

**SRI LANKA**

**Country Financial Accountability Assessment (CFAA) Study**

**Final Report**

**June 30, 2003**

**South Asia Region Financial Management Unit  
The World Bank**

## **SRI LANKA**

### **Country Financial Accountability Assessment Study**

#### Table of Contents

<b>1.</b>	<b>Executive Summary .....</b>	<b>1</b>
<b>2.</b>	<b>Public Financial Accountability – Central Government .....</b>	<b>5</b>
<b>3.</b>	<b>Public Financial Accountability – Provincial Councils and Local Governments .....</b>	<b>11</b>
<b>4.</b>	<b>Public Financial Accountability – State Owned Enterprises .....</b>	<b>13</b>
<b>5.</b>	<b>Public Audit.....</b>	<b>17</b>
<b>6.</b>	<b>Legislative Scrutiny of Public Funds.....</b>	<b>21</b>
<b>7.</b>	<b>Rights to Information .....</b>	<b>24</b>
<b>8.</b>	<b>Proposed Action Plan .....</b>	<b>26</b>

## PREFACE

The work on the draft report of the Country Financial Accountability Assessment for Sri Lanka was undertaken from February to October 2002 by a team comprising World Bank staff, government counterparts, and consultants. The work was carried out through a combination of field study in specific areas, review of existing studies and on going self-assessment reports of the Government, desk research, and extensive discussion and dialogue with concerned stakeholders in the Government, private sector, legislature, media, civil society, and donors.

This draft report was peer reviewed, and reviewed by the Government and the CFAA National Steering Committee. A Workshop was held on June 26, 2003 for discussion of the draft report by stakeholders from the Government, Parliament, academic institutes, media and civil society. Recommendations discussed at the Workshop have been incorporated into this final report.

The CFAA team comprised Julitta Rasiah (Task Leader), Vinod Sahgal, Vikram Chand, P K Subramanian, Tony Bennett (consultant), Ramesh Deshpande (consultant), Virendra Perera (consultant), and V. Kanagasabapathy (government counterpart). The team of local consultants included M. Somasundaram, Shivaji Felix, Naomal Goonewardena, J. C. Weliamuna, and Rohan Edrisinha.

Peer reviewers for this study included Marius Koen (AFTFM), David Shand (Financial Management Board), S. L. Athukorala (Asian Development Bank), John Fitzsimon (CGIAR) and P. Saravanamuttu (Centre for Policy Alternatives).

The CFAA team gratefully acknowledges the cooperation extended by government counterparts, members of parliament, donors, peer reviewers and the support received from other sector units within the Bank.

## 1. Executive Summary

---

### **The Country Financial Accountability Assessment Study**

1.1. The Country Financial Accountability Assessment (CFAA) is a tool designed by the World Bank to assist its clients. It assesses risks to the development objectives of a country arising out of any gaps or weaknesses in financial management of public resources. It provides recommendations for strengthening the institutional framework and organizational capacity for enhancing the effectiveness of the State's financial management of public resources. The assessment covers a range of processes, including parliamentary control of public funds and the Government's financial management and reporting practices at the three levels of government (including state owned enterprises). Equal emphasis is given to the effectiveness of the public audit function and public access to information provisions which are aimed at enhancing accountability and transparency.

1.2. The Bank and the Government of Sri Lanka recognize that building institutional capacity is a process that takes place over time. Accordingly, this assessment emphasizes the importance of taking actions that both stimulate demand for prudent financial management and build capacity of the Government to respond to the public's requirements for more efficient and effective delivery of services. An action oriented approach for strengthening public financial accountability and management is crucial for economic growth and sustaining a strong economy.

### **Sri Lankan Context**

1.3. The framework for public financial accountability in Sri Lanka is founded in the principles of governance associated with the model inherited from the British. This framework is widely accepted as appropriate for the country. The primary accountability institutions and organizations for financial management, control, audit and legislative scrutiny have, however, not evolved in line with the changes in the more advanced democracies of a similar background. This lapse has reduced the effectiveness of the system of public financial accountability in Sri Lanka, resulting in less than adequate assurance that public funds are used for the purposes intended with due consideration to economy and efficiency.

1.4. Financial accountability at the sub-national level is less well developed than at the center. The reasons for this are similar to those concerning the central Government, but more acute and pronounced. For example, the control over funds is subject to less public scrutiny and financial reporting is less regular. In addition, provincial and local governments' dependency on the central Government for funds and confusion over the role of the center vis-à-vis that of the provinces, result in excessive duplication of effort and resources. As regards public enterprises, there are over 216 state owned enterprises covering commercial, regulatory, promotional and educational activities in Sri Lanka. The majority of these are characterized by excessive staff; weak management; inefficiencies; heavy losses; dependency on budget transfers; and delayed publication of audited accounts, thus, further eroding public financial accountability.

### **Key Findings**

1.5. The will to reform is evident at both the political and bureaucratic levels. Several recent initiatives jointly taken by the government, legislators, and the Auditor General for improving accountability of key state owned enterprises, for strengthening the reporting requirements of government agencies, drafting of new laws, setting up organizational arrangements for improved oversight by the Treasury of state owned enterprises, and the 'e-Sri Lanka' initiative for implementing

the e-governance concept, confirm the desire to move ahead with much needed reforms. These are being supported by the World Bank through a Poverty Reduction Support Credit.<sup>1</sup>

1.6. Discussions with stakeholders on reforms centered around the urgent need to arrest further deterioration in public financial accountability. Five priority areas of concern were identified:

- ◆ Parliamentary control of the public purse has become ineffective and does not currently meet the expectations set in the Constitution. This can be restored by strengthening the oversight function provided by the public accounts and public enterprises committees (COPA and COPE) and establishing a standing committee to focus on the annual budget. The recent initiative taken by the COPE to probe into the performance of the Ceylon Electricity Board is noteworthy in this regard.
- ◆ The accountability of the executive at present is too focused on ‘spending to budget’, rather than on ‘managing for results’. This shift in focus, widely considered to be important, can be accomplished by introducing, on a progressive basis, a performance based culture with incentives that reward achievement of outputs and outcomes, and holding the secretaries of government to account for meeting departmental objectives and performance standards. In this context, recent efforts taken to base the year 2003 budget on a Multi-year Budget Framework (MTBF) are notable. It will be equally important to reduce the emphasis on concern with administrative processes and mere compliance with detailed rules and regulations. The Government’s move towards the setting up of a separate revenue agency is a good example of re-thinking on these lines. At the same time, it will be necessary to clarify the accountability relationship of the secretary of each ministry to his or her minister. The government has received advice on the issue of ministerial accountability from the Netherlands Court of Audit.
- ◆ The public audit function does not currently meet the standards expected of the auditing profession, and consequently, its impact on financial accountability is below its potential. This can be strengthened by making the Auditor General more independent of the executive and by building his capacity to provide more relevant audit information to Parliament. A preliminary study carried out by the Netherlands Court of Audit has endorsed the need for strengthening this institution. Recent initiatives of the Auditor General to improve the timeliness of audit reports is a significant step in this direction.
- ◆ The culture of governance that derives from colonial times is not appropriate to the present needs and the Government has expressed its intention to move towards a more open, participative form of governance and decision making. This can be accomplished by removing obstacles, such as the Official Secrets Act, and re-visiting the Establishment Code to bring Government in line with evolving good practices in other parts of the world.
- ◆ The lack of clarity over the accountability relationships of the central, provincial and local governments and financial reporting and oversight arrangements not being well aligned to the needs of a more devolved system of governance, weaken accountability at the sub-national governments. The efforts under way to address this issue should include greater specificity on financial accounting, reporting, auditing, and public scrutiny arrangements and capacity building at the sub-national levels.

---

<sup>1</sup> This credit through the International Development Association of the World Bank, signed on June 26, 2003, is for US\$ 125 million. It is the first in a series of annual PRSCs, and is designed to be consistent with Sri Lanka’s Poverty Reduction Strategy.

1.7. To address the above concerns, the GOSL wishes to move forward on two broad fronts. First, new legislation and rules to address institutional issues. Second, capacity building, including training, for improving organizational efficiency and effectiveness.

