

## A. Institutional Framework

7. The institutional framework should include adherence to IFAC-issued International Accounting Standards (IAS) and qualified accounting staff to provide the timely, relevant, and reliable financial information needed to support all fiscal and budget management, decision making, and reporting processes. The diagnostic questionnaires that were used in this assessment have facilitated the collection of information on the current arrangements and the apparent gaps in the present accounting laws and regulations of Sri Lanka; education and training of public sector accountants; application of a code of conduct; and numbers and characteristics of public sector accountants.

### (1) Accounting Laws and Regulations

8. **The accounting laws and regulations are prescriptive about the maintenance and compilation of accounts, but make no mention of International Accounting Standards.** Sri Lankan government organizations can be categorized into (a) ministries, departments, and constitutional bodies, including the Auditor General's Department; (b) non-revenue-earning statutory bodies and public enterprises; and (c) revenue-earning statutory bodies and public enterprises. The Sri Lankan Accounting and Auditing Standards Act (No. 15) 1995 requires that the latter group reports in accordance with Sri Lanka Accounting Standards. Categories (a) and (b) are required to report in accordance with the Financial Regulations (1992) issued by the Public Finance Department of the Ministry of Finance. These groups need to prepare cash-based budgets and financial reports. The Financial Regulations do not prescribe accounting standards in this respect.<sup>3</sup> The Government is considering introducing accrual budgeting and accounting as part of the Public Expenditure Management Reform Program. There is no current prescription by law for the adoption of IPSAS. Since 2002, the State Accounts Department has been preparing annual accounts according to the Cash Basis IPSAS, and the Auditor General has been certifying those accounts. Also, the formats for presenting financial statements for 2005 has been improved taking into account the good practice examples adopted by other countries. There is an intention to progressively move toward accrual accounting using IPSAS.

9. **Enacting the proposed Public Finance Bill can provide a firm basis for more effective enforcement and clarify the financial accountabilities of responsible parties.** There is a need

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<sup>3</sup> *Diagnostic Study of Accounting and Auditing Practices in Sri Lanka*, ADB, 2002.



for a better framework of financial accountability through a modern financial reporting framework. Producing annual audited accounts for each government department will provide a basis for holding senior managers accountable for their operations and use of budget funds. The Auditor General will need to specify the steps that departments should take to correct any accounting effects that lead to audit qualifications to the annual accounts.

## (2) Education and Training

10. **Government accountants are recruited on the basis of the results of a competitive examination for which a university degree in accounting or equivalent is required.** This qualification provides a solid basis for an effective accounting service but needs to be followed up with further training in the core competencies needed for public sector accounting and reporting.

11. **There is a need for constant upgrading of training for government accountants in the requirements of the Financial Regulations and in the standards for preparing financial statements.** Continued training after induction tends to depend upon requests rather than through a planned continued skills maintenance program. Currently **government accountants** take a 30-week induction training course that provides PFM foundation, but does not provide exposure to or training in accounting standards.

12. **Current training institutions provide a foundation for an international standard public sector accountancy qualification.** The Institute of Public Finance and Development Accountancy (IPFDA) was inaugurated in 1980 as a professional organization for public sector accountants and auditors in Sri Lanka. The objective of IPFDA is to improve public sector financial management systems in the field of budgeting, accounting, reporting, and auditing through the professional development of its membership. The Institute of Government Accounts and Finance (INGAF) was established in 1999 with the sponsorship of the Asian Development Bank. An arm of the Ministry of Finance, INGAF trains public sector accounting personnel, for the purpose of improving the financial management skills of public sector accountants and to develop computerized integrated government accounting.

13. **A training program that meets the International Education Standards (IES) for Professional Accountants is needed for the public sector accountants and auditors.** Plans to adopt the public sector program of the Chartered Institute of Public Finance and Accountancy (CIPFA) in United Kingdom for Sri Lankan conditions would provide the path for sustained, improved training. The plan is to use existing Sri Lankan training institutions (IPFDA and INGAF) that would be merged, upgraded, and monitored to international standards. The newly merged institution would be in a position to affiliate with IFAC after 10 years. The teaching institution would use the present CIPFA international certificate and diploma scheme as a basis for Sri Lankan qualifications. The CIPFA learning materials take into account international audit and accounting standards as required for adoption by public sector organizations. The modules cover the following elements:

- Financial reporting,
- Accounting for decision making,
- Audit I and II,

- Financial management,
- Law and taxation,
- Information systems management, and
- Management.

