

Public Disclosure Authorized

Report No. 39176-LK

Sri Lanka Public Sector Accounting and Auditing A Comparison to International Standards

Country Report

March 2007

Financial Management Unit
South Asia Region

Public Disclosure



Public Disclosure Authorized

Public Disclosure Authorized

Document of the World Bank

CURRENCY EQUIVALENTS
(Exchange rate effective March 21, 2007)

Currency Unit = Sri Lankan Rupee (Rs)
Rs = US\$1

Currency Unit = Sri Lankan Rupee (Rs.)
US\$1 = approx. Rs. 110

FISCAL YEAR
January 1 – December 31

Vice President : Praful C. Patel
Country Director : Naoko Ishii
Manager : Robert J. Saum
Task Team Leader : Pazhayannur K. Subramanian

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AG	Auditor General
CAO	Chief Accounting Officer
CFO	Chief Financial Officer
CIPFA	Chartered Institute of Public Finance and Accountancy, United Kingdom
DFID	Department for International Development
DG	Director General
IAASB	International Auditing and Assurance Standards Board
ICASL	Institute of Chartered Accountants of Sri Lanka
IAS	International Accounting Standard
IES	International Education Standards for Professional Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standard
INGAF	Institute of Government Accounts and Finance
INTOSAI	International Organization of Supreme Audit Institutions
IPFDA	Institute of Public Finance and Development Accountancy (Sri Lanka)
IPSAS	International Public Sector Accounting Standards (of IFAC)
IPSASB	International Public Sector Accounting Standards Board
ISA	International Standard for Auditing
MOF	Ministry of Finance
MOF&P	Ministry of Finance and Planning
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PSC	Public Sector Committee
SAI	Supreme Audit Institution
SLIDA	Sri Lanka Institute of Development Administration
SOE	State-Owned Enterprise
WB	World Bank

Acknowledgments

This assessment of accounting and auditing standards and practices in the public sector review was carried out in active collaboration with the Government of Sri Lanka and various stakeholders, particularly the Auditor General and his staff; and the Director General, Department of State Accounts, Ministry of Finance and Planning, and his staff. A workshop was held in Colombo on August 18, 2006 by the Government of Sri Lanka and the participating donors, to review the draft report and decide on the steps to be taken in this regard.

In particular, the following individuals and their departments provided time and expertise to this assessment:

Mr. S. C. Mayudunne, Auditor General (retired August 2006)
Mr. W. D. Hemaratne, Acting Auditor General (August-October, 2006)
Mr. P. A. Pematilaka, Director General, State Accounts, Ministry of Finance (Auditor General since October, 2006)
Mr. V. Kanagasabapathy, Director General, Department of Public Enterprises, Ministry of Finance (retired October, 2006, Financial Management Advisor to the Ministry of Finance since October 2006)
Mr. Ajith Rathnayake, Director General, Sri Lanka Accounting and Auditing Standards Monitoring Board
Mr. W. M. Wijepala, Deputy Auditor General, Auditor General's Department.
Mr. H. A.S. Samaweera, Deputy Auditor General, Auditor General's Department.
Mr. D. Widanagamachi, Director, Accounting Services, State Accounts, Ministry of Finance (Acting Director General, State Accounts since October, 2006)
Mr. P. Fernando, Director, Systems and Training, Ministry of Finance
Mr. Tennekoon, Director, Sri Lanka Institute of Development Administration
Mr. R. M.J.. Ratnayake, Audit Superintendent, Ceylon Petroleum Corporation
Mr. W. P. C. Wickramaratne, Audit Superintendent, National Water Supply and Drainage Board
Mr. P. B. Munasinghe, Director Establishment, Institute of Chartered Accountants of Sri Lanka
Mr. S. Sockalingam, Technical Director, Institute of Chartered Accountants of Sri Lanka
Mr. Danushka De Silva, Technical Manager, Institute of Chartered Accountants of Sri Lanka
Mr. Regis Chapman, US Treasury Resident Budget Advisor
Mr. Kandasamy, Advisor to Auditor General
Mr. Ruwanchandra, Consultant, Sri Lanka Institute of Development Administration

The review was conducted through a participatory process that involved these stakeholders. The provision of several responses to the diagnostic questionnaires by senior members of the Department of State Accounts and the Auditor General's Department was especially useful for the study. Two highly experienced local consultants were heavily involved in the study: Uditha Palihakarra, with a strong commercial sector background, was formerly CEO of the SME Bank of Sri Lanka, and President of the Institute of Chartered Accountants of Sri Lanka; Dyananda Wijesekara, with a government background, is Director, Finance and Administration, Techno Management Consultants; he was earlier employed as a senior-level government accountant in Sri Lanka and in several other countries.

The World Bank's Task Team for the assessment is responsible for the content of this report. Review comments were obtained from advisors and development partners and the country team.

Task Team

Mr. P K Subramanian (Lead Financial Management Specialist)
Ms. Jiwanka Wickramasinghe (Financial Management Specialist)
Mr. Ronald Points (Lead Consultant, Accounting)
Mr. Michael Jacobs (Lead Consultant, Auditing)

Advisors

Mr. Simon Bradbury, Manager, Loan Department, World Bank
Mr. David Goldsworthy, Operations Manager, International Technical Cooperation Program, UK National Audit Office
Mr. Noel Hepworth, Chartered Institute of Public Finance and Accountancy, London
Mr. Abdul Mudabbir Khan, Fiscal Affairs Department, International Monetary Fund
Mr. Ian Mackintosh, Chairman, UK Accounting Standards Board
Nominee of Asian Organization of Supreme Audit Institutions (ASOSAI) - Mr. N.R. Rayulu, Additional Comptroller & Auditor General (International Relations), Office of the CAG of India
Mr. Paul Sutcliffe, Technical Director, International Public Sector Accounting Standards Board, International Federation of Accountants

Development Partner Collaborators

Mr. David Biggs, Financial Management Advisor, UK Department for International Development
Ms. Kathleen Moktan, Asian Development Bank

CONTENTS

Executive Summary	viii
I. Introduction.....	1
II. Public Sector Accounting	3
A. Institutional Framework	3
(1) <i>Accounting Laws and Regulations</i>	<i>3</i>
(2) <i>Education and Training</i>	<i>3</i>
(3) <i>Code of Conduct.....</i>	<i>4</i>
(4) <i>Public Sector Accountant Arrangements</i>	<i>5</i>
B. Accounting Standards as Practiced	5
(1) <i>Setting Public Sector Accounting Standards.....</i>	<i>5</i>
(2) <i>Presenting Financial Reports.....</i>	<i>5</i>
III. Public Sector Auditing	7
A. Institutional Framework for Public Sector Auditing	7
(1) <i>Institutional Framework.....</i>	<i>7</i>
(2) <i>Setting Auditing Standards.....</i>	<i>8</i>
(3) <i>Code of Ethics</i>	<i>9</i>
(4) <i>Accountability in the Supreme Audit Institution</i>	<i>9</i>
(5) <i>Independence.....</i>	<i>9</i>
(6) <i>Qualifications and Skills for the Auditors</i>	<i>9</i>
(7) <i>Training.....</i>	<i>9</i>
(8) <i>Audit Competence</i>	<i>10</i>
(9) <i>Quality Assurance</i>	<i>10</i>
B. Auditing Standards as Practiced	10
(1) <i>Audit Planning.....</i>	<i>11</i>
(2) <i>Audit Supervision</i>	<i>11</i>
(3) <i>Reviewing Internal Controls</i>	<i>11</i>
(4) <i>Reviewing Compliance.....</i>	<i>11</i>
(5) <i>Audit Evidence.....</i>	<i>12</i>
(6) <i>Analyzing the Financial Statements</i>	<i>12</i>
(7) <i>Preparing Audit Opinions</i>	<i>12</i>
(8) <i>Reporting on Fraud.....</i>	<i>13</i>
(9) <i>Reporting on Compliance.....</i>	<i>13</i>
IV. Action Plans.....	14
Annex A. Methodology of the Assessment	18
Annex B. Accounting and Auditing Standards	20
<i>International Public Sector Accounting Standards.....</i>	<i>21</i>
<i>International Education Standards.....</i>	<i>21</i>
<i>International Financial Reporting Standards and International Accounting Standards.....</i>	<i>22</i>
<i>INTOSAI Code of Ethics and Auditing Standards.....</i>	<i>23</i>
<i>International Standards on Auditing</i>	<i>25</i>

Annex C. Sri Lankan Accounting Legislation.....	26
Annex D. Sri Lankan Audit Legislation.....	28
Annex E. Benefits of Accrual Accounting.....	31
Supplementary Detailed Table of Accounting and Auditing Standards Issues	
I. Public Sector Accounting.....	35
A. Assessment of the National Public Sector Accounting Environment.....	35
B. Assessment of National Public Sector Accounting Standards	38
C. Assessment of Accounting and Auditing in State-Owned Enterprises	40
II. Public Sector Auditing.....	41
A. Assessment of the Public Sector Auditing Environment.....	41
B. Assessment of Public Sector Auditing Standards and Practices	55

EXECUTIVE SUMMARY

1. This assessment of public sector accounting and auditing is generally meant to assist with the implementation of more effective Public Financial Management (PFM) through better quality accounting and public audit processes in Sri Lanka. It is intended to provide greater stimulus for more cost-effective outcomes of government spending. The specific objectives are (a) to provide the country's accounting and audit authorities and other interested stakeholders with a common strongly founded knowledge as to where local practices stand in accordance with the internationally developed standards of financial reporting and audit; (b) to assess the prevailing variances; (c) to chart paths to reduce those variances; and (d) to provide a continuing basis for measuring improvements

2. Adoption of international standards for accounting and auditing provides the basis for competent financial reporting and transparency. The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) has developed a core set of accrual-based International Public Sector Accounting Standards (IPSAS) besides a comprehensive IPSAS on the cash basis of accounting. IPSAS establish an authoritative set of independent international financial reporting standards for governments and others in public sector organizations. The study has taken the international standards as axiomatic with any acceptable options incorporated in the standards. The study has not assessed whether or not the country should adopt a limited version of the standards, as the processes of developing the standards have already considered any acceptable options in their text, but they do not override authoritative national standards issued by governments, regulatory or professional accounting bodies. Application of IPSAS by national authorities will support developments in public sector financial reporting directed at improving decision making, financial management, and accountability, and it will be an integral element of reforms directed at promoting social and economic development. The IPSASB has also developed guidelines on the transition from cash- to accrual-based reporting.¹ The traditional emphasis on cash accounting has been found inadequate through failure to recognize true costs, and all assets, and liabilities. Cash accounting can too easily neglect asset management, accumulating arrears, future liabilities (e.g., pensions), and contingent liabilities (e.g., guarantees).

3. Annex A explains the methodology used for the study. Annex B provides a summary of accounting and auditing standards referred to in this study. Annex C and D provide Sri Lanka accounting and auditing legislation, respectively. Lastly, Annex E includes a description of the benefits of accrual accounting. The desired lines of action to be taken as indicated by this assessment are summarized below.

4. **The plans to build on the current reporting under IPSAS through a path to implementation of the accrual IPSAS should be supported.** An implementation program for progressive adoption of accrual reporting is underway. The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSAS and Sri Lanka is progressing very well on this path.

¹ Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities, IFAC Public Sector Committee, December 2003.

5. The Table of Standards and Gaps appended at the end of this report provides a matrix detailing the current standards, the present position, and options for improvements. A summary of these accounting issues is shown in Table ES1.

Table ES1
Summary of Accounting Standards Issues in Sri Lanka

<i>Standard</i>	<i>Current status</i>	<i>Action to move towards the international standard</i>
1. Has the Public Sector Accounting Law adopted IPSAS?	Not formally. Since 2002, the Finance Department has been preparing annual accounts increasingly in accordance with the Cash Basis IPSAS. In 2005, additional disclosures were made as a first step towards presenting the account on an accrual basis. However there is no current prescription by law for the adoption of IPSAS.	A new law is not required at this time. Financial Regulations will be appropriately amended to adopt IPSAS. The Department of Public Finance of the Ministry of Finance & Planning (MOF&P) is to take the initiative by early 2007 in consultation with all stakeholders.
2. Does education and training of accountants accord with IES?	Substantially, but not formally. Government accountants are required to hold a university degree in accounting or equivalent. Further training is also provided but not in strict accordance with the IES.	A proposal for WB funding for collaboration with CIPFA is in progress and is currently under consideration by the Ministry of Finance (MOF). Implementation is likely during 2007. Director General (DG) State Accounts is to arrange to prepare a proposal to explore changes to the efficiency bar examinations in service progression with a view to including knowledge of IPSAS. DG State Accounts will also consider actions for the inclusion of IPSAS in the curriculum of universities and INGAF/SLIDA to meet IES. Progress is expected during 2007.
3. Does the Code of Ethics match international standards?	No. There is a Civil Service Code but this is not specific to accounting.	A specific code based on IFAC or the ICASL for use by public sector accountants. A Public Sector Committee (PSC) could explore the possibilities during early 2007.
4. Is there a body to prescribe public sector accounting standards?	No. ICASL provides standards for commercial accounting.	By mid 2007, DG State A/Cs to initiate a proposal for setting up a Public Sector Committee to establish standards for the government sector.
5. Are the financial statements in accord with international standards?	Government accounts are substantially in accord with Cash Basis IPSAS. State-Owned Enterprise (SOE) accounts follow IFRS but the accounts are usually qualified by the auditors on serious grounds.	DG State A/Cs is to take steps to arrange compliance with IPSAS for the core Government and non-commercial SOEs during 2007. World Bank (WB) is to discuss the support required with DG State A/Cs by mid 2007.
6. Is the statement of Cash Receipts and Payments in IPSAS form?	Yes, except that third party payments are not shown separately.	The 2005 accounts showed statements of financial performance, cash flows, financial position,

<i>Standard</i>	<i>Current status</i>	<i>Action to move towards the international standard</i>
7. Are accounting policies and explanatory notes required?	Yes	contingent liabilities, accounting policies and notes to the accounts. The transition path now underway will make the improvements that are needed. The World Bank arranged a workshop on IPSAS on October 27, 2006.
8. Are other disclosures in accord with IPSAS?	Yes	
9. Does the government issue a consolidated financial statement which consolidates all controlled entities?	No. Only the Central Government Sector is covered. Public enterprises, SOE and statutory boards are not included in the accounts.	Further steps will be needed to include controlled entities and WB is to discuss the support required with DG State A/Cs by mid 2007.

