budget document is in Dhivehi, and the CFAA team has relied on advice from MoFT on this.

Inclusion of information in the Budget Document

63. Government has made loans to public enterprises and individuals. While these appear to be correctly classified in the “net lending” figure in the “Government Budget in Statistics” the CFAA team understands that they are not shown in the Dhivehi language budget document presented to the People’s Majlis. Nor are loan guarantees, which represent contingent liabilities of the Government. These should be disclosed in future budget documents.

64. Although Ministry of Atolls administration and other Ministries’ expenditure in the Atolls are included in the budget, the revenues and expenditures of ADCs and IDCs on local development projects are not. They should be included in the Government budget document (and the eventual Government financial statement), suitably classified to separately distinguish them apart from the normal revenues and expenditures of Government.

“Unspent Balances”

65. An unusual feature of the method of budgeting of the Maldives Government is the concept of “unspent balances”. Shortly after the budget has been approved by the People’s Majlis and assented by the President, a President’s Office Circular (the “withdrawal circular”) will inform the spending units that part of their initial appropriations for non-salary expenses have been withdrawn as an across-the-board reduction by the MoFT (for 2000, the reduction was about 12%). Advice to the MMA on the amounts to be made available to the spending unit accounts will reflect this reduction. The spending units will return to MoFT at various times during the year and make proposals for reshuffling the reduction between different budget lines, and reinstating all or some part of the original appropriation, through Budget Control Forms.

66. This process provides a way for MoFT to control the level of spending by Ministries and Departments, in the absence of strong financial management capacity within them, but it poses some problems in terms of clarity and accountability for the spending of public funds:

- It is not clear to spending units what their real (“hard”) budget limits are, making it difficult for them to effectively prioritize and undertake good financial planning;
- Monitoring of performance against budget is difficult because of the shifting limits;
- There is an administrative workload, within both MoFT as well as spending units, associated with the management of the “unspent balances”; and
- It shifts responsibility and accountability from spending units to the MoFT for applying economic affordability criteria in the budget preparation, and (by relying on reshuffling budget within spending units rather than between them to reach budget saving targets) it limits the effective management of the budget during the year.

67. The IMF technical missions recommended the replacement of this process, with one whereby:

- The focus of determining economic affordability is shifted to budget preparation during the August-November period. The Budget Circular could be enhanced to provide guidance to Ministries and Departments on policy issues that will affect budget priorities, and macroeconomic information that would assist with revenue estimation and the setting of expenditure limits;
- Salary and allowance components of spending unit budgets are based on likely employment levels rather than the number of staff positions, as historically there has been a significant underfill of posts. Basing the budget on number of positions has raised an undue of uncertainty into the budget numbers as well as invites supply-led growth in staff costs;
- Adequate attention is given to the recurrent expenditure implications of proposed capital projects, which can be fed into subsequent years' budget requirements for current expenditure;
- Net discretionary expenditure ceilings are determined after considering revenue forecasts; surplus/deficit policy targets; first charges on the budget from committed expenditure such as loan amortization, interest payments and allowances for anticipated calls on Government loan guarantees; and a contingency fund managed by MoFT to meet unplanned but irrefutable claims on the budget during the year. These discretionary expenditure ceilings can then form the basis for budget negotiations based on Government priorities;
- The annual budget amounts of spending units contained in the budget appropriations approved by the People's Majlis, by being more robust estimates of what is required after being tested more thoroughly for affordability, become the ones allocated;
- MoFT introduce periodic (such as quarterly) releases of funds to spending units based on their expenditure ceilings and updates of the expected revenue/expenditure flows, to allow orderly management of the budget execution during the year.

68. The Government should give early consideration to reforming the budget process along the lines recommended above.

Analysis of spending unit submissions

69. There are currently 159 spending units providing their own data to MoFT during the budget formulation process. This puts a heavy burden on MoFT to review proposals, shifts away responsibility and accountability from Ministries and Departments for making intra-spending unit trade-offs, and may discourage such trade-offs during the year if budget reductions are required. The IMF recommended (at a time when there were 129 spending units) that Ministries and Departments should be made more responsible for formulating budget distributions to their spending units based on total budget envelopes identified for the Ministries and Departments. This recommendation should also be reconsidered for implementation as part of budget process reforms.

Linkage of Budget to National Development Plan and Public Sector Investment Programme

70. National Development Plans (NDPs), usually prepared on a three year-basis, sets out the Government's development objectives and priorities and sector-level investment

targets. An annual PSIP containing projects locally or externally funded is prepared annually. The Ministry of Planning and National Development (MPND) is responsible for facilitating the national planning process and submits the annual PSIP to MoFT to match plans with resources available under the annual budget.

71. MPND, in consultation with the line Ministries, screens projects submitted for inclusion in the annual PSIP for their consistency with the development priorities. A Project Appraisal Committee screens all major projects. There is an intention to better link the NDP with the annual PSIP and budget processes through the preparation of rolling three year PSIPs. The World Bank has recommended in its 1999 Country Economic Memorandum⁷ that this be formulated and prioritized as a public sector core expenditure program established within the context of a medium term budgetary framework, and should integrate recurrent expenditures arising from capital projects.

Budget monitoring

72. Budget monitoring of the expenditures of Ministries and Departments, is hindered by the laborious, manual accounting systems and lack of adequately human capacity within the Ministries and Departments to analyze and manage the budget position. MoFT must actively follow up with spending units on the monthly reports which they are required to prepare and submit to MoFT. The manual accounting system is planned to be modernized and replaced with a computerized system with the assistance of the ADB (see paragraphs 111-112 for more information on this).

73. Indicated below are some aspects of recognizing and recording expenditures against budget which limit the effectiveness of the monitoring of the budget by the Government.

Carried-over expenditure

74. Total expenditure incurred in any particular budget year is a composite of:

- Actual expenditures charged against the budget for that year; and
- expenditures incurred in the budget year, but which relate to commitments carried over from the previous year's budget. For a certain period of time (several months) these expenditures are charged against the previous year's budget.
- Expenditure commitments made against the current budget, but incurred in the following budget year, will for a certain period of time (several months) be charged when expensed to the current budget.

As a result, the link between total expenditure in any year and the actual amount appropriated by the People's Majlis for that year is not as clear as it should be.

⁷ CEM, pages 15-16

75. On the basis that the annual budgetary system would remain cash-based, the IMF Fiscal Advisor recommended that those expenditures which are actually made in any year should be charged to the current budget (with some allowance for cheques in transit during January). Commitments made during the year should not be charged to the Budget if actual expenditure falls in the following year. These should be a first charge on the following year's budget. This will improve certainty about the amount of budget surplus or deficit and enhance cash flow management.

Commitments

76. The accounting ledgers do not keep track of commitments arising from orders that have been placed by Ministries and Departments, until an invoice is presented for payment. When this occurs, the invoices are registered, the expense is then recorded in the expenditure ledger when it is charged, and actual payment of the expense by cheque is recorded in a third register (which the payee signs). The absence of commitment records raises the risk that budgets will be overspent because the total sum of expenses and orders made cannot be calculated. The new computerized accounting system should be designed to allow the tracking of commitments and accounts payable as well as actual expenses paid.

Foreign expenditure payments

77. When an importer is ready to deliver goods to the Government, the invoice is sent to the MMA for payment. MMA will provide the foreign currency and pay the invoice, and then send a debit note in rufiyaas for the corresponding amount to the appropriate spending unit. These are not always paid promptly by the units and sometimes payment is refused. As the expenditure will not be recorded in the Government ledgers until the rufiyaa bill is paid, there will be lags in expenditure data used for budget monitoring. Where the amount is not paid, it will go unrecorded in the Government's accounts as an "off-budget transaction" and there is a risk that spending units will increase their total expenditures above their appropriations. The amounts appear in the accounts of MMA as "Government Debt".

78. Payment procedures for foreign currency expenditures should be changed so that these are paid by MMA only after getting authorization from the appropriate Ministry or Department, at which time the spending unit's account at the MMA should be debited for the rufiyaa equivalent of the invoice. The expenses should then be recorded in the expenditure ledger of the spending unit against the relevant budget head.

Revenue accounts

79. Separate bank accounts are meant to be established for receipt of public revenues. The CFAA team did not verify whether all revenues received by Government Ministries and Departments (including foreign exchange revenues) and deposited into MMA accounts were credited to separate revenue accounts and recorded against revenue budget heads. Where Government accounts are managed as revolving accounts, into which revenues are deposited and out of which expenditures are made, there is the potential that revenues and expenses do not get recorded on a gross basis, or that they remain outside

the normal Government accounting. Revised budget procedures and the new computerized accounting system should be designed so as to ensure that revenues and expenditures are segregated in separate accounts and all revenues credited against revenue codes in the accounting system.

III. Disbursements, Receipts and Accounting

Recent reviews

80. Limited reviews of the government accounting system were made by the 1994 IMF Mission and by the ADB consultants providing technical assistance to the AO. There have been no fundamental changes to the system since those reviews and the reported observations concerning the deficiencies in the system remain current. These are incorporated in the sections below.

81. The ADB consultants helped in preparing a scoping document for future assistance to upgrade the government accounting system. This was followed by a technical assistance proposal to help define requirements and formulate a design for a new public accounting system, which ADB has agreed to fund. Work is expected to be carried out by an international consulting firm during the second half of 2000.

Types of revenues and expenditures in the public sector

82. The major items of Government revenue are from taxes – primarily tourism tax (paid by resorts on a bed occupancy basis) and import duty. Other important sources of revenue are from tourist resort lease rents, dividends from government business enterprises, and loan interest. A variety of permit fees, license fees, royalties, and stamp duties account for the major part of the balance.

83. The major items of Government expenditure are for salaries and allowances (recurrent expenditure) and capital equipment and construction (capital expenditure). The usual types of other recurrent expenditures are incurred, including communications, utilities and other services; office supplies; travel expenses; and repairs and maintenance.

Financial rules and regulations

84. The Government's consolidated Financial Regulations, prepared in 1992, have since been subject to many amendments by President's Office circulars. They spell out various financial and administrative policies and procedures in relation to such matters as receipts of Government revenue, foreign aid and other funds; budgetary expenditure;

travelling expenses; payments of civil service salaries and allowances, leave and attendance, fixed assets, government works, procurement, and petty cash.

85. No updated consolidation exists, and as a result it was difficult for the CFAA team to determine exactly the current requirements. The regulations are in need of comprehensive update. This should desirably be in the form of new Public Finance and Public Enterprise Acts and regulations, and be undertaken as part of the development of the new computerized, public accounting system. The MoFT should play a focal role as the Government's "financial controller" in the update of the financial policies (supporting the constitutional role of the Auditor General to prescribe the manner in which the accounts of the State should be kept), as well as the oversight of the public accounting system modernization project;

Revenue Process

86. The main receipt collection point in the Government is the Department of Inland Revenue (DIR) within MoFT. It is responsible for collecting all the revenue of the Government except for import and export duties, and transfers from public enterprises. Policies relating to collection and enforcement procedures for various types of fees, licenses, stamp duties, royalties, and other receipts are set out in a "Handbook on Revenue Collections". DIR collects funds through two methods:

- Direct payments (receive at the payment counters of DIR at Male' directly or through Atoll Offices); and
- Routed payments (made at the MMA).