#### *Institutional Reforms*

- ◆ Amend the standing orders and the Parliamentary Powers and Privileges Act, which govern the rules of procedure of Parliament, to allow for greater public access to the hearings of the COPA and COPE and for opportunities to further explore ways to enhance government productivity, over and above scrutiny based on audit information.
- ◆ Enact the proposed Public Finance bill after due consultation with stakeholders and review of recent similar legislations enacted in other countries, for financial management of the Government of Sri Lanka, the establishment and maintenance of the accounts of the State, and the control of public sector enterprises. Such legislation would have greater *authority* than the existing financial regulations promulgated by the Government, and consequently provide a firm basis for more effective enforcement. At the same time, this should clarify the financial accountability of the minister as distinct from the secretary of the ministry.
- ◆ Enact dedicated audit legislation that specifies the duties, powers and responsibilities of the Auditor General and provides safeguards for his financial and administrative independence from the executive. The Act should also provide for unrestricted access by the Auditor General to information, property and personnel associated with management of all significant public resources.
- ◆ Pass the proposed Freedom of Information bill, after due consultation with stakeholders, to allow for greater public access to information in line with the principles of more accountable and open system of governance.
- ◆ Develop the form and content of the financial accounts of the various levels of government, and common reporting standards consistent with international public sector accounting standards.

#### *Capacity Building*

- ◆ Build awareness, information sharing, and research capacity of the two oversight committees and the proposed new standing committee on the budget in the legislature.
- ◆ Strengthen the management control practices associated with revenue, expenditure, assets and liabilities of the Government. This work would complement initiatives currently being covered by the Public Expenditure Management Systems Project funded by the Asian Development Bank and would include simplification of Financial Regulations (FRs), modernization of accounting and financial reporting in conformity with international public sector accounting standards, and performance reporting in line with the evolution in more advanced democracies.
- ◆ Formulate an Institutional Development Plan for strengthening the Auditor General's Department. This would entail changes to the audit work program, methodology and the organizational structure, and, most importantly, a human resources strategy, including recruitment policy, compensation packages, training, and career development opportunities.
- ◆ Implement the proposed legislation on Freedom of Information through the development of policies, procedures, and training of personnel involved with the provision of timely and appropriate information to the public.

- ◆ Develop policies and practices for the preparation and dissemination of financial information, including by means of information technology under the e-governance initiative.

1.8. The assessment concludes that there are substantial opportunities for introducing institutional reforms for strengthening public financial accountability in Sri Lanka. There is every indication that the political will for reforms will be sustained. The Government seeks a time bound action plan for moving forward on each of the areas of reform and capacity building as outlined above. A proposed action plan has been agreed and a timetable has been tentatively added in Annex 8. In this regard, the GOSL has requested that donors fund a full-time National Program Coordinator who would act as a focal point to carry the plan forward and report to the Secretary, Ministry of Finance. The World Bank, in partnership with other development agencies, will support initiatives aimed at developing the action plan and provide technical assistance for implementation.

1.9. Findings of the other two subsidiary modules of the CFAA study, namely, the use of non-governmental organizations (NGOs) in donor financed development projects and review of financial management practices for donor funded projects are given in the respective technical annexes to this report. These two modules were carried out with a 'project focus', thus, their findings are not included in the main report which is focused on country level issues.

## 2. Public Financial Accountability – Central Government

---

2.1. The public financial accountability (PFA) framework<sup>2</sup> of the Government of Sri Lanka is archaic (adopted from the colonial rules). Consequently its objectives are generally limited to input control and compliance with administrative rules. The framework is no longer suitable to meet the needs of modern performance oriented management of public resources and effective delivery of government services. Actual adherence to this weak accountability framework is far below present expectations. The fiduciary implication is that even though funds might be accounted for (given the emphasis on expenditure controls), it cannot be ascertained whether they will be used for intended purposes. Nor can it be seen whether the expenditure represents value for money. Thus, there is a significant fiduciary risk<sup>3</sup> that public funds will not be properly used.

2.2. Several factors have contributed to this situation. This assessment contends that a series of technical fixes to the PFA framework, while necessary, alone will not bring about the required improvements. Technical assistance programs aimed at modernizing internal government practices should be coupled with efforts to stimulate external demand for sustainable reform, in particular, from the legislators and the civil society. These actions would support the Government's move towards a more open form of governance and, at the same time, provide the bureaucracy with sustainable motivation and a sense of urgency that would drive implementation of the PFA reforms, many of which are being developed with the assistance of donors, such as the Asian Development Bank.

### Overview of Current Situation

2.3. The Constitution of Sri Lanka explicitly states that the Parliament shall have full control over public funds. In line with this, each year, the budget is passed by Parliament and allocations confirmed in the Annual Appropriation Act. The ministry of finance is then tasked with the responsibility for implementing the budget.

2.4. In reality, Parliament's control over public funds is very weak. Actual expenditure often exceeds budget estimates, revenues are under realized and there is insufficient information on assets and liabilities of the State. As a result, budget deficit targets for the past several years have not been met. The frequency of budget revisions and significant supplementary estimates are additional indicators of weak parliamentary control<sup>4</sup>. Further evidence is the amount of time spent by the public accounts committee (COPA) on routine regularization of budget excesses, when it examines the audited appropriation accounts several years after the event. Aside from this, treasury controls over the release of funds, because of insufficient cash flow, further erodes parliamentary control. There are also several funds for which the accounts have not been tabled in Parliament.

2.5. The framework of financial control procedures to be followed by all government spending units, i.e. ministries and departments, in expending and reporting on public funds are laid out in the Financial Regulations (dated 1992). These control procedures<sup>5</sup> are adaptations from those prevailing

---

<sup>2</sup> Refers to the legal provisions, organizational arrangements, systems, procedures, and processes concerned with public financial accountability.

<sup>3</sup> Fiduciary requirement is that public funds are properly accounted for, used for the intended purposes, and that expenditure represents value for money; fiduciary risk is that public funds will not be managed/used in this way. [DFID]

<sup>4</sup> During year 2000, supplementary provisions amounting to \$ 457million, or 9.2% of the budget expenditure estimates, were approved by parliament.

<sup>5</sup> FRs were first issued in 1966 largely emulating the colonial rules and procedures of pre-independent Ceylon.

during the colonial period and focus only on the input aspect of expenditure control. They are issued by the executive (not by the legislature) and do not have the force of law. There is a significant and long standing practice of lack of compliance with the Financial Regulations (FRs), in form and in spirit. The final result is that government financial statements presenting the financial condition of the State (the State Accounts) have not been available on a timely basis and were not easily understandable. They are not comprehensive, for example, they do not reflect significant liabilities of the Government such as guarantees, and the numbers are not completely reliable because of reconciliation problems.

2.6. Apart from the above, another significant gap in the PFA framework is the lack of any mechanism for monitoring and reviewing outputs and outcomes of government expenditure. The current FRs do not encourage a culture of performance management, as distinct from administration of 'inputs'. In the absence of requirements for performance reports, there is no substantive basis on which either the legislators or the executive can demand accountability from the bureaucracy for performance, with due regard to economy and efficiency.

2.7. Further, public sector financial management endures many of the ills typical of the public sector as a whole in Sri Lanka. Excessive staff, but not of the caliber required, a culture reluctant to change, systemic inefficiencies, political interference, and limited use of technology. Therefore, technical fixes, as much as they are urgently needed, are difficult to implement in such an environment, and by themselves, will not lead to major improvements.

2.8. There are several reform initiatives that are currently under way for modernizing the PFA framework. The Public Expenditure Management Systems (PEMS) project<sup>6</sup> has carried out diagnostic studies and made recommendations in the areas of government budgeting, government accounting, and human resources for public financial management. The Government is committed to the introduction of a medium-term budgetary framework and performance indicators and targets in the budget document. A welcome development has been the production and audit of the State Accounts for the year 2002 within five months of the end of the year in a new user-friendly format. This is an important first step towards meeting the new international standard for cash-based government accounting.<sup>7</sup> A web site has been created for the Ministry of Finance and action is being taken to publish the annual reports and accounts of government agencies and major public enterprises on the web site.

2.9. Another significant recent development is the legislation titled the Fiscal Management (Responsibility) Act which makes the executive responsible for explicitly laid out fiscal management and financial condition requirements. In addition, a Public Finance Bill has been drafted and is currently under consideration by a Cabinet Committee. This is expected to lay a firm legal basis for improving performance and ensuring financial accountability of the Government.

2.10. The Government has transformed the FRs into a set of nine guidelines - on planning, budgeting, foreign aid, revenue management, government accounting, procurement, fixed asset management, stores management and internal auditing. These have eliminated obsolete and cumbersome procedures and made the rules more user-friendly. They will become mandatory and replace the old FRs on the coming into force of the Public Finance Act.

---

<sup>6</sup> The PEMS project is funded by ADB, managed for the Government by PricewaterhouseCoopers Lanka (Pvt) Ltd, and steered by a Steering Committee headed by the Deputy Secretary to the Treasury. It started August 2000 and is scheduled to close in July 2003.

<sup>7</sup> The standard setting body, IFAC, has also issued standards for accrual-based accounts, and is urging governments to move to an accrual base. The IMF also prefers an accrual base for its Government Finance Statistics series. The Government is planning a migration path to full accrual accounting, which is expected to take four years.