6. **There is a need to adopt the IFAC-issued International Standards on Auditing (ISA) in addition to the INTOSAI Auditing Standards already adopted, and auditing manuals and procedures should meet these standards.** Currently the INTOSAI Auditing Standards have not formally been adopted although there is a willingness to follow their prescriptions. New and amended laws should mandate the adoption of international standards. Audit recommendations and observations go unheeded in far too many instances. The implementation of the Cabinet Decisions on a National Audit Act and the implementation of the Institutional Development Plan for the Auditor General's Department should introduce modern audit methodologies and a modern audit organization.

7. The Table of Standards and Gaps at the end of this report shows each component of the standards, the present position, and the options for improvements that would bring Sri Lanka into closer conformance with international standards. A summary of these auditing issues is shown in Table ES2.

Table ES2
Summary of Auditing Standards Issues in Sri Lanka

<i>Standard</i>	<i>Current status</i>	<i>Action to move towards international standards</i>
1. Is the SAI statutory framework in accord with the needs of the INTOSAI Auditing Standards?	Partly. There is constitutional support, but there is no Audit Act that deals specifically with the Auditor General's duties and functions, and provides adequate administrative and financial arrangements to ensure proper support for PFM.	A draft audit act has been prepared and is awaiting approval. A decision is in prospect before the end of 2007.
2. Is there a body to prescribe public sector auditing standards?	No	The AG and the DG State A/Cs will coordinate the proposal for setting up of a PSC with the ICASL to establish standards for the government sector by mid 2007.
3. Have INTOSAI and IFAC audit standards been adopted?	Yes, but there is no document that lists out the public sector audit standards.	No action required until the Audit Act is passed.

<i>Standard</i>	<i>Current status</i>	<i>Action to move towards international standards</i>
4. Has a code of ethics equivalent to the INTOSAI standards been adopted?	No. The Code of Conduct for Public Sector Accountants is mainly based on the Establishment Code for Public Servants.	The proposed IDP likely to be implemented during 2007 will adopt a code of ethics equivalent to the INTOSAI Code.
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	Yes	
6. Does the SAI legal framework meet the INTOSAI standards for independence and powers?	No. For example, greater independence is needed in the areas of administration and resources.	The draft act addresses most of the eight core INTOSAI principles of independence.
7. Does education and training of auditors accord with INTOSAI and IES standards?	Not sufficiently. Peer reviews of the AG Department have shown several inadequacies.	A proposal for funding CIPFA collaboration is under discussion between MOF and the WB. The Institutional Development Plan (IDP) implementation will address skills analysis during 2007 and 2008.
8. Is the SAI equipped with the audit methods and technologies to meet the INTOSAI Auditing Standards?	No. The current audit methods are attuned to budget compliance checking. Major changes to audit methods are needed to support certification audit. Greater technology is needed.	The Institutional Development Plan prepared by the UK and The Netherlands SAIs will correct these deficiencies and implementation of the IDP is under discussion with the WB. Action is likely during 2007.
9. Does the SAI have the quality assurance programs to meet the international standards?	No	
10. Does the process to plan the audits meet international standards?	Partly. Audit planning is not sufficiently tailored to the audit client.	
11. Does the process to supervise the audits meet international standards?	No. Working paper systems are insufficient to support proper supervision.	
12. Does the process to evaluate the reliability of internal control meet international standards?	No. The orientation is to identify deficient transactions rather than verify the systems of control.	
13. Does the process used in audits to assess compliance with laws meet international standards?	Yes	
14. Does the audit process used to obtain evidence to support conclusions meet the international standards?	No. Working paper systems are insufficient.	
15. Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with?	Yes	

<i>Standard</i>	<i>Current status</i>	<i>Action to move towards international standards</i>
16. Does the auditor prepare an audit opinion on the financial statements in a form that conforms to international standards?	Yes	
17. Does the consideration of fraud and error in an audit of financial statements conform to international standards?	Yes	
18. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?	No. There is an inadequate system for response.	An appropriate system needs to be set up.

8. **Public Financial Management (PFM) should be improved through a more ambitious and comprehensive reform program.** Rapid progress is being made toward adoption of accrual reporting along IPSAS lines. Public financial management relies on a comprehensive and timely accounting and financial reporting system that is supported by competent assurance from a professional audit function, stating that the system is working properly and that the information is reliable. Current enforcement of adequate compliance with Financial Regulations in the general budget sector and corporate governance in the public enterprise sector falls short of satisfactory standards. Use of the PFM performance measurement framework developed by the Public Expenditure and Financial Accountability (PEFA)² program will be a good basis to develop and measure progress in the full cycle of PFM reform from budget formulation to legislative scrutiny and remedial action.

9. **Improvement of accounting and auditing skills.** Improved compliance with international standards requires properly trained staff. Basic accounting and auditing skills are good but post graduate skills are required that suit Sri Lankan conditions. The proposed improvement of accountancy training institutions through the adoption of the Diplomas and Certificates issued by the Chartered Institute of Public Finance and Accountancy in the United Kingdom should be used to strengthen public sector accounting and auditing skills.

10. **The preparation of a PFM indicators survey that provides the basis for monitoring progress in adopting and applying international standards.** Improvement of audit impact should be monitored through the progress of the institutional strengthening proposed for the Office of the Auditor General over the next few years.

² The PEFA Program is a partnership among the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the Strategic Partnership with Africa, IMF, and the World Bank. A Steering Committee, comprising members of these agencies, manages the Program. A Secretariat is located in the World Bank in Washington, DC.

I. INTRODUCTION

1. The basic purport of this assessment of public sector accounting and auditing is to facilitate more efficient Public Financial Management (PFM) through better quality accounting and public audit processes in Sri Lanka. Moreover, a greater stimulus is expected to be created for more cost-effective outcomes of government spending. The main objectives of this effort are to: (a) provide Sri Lanka's accounting and audit authorities and other interested stakeholders, with a common strongly founded knowledge regarding the status of local practices in accordance with the internationally developed standards of financial reporting and audit; (b) assess the prevailing variances; (c) chart paths to reduce the variances; and (d) provide an ongoing basis for measuring improvements.

2. Information on national standards and practices for accounting, financial reporting, and auditing in the government budget sector and in the state-owned enterprise sector were collected from diagnostic questionnaires that were completed in conjunction with country authorities. The diagnostic questionnaires incorporated the principles contained in the public sector accounting and auditing standards promulgated by International Organization of Supreme Audit Institutions (INTOSAI) and International Federation of Accountants (IFAC). The responses to these questionnaires have been further explored through discussions conducted by a World Bank team with the country authorities. These discussions included examination of accounts and audit reports and working papers to explore the quality of the processes and the products. Annex A further explains the methodology used for the study.

3. The analysis in this report has been conducted in the light of a concurrent public sector fiscal reform program supported by the Asian Development Bank (ADB) and the World Bank. Detailed studies of accounting and auditing have been conducted by ADB (Diagnostic Study of Accounting and Auditing Practices in Sri Lanka, 2002) and the World Bank (Country Financial Accountability Assessment, 2004). In addition, the United Kingdom and The Netherlands Audit Offices collaborated in producing the 2003 Institutional Development Plan for the Auditor General's Department.

4. These studies have examined the system of maintenance of public accounts in Sri Lanka in great detail. They show that the Financial Regulations (1992), which are the main authority for public financial management in the general government sector, focus only on the input aspect of expenditure control. They are issued by the executive branch (not by the legislature) and do not have the force of law. The studies found that there is a significant and long-standing practice of non-compliance with the Financial Regulations, in form and in spirit. The 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 are not comprehensive. In addition, the numbers are not completely reliable because of reconciliation and other problems. Reliability of financial data and timeliness of financial reporting have improved considerably in the presentation of financial statements for 2005. More needs to be done to develop performance budgets.

5. The Government of Sri Lanka has been making progress in improving the current state of affairs. The Financial Regulations are being transformed into a set of nine guidelines (on

planning, budgeting, foreign aid, revenue management, government accounting, procurement, fixed asset management, stores management and internal auditing) as part of simplifying the procedures and systems shifting focus more on outputs. This study found that so far, only one guideline had been implemented. The State Accounts have been produced in accordance with the Cash Basis International Public Sector Accounting Standards (IPSAS) and are intended to make the transition to the accrual basis or reporting in accordance with IPSAS. A significant gap in the public financial accountability framework has been the lack of a mechanism for monitoring and reviewing outputs and outcomes of government expenditure. This requirement will become more stringent with accruals, and the process must be tightened. A proposed Public Finance Bill (incorporating references to the financial guidelines), which has been drafted, lays a firmer legal basis for improving performance and financial accountability. But, action on the same has been deferred. Public sector auditing has been improving with wider coverage of public sector bodies and reporting that is more focused on material issues and general areas of control that need improving. What does not appear to have been improving has been the response to these identified deficiencies.

6. Annex B provides a summary of accounting and auditing standards referred to in this study. Annex C and D provide accounting and auditing legislation, respectively. And Annex E includes a description of the benefits of accrual accounting. The Table of Standards and Gaps at the end of the report summarizes each component of the current accounting and auditing standards, the present position, and the options for improvements that would bring Sri Lanka into closer conformance with international standards.

II. PUBLIC SECTOR ACCOUNTING

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.³ 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 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

³ Diagnostic Study of Accounting and Auditing Practices in Sri Lanka, ADB, 2002.

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
- 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 1, 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.

III. PUBLIC SECTOR AUDITING

A. Institutional Framework for Public Sector Auditing

23. Effective scrutiny by the legislature through comprehensive, competent external audit underpinned by International Standards on Auditing (ISA) enables accountability for the implementation of fiscal and expenditure policies. The environment for an effective supreme audit institution (SAI) requires a comprehensive approach to public financial management. Supreme audit institutions are not stand-alone institutions; they are part of a PFM architecture that also includes budgeting, accounting, internal control, audit and legislative oversight, and government response. Improving the way the Sri Lanka Supreme Audit Institution functions is integral to providing information for improving the overall PFM system, but the action must take place within the executive branch under the watchful eyes of the legislature and the public. A strong demand for good public sector external auditing is necessary for the supreme audit institution to have any impact. This requires willingness of the executive branch to accept and respond to external scrutiny over its management of funds and to ensure that the relevant reform action is taken. It also requires public disclosure of the audit reports to ensure public support for effective action.

24. The diagnostic questionnaires collected information describing the current arrangements in Sri Lanka and the apparent gaps in the following areas:

- Institutional framework for the supreme audit institution
- Process for setting auditing standards
- Use of Code of Ethics or Codes of Conduct
- Arrangements to ensure accountability in the supreme audit institution
- Arrangements to ensure independence
- Arrangements to ensure adequate skills and qualifications for the auditors
- Arrangement for providing training
- Arrangements to ensure a desired level of competence for the auditors
- Arrangements for quality assurance

(1) Institutional Framework

25. **The appointment and powers of the Auditor General should be specified in a new National Audit Act.** The Constitution and relevant laws⁴ provide for the President to appoint the Auditor General with a mandate to audit all government bodies. In practice, commercial state-owned enterprises are audited by accounting firms and reviewed by the AG Department, but the provisions are not very specific about the type of audit report required. The Auditor General does

⁴ Finance Act No. 38 of 1971, Ch. 252; Municipal Council Ordinance, Ch. 255; Urban Council Ordinance, Ch. 255; Pradesiya Sabha Act, No. 15 of 1987 (local government); and Lanka Accounting and Auditing Standards Act 1995.

not have the powers or the status to secure implementation of his recommendations, despite the severe problems in public financial management that are identified in his reports.

26. **Negotiations with donors over the implementation of the institutional strengthening program should be completed.** In October 2005, the Government of Sri Lanka approved the drafting of a National Audit Bill and an Institutional Development Plan to modernize the AG Department. The Ministry of Finance is being asked to liaise with donors for the necessary funding. Further discussions are needed to decide the best way to manage the process, including the possibilities for a sector-wide approach to the development.

27. **A review of PFM high-level indicators should be conducted.** Given the strong interdependencies among the elements of the PFM system, coordinated or integrated development programs would be important for successful implementation. Merely strengthening the AG Department will not work without the strengthening of internal controls and the legislative scrutiny processes. In this context, the use of indicators for measuring PFM performance would be very helpful.

28. **The new National Audit Act should provide a broader base to undertake all forms of audit and an adequate offences clause to ensure cooperation.** Forensic and performance audit are needed as part of a balanced audit program.

(2) Setting Auditing Standards

29. **The National Audit Act should specify arrangements to adopt INTOSAI and IAASB Auditing Standards.** The INTOSAI Auditing Standards supported by the detailed IFAC-issued International Standards on Auditing underpin a modern audit process. The International Audit and Assurance Standards Board (IAASB) is progressively rolling out international auditing standards. The INTOSAI is moving from maintaining its own auditing standards by seeking to support the IAASB's development of auditing standards. This is being done especially so that the IAASB audit standards appropriately reflect the interests of the international public sector audit community. The AG Department's current auditing approach is based together with some public sector elaboration on the ICASL Auditing Standards; but no document sets out the public sector audit standards as such. Without a formal document, there is no authoritative and credible basis for enforcement of standards.