87. Direct payments are entered every day by cashiers at the payment counters in Male' onto a Daily Payments Collection Sheet, and at the end of each day this Sheet is checked against the day's receipts issued and cash/cheques collected by the DIR Budget Officer. Separate deposit slips for cash and cheque receipts are prepared and the receipts are banked with MMA for credit to a revenue account. Deposits not made with MMA the same day are kept overnight in a safe.

88. Payments in respect of vehicle fees, non-fishing vessel fees, commercial land rent and uninhabited agricultural fees may be made at Atoll Offices. Atoll Offices report these fees on special purpose forms and these are submitted with collections to DIR, under the custody of the captain or an Atoll Office official, by boat according to vessel timetables. These are then checked and funds deposited by DIR in the same way as for payments received over the counter in Male'

89. Routed payments are reported to DIR by MMA on a Daily Credit Advice.

90. Receipts data from direct and routed payments is entered into a local computerized system called REVNET, which produces various management reports on revenue collected. Revenue data is used as input into budget reports prepared by MoFT.

91. Systems for collection of import and export duties were not reviewed under this CFAA.

Non-Payroll Expenditure Processes

92. Any imported item required to be used by Government Ministries and Departments, but has a price above Rf 500, is required to be bought from the State Trading Organization Limited (STO). Where the item is not available in STO, its price should be approved by the Ministry of Trade and Industries. . If the price of an item is less than Rf 500, it may be bought from any store provided that the price was checked from different stores and the least price was paid. However the amount of items purchased according to such method should not exceed Rf 5000 in any one month.

93. Price quotes are recorded by the accounts unit in Ministries/Departments with the suppliers' stamps/signatures on a single special purpose form – the CFAA team noted that, as a result, details of the quotes already recorded will be made known to the other suppliers as they complete the form. Purchases above Rf 5000 must be made by public tender, advertised on the radio and in the local newspapers. The CFAA did not undertake a detailed review of Government procurement policies and procedures, which may be covered in a future Country Procurement Assessment.

94. Purchase orders are raised by Ministries and Departments for all expenditure, except where there is provision for petty cash expenditures. The orders are recorded in a purchase order register, from which they are assigned a number, and are approved and signed, together with the quotation form, by the responsible head of office.

95. Funds availability is checked against the expenditure ledger, in which a running balance of available released funds is required to be maintained. However, commitments are not recorded, with the risk that budgets may be overspent.

96. When an invoice is received by the accounts unit, it is registered in an invoice register, in which it is allocated to an expenditure budget code. The invoice will be examined to determine if the invoice has been correctly prepared and a responsible manager will initial the invoice register to certify that the goods or services invoiced have been received and the invoice is in order to pay. The invoice, payment cheque and register is submitted to the responsible head of office, who will sign the register as approval to pay and then the cheque. For expenditures above Rf 10,000 two signatures are required.

97. Suppliers will collect cheques from the accounts unit of the Ministry/Department. They will sign a cheque register as evidence of receipt of payment. The cheque number and payment amount will also be entered in the expenditure ledger against a budget code. This will be the prime record of entry for the Government accounting system.

Methods of payment for non-payroll expenses

98. The primary method of payment to suppliers is by cheque. These are raised by the concerned Ministry or Department rather than centrally. Some Ministries and

Departments keep petty cash floats for small items of expenditure, but this is not widespread. Some Department officials advised that because of an absence of a petty cash float, they had to incur higher costs because of requiring invoicing for small expenses. With proper controls, petty cash floats can be efficient and effective mechanisms to fund minor expenses. Examples of controls include limits on the value of individual transactions which can be made with petty cash funds; requirements for payees to submit receipts as evidence of payments (filed to support the cheques raised to replenish the floats); maintained balances to which the floats are always replenished; frequent independent surprise checks of the cash and vouchers held by petty cash custodians; and requirements for regular reconciliation and replenishment of the floats. Petty cash custodians should not be responsible for also maintaining the accounting entries in the Government's ledgers. The more widespread use of petty cash floats should be examined by the Government and the new public accounting system should be designed to facilitate their accounting.

Accounting for expenditure transactions

99. There are three books of account kept for expenditure transactions by each spending unit in Ministries and Departments – a register for recording invoices received, a register for recording cheques issued (which is signed by the payee who must come to the unit to collect the cheque) and an expenditure ledger which records the expenses against budget heads. In the case of payroll expenses, a cheque will be raised and recorded in the cheque register, and salary expenses will be recorded in the expenditure ledger as for other expenses. These books are subject to periodic audit by the AO.

100. The recording system is a “single entry” system in the sense that at the time of recording an expense transaction there is no double posting to ledger accounts (once to an expenditure head and once to a cash head, which in a cash-based accounting system should always be in balance). In some cases, spending units use the MMA to effect a “double entry” system by opening different bank accounts to record different types of expenditures, so that the totals of expenditure ledgers for each type can be reconciled with each bank account balance. The spending unit books of account are kept manually and the whole process of recording is laborious and prone to errors and delays, which will affect the timeliness and accuracy of monthly expenditure reports of the spending units.

101. A chart of accounts by functional categories of expenditure (budget heads) is followed. The chart of accounts (coding system) used in the current public accounting systems does not allow for the ready accumulation of expenditure information beyond broad, functional categories of expenditures (budget spending heads). The lack of transaction data by programs and projects produced by a double entry system that promotes completeness and accuracy of data hinders the Government's monitoring of expenditures to ensure they reflect approved development plans and programs. It also makes the production of reliable data for use in the analysis of public expenditures by funding agencies difficult and costly.

102. Each month a reconciliation of the expenditure ledger and the balance of funds available is made, and details reported to MoFT. The laborious nature of the recording, the total reliance on manual methods and limited effectiveness of reconciliations (see

below) mean that summary expenditure data submitted to MoFT can be late (sometimes by several months), inaccurate or both.

Bank account reconciliations

103. Finance Regulations require Ministries and Departments to reconcile their books of account and the balance of the related MMA account on a monthly basis. The MMA produces computerized monthly bank statements which facilitate these reconciliations. Accounting staff interviewed indicated that these bank statements were considered reliable. Differences for reasons such as cheques in transit are required to be explained on a reconciliation sheet which is copied to the AO.

104. The lack of a full double-entry accounting system limits the effectiveness of the reconciliation. While the bank account balance will be reconciled with a “cash book running balance” established in the expenditure ledger, to ensure all amounts get recorded in the ledger, there are no entries to individual expenditure accounts whose sum can also be reconciled with these numbers to provide assurance over the integrity of accounting figures by budget head or other classifications.

Commitments and Liabilities

105. Although a register of purchase orders is required to be maintained, the accounting ledgers do not keep track of commitments that have been placed by Ministries and Departments, nor is an accounting entry made to record an accounts payable where goods and services are received before an invoice is received. The first entry is made only when the invoice is presented for payment.

Fixed asset records

106. Finance regulations require that records of fixed assets be maintained by Ministries and Departments, and that fixed assets be tagged to identify them as Government property. This is subject to audit by the AO. Fixed asset records are currently maintained in manual formats and there are no centralized records.

Advances to Atolls

107. To cover Atoll and Island Offices expenses, cash is advanced to the Offices through the Ministry of Atolls Administration on the basis of annual approved budgets. This is meant to operate on an imprest basis, with Atoll Offices forwarding expenditure returns, copied to the Audit Office, which account for the use of the advances, and which would form the basis of replenishment. Apart from this, other Ministries and Departments may send money (sometimes in the form of cash) directly to Atoll Offices to meet their own expenses in the Atolls. Expenditure reports will be sent to the appropriate offices with a copy to the Audit Office. Cash on hand is meant to be kept securely in the Offices.

108. The CFAA mission was advised that cash holdings may be supplemented by collections of lease rents, registration fees, fines and other types of Government revenue. In atolls with no banks, very often a large amount of funds will be kept in the Atoll Office vault until the revenues can be sent to the Department of Inland Revenue or the relevant office. For a number of reasons, there is little coverage of the Atoll and Island Offices by the AO (see paragraph 174). Design of the new accounting system should address these problems, in particular ensuring timely recording of revenue and expenses outside Male' in the Government's accounts, and prompt reconciliation of advances made to the Offices.

Loans by Government

109. The Treasury Department of MoFT maintains records of all loans by Government to public business enterprises, and to private persons. An informal spreadsheet based system has been developed within the Treasury Department to track the status of loans and repayments, and at the time of the CFAA an age analysis of repayment arrears was being prepared. However, no formal reporting system for these loans has been developed, and this is an area which will benefit from both better definition by Government of policies regarding the granting of loans as well as more rigorous management under a new public accounting system. Effective accounting and review of recoverability will be necessary for the implementation of a Government financial statement.

Human resource capacity in Government to manage accounting functions

110. There are very few qualified accountants or accounting technicians in the Maldivian civil service. The implementation of a new computerized system with much more rigorous accounting requirements, the demands within Ministries and Departments to analyze the accounting information for management purposes, and the implementation of an annual financial statement for the Government will require an upgrade in financial management skills across Ministries and Departments, including the MoFT. A focussed strategy to deal with the problems of lack of financial management capacity should be developed as part of a broader civil service reform strategy. External assistance to help fund suitably qualified consultants, who can fill in until an adequate number of civil servants complete their training, will be required for some time yet.

New Public Accounting System

111. Major areas to be covered in developing a new public accounting system include (i) establishing appropriate accounting structure and methods (ii) developing adequate accounting policies; (iii) designing requirements for a computerized accounting system;

(iv) strengthening the legal framework for public finance; (v) interfacing with budgeting and (vi) identifying implications for audit procedures⁸.

112. The technical assistance approved by the ADB for defining requirements and formulating a design for a new system will cover:

- Development of a new chart of accounts structure, likely to comprise a consolidated fund and subsidiary accounts for an operating fund, borrowing fund, lending fund, revolving fund, special fund, contingency fund and trust fund;
- Specification of types of accounting forms and records;
- Assessment of appropriate accounting base – cash, modified cash, modified accrual or full accrual;
- Accounting policies and type, content and format of annual Government financial statements
- Design, integration requirements, and input and output formats of a new computerized system;
- Assessment of options for developing or buying/customizing existing software;
- Development of a proposal for strengthening the legislative framework relating to Government accounting and financial management;
- Study of the impact of the new system on the budgeting process
- Assessment of needs relating to the AO's audit process, including changes in audit procedures and use of computer audit techniques, and training of auditors in the new system.

IV. Payroll

Types of public sector appointments

113. In 1990 the Government adopted a standard for classifying and grading jobs in the Public Service. The majority of civil servants are classified in the administrative/clerical group, but there are also technical groups such as teachers and doctors.

Laws and regulations concerning public sector employment

114. The PSD has the responsibility for overall monitoring of public sector employment, and advising government on employment policies and procedures. Guidelines have been issued (in Dhivehi only) for appointment, working hours, compensation, leave, transfers, promotions and termination of government employees. There are also financial related rules concerning the payment of salaries and allowances, leave, charges for late attendance, office hours, and recording of provident fund deductions contained in the Government's Financial Regulations (there is an unofficial English version of the 1992 consolidation, not updated).

⁸ "Technical Assistance to the Republic of Maldives for Capacity Building for the Maldives Public Accounting System" ADB, December 1999

Processes for appointment, transfer, promotions, salary increments, and termination of public sector employees

115. The policies, as explained by the PSD, are as follows:

(a) Appointment: Recruitment at managerial levels is undertaken by the PSD. Recruitment at lower levels is handled directly by the concerned Ministry. Procedures provide that posts will be advertised, a selection panel will review applications and qualifications, and will interview shortlisted candidates. Initially new recruits to the Public Service will be on probation for three months and all confirmations must be approved by the PSD. In the case where no suitable candidates available locally, the PSD will recruit candidate with the special skill from neighboring countries.