2.11. However, given that the parliamentary control of public funds, in reality, is weak, legislation alone, without broader institutional and public sector reforms, cannot improve the quality of public financial accountability.

2.12. Thus, it is critical that any effort for improving public financial management is done so with a holistic view, and more importantly, explores means for providing incentives for institutional change in the bureaucracy, for stimulating demand from legislators and civil society, for more open and productive government.

## **Key Issues**

### *Public Accounts*

2.13. All government spending and revenue collection units, depending on the nature of their activities, prepare appropriation accounts, revenue accounts, and advance accounts (these are advances for stores, trading activities, and staff loans). The consolidated accounts of the state are prepared by the Department of State Accounts in the Treasury and comprise monthly statements of cash receipts and payments, quarterly consolidated accounts (i.e. summary of cash receipts and payments for the quarter), and annual State Accounts (which in addition to the above, include loans granted and outstanding loan obligations). The latter two reports are published in the gazette; and the annual State Accounts include the Auditor General's certificate.

2.14. The assessment found that the form and content of these statements and the policies on disclosure of material information have recently been overhauled and are now much more useful in helping an informed reader evaluate the overall financial position of the state. The formats are not yet comprehensive as they exclude contingent liabilities, especially government guarantees on loans to state owned enterprises<sup>8</sup>. Further, there are reliability concerns, arising from reconciliation issues, e.g. total government expenditure and donor disbursements as reported by the Treasury in the Gazette are significantly different from those published in the Annual Reports of the Central Bank. Consequently, there are doubts about the reliability of the accounts and neither the public nor the legislators who approved the budget are able to evaluate the financial performance of the executive comprehensively.

### *Financial Management*

2.15. Lack of mechanisms for monitoring and reporting outputs and outcomes of government expenditure make it difficult to hold the executive accountable for performance. Issues concerning government budgeting, accounting, and control practices are discussed below.

2.16. The government budgeting process is characterized by lack of transparency in formulation, poor linkages with macro-economic policies, unrealistic estimates of expenditure and revenues, lack of fiscal discipline in cash and debt management, focus on inputs, and outdated and rigid economic classifications of expenditure. The PEMS project carried out a detailed study on this and developed a budgeting approach to include preparation of a medium-term expenditure framework (MTEF), a budget policy paper, and a fiscal framework; processes for extensive consultation and discussion of these documents by the cabinet; and a performance document to accompany the budget estimates submitted to Parliament<sup>9</sup>. The Government has initiated important measures to implement a multi-

---

<sup>8</sup> There is no complete record of all government guarantees. For Sri Lankan Airlines alone, government guarantees amount to US\$ 70 million.

<sup>9</sup> Sri Lanka: Strengthening Public Expenditure Management Systems Project – Revised Budget Procedures, February 2002, PriceWaterhouseCoopers.

annual and performance-based budget to strengthen public expenditure management. New budget procedures and formats have been developed.

2.17. Government accounting practices are characterized by manually cumbersome, single-entry recording and the cash basis of accounting, along the lines of the economic classifications of expenditure used for budgeting. The use of technology so far has only been to computerize the aforementioned accounting practices<sup>10</sup>. Though this has reduced the time taken to consolidate the accounts in the Treasury, it duplicates the departmental systems, some computerized but mostly manual (which continue in existence as CIGAS does not go down to lower levels of classification), and does not bring about any fundamental changes to the accounting policies or practices. The restructured PEMS project's diagnostic study identified the need for enhancing the CIGAS system, integrating and interchanging data amongst various departments in the Treasury, updating expenditure classification, and preparing a modern accounting and financial management framework<sup>11</sup>. Progress has been made in setting up a web-enabled network in the Treasury and computerizing a National Operations Room.

2.18. Internal control procedures, though comprehensive in coverage of transactional matters and spelt out in detail in the FRs, are excessively rule based and tend to thwart the spirit for promoting managerial accountability for performance.<sup>12</sup> FRs deal with all aspects of procedures and controls necessary for authorizing, approving, executing (procuring), recording, and reporting government expenditure. The PEMS study concluded that problems with FRs ranged from complete absence of controls in some areas to irrelevant controls in others. The revised guidelines too do not focus on controls to promote accountability for performance – outputs and outcomes. Another key aspect of internal controls, i.e internal auditing of the Government, is extremely weak and ineffective, in addition to lacking adequate resources and skills.

#### *Accountability Relationships*

2.19. The overall accountability for public financial management in the Government is dispersed among various ministries and agencies. The secretary (chief executive officer) for each ministry is appointed as the Chief Accounting Officer (CAO)<sup>13</sup> accountable for all aspects of financial management of the ministry and departments under his/her purview. The CAOs are required to follow the instructions given by the head of the Treasury, who is the CAO for the Ministry of Finance.

2.20. Secretaries are responsible for responding to the observations of the Auditor General and are the main witnesses in front of the public accounts committee (PAC). The CAOs, as part of the bureaucracy, are subject to instructions from the minister. Accordingly, it becomes necessary to clarify the respective responsibilities of the secretary and the minister for decisions taken by the ministry. At present there is no legal protection for secretaries against the risk of ministerial intrusions that may conflict with the requirements for prudent management of resources. The draft Public Finance Bill provides for the protection of a secretary where a minister issues a directive that is likely to result in unauthorized expenditure. The secretary has to inform the minister accordingly in writing

---

<sup>10</sup> Computerization Integrated Government Accounting System (CIGAS) is the key software and is widely used since its introduction in 1995.

<sup>11</sup> Sri Lanka: Strengthening Public Expenditure Management Systems Project – Accounting Options Report, July 2002, PriceWaterhouseCoopers.

<sup>12</sup> For instance, there is no provision in the new guidelines for a responsible officer at any level to exercise discretion in the application of expenditure rules in a transparent manner where there is a conflict between the rules and the achievement of outputs. This public interest 'over-ride' was in the old FRs, but not much used.

<sup>13</sup> There are Accounting Officers and Revenue Accounting Officers who are heads of department responsible for financial management of that agency. Whilst the former head government spending departments the latter head departments in charge of revenue collection.

and, if the minister nevertheless issues a written directive, the secretary sends copies to the Treasury and Auditor General. In practice, directives may not be made in writing. Moreover, the secretary normally owes his job to the minister and may be unwilling to prejudice his working relationship by opposing ministerial wishes. This issue has not been addressed.

### *Motivation for Change*

2.21. A critical issue is the lack of motivation for any type of change or modernization efforts within the bureaucracy. Though there are notable champions in the Government with tremendous commitment and zeal for change, much of the bureaucracy suffers from lethargy, inefficiencies, excess staff, and lack of professional expertise<sup>14</sup>. This makes it difficult for successful implementation of technical assistance programs. This is a public sector institutional issue, which, nevertheless, significantly affects accountability for public funds and cannot be ignored.

## **Recommendations**

2.22. As many recommendations to the PFA framework have already been proposed by the PEMS project, this assessment, whilst agreeing in principle with those, proposes additional measures that should be considered in order to provide an appropriate and sustainable institutional environment for implementing the technical fixes, and thereby, improving overall public financial management.

2.23. **Timely release of financial information.** With the advent of technology and the Internet, it is recommended that the Treasury publishes on the Internet, up to date financial information of line ministries and departments, no matter how rudimentary its form and content. This could help the public, in particular interested civil society institutions, legislators, and the media, to track on a timely basis, financial performance of the Government and stimulate debate and discussion on fund utilization well before the budget ceilings are breached. In this regard, the recent circular<sup>15</sup> issued by the Treasury instructing all government agencies to table in Parliament annual accounts and performance reports within 150 days of the end of the year and the ‘e-lanka’ initiative are noteworthy.

2.24. **Revise form and content of financial information.** The form and content of the financial information reported by the Treasury needs further development, if it is to convey relevant information on the *financial condition of the state in a comprehensive manner*. The statements required by the Fiscal Management (Responsibility) Act will help interested parties track the financial condition of the state. In this context, it is also crucial that all necessary steps be taken for implementing the Accounting Action Plan for moving from cash basis of accounting to full accrual accounting (in compliance with all IPSASs) by March 2007.<sup>16</sup>

2.25. **An enforceable PFA framework that promotes accountability for performance.** The current PFA framework is not enforceable and does not have any provisions for demanding performance accountability. Along with the initiative of the Medium-Term Expenditure Framework and the Fiscal Management (Responsibility) Act, the management control procedures and accounting practices too need to be changed to focus on accountability for outputs and outcomes, retaining only the minimum required control on inputs, and be given greater enforceability. Therefore, the proposed

---

<sup>14</sup> Human Resources Management Study of the PEMS project has developed specific proposals for improving recruitment, training and retention of staff for core functions in accounting, financial management and planning in the public sector.