30. The IFAC-issued International Standards on Auditing represent best international practices for the auditing profession, particularly in such areas of fundamental auditing practice as the following:

- audit evidence
- documentation
- audit materiality
- fraud
- audit errors
- audit opinions
- audit planning
- control environment assessments
- supervising the work of audit staff

(3) Code of Ethics

31. **The AG Department should adopt a specific Code of Ethics that is relevant to auditors.** Along with INTOSAI's Lima Declaration of Guidelines on Auditing Precepts,⁵ the INTOSAI Code of Ethics is considered an essential complement to the INTOSAI Auditing Standards. A Code of Ethics is considered as a statement of values and principles guiding the daily work of the auditors. The Sri Lanka Supreme Audit Institution has not adopted the IFAC-issued Code of Ethics for Professional Accountants or the INTOSAI Code of Ethics.

(4) Accountability in the Supreme Audit Institution

32. **The Institutional Development Plan should pay particular attention to achieving the 2003 peer review recommendations.** A 2003 peer review by The Netherlands Supreme Audit Institution satisfied the requirement for competent assessment of the accountability of the Sri Lanka Supreme Audit Institution. Its recommendations need to be implemented to complete the accountability process.

(5) Independence

33. **The proposed National Audit Act is needed to provide effective independence to the Auditor General.** Five of the eight core principles of SAI independence that were set out by INTOSAI are only partially, if at all, met by the current legislative and administrative framework. The five core principles are:

- The independence of the SAI Heads including security of tenure and legal immunity in the normal discharge of their duties.
- A sufficiently broad mandate and full discretion in the discharge of SAI functions.
- The freedom to decide on the content and timing of SAI reports and to publish and disseminate them.
- The existence of effective follow-up mechanisms on SAI recommendations.
- Financial and managerial autonomy and the availability of appropriate human, material, and monetary resources.

(6) Qualifications and Skills for the Auditors

34. The quality of accounting and auditing educational and training arrangements in the government's schools is not fully satisfactory. It does not meet the needs of modern accounting and financial management.

(7) Training

35. **A better training institution that meets international standards should be introduced.** The AG Department staff has good basic accounting qualifications. However, the

⁵ Lima Declaration of Guidelines on Auditing Precepts, October 1977, INTOSAI

Institutional Development Plan highlights a dearth of required auditing expertise. The proposed CIPFA training program would cover the training of both accountants in the certificate and diploma scheme initially and then move to the full CIPFA professional qualification as adapted for Sri Lanka circumstances.

36. **A skills analysis program based on international standards for competencies should be conducted.** The AG Department does not have basic facilities for training, research, and development. A proper need-based approach is required to be implemented to support the introduction of an audit methodology, and international accounting and auditing standards. The Institutional Development Plan needs to be used to strengthen the internal AG Department training facilities.

(8) Audit Competence

37. **Systems, methodologies, and facilities should be updated in accordance with the Institutional Development Plan to enable modern audit to be undertaken by the staff.** There is a need to develop specialist forensic audit and computerized audit capabilities. The audit orientation has to change from transaction to risk-based systems audit. It is necessary to strengthen the technical and professional competence of the AG Department and improve its operational capacity to produce and disseminate quality audit reports that meet international standards and serve the needs of the stakeholders. The AG Department needs to improve training, and to build in-house capacity for financial performance, fraud, environmental and computerized audits. An audit management system is needed that is supported by an up-to-date software and hardware configuration.

(9) Quality Assurance

38. **To improve quality assurance, the new Audit Methodology Manual, which would be prepared in accordance with the methods described in the Institutional Development Plan, is needed.** There is no quality assurance program currently in use. Audit supervision is expected to ensure quality. However, current audits are not timely, many findings lack materiality; the audit programs, which focus on compliance and financial (attestation) audits, are not at par with the best of international practices. Given the lack of acceptance within the AG Department of a previous manual prepared by consultants during the 1990s, it is crucial that the new manual be prepared by AG Department staff in consultation with experts and practitioners, with external consultants providing guidance, but not actually writing the manual.

B. Auditing Standards as Practiced

39. The diagnostic questionnaires have been used to collect information about the current arrangements for the audit methodology and the apparent gaps in the country for:

- audit planning
- audit supervision
- reviewing internal controls
- reviewing compliance with laws
- ensuring that adequate audit evidence is collected

- analyzing whether the financial statements accord with accounting standards
- preparing audit opinions
- reporting on fraud, and
- reporting on compliance

Out of this exercise came recommended activities that will help bring local standards in line with international standards.

(1) Audit Planning

40. **The new Audit Methodology Manual should introduce more comprehensive planning requirements based on the specific objectives of the audits.** Audit planning is not sufficiently tailored to suit the needs of the audit client. Recent modifications have sought to specifically identify those areas of concentration, but this is still insufficient for meeting international standards of audit planning. Most of the audits are aimed at identifying regulatory breaches. The reports of these audits are of minimal assurance value to either the preparers or users of the financial reports, or wider stakeholders. Nor are they of much value to those responsible for managing systems of internal control. Results from audits should hold the executive accountable for its fiscal and expenditure policies and their implementation.

(2) Audit Supervision

41. **A more comprehensively structured working paper system is needed for the audit to attain the normal audit objectives regarding the validity of transactions.** Current supervision is hampered by inadequate working paper systems and a poor audit methodology.

(3) Reviewing Internal Controls

42. **The overall audit procedures need to be changed and supported by the new Audit Methodology Manual.** The general budget sector audits examine transactions in accordance with the rules established by the Financial Regulations. They therefore report on where controls have not been applied. They do not approach the audit from the perspective of material misstatement of an accounting figure, but rather the failure of a transaction to comply with the rules. The effect of this approach is that there is no pressure on the system to improve as all of the effort goes into argument about the transaction, not the system of control. The 2003 Auditor General Activity Report notes that past audit reports had been merely post-mortem examinations, often delayed from 5 to 15 years; and that by and large the issues were not significant. INTOSAI has issued a paper on internal control standards⁶ that provide a good international benchmark for assessing internal controls.

(4) Reviewing Compliance

43. **Introduce recommendations to all audit reports, monitor the implementation of the recommendations, and report on the process in the Activity Report.** The AG Department uses

⁶ Guidelines for Internal Control Standards for the Public Sector, Internal Control Standards Committee, International Organization of Supreme Audit Institutions.

much of its resources for compliance type of audit work. An important issue is whether the audits are effective in dealing with instances of non-compliance. In some South Asian countries, the audit reports log large numbers of transactions for pursuit of recovery. These cases continue to be monitored until the matter is resolved, either by the Public Accounts Committee or the Auditor General. In local government matters, the Auditor General does have the power to disallow items of the accounts that are contrary to law and surcharge the responsible officer. The effectiveness of the Public Accounts Committee needs improvement. Also, it is necessary to implement stronger enforcement of surcharge processes. The 2003 Auditor General Activity Report states that recoveries of surcharges were small, with more than half the outstanding surcharges uncollected for more than 4 years. The same report recommends that for public corporations those responsible for irregularities should settle such losses.

(5) Audit Evidence

44. **The audit methodology and necessary supporting working papers should be more precisely defined in the new Audit Methodology Manual.** Currently working papers are organized by report paragraphs rather than the audit plan. They cover the details of the preparation and approval of the text of the audit paragraphs.

45. **The AG Department should, as per ISA 600 (8), examine on a sample basis some of the working papers of the ‘qualified auditors’ employed to audit government bodies.** Most certification audit work is done by accounting firms on behalf of the Auditor General, but these working papers are not reviewed by the AG Department.

(6) Analyzing the Financial Statements

46. **A revised audit methodology will improve the way in which the AG Department analyzes financial statements.** The AG Department uses a checklist for analyzing financial statements.

(7) Preparing Audit Opinions

47. **The requirements of ISA 700, *The Auditor’s Reports on Financial Statements*, should be adopted in full.** The audit scope and audit opinion paragraphs for the Consolidated Financial Statements 2004 do not contain the degree of detail set by ISA 700 in paragraphs 12 to 15. This creates doubts about the auditing standards used for the work. It also makes uncertain whether the audit provides a reasonable basis for the opinion, and if the audit was planned and performed to obtain reasonable assurance that the financial statements are free of material misstatement. The scope statement notes the limitations of staff, other resources, and time available. This would normally be read by a user of the accounts as an indication that the audit opinion on the accounts is thereby qualified although this is not clearly stated in the opinion paragraph.

(8) Reporting on Fraud

48. **Use of forensic audit methods would reduce fraud.** Much of the audit reporting seems to relate to fraudulent behavior. This orientation comes from the compliance testing approach. The use of specific forensic audit methods would enhance the effectiveness of the reporting on whether deficiencies arise from fraud rather than error or oversight.

(9) Reporting on Compliance

49. **Improve the effectiveness of the audit report by stronger enforcement of corporate governance requirements through the audit committees.** The study reveals a number of weaknesses in the success of the present reporting system (e.g., lack of depth, irrelevance, lack of brevity, etc.) Although the Auditor General submits a supplementary report with respect to statutory boards and corporations, no serious attempt seems to have been made by the boards of such institutions for improving controls and management of resources. In general, arrangements to improve corporate governance ought to apply to the whole public sector, including state-owned enterprises.

IV. ACTION PLANS

Standards Issue	Current Status	Steps to be Taken to Move Toward International Standards
<p>Accounting</p> <p>1. Has the Public Sector Accounting Law adopted IPSAS?</p>	<p>Not formally. The Finance Department has since 2002 been preparing annual accounts increasingly in accordance with the Cash Basis IPSAS. However there is no current prescription by law for the adoption of IPSAS.</p>	<p>Need for a financial management law adopting IPSAS full accrual by a specified date, and for the Department of State Accounts to develop a transition path⁷ first through the requirements of the Cash Basis IPSAS then to accrual IPSAS. Improvements in technology will be needed to support the system.</p> <p>No act is required at this time. Financial Regulations could be appropriately amended to adopt IPSAS. <i>Dept. of Public Finance of the MOF&P to take the initiative by mid 2007 in consultation with all stakeholders.</i></p>
<p>2. Does the education and training of accountants' accord with IES?</p>	<p>Substantially but not formally. Government accountants are required to hold a university degree in accounting or its equivalent. Further training is also provided but not in strict accordance with the IES.</p>	<p>The proposed improvement of accountancy training institutions should be used to strengthen public sector accounting and auditing skills.</p> <p>A proposal for WB funding for collaboration with CIPFA is in progress and is under consideration by MOF. Implementation is likely during 2007. <i>DG State A/Cs could prepare a proposal to explore possibilities of including IPSAS in the curriculum of universities and also inclusion of IPSAS in progress is expected during 2007.</i></p>
<p>3. Does the Code of Ethics match international standards?</p>	<p>No. There is a Civil Service Code but this is not specific to accounting.</p>	<p>A specific code based on IFAC or the ICASL should be prepared and adopted for use by public sector accountants. <i>A Public Sector Committee could explore the possibilities (see point 4 for setting up a PSC) during early 2007.</i></p>
<p>4. Is there a body to prescribe public sector accounting standards?</p>	<p>No. ICASL provides standards for commercial accounting.</p>	<p>The Ministry of Finance and the ICASL should establish a public sector committee to establish standards for the government sector.</p> <p><i>By mid 2007 DG State A/Cs to initiate a proposal for setting up a Public Sector Committee.</i></p>
<p>5. Are the financial statements in accord with international standards?</p>	<p>Government accounts are substantially in accord with Cash Basis IPSAS. SOE accounts follow IFRS but the accounts are usually qualified by the auditors on serious grounds.</p>	<p>Audit Committees in public sector entities should assure better compliance.</p> <p>A more effective supervisory regime is needed for SOEs.</p>

⁷ IFAC Public Sector Study 14 'Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities' provides transition guidance.

<i>Standards Issue</i>	<i>Current Status</i>	<i>Steps to be Taken to Move Toward International Standards</i>
6. Is the statement of Cash Receipts and Payments in IPSAS form?	Substantially. Third party payments are not shown separately	The transition path should make the improvements that are needed. <i>WB arranged a workshop on IPSAS on October 27, 2006.</i>
7. Are accounting policies and explanatory notes required?	Yes	
8. Are other disclosures in accord with IPSAS?	Substantially	
9. Does the government issue a consolidated financial statement which consolidates all controlled entities?	No. Only the Central Government Sector is covered. Public enterprises, SOE and statutory boards are not included in the accounts.	Further steps will be needed to include controlled entities. <i>WB to discuss the support required with DG State A/Cs by mid 2007.</i>
Auditing		
1. Is the SAI statutory framework in accord with the needs of the INTOSAI Auditing Standards?	Partly. There is constitutional support, but there is no Audit Act that deals specifically with the Auditor General and provides adequate administrative and financial arrangements to ensure proper support for PFM.	A specific National Audit Act is required that meets international standards. ⁸ The new Act should provide a broader base to undertake all forms of audit. The Audit Act should contain an adequate offences clause. <i>A draft audit act has been prepared and is awaiting approval. A decision is in prospect by end 2007.</i>
2. Is there a body to prescribe public sector auditing standards?	No	The Auditor General and the ICASL should establish a public sector committee to establish standards for the government sector. <i>AG and the DG State A/Cs will coordinate the proposal for setting up of a PSC by mid 2007.</i>
3. Have INTOSAI and IFAC audit standards been adopted?	Yes, but there is no document that lists out the public sector audit standards.	The National Audit Act should specify arrangements to adopt INTOSAI and IAASB International Standards on Auditing. Action awaits the approval of the new Audit Act as above.
4. Has a code of ethics equivalent to the INTOSAI standards been adopted?	No. The Code of Conduct for Public Sector Accountants is mainly based on the Establishment Code for Public Servants.	A code of ethics equivalent to the INTOSAI Code needs to be adopted. The proposed IDP implementation will address the adoption of INTOSAI code with guidelines for compliance. Implementation is likely during 2007.
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	Yes	

⁸ Guidance is provided by "A Model National Audit Office Act," The Association of Chartered Certified Accountants, United Kingdom, 2004.