(b) Transfer: Transfers between Ministries are approved per the guideline issued by the President's Office.

(c) Promotions and increments: Promotions are required to be based on qualifications and experience, and are subject to review by the PSD. The system of awarding annual salary increments based on a performance appraisal managed by an Employee Affairs Committee within each Ministry, was suspended in 1999 as it was not considered to be working satisfactorily, and ways to strengthen the system are being reviewed by PSD.

(d) Termination: This is usually occasioned by retirement or resignation of the employee. However, if termination is for cause, this will be preceded by a due process overseen by the PSD, usually involving warnings. In certain cases where a position is withdrawn due to redundancy then a three months notice will be given to the employee to find another job within the government.

Compliance with personnel processes are subject to audit by the AO.

Record keeping for public sector employee appointments, transfers, promotions and terminations

116. The personnel records of each employee are manually maintained in a personnel file in the concerned line Department, and the file will follow the employee if he/she transfers to another Department. If an employee is terminated then his/her personnel file will be transferred to the PSD. Efforts are being made by PSD to archive key data on such files microfiche to save space. Some 18,000 employee records are being kept, some partly on an Employment Management Information System (EMIS) developed within the Government in the mid-1990s. Records in this system are accessed and maintained only by PSD, but PSD aims to have the all employee records computerized, and maintained/updated by the concerned line Departments, once a Government-wide computer network is established.

117. The major databases maintained in EMIS are for persons (employee details), jobs, classifications; offices; requests (requests for personnel actions); employment history; job

remuneration; and person remuneration. EMIS can produce various monitoring reports providing statistics on such matters as remuneration; pensions; requests for appointments, terminations, and transfers; vacant positions, abolished positions.

Methods of payment

118. Government employees are paid by cash. Some Public Enterprises pay their employees by transfers to their bank accounts. A move to paying all civil servants by bank transfer would improve internal control – this should be examined as part of the modernization and computerization of the public accounting system.

Payroll transaction recording

119. All Government employees are paid monthly. Payroll recording is done manually in each line Department. Spreadsheet-based pay sheets are prepared for each payday showing all employees to be paid, the amounts of salaries and allowances payable, provident fund deductions and other deductions (such as late attendance fines). Changes to salaries and allowances from the previous month will be shown in red on the pay sheet. Copies of PSD approvals for promotions, transfers, increments and other changes in status will be attached to the paysheets.

120. The pay sheets are signed as prepared by the Budget Officer, checked by an Assistant Director and approved by the Director General. These officers will also sign a summary sheet which records the cheques issued for (a) total net pays – this cheque is cashed for insertion into pay envelopes; (b) the Provident Fund for total contributions and (c) other deductions. The balances on the two sheets must be reconciled.

121. Employees will sign the pay sheet when they receive their net pay envelopes. Persons collecting net pay on behalf of an employee also sign and must bring with them a signed request from the employee, which is attached to the pay sheet.

122. Compliance with accounting requirements is subject to audit by the AO.

Payroll number verification and reconciliation, and other controls over fictitious employees

123. Control rests with the line Departments, in particular the segregation of duties for preparing, reviewing and approving the pay sheets. Pay sheets record employee identification numbers which could be checked by an auditor against PSD records.

124. Overall reconciliations of the numbers of staff and the salaries and wages bill of the Government are not regularly done. A Government-wide computerized system for employee records would facilitate these kinds of reconciliations, both for financial control and employment policy monitoring purposes.

Accounting for payroll transactions

125. Charges to Government budget heads are recorded in the Departmental cheque registers and expenditure ledgers according to the budget heads, which are divided between (1) personal emoluments (salaries and wages, overtime, and various categories of allowances) and (2) pension and retirement benefits and gratuities. :

Degree of separation between authorization for personnel changes, payroll authorization, disbursement of pay and accounting functions

126. Personnel changes are authorized by PSD; payroll is authorized by the Departmental head, and disbursement of pay and accounting functions are carried out by the Departmental finance unit. With regard to the cashing of the net pay cheque, Finance Regulations require that there should be two employees present while withdrawing cash from MMA accounts, and that at least one must have an identity card issued by the AO authorizing them to withdraw cash. The unofficial English translation of the Finance Regulations do not refer to net pay distribution, but the CFAA team was advised that two persons must be present when sorting net pays into envelopes, and when the envelopes are distributed.

Record keeping for attendance and leave

127. These are kept manually in the concerned line Departments.

Special records for “force account” (Government labor on construction projects)

128. No special records such as muster rolls are maintained which can be used to allocate labor costs of Government employed laborers to particular projects or activities. Donor-financed development projects using “force account” labor will need to establish special arrangements for recording such costs attributable to the projects, for grant/loan disbursement and donor reporting purposes

V. Internal Audit

129. The Government internal audit function is very rudimentary, limited mainly to internal checking of books and records. It is housed within the AO and thereby indistinguishable to auditees from the external audit function. The government administration has now reached a size where the development of a modern internal audit function providing service to the management of Government Ministries and Departments, separated from the external auditor, will be highly desirable. As a first step, the Government would benefit from exposure to the documentation on modern internal auditing produced by Institute of Internal Auditors, the worldwide professional

body for internal auditors. This would assist the Government define the kind of internal audit services that it wants to have in the future, and would provide information on the steps needed to establish such services.

Regulatory requirements

130. There are no Government regulations concerning internal audit.

Recent Reviews

131. As part of their technical assistance to the AO, Stanton Partners examined the current status of internal audit in the Maldives public sector. The only internal audit function carried out within Government Ministries and Departments is the detailed account checking (e.g. cash counts, bank reconciliations and reviews of arithmetical accuracy of financial reports) by the Internal Audit Bureau (IAB) within the AO. The focus of their work is the tax revenue collecting Ministries and Departments. The consultants noted that the IAB is not staffed with well qualified individuals, and does not have effective work planning, methodology or working papers and is a remnant from the days when the AO also handled accounting as well as audit functions. The current situation is much the same, as indicated below:

Coverage

132. The AO Internal Audit Bureau covers, with limited scope, all Government Ministries and Departments. It does not cover public enterprises or other agencies outside central Government. Some public enterprises obtain internal audit services from private auditing firms.

Plans to move the function from the Audit Office

133. Within the AO, the Internal Audit Bureau forms a separate section, which is headed by Deputy Director. The ADB consultants recommended the creation of an Internal Audit Bureau within the MoFT, and that this would replace the existing unit in the AO, freeing up AO management time to focus exclusively on external audit. This was not agreed at the time, the Government preferring to see this function develop under the wing of the Auditor General before such a transfer should take place. At the same time, the AO has not had the capacity to develop the function.

Audit planning, methodology and quality assurance

134. Planning is limited. There is a focus on the major revenue collecting Ministries and Departments. Essentially, the internal audit function is one of internal check of Government books and records. The internal auditors will check on such matters as the completeness, and arithmetical accuracy of revenue collection forms (e.g. customs tax forms, tourism tax forms) and the timeliness of deposit of tax collections in the bank accounts. Audit programs are not very developed. Quality assurance is mainly exercised through the review of work by the Deputy Director of the IAB.

Reporting

135. Reports are prepared at the end of a review by the internal audit staff. These will report observations and contain recommendations for improvement of records and procedures in the areas covered.

Capacity

136. There is currently little capacity for a modern internal audit function in the AO or elsewhere in the Government. Before developing a proposal for developing the function, it is recommended that the Government, through the AO, obtain and review documentation on modern internal auditing produced by the Institute of Internal Auditors, the worldwide professional body for internal auditors. This will help the Government define the role that it wants internal audit function to play, review the optimum location for the function (preferably it should be moved out of the AO to let that office function on its external audit responsibilities), consider staffing needs, and identify the next steps in terms of development of the function. This could form the basis of a proposal for external technical assistance if necessary.

FUNDS FLOWS

137. Government budget funds are made available to Ministry and Departmental accounts by the MMA upon advice from MoFT of the approved releases (appropriations less “unspent balance”) at the beginning of the fiscal year. Additional funds may be made available during the fiscal year by MMA upon advice of further releases from MoFT.

138. Cheques are issued by the Ministries and Departments, not centrally by MoFT. This enables relatively quick handling of disbursements. The Government’s bank accounts will only be fully balanced every quarter by transfers of funds from the Treasury General Account (TGA), so if during this period total revenues coming into the Government revenue accounts with the MMA are less than expenditures paid out the MMA will in effect make short term interest free credit available to the Government.

139. At the time of the quarterly balancing of the bank accounts, deficits are cleared from the TGA through Ways and Means Advances provided by the MMA to the Government at less than market interest rates. These advances show up as lending to Government in the accounts of the MMA and a debt in the budget documents of the Government. The Ways and Means Advance mechanism allows for fairly smooth funding flows for Government expenditure, making deficit financing almost automatic in nature without need to revert to market borrowings. However, it carries economic risks in the sense that the MMA’s holding of such debt on a long term basis represents monetary creation.

140. There are no reported difficulties in recent times for donor-aided development projects receiving grant or loan funds. There are no restrictions on implementing Ministries or Departments having special accounts for grant or loan funds, or on their operation by the project implementing units.

LOCAL GOVERNMENT INSTITUTIONS

Functions of local government institutions

141. The Atoll Chief is the chief Government Officer who enforces law in the atoll/islands, acts as an agent of all ministries and is an intermediary for communication between the Government and local communities. The Atoll Chief is supported administratively by an Atolls Office. On each island there is an Island Chief and Island Office subordinate to the Atoll Chief.

142. Male' Municipality is an administrative office under Ministry of Home Affairs, Housing and Environment and provides services to the city of Male'. This Office undertakes such functions as maintaining street lights, roads, parks and issues licenses for shops.

Financial arrangements and accounting records for local government institutions

143. Each year, Atoll chiefs submit budget proposals for Atoll and Island administration to the Ministry of Atoll Administration, which is then forwarded to MoFT after review. The same budget formulation and authorization process applies as for any other spending unit of the Government. The Atoll Offices are required to maintain the same kind of (manual) accounting records as required for other spending units in the Government. All the revenues received in the Atolls are received by the Atoll Office and then transferred into the Atoll's account with MMA. The Ministry of Atoll Administration has set a guideline for holding cash in Atoll Offices, which limits cash on hand to Rf. 5000, though the CFAA team was advised that, because of delays in banking receipts, Atoll Offices often hold cash in excess that amount.

144. The Male' Municipality submits its budget to the Ministry of Home Affairs, Housing and Environment, which will review and forward to MoFT. The same budget formulation and authorization process applies as for any other spending unit of the Government. Revenue from land rent and other revenues are collected and deposited with the MMA. The Municipality is required to maintain the same kind of (manual) accounting records as required for other spending units in the Government. These are supplemented by a spreadsheet based system used by the Municipality to record and summarize revenue receipts.