<sup>15</sup> Public Finance Circular No. 402, Annual Performance Reports and Accounts of Ministries, Departments, Provincial Councils and Local Authorities, September 12, 2002.

<sup>16</sup> Sri Lanka: Strengthening Public Expenditure Management Systems Project – Accounting Framework Implementation Report, October 2002, PriceWaterhouseCoopers

Public Finance Act is critical and after due discussion with stakeholders, including civil society, and a review of recent similar enactments in other parts of the world, it should be passed by Parliament.

2.26. **Promoting a culture and building capacity for performance accountability.** This too is a long-term effort, but nevertheless critical. While the PFA framework modifications for improving performance accountability take effect, due consideration should be given for providing the right incentives, bringing pressure to bear on the bureaucracy for change, and building capacity for performance management. A precursor and a useful stimulus to this would be transparency of financial information of the Government. This could include publication of key performance information as mentioned above. All this should be given due consideration in formulating public sector reform initiatives.

### 3. Public Financial Accountability – Provincial Councils and Local Governments

---

3.1. Public financial accountability at the sub-national level is weaker than at the center. Causal factors are similar, except that they are more acute and pronounced at this level. In addition, the dependency on the central Government for funds and confusion over the role of the center vis-à-vis that of the province result in duplication of effort and resources. Fiduciary risk at the provincial and local authority level is assessed to be higher than at the central government level.

#### Provincial Councils<sup>17</sup>

3.2. Provincial councils were introduced in 1987 by way of the 13<sup>th</sup> Amendment to the Constitution as a possible solution to the ethnic crisis. This created another level of administration, often duplicating the role of the state and adding to the bureaucracy and has resulted in further inefficiencies in the use of public funds.

3.3. Sri Lanka has eight provincial councils. Budgetary transfers to the eight provincial councils amounted to 10% of total current outlays in 2001. More than 80% of this amount was to pay for recurrent expenses<sup>18</sup>. Provincial councils depend on the central Government for more than 80% of their financing needs. Administratively, funds are transferred by the Treasury, through the account of a central line ministry (the Ministry of Provincial Councils and Local Government) to the provincial councils. Recommendations for budget transfers to the eight provincial councils are made by the Finance Commission.

3.4. The provincial council consists of members elected by the voters of the province and is headed by the Chief Minister. The provincial government comprises the chief secretary and provincial ministries which handle the subjects devolved to them as per Schedule 9 of the 13<sup>th</sup> Amendment. Subjects in List 1 (those devolved to the councils) and in List III (those concurrently managed by the center and the province) cause confusion and has led to fragmentation and overlap of responsibilities between the central and provincial ministries and departments, mainly in the areas of education, health and roads<sup>19</sup>.

3.5. The PFA framework for the provincial councils include the 13<sup>th</sup> Amendment and the Provincials Councils Act of 1987. As per these provisions, responsibility for budgeting lies with the council, who then seeks the recommendations of the Finance Commission. However, in reality, it is widely believed that the weak capacity of the Finance Commission, dependency on the central Government for funds, and the fiscal stresses at the center, have made budgeting ineffective.<sup>20</sup>

3.6. All aspects of internal control procedures are described in the provincial Financial Rules, which are adaptations of the FRs of the central Government. Although accounts and reports of the province are required to be submitted to the council, they are late by 4-5 years, not comprehensive, and not relevant for assessing the financial performance and condition of the council. Auditing is

---

<sup>17</sup> A field study of the Western Provincial Council, which is considered to be relatively stronger than the others, was carried out for the purpose of this assessment.

<sup>18</sup> Fund transfer for recurrent costs are known as block grants.

<sup>19</sup> Capacity Building for Fiscal Devolution in Sri Lanka, Ashok K. Lahiri, Finance Commission, funded by the UNDP.

<sup>20</sup> This assessment did not cover the working of the Finance Commission.

carried out by the Auditor General of Sri Lanka and the audit reports are tabled in the council, but often subject to delayed scrutiny by the council members.

## Local Government<sup>21</sup>

3.7. Sri Lanka has three categories of local government, namely, Municipal Councils (14), Urban Councils (37) and Pradeshiya Sabhas (258), which are named according to the size of the metropolis they serve, the largest served by a municipal council. Local governments of the first two types have been in existence in pre-independent Ceylon; pradeshiya sabhas came into being after the 13<sup>th</sup> Amendment.

3.8. Local government revenue and expenditure is around 2.2% and 2.5% respectively of the totals of the general government<sup>22</sup>. Similar to the provincial councils, except for a few large local governments (e.g. the Colombo Municipal Council), they rely on the central Government for their recurrent expenditure.

3.9. Public financial accountability issues are similar to those of the provincial councils--lack of transparency in budgeting, accounts and reports are not relevant nor useful because of non availability or protracted delays, and procedures and controls for financial management are weak. Auditing of the accounts of local government is the responsibility of the Auditor General. In relation to local governments, the Auditor General has the power to surcharge public officers the amount of any deficiency or loss caused by him/her to a local authority on account of his/her negligence or misconduct. Apart from the issue of the Auditor General taking on an executive function, this surcharge provision itself has not been effective as the defendant has the right of appeal and the appeal process is very protracted.

## Recommendations

3.10. Issues of financial accountability are similar to those of the central Government. Therefore, any sustainable reforms taken at the center should be extended where appropriate to this level of government. It is noted that several initiatives are already under consideration for improving financial discipline at the sub-national level.<sup>23</sup> Given the upcoming changes to the provincial system, this assessment only makes recommendations for the interim.

3.11. **Donor projects to be used as catalysts for strengthening provincial and local governments.** In areas where donor projects are to be implemented and where the provincial councils and/or local governments can play a role, capacity building of these agencies should be part of the project. In the past, because of weak capacities and accountability issues of these agencies, duplicate structures had been set up for financial management of such projects, thereby losing the opportunity for capacity building at the local level.

3.12. **Develop the form and contents of the accounts of the sub-national government,** and common reporting standards consistent with steps being taken internationally towards more timely reporting of meaningful financial information on the financial position of governments at this level. Use of technology for timely publication of such information should also be considered.

---

<sup>21</sup> Field study was carried out of the Colombo Municipal Council and the Mahara Pradeshiya Sabha.

<sup>22</sup> Source: Central Bank Survey on Estimation of the Size of Local Government in the General Government. The latter comprises the central, provincial and local governments.

<sup>23</sup> General Treasury and the Committee on Public Accounts are currently reviewing accounting and reporting practices at the sub-national level in collaboration with the Finance Commission and the Provincial Councils.

## 4. Public Financial Accountability – State Owned Enterprises

---

4.1. Public financial accountability of state owned enterprises is weak and, until recently, was ineffective. In the recent past, concerted efforts were made by the government, legislators, and the Auditor General to improve the financial accountability of selected key enterprises. The situation is still far from satisfactory. Nevertheless, these progressive initiatives, even though triggered by a crisis situation, indicate the willingness of all concerned stakeholders to work jointly towards the common goal of improving public financial accountability.

### Overview of Current Situation

4.2. Sri Lanka has around 216 state owned enterprises covering commercial, regulatory, research, promotional and educational activities. Many of them are characterized by excessive staff, weak management, inefficiencies, heavy losses and dependency on budget transfers. Fiscal transfers to state owned enterprises in 2001 amounted to \$446m, about 3.1% of the GDP. Apart from this, state owned enterprises have heavy borrowings, most of them guaranteed by the Government (these are not reflected in the above numbers).

4.3. State owned enterprises<sup>24</sup>, for the purpose of this assessment, were broadly classified into four groups, namely, public commercial corporations, statutory boards, wholly owned government companies, and majority owned government companies. There are about 43 public commercial corporations, whose primary activity is in revenue-generating commercial operations, and about 138 statutory boards involved in the provision of certain services which do not generally earn revenues. Whilst public corporations are expected to be self-financing, statutory boards rely on government transfers. Notwithstanding the above, in 2001, transfers to public corporations amounted to \$ 43m and to statutory boards to \$ 244m. Public corporations also have substantial borrowings, guaranteed by the Government (\$ 19.8m).

4.4. Government owned companies (numbering around 35) range from wholly owned to majority owned companies that carry on commercial activities. Most of these were previously public corporations or government owned business undertakings which were converted to companies. Despite their actual and potential impact on public funds, government and legislative control over these companies are weak, if not absent. In some majority owned companies, because of management contracts given to third parties, there is no clear means for making these institutions accountable to the public. Most notable of these are Sri Lanka Telecom Limited and Sri Lankan Airlines Limited.