Standards Issue	Current Status	Steps to be Taken to Move Toward International Standards
6. Does the SAI legal framework meet the INTOSAI standards for independence and powers?	No. For example, greater independence is needed in the areas of administration and resources.	The new National Audit Law should provide for all of the eight core INTOSAI principles of independence. The draft act addresses most of the principles. Draft legislation has been prepared to establish a Public Sector Professional Accountancy Institute which merges two current public sector training institutes. This institute should follow IES requirements. A skills analysis is required for the AG Department and a review of training and performance management systems. <i>A proposal for funding CIPFA collaboration is under discussion between MOF and the WB. The IDP implementation will address skills analysis during 2007 and 2008.</i>
7. Does the education and training of auditors accord with INTOSAI and IES standards?	Not sufficiently. Peer reviews of the AG Department have shown inadequacies.	The AG Department needs to improve training, building in-house capacity for financial, performance, fraud, environmental and IT audits. An audit management system is needed for the AG Department. <i>An Institutional Development Plan has been prepared but not yet implemented. Implementation of this plan will deal with this issue and the deficiencies outlined in the items following.</i> A quality assurance program should be introduced.
8. Is the SAI equipped with the audit methods and technologies to meet the INTOSAI Auditing Standards?	No. The current audit methods are attuned to budget compliance checking. Major changes to audit methods are needed to support certification audit. Greater technology is needed.	
9. Does the SAI have the quality assurance programs to meet international standards?	No	
10. Does the process to plan the audits meet international standards?	Partly. Audit planning is not sufficiently tailored to the audit client.	
11. Does the process to supervise the audits meet international standards?	No. Working paper systems are insufficient to support proper supervision.	The Institutional Development Plan prepared by the UK and The Netherlands SAIs will correct these deficiencies, if implemented.
12. Does the process to evaluate the reliability of internal control meet international standards?	No. The orientation is to identify deficient transactions rather than verify the systems of control.	
13. Does the process used in audits to assess compliance with laws meet international standards?	Yes	
14. Does the audit process used to obtain evidence to support conclusions meet international standards?	No. Working paper systems are insufficient.	The Institutional Development Plan prepared by the UK and The Netherlands SAIs will correct these deficiencies, if implemented.

Standards Issue	Current Status	Steps to be Taken to Move Toward International Standards
15. Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with?	Yes	
16. Does the auditor prepare an audit opinion on the financial statements in a form that conforms to the international standards?	Yes	
17. Does the consideration of fraud and error in an audit of financial statements accord with the international standard?	Yes	
18. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?	No. The system of response is inadequate.	<i>Introduce a system of recommendations and methods to monitor that the recommendations are implemented, and report on the process in an annual AG Activity Report.</i>

ANNEX A. METHODOLOGY OF THE ASSESSMENT

As part of the general support program in South Asia for assessment and improvement of public sector accounting and auditing against international standards, the World Bank, with the cooperation of member governments, is conducting the Review of Public Sector Accounting and Auditing Practices in member countries. The development of the PFM Performance Measurement Framework⁹ by the Public Expenditure and Financial Accountability (PEFA) Program¹⁰ has opened the way for a diagnostic tool to be developed, that is referenced to the accounting and auditing standards of IFAC and INTOSAI, and other relevant international benchmarks. This exercise provides substantial insight into country performance in regard to the external auditing and financial statement reporting FM indicators.

A set of six questionnaires is used to collect relevant information on country practices:

- **The public sector accounting environment**—collecting basic information about financial laws and standards-setting arrangements, educational requirements for accountants compared with IFAC International Education Standards, ethical requirements compared with the IFAC Code of Ethics for Professional Accountants.
- **Public sector accounting practices for the general budget sector if using the cash basis of accounting**—compared with the requirements of the Cash Basis International Public Sector Accounting Standards (IPSAS).
- **Public sector accounting practices for the general budget sector if using the accrual basis of accounting**—compared with the IPSAS requirements that govern accrual reporting for the public sector.
- **Public sector auditing environment** compared with the provisions of the International Organization of Supreme Audit Institutions (INTOSAI) Code of Ethics and the INTOSAI general standards.
- **Public sector auditing practices** compared with the requirements of the INTOSAI field standards and reporting standards, and the IFAC International Standards on Auditing.
- **Accounting and auditing practices for state-owned enterprises**—compared with the requirements of the International Financial Reporting Standards (IFRS) and International Standards on Auditing that govern commercial reporting.

The responses to the diagnostic questionnaires, prepared by the relevant authorities in the country, with the help, wherever necessary, of in-country experts retained by the Bank, are supplemented by a due diligence review conducted by members of a World Bank task team from the country.

⁹ The PFM Performance Measurement Framework has been developed as a contribution to the collective efforts of many stakeholders to assess and develop essential PFM systems, by providing a common pool of information for measurement and monitoring of PFM performance progress, and creating a common platform for dialogue.

¹⁰ The PEFA Program is a partnership among the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa. A Steering Committee, comprising members of these agencies, is managing the Program. A Secretariat has been set up and is located in the World Bank in Washington, DC.

Various documents are examined as part of the review including relevant laws, codes of conduct, national accounting and auditing standards, accountant selection and promotion processes, training needs assessments, accountancy training course outlines, curricula and accreditation methods, sample accounts, and sample audit reports and working paper sets.

A country report on the assessment is prepared for each country and reviewed by an expert panel of advisors before examination by the World Bank country team. The draft is then shared with the Government for response before finalization.

ANNEX B. ACCOUNTING AND AUDITING STANDARDS

This contains a summary of the frameworks that have been used for the public sector accounting and auditing assessment

These have been compiled by the International Accounting Standards Board (IASB), the International Federation of Accountants (IFAC) and the International Organization of Supreme Audit Institutions (INTOSAI), which are cooperating in setting international standards for accounting and auditing.

The IASB is an independent, privately funded accounting standard-setter based in London, UK. The Board members come from nine countries and have a variety of functional backgrounds. In the public interest, IASB is committed to developing a set of high quality, understandable, and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world. The IASB issued International Accounting Standards (IAS) from 1973 to 2000. Since 2000, they have issued International Financial Reporting Standards (IFRS).

IFAC has its headquarters in New York, USA and comprises 163 member bodies, mainly the national professional accountancy bodies of most countries around the world. The IFAC Board established the International Public Sector Accounting Standards Board (IPSASB) to develop high quality accounting standards for use by public sector entities around the world, in the preparation of general purpose financial statements. These are the International Public Sector Accounting Standards (IPSAS). The full text of Standards and Exposure Drafts currently on issue is available at <http://www.ifac.org/publicsector>. The first 20 IPSAS are based on IAS to the extent appropriate for the public sector. IFAC also has established the International Auditing and Assurance Standards Board (IAASB) to prepare and promulgate International Standards on Auditing (ISA) and is now working in cooperation with INTOSAI on preparing public sector guidance on the use of ISA.

INTOSAI includes the Auditors General from almost all national government audit departments around the world and has its Secretariat in the Vienna offices of the Auditor General of Austria. Its Auditing Standards Committee, chaired by the Auditor General of Sweden, produces the INTOSAI Code of Ethics and Auditing Standards, a set of standards at a higher and more generic level than the IFAC-issued ISA. The Auditing Standards Committee is working with the IAASB to prepare practice notes explaining the application of each ISA in the public sector.¹¹

The various standards are listed on the following pages.

¹¹ Working Group on Financial Audit Guidelines, INTOSAI Auditing Standards Committee, Swedish National Audit Office, 2004.

International Public Sector Accounting Standards

- IPSAS 1, Presentation of Financial Statements*
- IPSAS 2, Cash Flow Statements*
- IPSAS 3, Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies*
- IPSAS 4, The Effects of Changes in Foreign Exchange Rates*
- IPSAS 5, Borrowing Costs*
- IPSAS 6, Consolidated Financial Statements and Accounting for Controlled Entities*
- IPSAS 7, Accounting for Investments in Associates*
- IPSAS 8, Financial Reporting of Interests in Joint Ventures*
- IPSAS 9, Revenue from Exchange Transactions*
- IPSAS 10, Financial Reporting in Hyperinflationary Economies*
- IPSAS 11, Construction Contracts*
- IPSAS 12, Inventories*
- IPSAS 13, Leases*
- IPSAS 14, Events after the Reporting Date*
- IPSAS 15, Financial Instruments: Disclosure and Presentation*
- IPSAS 16, Investment Property*
- IPSAS 17, Property, Plant and Equipment*
- IPSAS 18, Segment Reporting*
- IPSAS 19, Provisions, Contingent Liabilities and Assets*
- IPSAS 20, Related Party Disclosures*
- IPSAS 21, Impairment of Non-cash Generating Assets*
- Cash Basis IPSAS, Financial Reporting under the Cash Basis of Accounting*

International Education Standards

- IES 1, Entry Requirements to a Program of Professional Accounting Education*
- IES 2, Content of Professional Accounting Education Programs*
- IES 3, Professional Skills*
- IES 4, Professional Values Ethics and Attitudes*
- IES 5, Practical Experience Requirements*
- IES 6, Assessment of Professional Capabilities and Competence*
- IES 7, Continuing Professional Development*
- IES 8, Competence Requirements for Audit Professionals*

International Financial Reporting Standards and International Accounting Standards

IFRS 1, First-time Adoption of International Financial Reporting Standards

IFRS 2, Share-based Payment

IFRS 3, Business Combinations

IFRS 4, Insurance Contracts

IFRS 5, Non-current Assets Held for Sale and Discontinued Operations

IAS 1, Presentation of Financial Statements

IAS 2, Inventories

IAS 7, Cash Flow Statements

IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors

IAS 10, Events after the Balance Sheet Date

IAS 11, Construction Contracts

IAS 12, Income Taxes

IAS 14, Segment Reporting

IAS 16, Property, Plant and Equipment

IAS 17, Leases

IAS 18, Revenue

IAS 19, Employee Benefits

IAS 20, Accounting for Government Grants and Disclosure of Government Assistance

IAS 21, The Effects of Changes in Foreign Exchange Rates

IAS 23, Borrowing Costs

IAS 24, Related Party Disclosures

IAS 26, Accounting and Reporting by Retirement Benefit Plans

IAS 27, Consolidated and Separate Financial Statements

IAS 28, Investments in Associates

IAS 29, Financial Reporting in Hyperinflationary Economies

IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions

IAS 31, Interests in Joint Ventures

IAS 32, Financial Instruments: Disclosure and Presentation see also: See also Financial Instruments - other issues

IAS 33, Earnings per Share

IAS 34, Interim Financial Reporting

IAS 36, Impairment of Assets

IAS 37, Provisions, Contingent Liabilities and Contingent Assets

IAS 38, Intangible Assets

IAS 39, Financial Instruments: Recognition and Measurement see also: See also Financial Instruments - other issues

IAS 40, Investment Property

IAS 41, Agriculture

INTOSAI Code of Ethics and Auditing Standards

<p>Code of ethics</p> <p><i>Integrity.</i> Auditors have a duty to adhere to high standards of behavior (e.g. honesty and candidness) in the course of their work and in their relationships with the staff of audited entities.</p> <p><i>Independence, objectivity and impartiality.</i> The independence of auditors should not be impaired by personal or external interests. There is a need for objectivity and impartiality in the work and the reports, which should be accurate and objective. Conclusions in opinions and reports should be based exclusively on evidence obtained and assembled in accordance with the SAI auditing standards.</p> <p><i>Professional secrecy.</i> Auditors should not disclose information obtained in the auditing process to third parties except for the purposes of meeting the SAI statutory responsibilities.</p> <p><i>Competence.</i> Auditors must not undertake work which they are not competent to perform.</p>
<p>Basic postulates for the auditing standards</p> <p>(a) The SAI should consider compliance with the INTOSAI auditing standards in all matters that are deemed important/essential. Certain standards may not be applicable to some of the work done by SAIs, including those organized as Courts of Account, nor to the non-audit work conducted by the SAI. The SAI should determine the applicable standards for such work to ensure that it is of consistently high quality.</p> <p>(b) The SAI should apply its own judgment to the diverse situations that arise in the course of government auditing.</p> <p>(c) With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a need for the accountability process to be in place and operating effectively.</p> <p>(d) Development of adequate information, control, evaluation and reporting systems within the government will facilitate the accountability process. Management is responsible for correctness and sufficiency of the form and content of the financial reports and other information.</p> <p>(e) Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the government, and audited entities should develop specific measurable objectives and performance targets.</p> <p>(f) Consistent application of acceptable accounting standards should result in the fair presentation of the financial position and the results of operations.</p> <p>(g) The existence of an adequate system of internal control minimizes the risk of errors and irregularities. It is the responsibility of the audited entity to develop adequate internal control systems to protect its resources. It is also the obligation of the audited entity to ensure that controls are in place and functioning to help ensure that applicable statutes and regulations are complied with, and that probity and propriety are observed in decision-making. The auditor should submit proposals and recommendations where controls are found to be inadequate or missing.</p> <p>(h) Legislative enactments would facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit.</p> <p>(i) All audit activities should be within the SAI audit mandate.*</p> <p>(j) Legislative enactments would facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit.</p> <p>(k) SAIs should work toward improving techniques for auditing the validity of performance measures.</p> <p>(l) SAIs should avoid conflict of interest between the auditor and the audited entity.</p>
<p>* The full scope of government auditing includes <i>regularity</i> and <i>performance</i> audit.</p> <p>Regularity audit embraces:</p> <ol style="list-style-type: none">i. Attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements;ii. Attestation of financial accountability of the government administration as a whole;iii. Audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;

- iv. Audit of internal control and internal audit functions;
- v. Audit of the probity and propriety of administrative decisions taken within the audited entity; and
- vi. Reporting of any other matter(s) arising from or relating to the audit that should be disclosed, according to the SAI.