Financial management capacity in local government institutions

145. The same limitations apply as for the rest of the Government, exacerbated in the Atolls due to their remoteness.

Publication of financial information on local government activities

146. No specific financial reports or statements are prepared.

PUBLIC ENTERPRISES AND UNDERTAKINGS

Recent reviews

147. Using a World Bank Institutional Development Fund (IDF) Grant⁹, the Government engaged consultants from KPMG to develop the work program and train staff of the Public Enterprise Monitoring Unit in MoFT (now the Public Enterprises Monitoring and Evaluation Board), and provide recommendations for the reform and possible privatization of public enterprises. The consultants reported that some public enterprises had been performing poorly due to variety of reasons, including weak management and non-commercial mandates that resulted in poor investment decisions, overstaffing, and uneconomic diversification. Some had shown sustained losses and been in arrears in servicing their debt, as a consequence the Government had assumed the debt servicing burden. Because of lack of information on implicit/explicit subsidies and contingent liabilities, and the absence of explicit treatment of these costs in the budget, it was difficult to establish the extent of the burden of loss making SOEs on the budget.

148. Since the IDF grant, the Government has initiated a program to reform the public enterprise sector. Privatization is not considered by the Government to be a realistic option in the short term but could be considered in the future. The absence of an income tax system has made dividends generated by some public enterprises an important source of government revenue. There is also a concern that privatization will just create, in the absence of capital markets and institutional investors needed for wider ownership, private monopolies. The regulatory environment would also need strengthening.

149. Since the IDF grant, some public enterprises have initiated measures to improve efficiency and profitability including (i) steps to corporatize by becoming limited companies (ii) personnel rationalization and other cost cutting measures (iii) hiving off profitable units or closing down unprofitable activities (iv) increased emphasis on staff training and management reorganization and (v) financial restructuring by capitalizing or rescheduling the debt owned to government. However, the Government has also

⁹ IDF Grant for Public Enterprise Monitoring and Reform (No. 28841) signed September 1, 1994, completed September 1, 1997.

experienced continued problems with some public enterprises – the recent failure of Air Maldives being the most prominent example.

Legal framework for public enterprises and undertakings

150. Public enterprises that are fully owned by the Government have been created by Presidential Decree or by special legislation. Government-controlled public enterprises which are joint ventures or which have shares owned by the public have been incorporated as public companies under the Companies Act.

Overview of public enterprises

151. There are currently 20 entities which are classified by the Government as public enterprises:

Sponsoring Ministry	Public Enterprise	GOM Direct ownership	GOM PE ownership	Private ownership
President's Office	Air Maldives Ltd.	51%		49%
	Island Aviation Services Ltd.	100%		
Ministry of Transport & Civil Aviation	Maldives Ports Authority	100%		
	Maldives Airports Company Ltd	100%		
	Maldives Inflight Catering Services Pte Ltd.	60%		40%
Ministry of Communications, Science and Technology	Maldives Post Ltd.	100%		
	Dhivehi Rajjeyge Gulhum Private Limited (Dhiraagu) ¹⁰	55%		45%
Ministry of Trade & Industries	State Trading Organisation Ltd.	100%		
	State Electric Company Ltd.	100%		
	Allied Insurance Company		100% STO	

¹⁰ Dhiraagu is the telecommunications provider.

Sponsoring Ministry	Public Enterprise	GOM Direct ownership	GOM PE ownership	Private ownership
Ministry of Construction and Public Works	Building Construction & Mechanical Works	100%		
	Maldives Transport & Contracting Company Ltd.	52.5%	7.5% MNSL	40%
Ministry of Education	Book Production Unit	100%		
Ministry of Tourism	Nasandhura Palace Hotel	100%		
Ministry of Fisheries, Agriculture & Marine Resources	Maldives Industrial Fisheries Company Ltd.	80%	20% STO	
	Mifco Boatyard		100% MIFCO	
Ministry of Finance & Treasury	Bank of Maldives (Plc) Ltd.	60% (incl 9% Provident Fund)	5% STO 5% MTCC 5% Atoll and Island Committees	25%
Ministry of Health	Male' Water & Sewerage Company Ltd.	70%		30%
Ministry of Information, Arts & Culture	Maldives Academy of Performing Arts	100%		
	Maldives National Shipping Ltd.	100%		

Public Enterprise Monitoring and Evaluation Board

Establishment

152. The Public Enterprise Monitoring and Evaluation Board (PEMEB) was established within the MoFT in 1994¹¹, to provide oversight of the financial as well as other operating aspects of public enterprises. Start up of the Board was assisted by the IDF grant referred to above.

¹¹ Originally as the Public Enterprise Monitoring Unit, but converted to a Board in 1999.

Coverage/Objectives

153. PEMEB's mandate covers all public enterprises. Its objectives are to:

- study, monitor and analyze financial performance of public enterprises (PEs);
- study and analyze the annual budget of PEs
- standardize financial records and auditing practices of PEs
- monitor the assets of the PEs and analyze financial status before any injections of new capital
- analyze proposals to borrow on the strength of sovereign guarantees and maintain records of the utilization of such funds
- advise on the annual declared dividend
- formulate adjustment programs and advise on restructuring of weak PEs and study and analyze the results of such restructuring
- advise on the closure of any PEs which may not respond to adjustment programs as per above, provided that the PE has not been set up to meet a special/social need; and
- ensure all PEs are operated in an efficient manner and minimize expenditure for government budget to support the activities of the PEs

Organizational Structure

154. PEMEB is headed by a Director, and has 5 other staff plus an expatriate accountant volunteer.

Procedures for monitoring public enterprises

155. PEMEB currently monitors PEs by receiving audited annual financial statements, annual reports; quarterly summary financial statements, annual plans and performance reports; and other reports on an ad hoc basis as and when required by the PEMEB. Compliance by PEs with these reporting requirements is growing, though not yet at a satisfactory level. In some cases PEs are still delayed some years in submission of annual financial statements, or have not yet begun regularly submitting other reports required by PEMEB. This limits PEMEB's ability to monitor Government investments in the PEs, in particular to give early warning of financial difficulties.

Capacity to monitor public enterprises

156. Despite recent efforts to build capacity, PEMEB does not yet have sufficient staff with skills in the area of analysis and interpretation of annual plans and reports to enable it to fulfil a number of the above analytical functions. Presently PEMEB is highly dependant on the Director and on a UK volunteer staff member. While further accounting training for other staff will help, PEMEB also needs staff with sufficient high level management experience to enable it to effectively critique public enterprise investment plans. Existing staff acting under guidance can undertake certain other

PEMEB activities, such as the development of the PE database and comparative performance data recommended by KPMG.

Financial governance and reporting of public enterprises

157. KPMG identified that governance and oversight roles, and accountability of PE Boards need to be strengthened. These concepts are still not yet well developed. Specific areas where the Government needs to focus attention are:

- full implementation of annual planning processes based on performance targets, with specific plans for the following year and more general plans for the medium term (KPMG recommended a three year planning horizon);
- financial analytical capacity to assist Boards in evaluating investment proposals;
- regularity of Board meetings to monitor achievement of plans, and take corrective action where necessary;
- preparation of annual reports of financial and operational performance against targets; and
- annual reporting of PE results to the People's Majlis and the public.

158. PEs maintain their own financial management systems, separate from the Government's own systems, and are audited by the AO or by private sector accounting firms (some under contract to the AO, and some independently). Some PEs obtain internal auditing services from private sector accounting firms. The CFAA did not include an evaluation of individual PE accounting systems or internal controls, though it is noted that some PEs have had qualified or disclaimed audit opinions on their recent financial statements. It will be essential, for any future World Bank lending that benefits these PEs, that significant audit concerns are addressed in a timely manner. Important aspects which require attention are set out below:

- financial policies should be consistent with international accounting standards, should be clearly disclosed in notes to the financial statements, and should be the benchmark against which auditors render their opinions on the financial statements. Financial statement disclosure requirements, once clarified for companies (see paragraphs 243-251) be adopted fully by PEs and the auditor's opinion should also refer to compliance with these requirements;
- where PEs carry out activities which have a significant social good element, which would not otherwise be carried out under profit motives, these should be subsidized transparently by the Government and disclosed in the PE's financial statements (this was also a KPMG recommendation).
- Financial statements preparation and audit should be completed within six months of the end of the fiscal year. In some cases there are currently significant delays due to limited financial capacity or (in the case of Air Maldives) financial crisis.

PE governance is a potential area for further technical assistance in the form of secondment of additional financial and corporate governance experts to PEMEB who can

advise PEs on policies and procedures, provide training for PE Board members and management in governance and accountability, and oversee redevelopment of accounting systems.

GOVERNMENT AUDITING

159. A project in 1997-98 to build the capacity of the AO, supported by the ADB has established a system of government auditing which meets international standards, and includes an audit methodology, an audit manual and an audit management and review system. The effectiveness of the AO's systems established under the ADB technical assistance remains limited because of staff capacity constraints. The cost of time and travel for work outside Male' also hinders the extension of AO audits to the other Atolls. The development and operation of a new, computerized public accounting system will add a new challenge to the AO's capacity. It is difficult for the Auditor General to satisfy requests from auditee management for audits.

160. Donors have requested private audit firms to carry out audits of development projects that they are funding, rather than rely on audits by the AO. However, in order to reinforce the Auditor General's mandate, it will be desirable to have this done in future through the Auditor General, under contracting-out procedures or other arrangements which allow AO oversight. The AO's capacity will also require further strengthening before it can be in a position to provide the level of auditing across the public sector that would give reasonable assurance to donors offering budget support types of program lending.

161. The AO has undertaken its own self-assessment of its current external audit capacity and what it requires to bring its work into line with internationally accepted good practice. The main areas of weakness identified are the need for adequately qualified staff, particularly at senior level, in order to guide AO staff and ensure audit methodologies and practices developed are maintained; and inefficiencies and lack of timeliness in management reporting within the AO. The AO would like to:

- have two staff per year trained for a period of five years in auditing, accounting and information technology;
- obtain suitably qualified expatriates to fill some senior positions over the next three years after which Maldivians currently being trained are expected to be able to replace them;
- develop twinning arrangements with other Supreme Audit Institutions with similar audit methodologies and practices as those adopted under the ADB technical assistance;
- computerize in an integrated fashion the in-house audit planning, time recording and monitoring systems developed under the ADB technical assistance.

162. Further technical assistance to the AO should be accompanied by Government approval of a revised organization structure as recommended under the ADB technical

assistance project, and commitment of the Government to pass in the near future an Audit Bill along the lines of the one drafted under the ADB technical assistance. This draft Bill is awaiting the review of the Law Commission. It would also be highly desirable for the Government to develop, as recommended by the ADB technical assistance consultants, a separate remuneration scale for AO staff adequate to attract qualified and experienced staff, and to allow for significant restriction on outside work by the staff (see “Civil Service Reform” section of this report).

163. In the longer term, as further capacity is developed, Government should consider strengthening the independence and standing of the Auditor General through Constitutional amendment, in terms of greater security of tenure and reporting to the People’s Majlis (reinforcing what could be contained in the meantime in an Auditor General Act in terms of reporting and consultation with the Majlis on the budget of the AO). Such measures are adopted in many countries because of the unique role that is expected of the Auditor General in the accountability framework of their systems of government.

Constitutional requirements

164. Sections 124-129 of the Constitution relate to the Auditor General:

- Section 124 – provides for the Auditor General to be appointed by the President, and for the Auditor General to have the qualifications required to be a member of the People’s Majlis and who, in the opinion of the President is competent to perform the duties of the office of the Auditor General. Note that section 66 covers the qualifications required to be a member of the Majlis.
- Section 125 – provides that the Auditor General shall make before the President an oath set out in paragraph (k) of the Schedule to the Constitution.
- Section 126 – provides for the Auditor General to audit the accounts of the State and to prepare reports in relation to the accounts of the State and to perform such other duties in respect thereof in accordance with the law.
- Section 127 – provides that the accounts of the State shall be maintained in accordance with directions issued by the Auditor General on advice of the President.
- Section 128 – provides that the Auditor General may resign from office in writing to the President, and will continue to hold office until the President notifies his acceptance.
- Section 129 – provides that the President may remove the Auditor General from his office if, in the opinion of the President, the Auditor General has failed to perform satisfactorily the duties of his office.