4.5. The plethora of public enterprises, their weak capacity for financial management, limitations of the Auditor General's Department and the COPE for effective oversight, political interferences, lack of transparency in privatization deals, and absence of any means for making state owned companies accountable to the public have contributed to the overall weak accountability of this sector. However, a recent series of crises prompted some initiatives, including suo moto parliamentary hearings, which have had some noteworthy results (see box).

---

<sup>24</sup> There is not yet a legal definition of public enterprises in Sri Lanka. Article 170 of the Constitution defines a 'public corporation' as "any corporation, board or other body which was or is established by or under any written law other than the Companies Ordinance with funds or capital wholly or partly provided by the government by way of grant, loan or otherwise". The draft Public Finance Bill defines a public enterprise as "any public corporation, board or other body, which was or is established under any written law and includes a company in which the Government owns more than fifty percent of the shares". Note that the term includes both commercial and non-commercial bodies.

#### **A Noteworthy COPE Initiative**

The severe power crisis in 2001 provoked much public debate and media reports over the performance of the Ceylon Electricity Board (CEB). This prompted the COPE to summon CEB several times to parliament and thereafter published a report to be tabled in the whole house (this is the only COPE report published in four years). Sparked by renewed enthusiasm, apparently encouraged by the chairman of the COPE, the year 2001 witnessed several other loss making and mismanaged public enterprises being summoned to parliament. Following this, the treasury in early 2002 issued a circular, reducing the time given to enterprises for publication and submission of audited financial statements and annual reports, from ten to five months. The Auditor General too has taken action to issue audit reports within one month after the receipt of financial accounts from the entity.

4.6. The PFA framework for public corporations and statutory boards includes the omnibus and/or specific legislations, which spell out their purpose for existence and scope of activities. In addition, the Finance Act of 1971 clearly lays down pertinent financial management requirements for these enterprises, including provisions for performance reports and business plans for at least breaking even over any period of five years. For government owned companies, the governing legislation is the Companies Act. In addition to the above, all enterprises are required to comply with the Sri Lanka Accounting and Auditing standards<sup>25</sup>. The draft Public Finance Bill, Part IV, provides a new framework for accountability and control of all public enterprises, which is intended to replace the Finance Act. It does not require public enterprises to at least break even, but a rolling three-year corporate plan has to be prepared and if a loss is envisaged the approval of the relevant minister is required. Appointments to the board are to be made on the recommendation of a committee comprising the Prime Minister, the Minister of Finance and the relevant line minister. The board has to include a lawyer and an accountant. A Code of Best Practices in Corporate Governance has been issued, and the draft Public Finance Bill makes it mandatory on the board to ensure that it is followed.

4.7 The Government has declared its intention of setting up a State Holding Company and transferring its shareholdings in government owned companies to the holding company, initially on a pilot basis, to own and manage the Government's portfolio, as is done in Singapore. This would take the Government further out of the operations of business. Additionally, ten National Review Committees have been established from leading members of the private sector, professions and civil society, which will review the annual reports of all public enterprises, with the Public Enterprises Department as its secretariat, in parallel with (or before) legislative review. Their review meetings are expected to be open to the media and public.

4.8 Accounts of all public corporations, except companies, are audited by the Auditor General, who at times uses the services of a private auditor. Audited financial statements, except companies, are reviewed by the parliamentary committee on public enterprises (COPE). Government owned companies are expected to comply with the requirements in the Companies Act and are not subject to scrutiny by COPE. The draft Public Finance Bill requires that the Auditor General be the auditor of all public enterprises and allows that he may employ private audit firms. The Auditor General's reports on public enterprises, including government-owned companies, would then be tabled in Parliament and be subject to legislative review.

---

<sup>25</sup> Sri Lanka Accounting and Auditing Standards Act of 1995.

## Key Issues

4.9 Compliance with the relevant accounting and auditing standards and timeliness in terms of rendition of financial statements for audit and auditing of accounts, appear to be improving.<sup>26</sup> Nevertheless, there are considerable delays by many public enterprises in making their final audited financial statements and annual reports available to COPE and the public. Annual reports with audited statements most often are not available for review by the public. The moves toward greater transparency through the National Review Committees, publishing annual reports in the newspapers and putting them on the Ministry of Finance web site are to be welcomed.

4.10 Quality of information contained in these annual reports and the audited statements, however, is a significant concern. Partly arising from the lack of corporate plans, and partly due to the lack of capacity of these public enterprises, information produced in the annual reports is not sufficient to enable even an informed reader to assess the achievements and performance of these enterprises.

4.11 In addition, although the Auditor General has considerable autonomy in planning the scope of his audit work, he is not able to carry out value for money audits or to provide material and relevant observations on the performance of these enterprises. Consequently, the COPE too is unable to meaningfully assess the achievements of these enterprises (further details in section 6).

4.12 With regard to government owned companies, there is a significant breach in public accountability. These majority owned companies came about when the Government divested or privatized previously state owned enterprises. There is no oversight of companies where the Government has a significant financial interest or exposure, but has transferred management to a third party<sup>27</sup>. Neither the Government nor the COPE oversees these companies. The passing of the proposed Public Finance Bill, bringing these companies under the purview of the Auditor General, would close a major gap in public accountability for state investments.

## Recommendations

4.14 A concerted effort is required to improve financial accountability of state owned enterprises. The recent Treasury circulars<sup>28</sup> and the commitment of the COPE and the Auditor General will be key to the success to this process. Nevertheless, rules by themselves will not yield any benefits if there is no capacity in the public enterprises, COPE and the Auditor General to comply with the more stringent requirements. The next two chapters describe the actions needed for COPE and Auditor General, and this section will focus on the executive's oversight of public enterprises.

4.15 **Capacity in the Government to oversee public enterprises.** The Treasury has re-established the Department of Public Enterprises, whose primary responsibility is to review the accounts, annual reports and performance of public enterprises. It is critical that adequate capacity is built in this department, in terms of qualified staff, physical and IT infrastructure, to enable the Treasury to effectively supervise public enterprises.

---

<sup>26</sup> The time limit for tabling of annual reports and accounts of public enterprises in Parliament has recently been reduced from ten months to five months. Five months after the end of year 2002, more than half of the public enterprises have finalized their annual audited accounts, and few had also tabled their annual reports/accounts. This is a big improvement on past practice.

<sup>27</sup> For wholly owned companies, the government, through the treasury, is able to appoint directors to the board and oversee management.

<sup>28</sup> Public Finance Circular No. PF/PE 21, Annual Reports and Accounts of Public Enterprises, May 24, 2002, May 31 2002 and June 5, 2003.

4.16 **Corporate governance principles to be developed.** A Code of Best Practice that was recently formulated by the Government, with the assistance of the Asian Development Bank, should be fully implemented. The focus of this initiative is initially limited to six major public corporations and state banks. However, with adequate training and capacity building, the Treasury should extend this to other critical enterprises in a staged manner.

4.17 **Corporate governance principles to be implemented.** The Treasury has already taken the initiative to establish the Corporate Governance Unit in the Department of Public Enterprises for this purpose. There is now the need for capacity building and strengthening of this unit.

4.18 **Establishment of National Review Committees (NCRs) to review performance of state owned enterprises:** Ministry of Finance has set-up committees, with members drawn from civil society and professional organizations to carry out independent performance reviews of state-owned enterprises.

## 5. Public Audit

---

5.1. Public audit, to a large extent, is weak and its contribution in promoting financial accountability and governance in Sri Lanka is far below its potential. Quality, relevance, and timeliness of audit information reported need significant improvement to promote meaningful deliberations in the legislature and discussion by the public on the use and management of public funds. A combination of organizational and institutional factors have contributed towards the weakening of public audit over the years. Concerted effort from the government, legislators, and the president's office is necessary if this key pillar of financial accountability is to be strengthened and be made effective.

### Overview of Current Situation

5.2. Sri Lanka was well ahead of its neighbors in establishing institutional and organizational arrangements for public auditing. The present office of the Auditor General was established by the colonial rulers in 1799, and as early as 1907, accounting and auditing functions were segregated. Subsequent constitutional changes always ensured that the position of the Auditor General was retained with the required level of functional autonomy, and since 1931 his reporting responsibility has been to the legislature. Nevertheless, these changes did little to upgrade, in reality, his position from that of an auditor for colonial rulers to an independent 'watchdog' for assisting the Parliament in its responsibility as the 'overseer' of public funds.

5.3. Further, in the past 50 years, there have been minimal efforts to modernize the office of the Auditor General – either to upgrade the audit program and standards in line with evolving international best practices or to equip the office with the resources and skills necessary to respond to the challenges of a changing economy and public expenditure programs of the Government.