Performance audit entails the audit of economy, efficiency and effectiveness, and embraces:

- vii. Audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- viii. Audit of the efficiency of utilization of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies; and
- ix. Audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of activities compared with the intended impact.

General auditing standards

The auditor and the SAI must be independent.

The auditor and the SAI must possess the required competence.

The auditor and the SAI must exercise due care and concern in complying with the INTOSAI auditing standards. This embraces due care in planning, specifying, gathering and evaluating evidence, and in reporting findings, conclusions and recommendations.

The SAI should adopt policies and procedures to recruit personnel with suitable qualifications.

The SAI should adopt policies and procedures to develop and train SAI employees to enable them to perform their tasks effectively, and to define the basis for the advancement of auditors and other staff.

The SAI should adopt policies and procedures to prepare manuals and other written guidance and instructions concerning the conduct of audits.

The SAI should adopt policies and procedures to support the skills and experience available within the SAI and identify the skills which are absent; provide a good distribution of skills to auditing tasks and assign a sufficient number of persons for the audit; it must have proper planning and supervision to achieve its goals at the required level of due care and concern.

The SAI should adopt policies and procedures to review the efficiency and effectiveness of the SAI internal standards and procedures.

Field standards

(a) The auditor should plan the audit in a manner that ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner.

(b) The work of the audit staff at each level and audit phase should be properly supervised during the audit; the documented work should be reviewed by a senior member of the audit staff.

(c) The auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control.

(d) In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits.

Reporting standards

(a) At the end of each audit the auditor should prepare a written opinion or report, as appropriate, setting out the findings in an appropriate form; its content should be easy to understand and free from vagueness or ambiguity, it should include only information which is supported by competent and relevant audit evidence, and be independent, objective, fair and constructive.

(b) It is for the Auditor General to decide finally on the action to be taken in relation to fraudulent practices or serious irregularities discovered by the auditors.

International Standards on Auditing

<p>Framework:</p> <p><i>International Framework for Assurance Engagements</i></p> <p>General Principles and Responsibilities:</p> <p>200 <i>Objective and General Principles Governing an Audit of Financial Statements</i></p> <p>210 <i>Terms of Audit Engagements</i></p> <p>220 <i>Quality Control for Audits of Historical Information</i></p> <p>230 <i>Documentation</i></p> <p>230R <i>Audit Documentation</i></p> <p>240 <i>The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements</i></p> <p>240A <i>Fraud and Error</i></p> <p>250 <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i></p> <p>260 <i>Communications of Audit Matters with Those Charged with Governance</i></p> <p>Risk Assessment and Response to Assessed Risks:</p> <p>300 <i>Planning an Audit of Financial Statements</i></p> <p>315 <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i></p> <p>320 <i>Audit Materiality</i></p> <p>330 <i>The Auditor's Procedures in Response to Assessed Risks</i></p> <p>402 <i>Audit Considerations Relating to Entities Using Service Organizations</i></p>	<p>Audit Evidence:</p> <p>500 <i>Audit Evidence</i></p> <p>501 <i>Audit Evidence -- Additional Considerations for Specific Items</i></p> <p>505 <i>External Confirmations</i></p> <p>510 <i>Initial Engagements -- Opening Balances</i></p> <p>520 <i>Analytical Procedures</i></p> <p>530 <i>Audit Sampling and Other Means of Testing</i></p> <p>540 <i>Audit of Accounting Estimates</i></p> <p>545 <i>Auditing Fair Value Measurements and Disclosures</i></p> <p>550 <i>Related Parties</i></p> <p>560 <i>Subsequent Events</i></p> <p>570 <i>Going Concern</i></p> <p>580 <i>Management Representations</i></p> <p>Using the Work of Others:</p> <p>600 <i>Using the Work of Another Auditor</i></p> <p>610 <i>Considering the Work of Internal Auditing</i></p> <p>620 <i>Using the Work of an Expert</i></p> <p>Audit Conclusions and Reporting:</p> <p>700 <i>The Auditor's Reports on Financial Statements</i></p> <p>700R <i>The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements</i></p> <p>701 <i>Modifications to the Independent Auditor's Report</i></p> <p>710 <i>Comparatives</i></p> <p>720 <i>Other Information in Documents Containing Audited Financial Statements</i></p> <p>Specialized Areas:</p> <p>800 <i>The Auditor's Report on Special Purpose Audit Engagements</i></p>
--	--

ANNEX C. SRI LANKAN ACCOUNTING LEGISLATION

The **Finance Act (1971)** and the **Financial Regulations (1992)**, issued by the Ministry of Finance, require that ministries, departments, and constitutional bodies, such as the Auditor General's Office; and non revenue-earning statutory bodies and public enterprises report in accordance to this legislation. They prepare cash-based budgets and financial reports. The Financial Regulations do not prescribe accounting standards in this respect.

The **Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995** requires that revenue-earning statutory bodies and public enterprises report in accordance with Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka, and be subject to monitoring for compliance by the Sri Lanka Accounting and Auditing Standards Monitoring Board.

Financial Regulations Extracts

F.R. 150. Appropriation Accounts. Part 1, General Estimates. As soon as possible after the end of each financial year, accounting officers will arrange for Appropriation Accounts to be prepared for each programme of expenditure under their control: one for projects classified under recurrent expenditure, and one for projects classified under capital expenditure. The Appropriation Account will follow the general details of the Estimates and will indicate the financial provision in the Estimates (as altered subsequently by supplementary provision or virement, if any), the actual expenditure, and the saving or excess under each Programme/Project. It will also contain the accounting officer's explanations of the causes of any significant variations between total net provision and total expenditure under each object class, as well as notes of any unusual payments.

As a matter of accounting convenience, expenditure sanctioned by Special Law should be included in the main body of the Appropriation Account, together with a suitable footnote. The accounting officer for the programme will sign the Account in that capacity and will then submit the Account to the Chief Accounting Officer who will verify that it has been properly prepared, and that adequate explanations have been given of variations between estimated and actual expenditure. The Chief Accounting Officer will then sign the Account and forward it to the Auditor General as soon as possible. The Auditor General, after examination and certification, will forward the Account to the Director General, Department of State Accounts, Treasury for publication.

F.R. 151. Revenue Accounts. As soon as possible after the end of each financial year, each revenue accounting officer will prepare annually for publication a classified statement of revenue for which he is responsible. This statement will provide the details of the appropriate Heads, Sub-heads, Items, and Sub-items of Revenue, the description of such Revenue, the amount of Revenue earned during each of the three preceding financial years, the estimated Revenue of the year for which the statement is prepared, the actual amount of Revenue collected during that year, the excess or the shortfall of actual collections as compared with the estimated Revenue, and the reasons for the excess or shortfall. This Revenue Account will be signed by the person in the capacity as revenue accounting officer and forwarded to the Auditor General for examination and certification. The Auditor General, after examination and certification, will forward the Accounts to the Director General, Department of State Accounts, Treasury for publication.

F.R. 152. Committee on Public Accounts. The Committee on Public Accounts of Parliament has been set up by the following Standing Order:

- (1) There shall be a designated Committee on Public Accounts consisting of twelve members nominated by the Committee of Selection.
- (2) It shall be the duty of the Committee on Public Accounts to examine the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure and such other accounts laid before Parliament as the Committee may think fit, along with the reports of the Auditor General thereon, and the reports of the Auditor General on local authorities.
- (3) The Public Accounts Committee shall, from time to time, report to Parliament on the accounts examined, the finances, financial procedures, performance, and management generally of any department and local authority, and on any matter arising therefrom.
- (4) The Public Accounts Committee may, when it considers necessary, appoint subcommittees of its own members to examine and report to the full Committee on all accounts and the finances and management of such departments and local authorities as the Committee may direct.
- (5) The Public Accounts Committee or any of its subcommittees shall, for the performance of its duties, have the power to summon before it and question any person and call for and examine any paper, book, record or other document and to have access to stores and property.

Chief Accounting Officers and Accounting Officers must appear before the Public Accounts Committee, when required, and answer questions on all matters arising from the Accounts of the Auditor General Report. The Chief Accounting Officers and Accounting Officers, who sign the Appropriation Accounts, are the persons answerable for the accounts. Yet for reasons of administrative convenience, the Public Accounts Committee will usually examine in the first instance those officers holding the posts at the time the accounts were examined. A Chief Accounting Officer or Accounting Officer has the right, however, to consult the person who signed the Appropriation Account that is being discussed.

F.R. 153. Treasury Minutes. After the receipt of the Report of the Public Accounts Committee, the Treasury will issue, under the hand of the Secretary to the Treasury, on the instructions of the Minister of Finance, the Minutes relating to the various matters dealt with in the Auditor General Report. It is the duty of all Chief Accounting Officers and Accounting Officers to study the Report and the Treasury Minutes thereon and be guided by them with regard to future financial operations.

ANNEX D. SRI LANKAN AUDIT LEGISLATION

Extracts from Chapter XVIII of the Constitution of Sri Lanka

Article 153

(1) There shall be an Auditor General who shall be appointed by the President and who shall hold office during good behaviour.

(2) The salary of the Auditor General shall be determined by Parliament, shall be charged on the Consolidated Fund, and shall not be diminished during his term of office.

(3) The office of the Auditor General shall become vacant:

- (a) upon death of the Auditor General;
- (b) upon resignation of Auditor General in writing addressed to the President;
- (c) upon the Auditor General attaining the age of sixty years;
- (d) upon removal of Auditor General by the President on account of ill health or physical or mental infirmity; or
- (e) upon removal of the Auditor General by the President upon an address of Parliament.

(4) Whenever the Auditor General is unable to discharge the functions of his office, the President may appoint a person to act in the place of the Auditor General.

Article 154

(1) The Auditor General shall audit the accounts of all Departments of Government, the Offices of the Cabinet of Ministers, the Judicial Service Commission, the Public Service Commission, the Parliamentary Commissioner for Administration, the Secretary-General of Parliament and the Commissioner of Elections, local authorities, public corporations, and business or other undertakings vested in the Government under any written law.

(2) Notwithstanding the provisions of paragraph (1) of this Article, the Minister in charge of any such public corporation or business or other undertaking may, with the concurrence of the Minister in charge of the subject of Finance, and in consultation with the Auditor General, appoint a qualified auditor or auditors to audit the accounts of such public corporation or business or other undertaking. Where such appointment has been made by the Minister, the Auditor General may, in writing, inform such auditor or auditors that he proposes to utilize their services for the performance and discharge of the Auditor General's duties and functions in relation to such public corporation, business, or other undertaking; and thereupon such auditor or auditors shall act under the direction and control of the Auditor General.

(3) The Auditor General shall also perform and discharge such duties and functions as may be prescribed by Parliament by law.

(4) (a) The Auditor General may, for the purpose of the performance and discharge of his duties and functions, engage the services of a qualified auditor or auditors who shall act under his direction and control.

(4) (b) If the Auditor General is of the opinion that it is necessary to obtain assistance in the examination of any technical, professional, or scientific problem relevant to the audit, the Auditor General may engage the services of:

- (i) a person not being an employee of the department, body or authority the accounts of which are being audited, or
- (ii) any technical or professional or scientific institution not being an institution which has any interest in the management of the affairs of such department, body or authority,

and such person or institution shall act under direction and control of the Auditor General.

(5) (a) The Auditor-General or any person authorized by him shall, in the performance and discharge of his duties and functions, be entitled:

- (i) to have access to all books, records, returns and other documents;
- (ii) to have access to stores and other property; and
- (iii) to be furnished with such information and explanations as may be necessary for the performance of such duties and functions.

(5) (b) Every qualified auditor appointed to audit the accounts of any public corporation, or business or other undertaking, or any person authorized by such auditor shall be entitled to like access, information, and explanations in relation to such public corporation, or business or other undertaking.

(6) The Auditor General shall, within ten months after the close of each financial year, and as and when he deems it necessary, report to Parliament on the performance and discharge of his duties and functions under the Constitution.

(7) Every qualified auditor appointed under the provisions of paragraph (2) of this Article shall submit his report to the Minister and also submit a copy thereof to the Auditor General.

(8) In this Article, "qualified auditor" means:

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

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

Extracts from the Financial Regulations

Financial Regulation 154. Duties and functions of the Auditor General. The relevant Sections of Article 154 of the Constitution set out the duties and functions of the Auditor General in so far as they relate to Government Departments.

All Chief Accounting Officers and Accounting Officers should ensure that every assistance is given to the Auditor General, and Officers authorized by him in writing, for the performance of their duties and functions.

Financial Regulation 155. Audit Queries. The duties of audit are not exclusively the function of the Auditor General. The Minister of Finance, to whom has been assigned the function of supervising the public administration of the Island on its financial side, has a right to authorize an additional audit by any other person or organization that he may choose. Nevertheless, the functions of the Auditor General are imposed on him by the Constitution; and it is the duty of Chief Accounting Officers and Accounting Officers that letters and queries addressed to them by the Auditor General, or any officer authorized by him, is dealt with promptly and complete answers given. When a final reply cannot be given immediately, an interim report should be made. The Accounting Officer should inspect the Audit Query Register, referred to in Financial Regulation 452(1) on first assuming office, and at regular intervals thereafter in order to ensure not only that audit queries are promptly investigated but also that steps have been taken to correct any shortcomings which they reveal. The Chief Accounting Officer will also personally inspect the Audit Query Register from time to time as part of his supervisory functions. It should be clearly noted that, notwithstanding the examination of the accounts by the Auditor General, the responsibility for their accuracy and correctness rests entirely with the Accounting Officers concerned.