ADB Project on Capacity Building of the Audit Office and current status of agreed recommendations

165. The ADB funded a capacity building project in the AO, which was carried out from August 1997 to December 1998 by Stanton Partners, an Australian-based consulting firm. The technical assistance to the AO comprised the following broad tasks¹²:

- review of the AO procedures and practices;
- strengthening of financial and performance auditing;
- strengthening of the office and audit portfolio management; and
- strengthening of computer auditing.

As a result of the technical assistance, an Audit Bill was drafted, AO organizational restructure was carried out, audit planning and monitoring systems were adopted, the AO introduced new risk-based audit methodologies and working paper practices, computer hardware was installed and networked, and staff received related training. An audit manual was prepared to codify the AO's new policies and procedures. Details of these initiatives, the status of implementation of the recommendations in the final report of the consultants, and continuing capacity building needs are discussed below.

Audit Legislation

166. There is currently no Audit Act. As Constitutions do not typically go into much detail on the functions and powers of an Auditor General, such legislation is seen as international good practice, as it ensures clarity in these matters and can be a vehicle for promoting the independence of the office. As part of the ADB technical assistance, a proposed Audit Bill was drafted and this has since been revised. The current draft has been referred to the Law Commission for review. The CFAA team was advised that the passing of Audit legislation was a high priority for the Government, and it was expected that the review of the legislation would be completed later this calendar year.

167. To be effective, the Audit Act should set out, among other things, the powers and functions of the Auditor General, a requirement for the President to submit to the People's Majlis the Auditor General's report on an audit of the annual financial statements of the Government (at such time as a Finance Act is in place and annual financial statements are prepared), and provision for other Auditor General reports to be presented to the People's Majlis. The Audit Act would also usefully provide for such matters as the contracting out of audits, an independent financial audit of the AO, indemnities and confidentiality requirements.

¹² Capacity Building of the Maldives Audit Office (TA No. 2759-MLD) – Final Report, Stanton Partners, December 1998, Executive Summary

Independence

168. The Auditor General is independent within the Government, and holds the rank of a Minister of State which establishes a senior standing. While he does not enjoy complete independence from the Executive branch of Government, as envisaged in the Auditing Standards issued by the International Organisation of Supreme Audit Institutions (INTOSAI), in practice, he has considerable discretion and the scope of his work is only limited by human resource capacity constraints that are endemic to the Maldives public sector.

169. Inclusion in an Audit Act of a clause which makes it clear that the Auditor General has complete discretion in the performance or exercise of his or her functions or powers will significantly enhance the appearance as well as fact of his independence. It would be desirable for such a clause to indicate that the Auditor General is not subject to direction from anyone in relation to (a) whether or not a particular audit is to be conducted; (b) the way in which a particular audit is to be conducted; or (c) the priority to be given to any particular matter.”.

170. The Auditor General may be removed by the President under Section 129 based on the President’s opinion that he has failed to satisfactorily performed his duties. Similar arrangements apply to Judges. To enhance their independence, many countries limit the scope for arbitrary or unreasonable removal of such office holders either by spelling out in law very specific criteria whereby this may be carried out, or by sharing the responsibility for determining the grounds for their removal. In the case of the Auditor General, a future Public Accounts Committee of the People’s Majlis could be brought into any deliberation over his removal from office

171. Further comment on reporting to the Majlis is contained in the “Legislative Oversight section of this report.

Coverage of Government Operations

172. There is no limitation in scope, in the Constitution or in other legislation, of the Auditor General’s coverage in the public sector. The Auditor General has indicated that in practice the Government accepts his mandate to cover the entire public sector, including wholly owned public enterprises, joint ventures where the Government has a controlling share, trusts where a Government entity has a controlling interest, and the security and public order services. In some cases, because of lack of capacity, financial audits of public enterprises have been carried out by private audit firms engaged directly by the enterprises concerned. It is intended that such firms will continue to conduct these audits, but, as capacity of the AO is increased, to do so under contract with the Auditor General.

173. There is also no limitation to the type of audits that the AO may carry out. The Government is supportive of the idea that the AO should have the capacity to conduct not only compliance and regularity audits, but also full financial audits and performance audits.

174. However, in practice, two factors have limited desired coverage, even taking into account the contracting out of certain financial audit work to private audit firms. One is human capacity and the other is the difficulty of arranging travel of auditors outside Male'. There is one staff with a master's degree in accounting and two others who have completed a first degree in accounting and commerce. The situation will be improved when two other staff return from overseas accounting studies this year. Also, a number of staff have now obtained the Association of Accounting Technician qualification, and there are other staff who are presently studying for that qualification. There is currently a large backlog of audits in the AO's strategic and annual work plans due to this limited capacity, and the scope of audits that are completed are much more limited than the Auditor General would like. The expense of inter-atoll and intra-atoll travel, and the need for staff to remain in Male' when they are studying at the Institute of Management and Administration (IMA), also makes it difficult to achieve adequate coverage of the outer Atolls. With regard to the annual work plan for 1999, the situation was as follows:

Planned audits	=	56
Completed	=	29
Not started	=	27 (of which 13 were audits outside Male')

175. The ADB technical assistance established a base which needs to be nurtured. The AO has done its own self assessment of its current situation and where it wants to be in the future. The results of this are incorporated in the sections below.

Organizational structure of the Audit Office

176. The organization of the AO has evolved since it was first established in 1949. Originally it was under the Finance Department, and handled both auditing and accounting functions within the Government. In 1968 the AO was transferred under the President's Office and in 1994 accounting functions and staff were transferred to the MoFT. At present the AO has 66 staff. Of the professional staff, 23 staff are assigned to 2 Regulatory Audit groups, 6 staff are assigned to a Financial Statement Audit group, 4 staff are assigned to a Performance Audit group and 3 staff are assigned to an Information Systems audit group.

177. The ADB technical assistance consultants concluded that the AO did not have an efficient organization in terms of its audit mandate, with a large percentage of staff not involved in direct audit work. A number of staff were engaged in full time checking of accounts, as part of the Government's internal control processes – a residual feature of the AO's previous accounting responsibilities. The roles and responsibilities of audit staff were not well defined, and there was a need to introduce more systematic recruitment, promotion and training arrangements to make the AO more attractive to local, well qualified job seekers.

178. Status of the consultants' recommendations in this area are as follows:

<i>Recommendation</i>	<i>Status</i>
1. Establish an organization structure comprising, in addition to the Auditor General, a Deputy Auditor General; two audit groups headed by a group director; small corporate support, executive support (planning) and information technology sections; and Policy and Development committees of staff on professional development and audit practices and standards.	Being gradually adopted, as post below Deputy Auditor General are being filled as and when staff sent overseas for training return. Committees are established. A Deputy Auditor General may be appointed in future as suitably experienced staff are identified.
2/17. Policy and Development committee be established under the chairmanship of the Deputy Auditor General.	An Audit Procedures, Practices and Development Committee (APPDC) comprising senior staff has been established, to oversee the implementation of audit methodology and the audit manual, and provide quality assurance function.
3. Establish an Internal Audit Bureau under the MoFT to service Government ministries and possibly public enterprises, to which existing accounts checking functions can be transferred from AO.	Not yet implemented. A modern internal audit function needs to be developed and the Government would like to see that done under the wing of the Auditor General before transferring the responsibilities out. At the same time capacity constraints prevent AO from being able to develop the function. Thus the situation is much the same as when the ADB TA concluded (see section on Government Internal Audit for more information).
4. Establish a Management Committee consisting of the Auditor General, Deputy Auditor General and two group directors	Management Committee has been established, comprising senior staff under the current organization structure and chaired by the Auditor General.
5. Transfer non-external audit functions (accounts checking) to the new Internal Audit Bureau	See comments for (3) above.
6. Establish benchmark responsibilities for defined levels of audit staff	Job descriptions have been prepared for staff and experience/qualifications are established for each job.
7/8. Implement a strategy of progressively phasing out lower level audit positions and direct savings to better remunerated positions in order to attract and retain qualified staff	Not yet implemented. Will require action of (9) below first, and revision of budget system to accommodate shift of savings in this way.
<i>Recommendation</i>	<i>Status</i>
9. Consider developing a separate	Not yet implemented. Requires approval of

remuneration scale for AO within the government salary structure	President's Office
10. Consider recruiting 2 expatriates for senior positions until such time as suitably qualified Maldivians can be hired	One volunteer from Stanton Partners is currently working in the AO and a consultant funded by the Commonwealth Secretariat is expected to join for 2 years.
11. Seek to recruit new staff with good qualifications (in the absence of many qualified accountants, focussing on school graduates with "Advance" levels, especially in English language, with AAT qualifications and/or the aim to study accounting)	AO is trying to do this, but is not yet able to attract such staff. There is a lot of competition from the private sector which can offer more attractive remuneration packages. Action on (9) above will be important to help implement this recommendation
12a. Current auditors should be encouraged to complete AAT qualifications.	Being implemented
12b. Upgrade graduate recruitment process by visits to local schools and institutes to promote the AO	Being implemented (see 11 above)
13. Qualification and membership of an accounting body be given prime consideration in the recruitment and promotion of staff, particularly senior staff	Qualifications and experience are set out in the job descriptions. Lack of suitable candidates has meant the recommendation is implemented in theory but not tested in practice.
14. Selection committees of suitable staff and structured interview criteria be adopted for recruitment decisions	As above.
15. A "career development" program be put in place to help staff manage their careers in the AO	Being implemented. The AO is facing funding problems with respect to having AAT qualified staff continue their professional development by seeking full accounting qualifications. Budget process should be implemented that recognizes the need for continuing professional development.
16. Staff counseling process be introduced into the AO and senior staff given training in counseling techniques	Being done by the Director of Audit on a case by case basis
18. Training needs analyses should be conducted on a continuing basis to ensure that training given is targeted to the needs of the Office	Being implemented by the APPDC
<i>Recommendation</i>	<i>Status</i>
19. Develop mechanisms to ensure that training received by staff is fully applied in their audit work	Being implemented. Trainees are required to submit a report to the APPDC summarizing their course and how it can be applied. Input into audit work is discussed in the Management Committee.

20. Rationalize responsibilities between AO and Ministry of Finance for delivering training at the MCMA (now Institute of Management and Administration), to free up more resources for audit tasks.	No longer relevant – the training in question has been discontinued.
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Corporate and audit planning

179. The ADB consultants assisted the AO develop a planning process based mainly on that of the Australian National Audit Office. It consists of the following elements:

- Client auditee portfolio – a database (set of permanent files) of the nature, objectives, organization structure, governing legislation, policies and financial operations of each auditee. This forms the foundation of the planning process and needs to be updated on a continuous basis. About 50% of the auditees have had the files established. AO is starting to scan the documents so as to keep them electronically.
- Strategic audit plan (SAP) – maintained on Excel spreadsheet, this contains audit activities in all areas of the audit mandate over a three year period, and estimates budgeted time needed for these activities. The aim is to base the plan on 3 yearly audit cycle and planning audits in areas of greatest risk. This is being implemented and updated every year.
- Annual work program (AWP) – also maintained on Excel spreadsheet, this is developed from year 1 of the SAP. This is the program of audits planned to be undertaken in a particular year after the AO management committee has considered both the SAP and available resources. As discussed above, there is a backlog in the AWP's due to staff and travel constraints.
- Forward work schedule – prepared manually by the Audit Groups to identify individual audit tasks to be undertaken over the following 3 months and to allocate personnel to each task. This is being implemented on a rolling basis – reviewed with audit managers each week.