5.4. Like any other government department, the Auditor General's Department faces resource constraints. It is unable to attract, train, and retain professionally qualified staff, is restricted by the rules of the bureaucracy, and is not adequately protected from interference by the executive arm of government. The outcome, as currently evidenced, is that the audit information is not timely, lacks materiality, and the audit programs focus on compliance and financial (attestation) audits, which are not on par with international best practices.

### Key Issues<sup>29</sup>

5.5. There are two major issues that need to be addressed. The first issue is the independence of the Auditor General and the second is the quality of audit information.

#### *Independence*

5.6. Article 153 of the constitution provides for the appointment of the Auditor General by the President. The removal thereafter is by Parliament and or by a special address by the President to the Parliament. Though the functional independence of the Auditor General has been hitherto safeguarded by this Article, his financial and administrative independence, due to the absence of constitutional and legislative provisions on the subject, is constrained by the executive arm of government as set out in the next two paragraphs.

---

<sup>29</sup> The assessment's identification of these issues as key impediments are consistent with the conclusions in the report of the Netherlands Court of Audit (*Algemene Rekenkamer*), released after their preliminary mission.

5.7. The Auditor General depends on the General Treasury for his budget, and the resource allocation for his department is not linked to fiduciary risks. Unlike in other advanced commonwealth countries, the budget of the Auditor General in Sri Lanka is not subject to scrutiny or approval by a legislative committee, nor are there any safeguards against executive control over his budget. Similar to the problems faced by other government departments, the Auditor General's Department too has budget cuts imposed on it by the General Treasury and often encounters delays in obtaining the approved funds. Currently, about 25% of the staff positions in the Auditor General's Department are vacant due to lack of funds.

**Table 1: Auditor General's Budget (LKR millions)**

Year	Amount Requested	Amount Allocated	Amount Expended
1997	140.977	132.312	123.202
1998	161.615	116.997	113.299
1999	182.925	167.540	153.304
2000	191.064	176.746	157.673
2001	308.836	218.920	189.215

5.8. Control over administrative matters relating to the appointment, promotion, transfers, disciplinary issues, and overseas training of staff of the Auditor General rests with the secretary to the President<sup>30</sup>. The recent amendment to the Constitution has vested those powers of staff appointment to the Public Service Commission, which is not yet operational. Further, as the Constitution does not include Auditor General in the 'public officers' exception list, all administrative regulations of the Government, as described in the Establishment Code, are applicable to the Auditor General himself and to his staff. This further constrains the administrative independence of the Auditor General. There have been many instances where this lack of administrative control over his office has significantly hampered the audit work.

#### *Audit Information*

5.9. The Auditor General in the recent years has made considerable progress in clearing the backlog of audits and expediting preparation and submission of reports to Parliament. Nevertheless, audit reports are not available to the public on a timely basis. The assessment found delays across the entire audit process which were essentially due to factors beyond the control of the Auditor General. Less than 50% of the government agencies rendered their 2000 accounts for audit on time. Thereafter, numerous and inordinate delays are encountered in translation, review by parliamentary committees and eventual printing by the government press. On average, audit reports are not available in the public domain until 5-6 years after the end of the financial year to which they relate.

5.10. Information reported by the Auditor General does not have the sufficient impact. This may in part be due to insufficient emphasis on deployment of multi-disciplinary audit teams. Audit reports do not contain sufficiently material and relevant issues for evaluating efficiency and effectiveness of the use of public funds, and are not presented in easily comprehensible formats.

5.11. Information contained in most of the audit reports is not relevant for assessing the overall performance of government agencies. Audit observations focus on issues regarding compliance with

---

<sup>30</sup> The Minutes of the Sri Lanka Audit Service and the Sri Lanka Audit Examiners Service, to which all staff of the Auditor General's Department belong, explicitly states this.

government rules and attestation of the financial statements. Further, such audit observations are often not material and do not address systemic or organizational issues. Very few performance or value for money audit reports have been produced thus far, due to resource constraints and lack of sufficiently trained staff in the department. The format of audit reports is not appropriate for triggering debate or discussion. Not only are they excessively lengthy, but they also fail to highlight pertinent issues.

5.12. This assessment found that the annual State Accounts are not tabled in Parliament. They are audited by the Auditor General and his comments and opinion are included in his annual report to Parliament, but the accounts themselves are not tabled by the Minister of Finance. Parliament receives the appropriation accounts and revenue accounts, which detail actual expenditures and revenues against the authorized provisions, but not the overall accounts. It is intended that this will be corrected with effect from the State Accounts for 2002, which are presently being certified.

5.13. Another significant lapse is the level of coverage of public audit. The Constitution provides for public audit of all government agencies, public corporations, provincial councils, local authorities, and commissions – a total of over 1,500 institutions. However, in the recent past, defense expenses, which accounted for 15% of government expenditure in the year 2000, were exempted from audit. A special provision in the Government's Financial Regulations was invoked citing the national security interests as the reason. As a result, the Auditor General was denied access to records and had to be content with only a certification by the President and Minister of Finance as regards defense expenditure. Further, companies in which the Government has significant financial exposure, by way of commitments or government guarantees, are also not covered by public audit.

## Recommendations

5.14. **Enact dedicated audit legislation** to specify the duties, powers and responsibilities of the AG, define more clearly his scope of work, and provide for greater financial and administrative independence. An Audit Act has been proposed for appointment of the Auditor General as an officer of Parliament, to provide administrative and financial independence, to clarify the scope of public audit, and to define the relationship with internal audit units. A constitutional change too will be required to include the Auditor General in the exception to the 'public officers' list so as to relieve him from the administrative control of the executive.

5.15. **Formulate an Institutional Development Plan (IDP)** for strengthening the office of the AGD. The IDP should encompass changes necessary to the AG's mission, methodology, organization structure, and most importantly, a human resources strategy (including recruitment policy, compensation package, training, and career development for a multi-disciplinary audit staff) for carrying out a more relevant work program. The IDP should be developed in close consultation with key stakeholders, including the government, legislators, president's office, media, and civil society.

5.16. **Take action to table in Parliament an audit report on the consolidated accounts of the state under the new format and carryout special audits on systemic issues of national importance to the government.** The new format developed for presenting the consolidated financial statements of the state should be further refined in line with international standards and incorporated in the proposed Public Finance Bill. These statements, together with the Auditor General's report, should be tabled in Parliament. The special audits in areas identified as national importance to the government should be carried out in order to address critical systemic issues in the government.

5.17. **Publish audit reports on the Internet** as soon as the audit is finalized so as to expedite the publication of these reports to the public. This idea is already under consideration by the Auditor General but his office requires assistance for its implementation.

5.18. **Develop a system of periodic peer review** and technical guidance, as proposed by the Netherlands Court of Audit. This will be of benefit to the Auditor General during formulation and implementation of the IDP.

## 6. Legislative Scrutiny of Public Funds

---

6.1. The legislative scrutiny of public funds is weak. Contrary to evolving practices, the proceedings of the committees on public accounts (COPA) and public enterprises (COPE) are not transparent nor open to the public. The committees do not have the necessary technical capacity or the incentives to discuss and enforce accountability for the government's performance to stated goals. Further, there is no budget or estimates committee for deliberating on the national budget before it is considered by the whole house.

6.2. Institutional factors affecting COPA and COPE affect other committees in Parliament as well. Nevertheless, given the significance of COPA and COPE in promoting accountability for public funds and their 'non-partisan' basis for operation, it is critical that priority consideration be given for strengthening these two committees in Parliament, which could then serve as precedents, in addition to building confidence and support, for broader institutional reforms of parliamentary procedures.

### Overview of Current Situation

6.3. Sri Lanka has two standing committees of Parliament for carrying out the function of legislative scrutiny of public funds. The Committee on Public Accounts (COPA) reviews the accounts of all ministries, departments, and local authorities, whilst the Committee on Public Enterprises (COPE), which came into existence in the late 1970s, reviews the accounts of public corporations and government business undertakings. The 15 members of each of the two committees are nominated by the Selection Committee<sup>31</sup> at the beginning of each parliamentary session. Contrary to practices in more developed commonwealth countries, Sri Lanka does not have a budget or estimates committee.

6.4. Parliamentary procedures, in particular, the standing orders relating to COPA and COPE, are outdated, not in line with international best practices, and need reform. The organizational and administrative constraints faced by Parliament itself, especially the lack of sufficiently trained professional staff, also contribute towards the weakening of this oversight function.