### (3) Code of Conduct

14. **The Code of Ethics is embedded within the Establishment Code for Public Servants and is less prescriptive than the standard code for professional accountants.** The general knowledge of the requirements of the Establishment Code is poor. A code of ethics is needed to improve financial compliance. The cultural support that a strongly directed Code of Ethics can create would be helpful in improving public financial management.

15. **A specific code based on IFAC or the Institute of Chartered Accountants of Sri Lanka (ICASL) should be prepared and adopted for use by public sector accountants.** These two professional accounting bodies have codes which suit their specific institutional needs. The public sector codes would need to be directed to the needs of the public sector. The IFAC-issued Code of Ethics for Professional Accountants provides a useful basis for the public sector code. The proposed CIPFA training program would cover the training of both accountants and auditors. The certificate and diploma scheme would initially be used, and then the full CIPFA professional qualification would be used, as adapted for Sri Lanka circumstances. With both qualifications, those who are accepted into CIPFA membership, whether as affiliates (for the diploma holders) or as qualified accountants (for those who complete requirements for the full professional qualification), would be required to abide by the CIPFA code of discipline and ethics. This is based on the IFAC Codes.

### (4) Public Sector Accountant Arrangements

16. **For each public sector body that prepares annual accounts, there should be a professionally qualified chief financial officer (CFO) who is to be responsible for maintaining systems of internal financial controls that manage risks, and for preparing the accounts for signature by the chief accounting officer (CAO).** Audits are not currently effective in ensuring that systems of internal financial controls work well. The audit results are not being translated into effective remedial action. The CFO function needs to be upgraded in order to get this work done.

## B. Accounting Standards as Practiced

17. The diagnostic questionnaires have collected information on the current arrangements and the apparent gaps in Sri Lanka for setting public sector accounting standards, and for presenting financial reports. Out of this exercise came recommended activities that will help bring local standards in line with international standards.

### (1) Setting Public Sector Accounting Standards

18. **More formalized arrangements are needed for setting accounting standards for the public sector.** For commercial accounting, the ICASL is empowered by law to establish accounting



and auditing standards, and the relevant committees (such as the Public Sector Accounting Committee) usually adopt IFAC standards after a short period of time for consideration. With IFAC promulgating IPSAS, it would be appropriate to amend the Sri Lanka Accounting and Auditing Standards Law (1995) to add responsibility for public sector standards. The Financial Regulations set out the detailed rules for the cash-based system of accounts. These are currently intended to support the use of Cash Basis IPSAS.

## (2) Presenting Financial Reports

19. **The accordance of the annual Sri Lanka consolidated financial statements with Cash Basis IPSAS, Part I, is incomplete.** Time tables are needed for consolidation of controlled entities into the cash basis statements as per 1.6.5 of the Cash Basis IPSAS (e.g. public enterprises), and for the transition path to the adoption of accrual accounts based on IPSAS.

20. **The enforcement procedures for the Financial Regulations are weak.** Audits show substantial lack of compliance. The response to audit findings is inadequate.

21. **Greatly increased attention needs to be given to corporate governance issues for state-owned enterprises (SOEs) where the Auditor General qualifies the annual accounts.** The state-owned enterprises apply International Financial Reporting Standards (IFRS). They should also comply with governance requirements established by the Department of Public Enterprises and by the ICASL Code of Best Practice. However, in the year 2003, only 10 of the 178 SOE accounts received unqualified audit opinions. The Auditor General expressed a disclaimer on 29 public corporations and noted a lack of response to problems identified in earlier years.

22. **In the event of continued failures in corporate governance, the actions taken with respect to directors of public corporations need to be reviewed.** There is a clear problem in corporate governance where serious audit objections that lead to disclaimers on accounts are uncorrected. Long-standing receivables were noted as a particular problem. Failure by directors who are not meeting their responsibilities to deal with such issues leads to increased tax-payer burdens.