180. There is some inefficiency and potential for error due to the mixture of spreadsheets and manual records to manage the planning process, and there is no integration with time recording data (see below). The Auditor General has identified this as an area where external assistance would be desirable.

Audit portfolio management

181. The ADB consultants assisted the AO in establishing a time recording system. A timesheet was designed and audit staff trained to complete it according to a coding system. Checking procedures were introduced, and a time recording software package was obtained and installed to facilitate reporting on the progress of audits, review actual time taken against budgeted time, and measure productivity of audit staff.

182. At the time of the CFAA, the process is still in use except that the software package has been substituted by an Excel spreadsheet based system – because of problems encountered by AO with the software. All audit staff are required to fill in a weekly timesheet for the paid time they have spent. Productivity and variance reports are being produced on a weekly basis and reviewed by AO management. A notable feature of current time recording statistics was a relatively high amount of “idle time” reflecting difficulties faced by audit staff when auditee staff and records are not available during the course of an audit. Audit productivity in the AO is interlinked with auditee efficiency.

Audit Practices and Standards (including risk based methodology)

183. During the ADB consultancy, the AO adopted methodologies for financial auditing (including compliance and regularity auditing) and certain aspects of performance auditing (particularly for the small-scale reviews for which the AO only has capacity at the moment). A risk-based audit approach was developed drawing on practices of the Australian and UK National Audit Offices. These are documented in an Audit Manual (July 1998) which is in English, and which cross-references policies to the International Standards on Auditing.

184. The Manual is extensive (perhaps too daunting for many AO staff) and covers essential matters including audit planning, evidence, materiality, risk analysis, internal control analysis (manual and automated environments), documentation, quality control, reporting, and the role of auditors in relation to detection of fraud and corruption. It could benefit in future from greater customization of information pertinent to Maldives, being very generic in nature, and translation into Dhivehi. However, the main issue in terms of audit practices and standards is that with few suitably qualified and experienced seniors to give guidance to the staff, the application of the audit practices and standards codified in the Manual is a major challenge for the AO. The Director of Audit advised the CFAA team that he spends time in regular meetings with staff discussing selected areas of the Manual that have high relevance, to reinforce understanding of the requirements in the Manual.

Capacity to conduct financial and performance audits

185. At the moment only a few staff members have accounting degrees and/or professional accounting qualifications. As well as their AO work they are also called on to spend time helping other Ministries. Some existing audit staff have obtained Association of Accounting Technician (AAT) qualifications, and all new staff are undertaking training for this qualification at the Institute of Management and

Administration. These are staff from which the Auditor General would like to select for further professional training.

186. Three staff have also received scholarships for university training under the World Bank's Second Education and Training Project. The Auditor General hopes that further opportunities will be available to staff under the Third Project which has just been signed.

187. Current human capacity limitations limit to a significant extent to which the AO can undertake financial, regularity and compliance and performance audits as laid down in the Audit Manual.

Capacity to audit computerized systems

188. Some limited capacity to audit computerized systems was built during the ADB technical assistance. There are no AO staff with information technology qualifications. While the government accounting systems remain largely manual this is not a significant problem, but it will be essential that when these systems are computerized (envisaged under further ADB technical assistance projects), the AO should develop their capacity to audit in the new environment. It is envisaged under the ADB technical assistance for development of a new public accounting system that the related needs of the AO will be further reviewed.

Audit quality assurance

189. The AO's Audit Manual (Section 8) sets out in detail the requirements for audit supervision and review in line with International Standards on Auditing. Shortage of qualified senior staff make application of these requirements difficult for the AO.

Contracting out of audits

190. AO does not have the capacity to undertake all types of audits required to achieve adequate coverage of the public sector. At present, private audit firms carry out the financial audits of most public enterprises, as well as audits of Government-executed development projects to meet donor agreement requirements. In some cases, this has been through a contracting out process whereby the private firms undertake audits on behalf of the Auditor General, in other cases there is no connection with the Auditor General and, theoretically, the AO could conduct its own audits in parallel. In a few cases there are plans to formalize the existing situation through a contracting out approach.

191. The ADB technical assistance project helped the AO develop systems and procedures for the contracting out of audits. As AO develops further capacity to review the work of the contracted auditors, it will be desirable to extend the contracted audits to other public enterprises and to development projects. This will strengthen the mandate of the Auditor General to audit the entire public sector, leverage the expertise of private audit firms in such areas as the audits of commercial operations, provide an opportunity

for AO staff to be more exposed to audit techniques of the firms, and allow the AO to focus more efforts on performance audits. AO could remain a lean organization but increase its oversight of Government operations.

Audit reporting and follow up practices

192. The AO Audit Manual (Section 1) sets out acceptable reporting and follow up practices, including standard approaches to documenting audit observations for discussion at exit interviews, recording comments by management to the observations, and incorporating action plans into audit reports (management letters) for subsequent follow up. For financial statement audits, the Audit Manual sets out the forms of audit opinion in line with International Standards on Audit.

193. All outgoing audit reports are signed by the Auditor General.

ANTI-CORRUPTION AND CIVIL SERVICE REFORM INITIATIVES

194. The establishment in 1991 of an ACB was an important step taken by the Government to ensure that major corruption does not take root in the Maldives public sector. However, although the ACB does have some staff qualified in law and accounting, it remains limited in its effectiveness because of human capacity constraints. There is only limited budget for continuing professional development through training and regular interaction with counterpart agencies elsewhere in the world. The Board's policies, methodologies and documentation requirements have not yet been recorded for staff in any reference manuals. As with the AO, the cost of travel also makes it difficult for the ACB to extend its work beyond Male'.

195. Civil service reforms to attract and retain qualified and experienced professional staff, including financial managers, auditors and investigators, who can be exclusively employed in public service, will be highly desirable. This will assist efforts to further professionalize the civil service. It will also address concerns that, as the business of Government continues to grow, the current policy of allowing civil servants (in sensitive sectors at least) to engage in outside employment will increase the potential for conflicts of interest. The PSD needs to build its capacity to facilitate within the Government the planning and management of reforms. Preliminary studies will be needed to identify suitable reform options which the PSD can discuss with the Network of Senior Government Officials and use to formulate proposals to the Advisory Committee on Public Sector Reform and Modernization.

196. The development of service delivery standards and other performance measures for Government departments will also improve accountability. This is at an early stage in the Maldives, and is another area where exposure of the PSD and other Government officials to practices in other countries where these have been developed would be desirable.

Criminal Code concerning corruption

197. The Criminal Code has penalties for fraud, embezzlement and related crimes, and prosecutions based on ACB investigations will be based on the Criminal Code.

Anti-Corruption Board

198. The ACB was established in 1991. The ACB reports to the President's Office and is given wide powers of discretion in determining its work. The mandate covers the whole public sector, including public enterprises. A new Act to extend the purview of the ACB to the private sector is under consideration. ACB staff are not permitted to undertake outside employment and in compensation they receive allowances on top of the regular civil service pay scale for clerical/administrative staff.

Organizational Structure

199. The ACB is headed by a Commissioner who holds the rank of a Director General within the Government service. The Board comprises the Commissioner and the four senior managers who head four sections of the ACB:

- Operations Section headed by an Assistant Director General, and comprising 6 other staff. This section is responsible for carrying out investigations;
- Prevention Section headed by a Director, and comprising 5 other staff. This section looks at work procedures in government offices, looking for loopholes in prevention and detection controls over corrupt practices. The unit also carries out public awareness and education activities;
- Internal Control Unit comprising a Deputy Director, which assists management with monitoring work progress
- Administrative Section headed by an Assistant Director General, comprising 13 other staff mainly providing administrative support to the three other sections.

Procedures for receiving and registering of allegations

200. Allegations can come in any form and may be anonymous. A record is raised in the ACB for each complaint received. A spreadsheet-based database is kept to record and track the status of complaints received.

Capacity to conduct investigations

201. At present, the ACB investigate every allegation received. However this may not be possible in future because of the steady increase in the number of allegations. The ACB take this increase as evidence of growing confidence in their work.

202. The professional staff include 2 staff with overseas legal and accounting degrees, 1 staff with a local legal diploma in Maldivian law, 2 staff with Association of Accounting Technicians diplomas as well as training from the National Institute of Management in India, and one other undertaking legal training. Two administrative staff are undertaking local administrative training at the IMA, the Law Institute, and in India. There have also been some visits by staff to similar agencies in Hong Kong, Philippines and Thailand. Although relatively well staffed by educated personnel, the ACB identifies expertise in the conduct of investigations as lacking and an area for further capacity building.

203. The ability to successfully investigate serious complaints concerning large sums of money will be critical to the credibility of the ACB.

Work planning and management

204. The Investigation Unit acts on complaints and other information received, but can also initiate its own investigations. The Auditor General will refer the results of audits indicating corrupt practices to the ACB for investigation. The status of investigations and other activities of the ACB are tracked by management on spreadsheets and this is monitored by the Internal Control Unit.

Investigation practices and procedures

205. A team is established to review the allegation and a plan for the review is prepared. This may involve looking at financial records (the ACB has power to look at the private financial records of individuals under investigation), as well as interviewing people. There is no manual documenting the ACB's investigation policies, procedures, practices.

Reporting practices

206. An annual report is prepared by the ACB for the President's Office. There is no public report although the Board will provide non-confidential information on their work in response to public inquiries. The Commissioner has also been interviewed in the local Media.

Linkages of Commission work with Criminal Justice System

207. Cases determined by the Board to warrant criminal prosecution are referred to the Attorney General, who will be responsible for prosecuting the cases in court.

Prevention measures

208. The ACB conducts public awareness campaigns through television commercials, and mailings of information. It is also planning to produce posters for awareness campaigns and to work with local schools to promote its messages to young children.

Freedom of Information mechanisms

209. These have not been developed.

Government services delivery standards

210. At present these are not developed, although a process just instituted by the Government of requiring Ministries and Departments to develop performance indicators will provide the basis for comparison of performance with funds spent, to support value for money assessments. Services delivery standards can be set at micro level such as the time to process an application form submitted by a member of the public for a license or similar requirement, or macro level, such as the time to complete a particular construction project to specifications. The development, publication and monitoring of such standards would not only help improve administrative efficiency but also provide an additional disincentive for corrupt practices in the provision of services.

Civil service pay scales and employment policies

211. As indicated under the Payroll section of this report, pay scales and benefits are determined for various categories of staff (e.g. clerical/administrative, teachers, doctors, uniformed services). These are approved by the PSD.

212. Generally, civil service pay scales are low. It is common practice for civil servants to hold private jobs after official Government hours (which end at 2.30pm in the afternoon) to supplement their income. Also indicated in an earlier section of this paper, in order to meet the demands of economic development of the country at a time when there were few Maldivians trained and experienced in managing large enterprises, no restrictions were made on Ministers or other public office holders in the Executive (other than the President) from also engaging in private business.