ANNEX E. BENEFITS OF ACCRUAL ACCOUNTING

Extract from Study No. 14 “Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities,” IFAC Public Sector Committee, December 2003.

1.18. The PSC has commented extensively on the benefits of accrual accounting for governments and individual public sector entities in previous Studies (Studies 5, 6, 8, 9 10 and 11) and Occasional Papers (Papers 1, 3, 5, 6 and 7). In order to provide some context for readers who are not familiar with the Public Sector Committee’s other publications, this section contains a summary of the benefits of reporting on the accrual basis.

1.19 The information contained in reports prepared on an accrual basis is useful both for accountability and decision-making. Financial reports prepared on an accrual basis allow users to:

- assess the accountability for all resources the entity controls and the deployment of those resources;
- assess the performance, financial position and cash flows of the entity; and
- make decisions about providing resources to, or doing business with, the entity.

1.20 At a more detailed level, reporting on an accrual basis:

- shows how a government financed its activities and met its cash requirements;
- allows users to evaluate a government’s ongoing ability to finance its activities and to meet its liabilities and commitments;
- shows the financial position of a government and changes in financial position;
- provides a government with the opportunity to demonstrate successful management of its resources; and
- is useful in evaluating a government’s performance in terms of its service costs, efficiency and accomplishments.

Financial Position

1.21 Accrual accounting provides information on an entity’s overall financial position and current stock of assets and liabilities. Governments need this information to:

- make decisions about the feasibility of financing the services they wish to provide;
- demonstrate accountability to the public for their management of assets and liabilities recognized in the financial statements;
- plan for future funding requirements of asset maintenance and replacement;
- plan for the repayment of, or satisfaction of, existing liabilities; and
- manage their cash position and financing requirements.

1.22 Accrual accounting requires organizations to maintain complete records of assets and liabilities. It facilitates better management of assets, including better maintenance, more appropriate replacement policies, identification and disposal of surplus assets, and better management of risks such as loss due to theft or damage. The identification of assets and the recognition of depreciation help managers to understand the impact of using fixed assets in the delivery of services, and encourage managers to consider alternative ways of managing costs and delivering services.

1.23 Accrual accounting provides a consistent framework for the identification of existing liabilities, and potential or contingent liabilities. The recognition of obligations meeting the definition of a liability and the criteria for recognition:

- compels governments to acknowledge and plan for the payment of all recognized liabilities, not just borrowings;

- provides information on the impact of existing liabilities on future resources;
- means that it is possible to allocate responsibility for the management of all liabilities; and
- provides necessary input for governments to assess whether they can continue to provide current services and the extent to which they can afford new programs and services.

1.24 Accrual accounting highlights the impact of financing decisions on net assets/equity and may lead governments to take a longer term view when making financing decisions than is generally possible when relying on cash or modified cash reports. Information on net assets/equity also means that governments may be held accountable for the financial impact of their decisions on both current and future net assets/equity. Changes in an entity's net assets/equity between two reporting dates reflect the increase or decrease in its wealth during the period, under the particular measurement principles adopted and disclosed in the financial statements. Under the accrual basis of accounting, the financial statements will include a Statement of Financial Position which discloses information about assets and liabilities. Where assets and liabilities are not equal, a residual figure for net assets/equity will be reported. Where this figure is positive, it can be interpreted as the net resources that may be applied for the provision of goods or services in the future, and therefore the community's investment in the reporting entity. Where the figure is negative, it may be viewed as the amount of future taxation or other revenues which are already committed to paying off debt and other liabilities. Net assets/equity can comprise some or all of the following components:

- contributed capital;
- accumulated surpluses and deficits; and
- reserves (for example revaluation reserve; foreign currency translation reserve).

Financial Performance

1.25 Accrual accounting provides information on revenues and expenses, including the impact of transactions where cash has not yet been received or paid. Accurate information on revenues is essential for assessing the impact of taxation and other revenues on the government's fiscal position, and in assessing the need for borrowing in the long term. Information on revenues helps both users and governments themselves to assess whether current revenues are sufficient to cover the costs of current programs and services.

1.26 Governments need information about expenses in order to assess their revenue requirements, the sustainability of existing programs, and the likely cost of proposed activities and services. Accrual accounting provides governments with information on the full costs of their activities so that they can:

- consider the cost consequences of particular policy objectives and the cost of alternative mechanisms for meeting these objectives;
- decide whether to fund the production of services within government sub-entities, or whether to purchase goods and services directly from non-government organizations;
- decide whether user fees should cover the costs associated with a service; and
- allocate responsibility for managing particular costs.

1.27 Accrual accounting can provide financial information on whether sub-entities are delivering specified services, and delivering them within agreed budgets. The same information, at a more detailed level, can also be used within sub-entities for the management of activity and program costs.

1.28 Accrual accounting allows an individual entity to:

- record the total costs, including depreciation of physical assets and amortization of intangible assets, of carrying out specific activities;
- recognize all employee-related costs and to compare the cost of various types of employment or remuneration options;
- assess the most efficient way of producing their goods and services and of managing the resources over which they have been delegated authority;
- determine the appropriateness of cost-recovery policies; and
- monitor actual costs against budgeted costs.

Cash Flows

1.29 Accrual accounting provides comprehensive information on current cash flows and certain projected cash flows, including the cash flows associated with debtors and creditors. It can therefore lead to better cash management, and may assist in the preparation of more accurate cash budgets.

Supplementary Table of Standards and Gaps

I. Public Sector Accounting	35
A. Assessment of the National Public Sector Accounting Environment	35
(1) The Accounting Law	35
(2) Education and Training of Public Sector Accountants.....	36
(3) Code of Ethics for Public Sector Accountants	37
(4) Public Sector Accountant Arrangements.....	37
B. Assessment of National Public Sector Accounting Standards.....	38
(1) Framework for the Preparation and Presentation of Financial Statements.....	38
(2) Preparation and Presentation of Financial Statements on the Cash Basis.....	39
C. Assessment of Accounting and Auditing in State-Owned Enterprises.....	40
II. Public Sector Auditing.....	41
A. Assessment of the Public Sector Auditing Environment	41
(1) Statutory Framework	41
(2) Setting Auditing Standards	44
(3) Code of Ethics	45
(4) Accountability in the SAI	45
(5) Independence provided by the Legislation.....	46
(6) Qualifications and Skills of the Auditor	51
(7) Training	52
(8) Audit Competence	52
(9) Quality Assurance.....	53
B. Assessment of Public Sector Auditing Standards and Practices.....	55
(1) Planning	55
(2) Supervision	56
(3) Internal Controls	57
(4) Compliance with Laws	59
(5) Evidence	60
(6) Analysis of Financial Statements	60
(7) Reporting on Financial Statements.....	62
(8) Reporting on Fraud.....	63
(9) Reporting on Compliance.....	63

I. PUBLIC SECTOR ACCOUNTING

A. Assessment of the National Public Sector Accounting Environment

Timely, relevant, and reliable financial information is required to support all fiscal and budget management, decision making and reporting processes.

(1) The Accounting Law

STANDARD	PRESENT POSITION	OPTIONS FOR IMPROVEMENT
<p>1. For reliability the requirements for public sector accounting and reporting should be specified by law, cover all government-owned entities, specify the methods by which accounting and auditing standards are to be set for the public sector, specify the reporting requirements, and lay down time tables for the publication of audited annual accounts.</p>	<p>Public sector accounting is based on provisions in the following laws:</p> <ul style="list-style-type: none"> • Constitution of Sri Lanka 1978 • Financial Regulations of Sri Lanka 1992 • Finance Act No 38 of 1971 • Financial Responsibility Act of 1987 <p>Local Government Acts and Ordinances</p> <p>Current financial management laws do not provide a sufficient basis for modern efficient and effective PFM. Accurate and timely accounting information is needed for orderly and reliable departmental budget implementation and efficient audit activities. For the general budget sector, the Government has adapted the Financial Regulations to follow the Cash Basis IPSAS, Part I, presenting a statement of cash receipts and cash payments in line with IPSAS Cash Standard 1.3.4. The enforcement procedures for these regulations are weak. There is a need for constant upgrading of officer training in the requirements.</p> <p>The Sri Lanka Accounting and Auditing Standards Act 1995 adopted international accounting and auditing standards to improve financial disclosure for the commercial sector including public corporations involved in the sale of goods or the provision of</p>	<p>Legislation for the public sector financial management of each public sector entity needs to be updated covering:</p> <ul style="list-style-type: none"> • custody of money and property • the accounting framework • adoption of IPSAS • financial management • auditing of financial statements • adoption of auditing standards based on ISA and INTOSAI Auditing Standards • compliance with general policies of the Government • imposition of penalties for malpractices • contents of annual reports • contents of annual financial statements. <p>Enact the proposed Public Finance Act to provide a firmer basis for more effective enforcement and clarify the financial accountabilities of responsible parties.</p>

	<p>services. It also established the Sri Lanka Accounting and Auditing Standards Monitoring Board to monitor compliance. However arrangements for the general budget sector are not legislated and practices are therefore not supported by adequate direction.</p>	
<p>2. Compliance with IPSAS for non-commercial bodies and IAS for commercial bodies is needed for consistent transparency.</p>	<p>The Government has stated its intention to adopt the accrual-based IPSAS as the basis for government budgeting and accounting. A draft Public Finance Act is under consideration.</p> <p>Annual financial statements are published according to Cash Basis IPSAS, Part 1, for the general budget sector. Annual government accounts are not published in a sufficiently timely way. They do not provide sufficient information about public sector performance and public assets and liabilities either in aggregate or by entity.</p> <p>In 2002 ADB reported a decline in the standard of financial reporting by public corporations.</p>	<p>A time table is 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).</p>
<p><i>(2) Education and Training of Public Sector Accountants</i></p>		
<p>3. For reliability, the curriculum requirements for the accountants of public sector should accord with internationally recognized standards of accounting training as established in the IES for Professional Accountants.</p>	<p>Government accountants are recruited on the basis of the results of a competitive examination, consisting of six 3-hour papers on financial management, for which a university degree in accounting or equivalent is required.</p> <p>A 2002 ADB report found that government accountants and auditors do not have adequate or appropriate professional qualifications. These should have specified academic qualifications, professional examinations, practical experience, and continuing professional education requirements. Current INGAF and SLIDA courses do not provide training of the standards set by the IES. There is no specific training</p>	<p>A training program in Sri Lanka that meets the IES is needed for the public sector accountants and auditors. Plans to have the UK CIPFA adapt its public sector program for Sri Lanka conditions provide the path for sustained improvement using a Sri Lanka based training institution monitored to international standards.</p>

	<p>for public sector accountants except the Induction Training given at recruitment given in SLJIDA. A scholarship scheme exists to release a few accountants for ICASL training.</p> <p>The use of foreign training is expensive and potentially wasteful as its curricula are not oriented towards the Sri Lankan environment. The ADB study found deficiencies in the accreditation methods of the Institute of Public Finance and Development Accountancy.</p>	
<p>4. For reliability, public sector accountants should be provided with continuing professional training requirements that accord with internationally recognized standards of accounting training.</p>	<p>All government accountants hold at least a university degree of equivalent and most of them hold part qualifications of ICA, CIMA. A continuing training and professional development program should be a professional requirement that has not yet been met. The intention for accountants to be required to pass two efficiency bar examinations for their promotions has not yet been implemented.</p>	<p>INGAS and SLJIDA offer good facilities for continuing training in accounting and related matters, and occasional training needs analyses should be conducted to identify and fill the needs for training.</p>
<p>(3) Code of Ethics for Public Sector Accountants <i>The INTOSAI code covers integrity; independence, objectivity and impartiality; professional secrecy; and competence.</i></p>		
<p>5. For reliability, public sector accountants should be required to adhere to the principles laid down in a code of ethics that are at least in accord with the internationally recognized standards for professional accountants. This may be based on IFAC or INTOSAI codes.</p>	<p>The general civil service establishment code applies to all.</p>	<p>A specific code of ethics based on IFAC or the Sri Lanka Institute of Accountants should be prepared and adopted.</p>
<p>(4) Public Sector Accountant Arrangements</p>		
<p>6. For timeliness, relevance, and reliability, there should be a professionally qualified CFO function to be responsible for maintaining systems of internal financial controls that manage risks, and for preparing regular financial accounts for each government entity.</p>	<p>The secretary (CEO) for each ministry is appointed as the CAO accountable for all aspects of financial management of the ministry and departments under their purview. The CAO is required to follow the instructions given by the head of the Treasury, who is the CAO for the Ministry of Finance. Grade 1 officers generally perform as the CFOs. They are</p>	<p>CFOs should be professionally qualified as departments move toward preparing their own annual financial statements for audit and report.</p>

<p>The CFO should also be responsible the following:</p> <ul style="list-style-type: none"> • maintenance and management of the chart of accounts • to ensure the most appropriate technological support for financial management practices • manage training and education needs for financial management • report on key performance indicators • assist program managers develop an effective financial approach to the delivery of expected outcomes 	<p>responsible for preparing annual financial statements.</p>	
---	---	--

B. Assessment of National Public Sector Accounting Standards

Financial reporting must be adequate to meet the accountability demands of stakeholders