6.5. The specific standing orders applicable to COPA and COPE, together with the Parliamentary Powers and Privileges Act, do not permit publication of any proceedings of committees of Parliament before they are reported to the house as a whole. Thus, COPA and COPE deliberations are held 'in camera'. As a result, there is little incentive or pressure for COPA and COPE members to meet regularly and engage in meaningful deliberations. Further, COPA and COPE secretariat in Parliament is inadequately resourced and is not able to provide the necessary technical support to the members, who themselves lack exposure and experience for effectively discharging this responsibility. Consequently, the legislative scrutiny of public funds is very ineffective.

### Key Issues

6.6. The issue of transparency of the COPA and COPE proceedings and the capacity to hold effective committee deliberations are fundamental for improving public financial accountability. Even if limited to COPA and COPE, it is critical that actions be taken in this regard because strong legislative scrutiny is essential for strengthening accountability institutions discussed in other parts of this report.

---

<sup>31</sup> The Selection Committee consists of the Speaker and 17 members including the leaders of political parties (or their nominees) nominated at the commencement of each session.

### *Transparency*

6.7. Apart from the developed countries in the commonwealth, Pakistan, Nepal and some states in India have taken action to make their committee hearings transparent. However, because of provisions in section 130A of the Standing Orders and section 17 of the Parliamentary Powers and Privileges Act, public nor the media are not allowed to witness the proceedings of COPA and COPE in Sri Lanka. The earlier practice of printing the minutes of evidence of the proceedings (verbatim recording) was abandoned over a decade ago. As a result, currently, the public has no access to the examinations of COPA and COPE, and remains largely ignorant of these deliberations.

6.8. Lack of transparency and the absence of an audience lessens the incentives for the members to be present at the COPA and COPE meetings. In fact, there are numerous instances where scheduled committee meetings had to be cancelled because of lack of a quorum. This also adds to the backlog of audit reports to be reviewed by the committees. Consequently, there is a tendency to bunch reviews. On review of a COPA agenda for a particular meeting, it was revealed that just over an hour was allocated for reviewing the audit reports of four agencies with expenditure over \$11.5 million, whilst COPE, for just one day, summoned 15 corporations.

6.9. Further, when proceedings are held ‘in camera’, there is an impact on the quality of debate and discussions. In the absence of an audience and public pressure, there may not be any motivation for the committee members to be adequately prepared to engage in qualitative performance issues of government expenditures. The media and the public will continue to remain ignorant of how Parliament exacts accountability for the use of public funds, and thus, unable to exert any pressure on the members to voice their concerns in Parliament.

6.10. In the recent past, the chairman of COPE took the initiative of seeking the Speaker’s permission to allow the media to attend the meetings. COPE also placed an advertisement in the press requesting the public to provide information about any complaints they had against public corporations. Similarly, COPA too has taken initiatives to scrutinize performance of ministries and departments, particularly in cases where there had been serious audit observations. As described in chapter 4 on Public Financial Accountability – State Owned Enterprises, these intermittent initiatives though laudable and useful, cannot lead to any sustainable change unless the standing orders themselves are amended.

### *Effectiveness of Deliberations*

6.11. Committee deliberations do not focus on the primary objective of exacting accountability from the executive for its performance and achievement of the stated goals, utilizing the approved budget. The main reasons for this are elaborated below.

6.12. COPA deliberations tend to focus mainly on the more minor matters such as trivial budget excesses (or revenue deficits) and instances of non-compliance with government procedures. COPE deliberations, on the other hand, look beyond budget excesses but nevertheless lack focus and do not address performance of public corporations. As mentioned in the previous section, audit information submitted by the Auditor General does not highlight substantive performance issues to stimulate such deliberations. Further, staff deployed by the secretariat are not sufficiently multi-disciplinary and lack expertise to examine issues of performance.

6.13. Lack of secretariat resources serving COPA and COPE is another factor affecting the quality of deliberations. There is no research capacity in the secretariat nor experts who can interpret audit reports and provide briefings to the members so as to enable them to engage in meaningful discussions. In addition, there is no facility for monitoring, and thus, there is no track of past

recommendations and discussions and hardly any follow-up of prior year issues. The lack of exposure and experience of the committee members themselves further exacerbates this problem.

6.14. Consequently, committee proceedings depend upon, and on occasions are led by, the Auditor General. At times, the Public Finance Department in the Ministry of Finance provides background information to the committee members. However, the parliamentary committee's heavy dependence on the Auditor General and the Government, who should all be witnesses at these examinations, compromises their objectivity in evaluating the executive's performance.

6.15. Another impediment to quality deliberation is the inordinate delays in the committees' examination of audit reports. On average, if an audit report is to be reviewed at all, it is late by at least 5-6 years. As the responsible government officials are most likely to have moved on since then, very often, the budget excesses are retroactively approved and explanations for non-compliances accepted. This negates the value of such an examination.

## **Recommendations**

6.16. **COPA and COPE hearings should be made public.** The provisions in the Parliamentary Powers and Privileges Act and the Standing Orders should be reviewed and amended to allow for this on a priority basis for the two oversight committees.

6.17. **A capacity building program for strengthening the secretariat.** This will encompass provision of full-time research staff, building awareness amongst members of the committees and secretariat staff of practices in commonwealth countries with similar oversight arrangements as well as training. Additionally, it should include other infrastructure facilities, in particular, computerized monitoring systems.

6.18. **A Parliamentary Committee on Budgets.** In order to promote debate and qualitative discussion on the national budget at the preparation stage, it is important that a parliamentary committee initially reviews the budget and provides its comments to the whole house.

## 7. Rights to Information

---

7.1. Public access to financial information of the Government and state run organizations is very limited in Sri Lanka. Stymied by outdated and, at times, punitive legislative provisions, restricted by a government culture that does not promote transparency and active disclosure, and constrained by inadequate capacity and lack of resources of government organizations to make relevant information available on a timely basis, citizen's access to public financial information in Sri Lanka is far from satisfactory. One critical way to promote transparency is by bolstering public access to financial and other information through freedom of information (FOI) legislation. Freedom of information laws, common in several countries across the world, not only provide for routine release of information important for improved accountability but also allow citizens to request information, thus providing a powerful deterrent to malfeasance in government.

### Overview of Current Situation

7.2. Sri Lanka has historically not had a strong policy favoring pro-active release of government-held information. As a result, the public has not been able to access information on issues of public interest, such as government decisions involving procurement, revenue collection, and recovery of loans. Severe criminal and civil defamation laws constrained media freedom. This has been reinforced by the Establishments Code, which prohibits officials from sharing information without explicit permission from higher officials. This and the Official Secrets Act (1923) combine to frustrate easy access to information. Some information is made available through informal channels, as well as tabling in the legislature or publishing in the Gazette. Neither tabling nor publishing in the Gazette seems to have been particularly effective in spreading information. Material tabled in the legislature (often untimely) is more often than not ignored by the general public, while the circulation of the Gazette is highly restricted often again with dated information. As part of a normalization policy, there is a move towards greater liberalization of the press and the criminal defamation law was removed recently from the statute books.

7.3. An FOI bill, drafted jointly by the Editors' Guild, Free Media Movement, Centre for Policy Alternatives, and interested civil society institutions, contains only narrow exceptions, mostly for national security and law enforcement matters. This bill also provides for whistle-blower protection for those who publicize instances of corruption in government, creation of an independent commission to hear appeals and a push for a more open access to information policy across government departments. The bill also contains provisions for robust *suo-moto suamotu* (routine) disclosures, penalties for non-compliant officials, and overriding contrary laws, such as, the Officials Secrets Act. The draft bill draws on best practices from several other countries.

### Recommendations

7.4. **Adopt an FOI Act** with minimum exceptions, strong *suo-moto* or routine disclosure provisions, independent appeals process, penalties for non-compliance, and a Commission to oversee administration of the Act. Reform the Official Secrets Act, the Establishments Code, and the Parliamentary Powers and Privileges Act to permit officials to disclose information according to the requirements of a FOI Act.

7.5. **Routine release of critical financial information under FOI:** In order to reinforce public and financial accountability, Government should routinely disclose, on a regular basis and in a timely fashion, as part of its *suo-moto* obligations under an FOI Act, audited financial statements tabled in Parliament; tender bids and awards with a comparative evaluation; departmental budgetary estimates

and accounts; performance reports; verbatim reports of Parliamentary oversight committees (i.e. COPA and COPE); public debt; assets and liabilities of public servants including ministers; draft bills, administrative orders and circulars; financial rules, codes, and laws; details of public works, past and present, including stages of completion; and full information on subsidies, off-budget borrowing, and government investments.

7.6. **Appoint and train Information Officers in public authorities**<sup>32</sup> to facilitate timely provision of information to the public. The proposed FOI bill mandates every public authority to appoint an Information Officer, whose duty will be to deal with requests for information and to render all necessary assistance to any citizen making such requests.