213. The increasing demands on Government are making it increasingly difficult for the layer of experienced managers in the Maldivian Public Service to be only partly occupied with official business. There is also a concern that as such functions of Government as internal revenue collection, company registration and monitoring, and public procurement grow, the potential for conflicts of interest will increase.

214. The ACB provides an example of where it has been possible to establish a unit where the staff are devoted exclusively to their official duties. Unlike most other parts of the Public Service, Board members and staff are prohibited (under the ACB's enabling

legislation) from working outside the Government in private business, or as an employee of someone else. To compensate for this, ACB staff receive special allowances over and above their normal Government salaries and allowances.

215. The PSD is a key agency for any effort to undertake civil service reforms. It is a very new unit, having been established only in September 1999. As well as taking over the employment administration functions (e.g. approving appointments and transfers, setting pay scales) previously handled by an Employment Affairs Section of the President's Office, the aim of the PSD is to modernize and reform the Maldivian Public Service, and promote best practices and a culture for continuous improvement within the Public Service. The PSD is intended to comprise 6 units:

- Public Sector Modernization and Planning Unit – functions will include overseeing reform efforts, developing client charters, change management support, and drafting appropriate legislation of the Public Service;
- Human Resource Development and Training Unit;
- Organisational Development Unit – functions will include providing technical advice in the formulation of mission, vision and objectives of government departments, and strengthening and maintaining the classification and grading system of the Public Service;
- Personnel Unit – functions will include the appointment, transfer and termination of Government employees, and employee performance appraisals;
- Information Systems Unit – functions will include maintaining the records of Government employees and developing and managing a computerized system which would be networked with Government departments, to enable decentralized management of the Public Service employee databases; and
- Research and Publications Unit – functions will include research on new management techniques and best practices and their adaptation to the Maldivian Public Service, publishing and holding workshops and seminars on improving management and productivity of employees, and maintaining links with counterpart agencies in other countries

216. Another element established to promote civil service reform is the Network of Senior Government Officials, inaugurated by the President to share and exchange views on strategies for public services reform and modernization. Core participants are the heads of the Employee Affairs Committees in Government Ministries.

217. Also, an Advisory Committee on Public Sector Reform and Modernisation, comprising several Ministers, the Executive Secretary to the President, and the Director General and the Assistant Director of the PSD, has been formed to advise the President on reforming and modernizing the Public Service in line with the objectives of the

“National Vision 20/20”. This Advisory Committee will draw on the research of the PSD in formulating policy changes affecting the Public Service.

218. The PSD is still at a very early stage of development. Aside from the inherited employment administration functions, only the Public Sector Modernization and Planning Unit and the Organizational Development Unit are functioning. Development of other functions is expected to require external technical assistance given the limited capacity within the Government.

219. One aspect of direct relevance to the CFAA is the need for reforms to attract and retain a qualified and experience professional staff within the Maldivian Public Service, including financial managers, auditors and investigators, who can be exclusively employed in public service. The PSD needs to build its capacity to facilitate within the Government the planning and management of implementation of reforms. Preliminary studies will be needed to identify suitable reform options, drawing on lessons from other small, fast growing economies, that can be discussed with the Network of Senior Government Officials and submitted to the Advisory Committee for consideration.

MODULE 2 – ACCOUNTING/AUDITING PROFESSION AND EDUCATION

Current structure and capacity of local accounting profession

220. At the beginning of April 2000, there were 294 accountants holding various qualifications (279 males and 15 females) in the Maldives¹³. The vast majority of these are employed in commerce, in particular the tourism sector. Audit work is dominated by the local offices of three international accounting firms. Qualified accountants in these firms are licensed by the AO, under the Companies Act, to carry out audits of public companies and companies with shares over Rf. 1 million. The Companies Act requires that such audits be carried out by “chartered accountants or CPAs”, although these qualifications are not defined (this is further discussed in Module 3 of this report). These firms also carry out some audits of donor-financed development projects, either independently or on behalf of the Auditor General.

221. Most of the accountants in industry and commerce, and in the international accounting firms, are expatriates. The supply of qualified Maldivian accountants has not been sufficient to keep pace with the demand from the private sector, spurred by economic growth and the requirements of the Companies Act. There are about 5 Maldivians with internationally recognized professional accounting qualifications (the current Auditor General has the distinction of being the first) and less than 20 Maldivians have degrees in accounting. A further number of Maldivians have obtained Association of Accounting Technician (AAT) qualifications administered by the UK-based AAT, through study at the IMA in Male’.

¹³ Source: Ministry of Planning and National Development, Statistical Section. Figures as of April 9, 2000.

222. Accountants and accounting technicians can earn attractive remuneration packages in the private sector that cannot be matched by the Government. There is therefore a significant shortage of qualified accountants and accounting technicians in the Government, including the public enterprises.

223. The local offices of the international accounting firms are subject to the quality control requirements of their firms. All are required to adopt the international firm's standards and practices, in which case their work should meet international standards. In each case, quality assurance is provided by the firm's practice based in Sri Lanka. There are only 5 (Sri Lankan or Indian) chartered accountants among the firms, although there are also a number of management accountants. While it was beyond the scope of the CFAA mission to evaluate whether international standards are actually complied with by the firms, or assess the relative quality of the firms, variations can be expected based on the number and qualifications of their staff, and the exact nature of quality assurance programs to which the offices are subjected. The firms' acceptability to undertake audits in the public sector should be evaluated by the AO on a case by case basis against the proposed audit terms of reference.

Status of actions to establish local accounting professional body and standard setting capabilities

224. Although the Government would like to see a local professional accounting body with standard setting capabilities developed, and an Accounting and Auditing Standards Committee (AASC) has been constituted by the President's Office comprising qualified accountants from the AO, the MoFT, Ministry of Trade and Industries and the Chamber of Commerce to look into the matter, no significant progress has been achieved in this regard.

225. The lack of a local professional accounting body hinders the implementation of consistent local reporting standards, as the accountants will follow the standards of the countries in which they qualified. Likewise, there is reliance on the auditors to observe the professional code of ethics of the accounting bodies from which they received their qualification. In the absence of a local professional body there is no scope for local enforcement of professional standards and ethics.

226. The AASC needs to develop a strategic plan to move forward on establishing a local accounting profession. This needs to take account of the current profile (few fully qualified Maldivian accountants, increasing number of Maldivian accounting technicians, potential for locally qualified management accountants, and continued reliance on expatriates who should be brought under a local accounting, auditing and ethical standards regime when established). No external assistance is currently provided by donors in this area, and modest technical assistance to the AASC that would allow for exchanges with existing professional accounting bodies in the region and elsewhere to help develop this plan will be beneficial.

Use of private sector firms to undertake audits in the public sector

227. Because of the AO's capacity constraints discussed in paragraphs 185-187 of this report, a number of public sector audits are carried out by private audit firms, including audits of the public business enterprises and development projects financed by donors and international lending institutions. In some cases these are audits carried out under contract from the Auditor General, in other cases the audits have been contracted directly by the auditee. The Auditor General wishes to continue the practice of using private audit firms but under contracting out or similar arrangements that give the AO an oversight role.

228. Donors have requested private audit firms to carry out audits of development projects that they are funding, because of limits on the capacity of the Auditor General to carry these out. Although this remains the case, in order to reinforce the Auditor General's mandate, it will be desirable to have the audits by these firms overseen by the Auditor General, either through formal contracting out procedures as proposed for the ADB-financed Regional Development Project, or equivalent arrangements for technical oversight by the AO as has been adopted for the World Bank-financed Education and Training Projects.

Programs for the training of accountants and accounting technicians and capacity of local training institutes

229. The Fifth National Development Plan 1997-2000 provides that by 2020 the Nation will be self-sufficient in accountants¹⁴. As indicated below, capacity building in this area is already receiving Government and World Bank support.

230. Vocational courses in commerce offered as part of the high school curriculum (which follows the UK curriculum) are very popular. School leavers wishing to pursue a career in accounting do have the opportunity for undertake accounting technician training locally. Beyond that they must undertake academic and professional study overseas.

231. The IMA, which was established in 1991 and now part of the Maldives College of Higher Education (MCHE), provides local courses (on a cost recovery basis) on accounting and management. IMA receives assistance from the World Bank-supported Education and Training Projects for capacity building. It currently has about 500 students who are primarily sponsored by either Government or private sector employers. Education is based in Male', where new Government-financed facilities are under construction, but the College hopes to establish distance learning facilities in future to extend training to the other Atolls.

232. The IMA provides training for the Association of Accounting Technician (AAT) diploma, which is accredited by the AAT – an international accounting technician professional body based in the United Kingdom. AAT visit annually to inspect the IMA

¹⁴ Fifth NDP, Volume I, Chapter 2, page 4

to ensure that it is maintaining the accreditation criteria. IMA is also beginning to start offering training for the Chartered Institute of Management Accountants (CIMA-UK) qualification. Both the AAT and CIMA courses have work requirements as part of the course. An arrangement with Middlesex University in the UK is planned, so that IMA can offer courses in finance, business management, accounting, and information technology that would lead to a business degree conferred by the University.

233. The World Bank supported Education and Training Projects have provided Government scholarships for a number of young Maldivians to undertake overseas training in accounting and other finance related areas. Until such time as the Maldives can become self-sufficient in accountants, and can provide a comparable level of academic and professional training locally, overseas study (mostly supported by Government and privately sponsored scholarships) will remain the only means for developing qualified Maldivian accountants.

MODULE 3 – ACCOUNTING/AUDITING REGULATORY FRAMEWORK FOR THE PRIVATE SECTOR

Context

234. In the Maldives, the tourism, fisheries, construction and trading sectors are the most important for the private for-profit sector. Many businesses are small, owned and operated by families or small groups of business partners. There is no income tax at present, although this may be introduced in the future. Tourism taxes and import duties are the main forms of impost currently paid by private businesses to the Government.

Forms of registration for private sector firms

235. The Companies Act of the Republic of Maldives (Law No. 10/96) governs the formation, registration and management of companies in the Maldives¹⁵. There are two forms of companies which may be registered under the Companies Act - private and public companies:

- Two or more persons may form a private company, provided the authorized capital stipulated in the memorandum and articles of association is not less than Rf. 2,000. The articles must state that the company cannot sell shares to the public, shares can only be transferred to a party approved by the Board of Directors, and the number of shareholders is limited to 50; and
- Ten or more persons may form a public company, provided the authorized capital is at least Rf. 1,000,000. A public company can sell shares to the public after issuing a prospectus which contains information specified in the Companies Act, including

¹⁵ An unofficial English translation has been prepared by the Ministry of Trade, Industries and Labour.

details of the assets, liabilities and other obligations of the company, and the financial status of the company.

Liability of members is limited to the unpaid amount of the shares held by the members.

236. There is also a Partnership Act under which partnerships are required to be registered. This was not reviewed under the CFAA.

Government companies

237. Sections 95-97 of the Companies Act refers to Government companies. Companies whose shares are held solely by the Government or by a body of the Government shall be formed by a separate law or Presidential Decree. This shall contain the name of the company, its objects, authorized capital and the articles of association of the company. Liability is limited to the unpaid amount of the shares held by the Government.

238. Government-controlled companies which are joint ventures or have a portion of their shares held by the public are fully governed by the Companies Act.

General matters covered in the Companies Act

239. The 1996 Companies Act, along with other commercial laws, has been enacted to help establish a conducive environment for private sector business. The Companies Act is based on legislation in some other Commonwealth countries. Every company is required to have a memorandum and articles of association containing, among other things, the names of persons forming the company, the objects of the company, the authorized capital, the registered office and the regulations for the company. The memorandum and articles must be submitted to the Registrar of Companies together with registration and annual fees in order to be registered. Once registered, the registrar will issue a certificate of incorporation.