(1) Framework for the Preparation and Presentation of Financial Statements

<p>7. National accounting standards should accord with international standards to provide consistency. The responsibility for establishing the national accounting standards for the public sector should be well defined to provide reliability.</p>	<p>For commercial accounting the ICASL is empowered by law to establish accounting and auditing standards. IFAC-issued ISA and IAS are generally adopted after a short time lag.</p> <p>IAS 29 and IFRS 1 have not been adopted because of lack of relevance for Sri Lanka. IAS 32, 39 and 41, and IFRS 2 -7 are being adopted as per a work schedule.</p> <p>All auditing standards have been adopted and modifications for 2004 will progressively be incorporated.</p> <p>For government, the ICASL has no role. The Ministry of Finance is responsible in general but no specific consideration has been given to this issue.</p>	<p>With the promulgation by IFAC of IPSAS, it would be appropriate to amend the Sri Lanka Accounting and Auditing Standards Law 1995 to add responsibility for public sector standards.</p> <p>A further longer-term time table is needed for the transition path for provision of the additional information encouraged by Part 2 of the Cash Basis IPSAS, and of the further movement toward full accrual reporting based on IPSAS.</p> <p>The IFAC PSC transition guidance and the IPSASB Exposure Draft 28, <i>Disclosure of Financial Information about the General Government Sector</i> should be considered.</p>
---	---	--

<i>(2) Preparation and Presentation of Financial Statements on the Cash Basis</i>		
<p>8. The Government should have adopted a national accounting and reporting framework based on recognized international standards to provide authority.</p>	<p>Government has adapted Financial Regulations that substantially follows the Cash Basis IPSAS plus some accrual elements.</p>	
<p>9. If the Cash Basis IPSAS has been adopted as a national standard, reporting should comply with the standard to ensure consistency.</p> <p>If the accrual basis is adopted, disclosures made with respect to the general government sector shall include at least disclosure of the following:</p> <ul style="list-style-type: none"> • Assets by major class, showing separately the investment in other sectors • Liabilities by major class • Net assets/equity • Total revaluation increments and decrements and other items of revenue and expense recognized directly in net assets/equity • Revenue by major class • Expenses by major class • Net surplus or deficit • Cash flows from operating activities by major class • Cash flows from investing activities • Cash flows from financing activities <p>(Oct 2005 IPSAS ED 28)</p>	<p>The Cash Basis has been adopted and the 2004 accounts are in compliance with Part 1 apart from consolidation of non-commercial public enterprises, disclosure of third party payments, and disclosure of restrictions on cash balances. The 2005 accounts have been substantially expanded to include accrual elements, and Sri Lanka is embarked on a path to accrual reporting in accordance with IPSAS.</p> <p>In addition annual accounts are being prepared and audited for ministries/departments.</p>	

C. Assessment of Accounting and Auditing in State-Owned Enterprises		
<i>Financial Statements should comply with IAS and IFRS</i>		
<p>10. Financial statements should include (a) balance sheet, (b) income statement, (c) statement of changes in equity or a statement of recognized gains and losses, and (d) cash flow statement [IAS 1.8].</p> <p>Financial statements should present fairly (or give a true and fair view of) the financial position, financial performance, and cash flows of the entity. [IAS 1.13].</p> <p>Financial statements should be prepared on the accrual basis of accounting [IAS 1.27].</p> <p>Financial statements should be prepared using the accounting policies established by the International Accounting Standards. [IAS 1].</p>	<p>SOEs apply IFRS. They should also comply with governance requirements established by the Department of Public Enterprises and by the ICASL Code of Best Practice. This includes the Board having responsibility to assess the systems of internal control maintained by management and to operate an Audit Committee. A report on the risk management and control framework is to be included in the Annual Report.</p> <p>Only 10 of the 178 SOE accounts for 2003 received unqualified audit opinions. The AG expressed a disclaimer on 29 public corporations, and noted a lack of response to problems identified in earlier years. There is a clear problem in corporate governance when serious audit objections that lead to disclaimers on accounts are uncorrected.</p> <p>Long-standing receivables were noted as a particular problem. This leads to increased tax-payer burdens.</p>	<p>Greatly increased attention needs to be given to corporate governance issues for SOEs when the AG qualifies the annual accounts.</p> <p>The actions taken with respect to directors of public corporations in the event of continued failures in corporate governance need to be reviewed.</p>

II. PUBLIC SECTOR AUDITING

A. Assessment of the Public Sector Auditing Environment

An effective scrutiny by the legislature through comprehensive, competent, external audit enables accountability for the implementation of fiscal and expenditure policies.

The environment for an effective SAI requires a comprehensive PFM approach. SAIs are not stand-alone institutions; they are part of a PFM architecture that also includes budgeting, accounting, internal control, audit and legislative oversight, and government response. Improving the way the SAI functions is integral to providing information for improving the overall PFM system, but the action must be within the executive branch under the watchful eyes of the legislature and the public. A strong demand for good public sector external auditing is necessary for the SAI to have any impact. This requires willingness of the executive branch to accept and respond to external scrutiny over its management of funds and to ensure that suitable action is taken for reforms. It also requires public presentation of the audit reports to ensure public support for effective action.

(1) Statutory Framework

11. Statutory auditing requirements should be established by legislation.

Current relevant laws are:

- Constitution of the Democratic Socialist Republic of Sri Lanka
- Finance Act No.38 of 1971 Ch. 252
- Municipal Council Ordinance Ch 255
- Urban Council Ordinance Ch 255
- Pradesiya Sabha Act No. 15 of 1987 (local government)
- Lanka Accounting and Auditing Standards Act 1995

The Constitution and the laws above provide for the AG to audit all government bodies; although in practice Government Business Enterprises are audited by accounting firms and reviewed by the AG Department. However, the provisions are not too specific about the type of audit report required.

The legislation does not give sufficient administrative authority to the AG to ensure that the

Enact dedicated audit legislation that specifies the duties, powers, and responsibilities of the Auditor General and provides safeguards for the AG's financial and administrative independence from the executive branch.

Complete negotiations with donors over the implementation of the institutional strengthening program that the World Bank is considering. This program would resource part of the activities as envisaged in the modernization proposal. The Ministry of Finance is asked to liaise with donors for the necessary funding. Further discussions are needed for evolving the best way to manage the process, including the possibilities for a sectorwise approach to the development.

Conduct a review of PFM high-level indicators. Given the strong interdependencies between the elements of the PFM system, coordinated or

<p>12. The SAI should have authority to conduct a full range of audits for all government-owned or government-controlled entities, including regularity, financial, and performance audits. (INTOSAI Lima Declaration Sections 18-19).</p>	<p>AG Department is adequately protected from interference by the executive branch.</p> <p>There is no Audit Act that deals specifically with the Auditor General. The Government of Sri Lanka had approved in October 2005 the drafting of a National Audit Bill and an institutional development plan expected to cost US\$19.5 million to modernize the AG Department.</p> <p>Until the legislation and the audit functions are brought up to the international standards, the AG operations will continue to be inadequate to support the PFM system. Complementary developments in the accounting, internal controls, and legislative scrutiny functions will also be needed for the PFM function to perform in an adequate manner.</p>	<p>integrated programs of development are important for success. The World Bank regularly conducts PFM indicator assessments for its members, which provide an overall framework for dealing with the financial management risks through reform of PFM. Sri Lanka has not yet been addressed.</p>
<p>As per Section 154 of the Constitution of the Democratic Socialist Republic of Sri Lanka, "The Auditor General shall audit the accounts of all departments of Government, local authorities, public corporations and business or other undertakings vested under any written law."</p> <p>Various laws governing public bodies specify the matters to be examined by the audits. In some cases the laws allow a limited form of performance audit through examining whether there has been economy and efficiency in the commitment of funds and the utilization of funds. The AG's reports contain frequent reference to uneconomic transactions and under-utilized assets.</p>	<p>The new National Audit Act should provide a broader base to undertake all forms of audit. The World Bank has already given advice in respect of the content of the proposed law. Further to this advice, it is recommended that the law should include an overall objectives clause as follows:</p> <p>(1) The objectives of the Office of the Auditor-General shall include providing an opinion on whether or not:</p> <ul style="list-style-type: none"> (a) the public accounts provide a true and fair view of the finances of the government and the individual public bodies to which they refer; (b) the financial transactions of the government and public bodies comply with relevant legislation, and regulations issued by any relevant competent body; (c) the financial affairs of the government and public bodies have been managed with due regard to probity, and that their statutory and ethical duties to Parliament and the public have been met in an open and even-handed manner; 	<p>The new National Audit Act should provide a broader base to undertake all forms of audit. The World Bank has already given advice in respect of the content of the proposed law. Further to this advice, it is recommended that the law should include an overall objectives clause as follows:</p> <p>(1) The objectives of the Office of the Auditor-General shall include providing an opinion on whether or not:</p> <ul style="list-style-type: none"> (a) the public accounts provide a true and fair view of the finances of the government and the individual public bodies to which they refer; (b) the financial transactions of the government and public bodies comply with relevant legislation, and regulations issued by any relevant competent body; (c) the financial affairs of the government and public bodies have been managed with due regard to probity, and that their statutory and ethical duties to Parliament and the public have been met in an open and even-handed manner;

<p>13. The legislation should list out penalties in the event of non-compliance with the auditing requirements. These penalties should be applied appropriately.</p>	<p>Under the Financial Regulations Section 154, all Chief Accounting and Accounting Officers should ensure that every assistance is given to the Auditor General and AG-authorized Officers (in writing), for the performance of their duties and functions. Provisions in the Finance Act and the Auditing and Accounting Standards Act allow for penalties with respect to some bodies. There have been some cases of action taken but details are not available.</p>	<p>(d) the government, public bodies, and public money have been managed with due regard to value for money and that officers have made the best use of the resources for which they are responsible. (2) The Auditor-General will provide recommendations and advice to Parliament on significant issues which the Auditor-General has discovered in the course of his/her work.</p>
		<p>The new National Audit Act should contain an adequate Offences Clause along the following lines: (1) Any person commits an offence, without lawful justification or excuse, if he/she: (a) intentionally obstructs, hinders or resists the Auditor-General; (b) intentionally refuses or fails to comply with any lawful requirement of the Auditor General; (c) makes a statement or gives information to the Auditor General knowingly or recklessly to the fact that the statement or information is false or misleading; (d) willfully suppresses any information required by the Auditor General in the performance of his/her duties; or (e) represents directly or indirectly that the person holds any authority under this act when the person knowingly does not hold that authority. (2) For the purpose of subsection (a), "the Auditor-General" includes any member of the AG staff or other auditor acting with AG authority. (3) Any member of the AG staff or other auditor acting with his/her authority commits an offence if he/she: (a) demands or takes any bribe, gratuity, recompense, or reward for the neglect or non-performance of his/her duty;</p>

		<p>(b) willfully fails to report to the Auditor General any abuse or irregularity that comes to his/her notice in the course of his/her auditing duties; or</p> <p>(c) makes any report to the Auditor General that he/she knows to be false or has no reason to believe to be true.</p> <p>If the Auditor General has reason to believe that an offence has occurred, he/she shall request that the Director of Public Prosecutions take appropriate action to prosecute the offender(s).</p> <p>A person who is convicted of committing an offence as stated in Section 51 is liable, on summary conviction, to a fine not to exceed ... and/or to imprisonment for a term not to exceed five years. An organization which commits such an offence is liable, on summary conviction, to an unlimited fine.</p>
<p>(2) Setting Auditing Standards</p>		
<p>14. The government should have adopted the INTOSAI Auditing Standards and the IAASB International Standards for Auditing for public sector entities. (ISA 200.5 and INTOSAI Auditing Standards 1.0.14).</p>	<p>The AG Department's current auditing approach is based on the Auditing Standards set by the ICASL together with public sector elaboration on some of the ICASL Auditing Standards. However there is no document that lists out the public sector audit standards. Without any formal document there is no authoritative and credible basis for financial reporting standards.</p>	<p>The formal government adoption of International Standards on Auditing in the new National Audit Act would be a credible solution, as per the following formulation:¹²</p> <p>The Auditor General shall determine which auditing standards should be applied; and may establish auditing standards and a code of ethics specific to the audits performed by the Office of the Auditor General. In applying generally accepted governmental auditing standards:</p> <p>(a) The auditing standards and code of ethics published by the INTOSAI and the IAASB may be used for conducting audits of central government bodies.</p>

¹² Adopted from clause 40 A Model National Audit Office Act, The Association of Chartered Certified Accountants, 2004

		<p>(b) The auditing standards and code of ethics published by the IFAC may be used for conducting audits of public enterprises.</p> <p>(c) Other recognized or required standards issued or accepted by funding or donor organizations may be used in conducting audits of their projects.</p>
<p>(3) Code of Ethics</p>		
<p>15. The INTOSAI Code of Ethics should have been fully adopted by the SAI, communicated to all staff and applied. (IFAC ISA 200.4 and INTOSAI Code of Ethics 4).</p>	<p>There is no specific Code of Ethics applicable to Government Accountants. The SAI has not adopted the IFAC Code of Ethics or INTOSAI Code of Ethics for its staff. The Code of Conduct for Public Sector Accountants is mainly based on the Establishment Code for Public Servants, developed by the Ministry of Public Administration. The Code of Ethics issued by the ICASL applies only to its members.</p> <p>There is no program for training or dissemination of a Code of Ethics. To be effective, a developing SAI needs its own Code of Conduct that is communicated to all staff, who must be required to subscribe to its elements, with policies and procedures in place for protecting whistle blowers.¹³</p>	<p>The AG Department should adopt a Code of Ethics.</p> <p>A register of the interests held by senior audit staff should be in place.</p> <p>Policies and procedures for protecting whistle blowers should be adopted.</p>
<p>(4) Accountability in the SAI</p>		
<p>16. There should be an accountability process in the SAI. (INTOSAI Auditing Standards 1.0.20).</p>	<p>The AG Department has management meetings. Circular instructions are issued to staff from time to time by the AG.</p>	
<p>17. There should be clear responsibility in the SAI for (a) advising on internal finance, keeping proper financial records and accounts, and maintaining</p>	<p>The general requirements of the public service financial rules are applied.</p>	