7.7. **Improve records management practices**, in collaboration with the Department of National Archives, to provide better access to Government held records (e.g. streamlining creation, closing, and destruction of files; improving indexing, cataloging, storage, and retrieval systems, including a system for classifying documents in line with the criteria established by the Act.)

7.8. **Publicize widely the FOI Act** to encourage demand for information from ordinary citizens.

---

<sup>32</sup> The proposed FOI bill defines Public Authority as a Ministry of the Government; any body or Office established by or under the Constitution; a Government Department; a corporation, board or other body established by or under any written law, other than the Companies Ordinance; a company in which the state is a shareholder; a local authority; and any department or other authority or institution established or created by a Provincial Council.

## 8. Proposed Action Plan

Accountability Institution	Action	Status at June 26, 2003	Indicative Timetable	Responsibility/Support
A. Legislative Scrutiny of Public Funds	<ol style="list-style-type: none"> <li>1. Amend the standing orders of COPA and COPE and the Parliamentary Powers and Privileges Act to allow for greater public access to the hearings.</li> <li>2. Provide for a Parliamentary Committee on Budgets to promote debate and qualitative discussion on the national budget at the preparation stage</li> <li>3. Build awareness, information sharing and research capacity of the secretariat that serves COPA and COPE</li> </ol>	Government committed to policy. Consultancy report due by July 31.	March 2004	COPA, COPE, Sec.Gen of Parliament/WB
			March 2004	Sec.Gen of Parliament/WB
		Consultancy report due by July 31.	Short term – new appointments December 2003. Medium term institutional building 2003-2005	COPA, COPE, Sec.Gen of Parliament/WB
B. Public Financial Accountability Framework	<ol style="list-style-type: none"> <li>4. Enact Fiscal Management (Responsibility) bill and Public Finance bill clarifying financial management in ministries and departments and for oversight of public sector enterprises.</li> <li>5. An enforceable PFA framework that promotes accountability for performance - base annual budget on a transparent medium-term fiscal framework, and improved project preparation, appraisal and monitoring system; extend budget process into</li> </ol>	Fiscal Management (Responsibility) Act passed. Public Finance bill under consideration by Economic Policy Committee of Cabinet	Public Finance Act January 2004	EPC, DPF, DPE
		New budget formats and procedure developed; Budgeting and Planning Guidelines drafted; initial MTMF prepared; budget classification mapped to COFOG; budget preparation information system developed; line agency expenditure ceilings for 2003	Medium term – 2003-2006	NBD, NPD and MoPDI/ADB (PEMS)

Country Financial Accountability Assessment

Accountability Institution	Action	Status at June 26, 2003	Indicative Timetable	Responsibility/Support
	performance management	applied; capital budget training given; in-depth reviews of functions and expenditure budgets of line agencies started		
6.	Promoting a culture and building capacity for performance accountability - build FM capacity through improved strategic planning and HRM in MoF	HRM Committee has agreed MoF departmental functions and new HRM policies and procedures; new public sector FM qualification developed and IPFDA being incorporated to provide professional PFM training and accreditation	Medium term – MoF capacity building 2003-2004 IPFDA institutional and cadre development 2003-2008	IPFDA, MoF/ WB, CIPFA
7.	An enforceable PFA framework that promotes accountability for performance by strengthening the management and control practices associated with revenue, expenditure, assets and liabilities of the Government including simplification of the Financial Regulations	Nine Guidelines finalized (to be approved by Treasury, printed and disseminated, superseding the 1992 FRs, later to be given legal status by PF Act)	Continuing	DPF, General Treasury/ADB (PEMS)
8.	Publish financial information of the Government on the Internet	MoF website under construction. Pages for ERD, FPEAD, NBD and Procurement Support Bureau of PFD available, including data on foreign-funded projects, 2003 Budget Highlights, budget circulars and tendering guidelines. DSA, DPF and DPE websites in process.	Continuing	MoF/ADB (PEMS)
9.	Revise form and content of monthly and annual financial statements and reports on performance of ministries and departments, provincial councils, local authorities, and state-owned	Circular issued requiring ministry audited accounts within 5 months of year end; financial reporting format agreed and FY 2002 central government accounts prepared in new	Medium term – 2007 (central and provincial governments)	DSA, DPF/WB, CIPFA

Country Financial Accountability Assessment

Accountability Institution	Action	Status at June 26, 2003	Indicative Timetable	Responsibility/Support
	enterprises, and consolidated ministry and whole-of-government accrual accounts in line with international public sector professional standards.	format toward IFAC-PSC cash-based standard.		
C. Provincial Councils and Local Authorities	10. Streamline financial management and accountability arrangements for donor funded development projects to use the existing systems at the sub-national level.	Workshops held in all PCs, promoting the central government accountability framework in draft PF bill; some donors attempting to use existing accountability systems	Medium term- 2003-2006	PCs, Finance Commission, MHAPCLG, donors/ ADB (PEMS)
D. State Owned Enterprises	11. Establish and build capacity of the Department of Public Enterprises	PED established; monitoring system being restructured.	Medium term – 2003-2005	
	12. Promote corporate governance principles for State Owned Enterprises; implement Code of Best Practice; and establish National Review Committees (NCRs) to review state owned enterprises.	Circular issued requiring PE audited accounts within 5 months of year end. 50% of PEs have provided their audited financial accounts for 2002 by May 31, 2003, and 10% have provided annual reports. Code of Best Practice in Corporate Governance agreed and being piloted in 6 public corporations. 10 National Review Committees set up and 60 members appointed to monitor PE performance. State Holding Company being established to own and manage state investments in government-owned companies	Medium term – 2003-2007	PED (Corporate Governance Unit)/ADB, WB
E. Public Audit	13. Strengthen the financial and administrative independence of the Auditor General.	Public Audit bill being proposed for appointment of AG as officer of Parliament, to provide administrative and financial independence, to clarify the scope of public audit, and define the relationship with internal audit units; Constitutional amendment proposed to	March 2004	AG/ World Bank

Accountability Institution	Action	Status at June 26, 2003	Indicative Timetable	Responsibility/Support
		add the AG to the list of exceptions to the definition of public officer		
	14. Formulate an Institutional Development Plan for strengthening the Auditor General's Department and enhancing the impact of its reports.	Project for Strengthening Public Audit being developed	Short term – May 2004	AG/ World Bank
	15. Table in Parliament the audited consolidated accounts of the state.	2002 accounts prepared and rendered to AG	Short term – Year 2002 accounts by September 2003	DSA, AG
	16. Carryout special audits on identified systemic issues of the government		June, 2004	AG
	17. Post public audit reports on the Internet (part of the 'e-lanka' initiative)	Policy under discussion; assistance required for implementation	Short term – 2003-2004	AG/e-lanka project
	18. Arrange for a system of periodic peer review	Under consideration	Medium term – 2004 onwards	AG/NCA
F. Rights to Information	19. Enact the proposed Freedom of Information bill, and amend the Official Secrets Act and the Establishment Code, after due consultation with stakeholders.	Final draft of FoI Bill with PM	May 2004	Office of PM
	20. Appoint and train Information Officers		Medium term – January 2004 onwards	
	21. Improve records management practices		Long term – October 2003 onwards	Department of National Archives/ MoF
	22. Publicize the Act and its provisions to encourage demand for information		Medium term – 2004 - 2006	MoF/ Ministry of Media and Mass Communication

<b>Accountability Institution</b>	<b>Action</b>	<b>Status at June 26, 2003</b>	<b>Indicative Timetable</b>	<b>Responsibility/Support and Mass Communication</b>
	from ordinary citizens and reinforce public financial accountability.		2004 - 2006	

AG	Auditor General
CIPFA	Chartered Institute of Public Finance and Accountancy (UK)
COFOG	Classification of Functions of Government
COPA	Committee on Public Accounts (also called PAC)
COPE	Committee on Public Enterprises
DMS	Dept of Management Services (Treasury)
DSA	Dept of State Accounts (Treasury)
FPEAD	Fiscal Policy and Economic Affairs Department (Treasury)
FRs	Financial Regulations
HRM	human resource management
IFAC-PSC	International Federation of Accountants – Public Service Committee
IPFDA	Institute of Public Finance and Development Accountancy (Sri Lanka)
MHAPCLG	Ministry of Home Affairs, Provincial Councils and Local Government
MoF	Ministry of Finance
MoPDI	Ministry of Policy Development and Implementation
MTMF	medium-term macroeconomic framework
NBD	National Budget Department (Treasury)
NPD	National Planning Department
PED	Public Enterprises Department (Treasury)
PEMS	Public Expenditure Management Systems (ADB-supported project in the Treasury)
PFD	Public Finance Department (Treasury)