240. Every company is managed by a Board of Directors and is required to have a company secretary and hold an annual general meeting chaired by the Chairman of the Board.

241. The ADB consultants providing technical assistance to the AO conducted a detailed review of the unofficial translation of the Companies Act as part of their terms of reference. The review did not include legal form and validity of the Act itself. The consultants prepared a brief note¹⁶ indicating 40 areas which needed correction or clarification and recommended that the note be considered as input into any official review of the Act. Areas for clarification relating to financial accountability, the focus of this CFAA, are noted in the section below.

¹⁶ See “Review of the Companies Act of the Republic of Maldives – Law No. 10/96”, Section 6.5 of the “Final Report – Capacity Building of the Maldives Audit Office”, December 1998

Accounting/auditing regulatory framework for companies

242. Section 63 of the Companies Act requires that every company shall keep clear and sufficient accounting records of receipts and expenditures, assets, liabilities and obligations of the company. Section 64 requires that the accounting records be kept at its registered office for 3 years (private companies) and 6 years (public companies). The reasons for different retention periods are not clear and recommendations of the ADB consultants for similar retention periods, and clarification of the forms of acceptable records (manual, electronic, microfiche) should be considered during the next review of the Companies Act.

243. Sections 65-67 requires that every company prepare annual financial statements showing income and expenses, profit and loss, the annual balance sheet (including the share capital and paid up capital), the manner in which all immovable properties of the company are valued and an annual directors' report. Section 67 also requires that the accounts should specify "information generally expected to be disclosed in relation to the assets and liabilities of the company". This is vague and, as pointed out by the ADB consultants, does not promote comparability of company financial statements. During the next revision of the Companies Act the specific disclosures required of all companies should be set out.

244. Section 65 requires that the company shall "pass the accounts by the Board of Directors in accordance with the articles of association. The accounts shall be signed by the Board of Directors." During the next revision of the Companies Act, this should be clarified, as recommended by the ADB consultants, to state that the Board of Directors should approve the accounts and resolve to appoint at least two directors to sign the accounts on the Board's behalf. Repetition of these requirements in Section 68 can be eliminated. Section 68 provides that the annual accounts, directors' report and audit report shall be laid before the company in general meeting.

245. Section 69 requires that the annual accounts, directors' report and audit report shall be delivered to the Registrar of Companies within 15 days of the annual general meeting.

246. Section 70 requires that every company shall appoint an auditor and fix their remuneration at the annual general meeting and that every public company and companies whose share capital is more than Rf 1 million shall appoint chartered accountants or CPAs approved by the AO to act as their auditors. The qualifications for such are not defined, and in the absence of a local accounting profession, the AO must exercise judgement as to the acceptability of foreign accounting qualifications.

247. At present only qualified accountants employed in the three local practices of international accounting firms have been approved by the AO under Section 70. In practice the AO recognizes qualifications equivalent to "chartered accountant" or "CPA" bestowed by member bodies of the International Federation of Accountants. Consideration should be given, during the next review of the Companies Act, to recognizing as an interim measure until a local accounting profession can be fully

established. Specific criteria recommended by the ADB consultants¹⁷ in terms of membership of professional accounting bodies with appropriate academic and professional standards of entry, and knowledge of the Maldives Company Act, provide a guide as to particular requirements that could be established to provide a sound basis for the AO's approval.

248. Section 70 also provides that auditors of the company shall be removed at the annual general meeting. The ADB consultants recommended that there should also be provision for removal of auditors between annual general meetings with the consent of the Registrar of Companies. This should be considered during the next review of the Companies Act.

249. Section 71 provides that the auditor's report shall state whether or not the accounts "are true and show an accurate status of the company and whether or not the accounts reflect the real financial status of the company as seen from the books of the company". As the ADB consultants have pointed out, this is onerous and would require extensive audit procedures not customarily expected for a normal financial audit. During the next revision of the Companies Act, the auditor's opinion should reflect international practice and be framed in terms of whether the accounts "present fairly" (or "give a true and fair view") of the financial operations and position of the company.

250. The Companies Act does not specify any accounting and auditing standards according to which the financial statements should be prepared and audited. This does not promote comparability of company financial statements, and makes it difficult to enforce proper disclosure. Until such time as local accounting and auditing standards are developed, consideration should be given to specifying in the Companies Act the requirement for companies to prepare their accounts in accordance with International Accounting Standards and for company auditors to apply International Standards on Auditing. This should be reflected in the wording of audit opinions on company financial statements. Eventual local standards should be consistent with these international standards, differences being to clarify application of the standards to local context.

Registrar of Companies

251. The Registrar of Companies is an official of the Ministry of Trade and Industries. Although companies are required to deliver copies of their financial statements and audit reports to the Registrar, there are insufficient qualified staff in the Registrar's office to adequately review these reports. Consequently the Registrar is not well positioned to perform his role as a protector in relation to shareholders and potential investors of public companies, and to lenders and creditors of companies, particularly the smaller ones that cannot expect to get their own special purpose financial statements from the companies. The development of a civil service reform strategy, referred to elsewhere in this report, that would help attract and retain well qualified accountants in the public sector, applies to the needs of the Registrar's Office as well as other parts of the public sector.

¹⁷ See "Discussion Paper – Review Current Auditing and Accounting Standards", Section 12.1 of the "Final Report – Capacity Building of the Maldives Audit Office", December 1998.

Non-profit societies and other organizations

252. General legislation governing non-profit entities is not clear regarding financial reporting and auditing requirements. The bulk of non-profit entities are clubs and associations, and accountability arrangements for these were not the subject of any review in this CFAA. However, it is noted that a new class of non-profit charitable societies (non-governmental organizations) is emerging which is attracting local and international funding. While donors implementing development activities through these organizations may be getting special purpose financial reports to satisfy the accountability requirements in relation to their funds, the accountability requirements for the entity as a whole are not clear.

253. Government should include in its legislative priorities the clarification of laws relating to the requirements for financial reporting and auditing of non-profit entities. External technical assistance on this, as part of a package of assistance to develop the general legal framework governing non-profit societies and other organizations, may be helpful.

Microfinance operations

254. Microfinance operations supporting various productive enterprises in the outer Atolls have been undertaken over the last decade under projects assisted by the International Fund for Agricultural Development (IFAD) and executed by the Development Banking Cell of the Bank of Maldives Ltd. (BML). The first project – the Atoll Credit and Development Banking project – covered the northern and central Atolls and is completed, with lending continuing using reflows. The second project – the Southern Atolls Development Project – is being cofinanced with UNDP, covers the southern Atolls and also includes a social infrastructure development component implemented by the Ministry of Atolls Administration.

255. The microfinance operations include lending with and without collateral, depending on the size of the loans. In practice loans have been to individuals rather than groups. The Development Banking Cell of BML advised the CFAA team that repayment on the first project has been 98%. Unlike in other countries in the region, non-government organizations are not active in this sector. Due to costs associated with the geography of the Maldives, significant involvement of NGOs in this sector is not expected in the near future. No special regulatory arrangement is in place for microfinance operations and they are treated by BML as part of their regular portfolio of credit services to customers. The financial management of the microfinance operations is mainstreamed as part of BML financial management systems.

ANNEX 1

Partial List of Officials Met During CFAA Team Visit

Maldives Country Financial Accountability Assessment

Ministry of Finance and Treasury

Hon. Mr. Arif Hilmy, State Minister
Mr. Adam Maniku, Deputy Minister
Mr. Ibrahim Mohamed, Director, Public Enterprise Monitoring and Evaluation Board
Mr. Abdullah Jihad, Deputy Director, Department of Inland Revenue
Mr. Riaz Shareef, Assistant Director
Ms. Aminath Ali Manik, Assistant Director
Mr. Mohamed Mihad, Senior Budget Analyst

Attorney General's Office

Hon. Dr. Mohamed Munawwar, Attorney General
Ms. Fathmath Shanaz Abdulla, State Attorney

Ministry of Human Resources, Employment and Labour

Hon. Mr. Abdullah Kamaludeen, Minister
Mr. Riluwan Shareef, Director General
Mr. Shahid Ali, Project Implementation Unit, Education and Training Projects

Ministry of Justice

Hon. Mr Ahmed Zahir, Minister
Mr. Ahmed Mohamed, Principal Judge, Criminal Court
Mr. Ahmed Rasheed, Deputy Director

Ministry of Planning and National Development

Hon. Mr. Ibrahim Hussain Zaki, Minister
Mr. Hamdun Hameed, Deputy Minister

President's Office

Dr. Mohamed Asim, Director General, Public Service Division
Mr. Moosa Fathee, Assistant Director, Public Service Division

Ministry of Atolls Administration

Mr. Mohamed Farook, Director

Ministry of Fisheries, Agriculture and Marine Resources

Mr. Jadulla Jameel, Executive Director
Ms. Fathin Hameed, Director

Mr. Mohamed Zuhair, Director, Agricultural Services

Ministry of Foreign Affairs, Department of External Resources

Mr. Ahmed Latheef, Director General

Ms. Aminath Didi, Director

Ministry of Home Affairs, Housing and Environment, Male' Municipality

Mr. Ahmed Shareef, Chairman

Ministry of Tourism

Mr. Mohamed Saeed, Deputy Minister

Mr. Ahmed Muizzu, Legal Counsel

Ministry of Trade and Industries

Mr. Ahmed Naseem, Director General of Investments, Foreign Investment Services Bureau

Mr. Idham Adnan, Registrar of Companies and Assistant Director

Audit Office

Hon Mr. Ismail Fathy, Auditor General & Minister of State

Mr. Ahmed Shahid Jameel, Director of Audit

Anti Corruption Board

Mr. Abdul Forouk Hassan, Commissioner

Mr. Abdullah Adam, Assistant Director-General, Operations

Mr. Abdul Azeez Moosa, Assistant Director General, Administration

Mr. Ali Rasheed Umar, Assignment Officer

Secretariat of the People's Majlis

Mr. Mohamed Nasheed, Secretary General

Maldives College of Higher Education

Mr. Hassan Hameed, Principal

Mr. Hussain Haleem, Deputy Director

Maldives Monetary Authority

Ms. Khadeeja Hassan, General Manager

Mr. Abdul Ghafoor, Deputy General Manager

Mr. Ibrahim Naeem, Operations Manager

Bank of Maldives

Mr. Mohamed Ahmed, Assistant General Manager

Ms. Fathimath Manike, Manager, Development Banking Cell

Maldives Industrial Fisheries Company

Mr. Adnan Ali, Director, Operations
Mr. Mohamed Haneef, Finance Director
Mr. Machnaike, Chief Accountant

State Trading Organisation

Mr. Mohamed Maniku, Managing Director
Mr. Ismail Ibrahim, Deputy Director

Maldives National Chamber of Commerce and Industry

Mr. Mohamed Areef, Board Member
Mr. Maizan Omar Manik, Board Member
Mr. Ahmed Nashid, Board Member

KPMG Ford, Rhodes, Thornton & Co

Mr. Jagath Chandana Perera, Partner

Ernst & Young

Mr. Roshan Gundwardene, Country Manager
Mr. Krishna Rengaraj, Manager, Management Consulting

Pricewaterhouse Coopers

Mr. V Surendran Menon, Resident Manager