¹³ Adopted from SAI Maturity Model, UK National Audit Office, 2005

<p>systems of internal control; (b) for ensuring compliance with laws and regulations.</p> <p>18. The SAI should prepare an annual report on its operations and performance that is separate from its reports on its audits. It should provide an objective, balanced and understandable account of activities and achievements, and details of financial position and performance.</p>	<p>The annual Activity Report of the Auditor General tabled in the Parliament includes performance commentary, organizational details, and summaries of the audit findings for the year, which are set out in detail in over 30 other report volumes. For example the 2003 report includes a self assessment of the current strengths and weaknesses of state audit. It also contains an assessment of the SAI against INTOSAI standards.</p> <p>A corporate plan is being prepared.</p>	
<p>19. The SAI should prepare a corporate plan or equivalent.</p> <p>20. The SAI should undergo peer review or independent performance audit.</p>	<p>Done. A 2003 Peer Review by the Netherlands SAI noted the need for:</p> <ul style="list-style-type: none"> • a National Audit Act • AG status as that of Supreme Court Judge • budget to go to Parliamentary Committee • give audit reports to the media • more autonomy 	<p>The Institutional Development Plan should pay particular attention to achieving the Peer Review recommendations in practice.</p>
<p>(5) Independence Provided by the Legislation</p>		
<p>If the SAI is to provide effective external scrutiny, legislation should be adequate for the following core principles of SAI independence:</p>		
<p>(a) The existence and <i>de facto</i> application of an appropriate and effective constitutional and legal framework (b) The independence of the SAI Heads including security of tenure and legal immunity in the normal discharge of their duties (c) A sufficiently broad mandate and full discretion in the discharge of SAI functions (d) Unrestricted access to information (e) The obligation to report on their work (f) The freedom to decide on the content and timing of their reports and to publish and disseminate them (g) The existence of effective follow-up mechanisms on SAI recommendations (h) Financial and managerial autonomy and the availability of appropriate human, material and monetary resources (Core Principles of SAI Independence, INTOSAI Subcommittee on SAI Independence, 2004).</p>		
<p>21. There should be an appropriate and effective constitutional/statutory/legal framework for the extent of SAI independence and powers, and an</p>	<p>By the Sri Lanka Constitution, the AG Department has coverage of all government bodies and adequate powers to carry out its audits. The gap is that legal</p>	<p>Complete the drafting and passage of the National Audit Act.</p>

<p>adequate de facto application of the provisions of this framework. (INTOSAI Auditing Standards 1.0.15 and 2.2.2).</p>	<p>provisions governing audit are contained in acts primarily written for other purposes. Effective application of powers can be better ensured through an act written directly for the SAI.</p>	
<p>22. The legislation should spell out in detail the extent of SAI independence. (INTOSAI Lima Declaration Section 5).</p> <p>The legislation should assure the independence of the SAI Heads and “Members” (in collegial organizations) and that there is security of tenure and legal immunity in the normal discharge of their duties. (INTOSAI Lima Declaration Section 6).</p>	<p>The Constitution does not specify this. Without clear independence the AG is constrained in his/her activities.</p>	<p>The National Audit Act should contain clauses specifying AG independence along the following lines:</p> <ul style="list-style-type: none"> (a) The Auditor General shall act independently in the exercise and performance of his/her functions, duties, and powers. (b) The Auditor General shall be immune from legal prosecution in the normal discharge of his/her duties during the period of his/her office or after he/she has left office. (c) Before undertaking his/her duties, the Auditor General shall take an oath, administered by the Speaker of Parliament, pledging to perform honestly and impartially the duties of the office, abide by the laws, and uphold the Constitution. <p>The salary, superannuation, benefits, and other conditions of service for the Auditor General shall be the same as those for the Supreme Court Judge.</p>
<p>23. The SAI constitutional/statutory/legal framework should ensure that it has available sufficient human, material, and monetary resources. (INTOSAI Lima Declaration Section 7).</p>	<p>The legal framework does not do this. There are financial and other constraints in making available sufficient resources. The recent Country Financial Accountability Assessment found that “Like any other government department, the Auditor General’s Department faces resource constraints.”</p>	
<p>24. A fixed term must be long enough to survive changes of government and avoid pressures concerning re-appointment which create obstructions in the term of office of the SAI office bearer. A single non-renewable appointment is preferable to avoid those pressures. (INTOSAI Working Group on SAI Independence, 2004).</p>	<p>The Constitution allows the Auditor General to serve in office during a sustained period of good behavior. Removal can take place upon an address of Parliament.</p> <p>Non-renewable appointment of a professionally qualified accountant for a fixed term of 10 or more</p>	<p>Legislation should specify the grounds upon which removal might be considered and the process by which any alleged infringement might be judged.</p> <p>Clauses along the following lines might be considered:</p> <ul style="list-style-type: none"> (a) The Auditor General may be removed from office only by the provisions of this section.

	<p>years is preferred for reasons of competence and independence.</p> <p>More specific removal provisions are needed to prevent potential political pressures.</p>	<p>(b) The Auditor General may be removed from office only on the grounds of inability to discharge the functions of his/her office (whether arising from infirmity of body or mind or any other cause whatsoever) or for misconduct.</p> <p>(c) The Auditor General shall be removed from office by the President if the question of removal from office has been referred to a Parliamentary tribunal appointed under this article and the tribunal has recommended to Parliament that the Auditor General ought to be removed from office for inability as aforesaid or for misconduct and the Parliament has endorsed the recommendation.</p>
<p>25. The legislation should ensure that there is a sufficiently broad mandate including financial and performance audit, and allow full discretion in the discharge of SAI functions. (INTOSAI Lima Declaration Section 4).</p>	<p>The Auditor General has statutory responsibilities to report to the Parliament on his/her audits, under the statute, with a view to improving public sector administration and accountability. The legislation does not specifically state that the AG Department is free to publish and disseminate its reports once they have been formally tabled as required by law, but the AG Department could do so, if it thinks fit.</p>	
<p>26 The legislation should ensure that the SAI Head is free to determine the organization of the audit office, including personnel and contract management systems and material acquisition/disposal policies and procedures. The SAI Head should be able to determine personnel policies, including the selection, recruitment, training, remuneration, promotion, discipline, and dismissal of staff and contract personnel. (INTOSAI Lima Declaration Section 6).</p>	<p>There are financial and other constraints in making available sufficient resources. The AG Department is under the administrative control of other agencies and has no legal authority, for example, to transfer staff from one station to another, to take disciplinary action, or to suspend a salary increment.</p> <p>The AG budget in Sri Lanka is not subject to scrutiny or approval by a special legislative committee, nor are there any safeguards against executive control over this budget.</p> <p>Similar to the problems faced by other government departments, the AG Department has budget cuts imposed on it by the General Treasury and often encounters delays in obtaining the approved funds.</p>	<p>Greater autonomy should be given to the AG. Suitable clauses are as follows:</p> <ul style="list-style-type: none"> • The Auditor General shall employ such persons as are necessary for efficiently and effectively executing the AG functions, duties, and powers. Within the framework of the budget approved for the Office of the Auditor General, the Auditor General has the authority to assess staffing needs and appoint, train, assign, pay, promote, reward, and dismiss staff members. • Employees in the Office of the Auditor General shall be considered to be in an excepted service. They are not part of the public service nor are they subject to any of the rules, regulations, or procedures promulgated by Public Service

	<p>In these circumstances, the AG is in no position to meet SAI international standards.</p>	<p>Commission.</p> <ul style="list-style-type: none"> • The Auditor General shall establish job descriptions with clearly defined responsibilities, qualifications, and performance expectations for all positions in the Audit Office. • The staff of the Office of the Auditor General shall be managed to ensure that: <ul style="list-style-type: none"> (a) there is fair, open, and equal treatment of individuals applying for or being offered positions; (b) staff appointments and advancement decisions are made on the qualification and merit of all individuals eligible for consideration ;and (c) disciplinary, removal, or other adverse actions are done in accordance with clear, established and consistently applied criteria and processes. <p>The staff shall be appointed at such remuneration and on such other terms and conditions as the Auditor General may decide. In so deciding, the Auditor General shall consider the terms and conditions determined by the Public Services Commission.</p>
<p>27. There should be unrestricted access to information. (INTOSAI Lima Declaration Section 10).</p>	<p>The Constitution provides for this.</p>	

<p>28. The legislation should give the SAI the right and obligation to report on their work. (INTOSAI Lima Declaration Section 16).</p> <p>The legislation should give the SAI the right and obligation to report effectively on its work, and the freedom to decide on the content and timing of its reports and to publish and disseminate them expeditiously. (INTOSAI Lima Declaration Section 17).</p>	<p>The Constitution provides for this.</p>	
<p>29. To the extent the findings of the SAI findings are not delivered as legally valid and enforceable judgments, the Supreme Audit Institution shall be empowered to approach the authority which is responsible for taking the necessary measures and require the accountable party to accept responsibility. (Lima Declaration Section 11.2).</p>	<p>The Constitution does not give the AG Department powers to enforce findings, and the general standard of response to audit findings is not at a satisfactory level. The SAI does not have the status nor the resources or methods to gain compliance with its recommendations.</p> <p>In the absence of much stronger remedial actions by government agencies on the findings of the audit, the history of repetitive reports of misdemeanors will continue and PFM in Sri Lanka will not improve to a satisfactory level.</p> <p>There should be a greater willingness by the executive branch to follow up and implement the SAI findings (which might require departmental Audit Committees to set a stronger performance management approach). Also there needs to be a much stronger interaction between the SAI and the legislative oversight committees to follow up SAI reports more systematically, and cause system improvements for the overall PFM structures in Sri Lanka. This may require support from donors for strengthening the Committee processes.</p>	<p>Improve the audit and reporting methodologies of the AG Department.</p> <p>Introduce practice management systems which include audit recommendation tracking systems through to implementation (e.g. ADM Plus as used by the Pakistan SAI).</p> <p>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 Committee on Public Accounts and Committee on Public Enterprises.</p> <p>Build awareness, information sharing, and research capacity of the two oversight committees and the proposed new standing committee on the budget in the legislature.</p>

(6) Qualifications and Skills of the Auditor		
<i>The SAI needs qualified accountants to sign audit opinions. Auditors must have adequate professional expertise and technical knowledge to carry out audits.</i>		
<p>30. The syllabus of the government and SAI accounting schools should cover all areas recommended by IFAC-issued IES.</p>	<p>The quality of accounting educational and training arrangements in the government schools is not satisfactory as it does not meet the needs of modern accounting and financial management. AG Department staff has good basic accounting qualifications, but a dearth of required auditing expertise has been highlighted in the Institutional Development Plan.</p>	<p>Introduce a better training institution that meets the established international standards.</p> <p>Draft legislation has been prepared to establish a Public Sector Professional Accountancy Institute which merges two current public sector training institutes (Institute of Public Finance and Development Accountancy and the Institute of Government Accounts and Finance).</p> <p>The assistance of the UK CIPFA has been sought to support a relevant professional diploma.</p> <p>The new Institute is envisaged to secure membership of IFAC within a five- to ten-year period.</p> <p>Provide for adequate funding of the Institute.</p> <p>The idea of creating an institution teaching at international levels is supported by proposed World Bank funding but further funding may be needed.</p> <p>Use the Institutional Development Plan to fill current short-term gaps in skills. The implementation of the IDP would strengthen the training programs in the shorter term.</p>
<p>31. There should be adequate professional criteria for recruitment and promotion of auditors. (INTOSAI Lima Declaration Section 14 and INTOSAI Auditing Standards 2.1.4).</p>	<p>Recruitment requires an accounting degree. Promotion is based on seniority.</p>	<p>Introduce a greater element of merit into the promotion process along with tests for competencies as levels for promotion. There has been an intention to introduce examinations to act as tests for promotion at two levels, but no action has been taken.</p>

<p>(7) Training</p>	<p>32. The SAI should operate a continuing professional development program for its professional personnel. (INTOSAI Lima Declaration Section 14 and INTOSAI Auditing Standards 2.1.5-2.1.12).</p>	<p>The AG Department does not have basic facilities for training, research and development. A proper needs-based approach is required to support the introduction of an audit methodology, and international accounting and auditing standards.</p>	<p>Conduct a skill analysis program based on international standards for competencies. Use the IDP to strengthen the internal AG Department training facilities.</p>
<p>(8) Audit Competence</p>	<p>33. The SAI should equip itself with the full range of up-to-date audit methodologies, including systems-based techniques, analytical review methods, statistical sampling, and audit of automated information systems. (INTOSAI Auditing Standards 2.2.37).</p>	<p>The audit methodology for the general budget sector is aimed at finding non-compliant transactions, not attesting to the reliability of a specified system of internal control and reporting.</p> <p>The AG Department's basic audit approach is pivoted on compliance testing of a 3-month selection of transactions. There is no intention to form an opinion about the validity of the annual expenditure as a whole. The intention of the testing is to help to identify possible or actual instances of noncompliance with those laws and regulations which provide a legal framework within which the entity conducts its affairs. It is only incidental that this also can provide some confidence about the accuracy of the financial accounts, but this can only be done if the transactions are selected on a systematic sample basis in accordance with the relevant ISA.</p> <p>There is no concept of audit confidence—that is, the confidence level that is implicit in the audit opinion and which underpins the level and extent of audit testing required in order to express that opinion.</p> <p>Without substantially different audit methodologies and substantially more IT support, the SAI will not be able to take full advantage of its staff's knowledge</p>	<p>Implement the Institutional Development Plan. Systems, methodologies, and facilities need to be updated in accordance with the Institutional Development Plan to enable modern audits to be undertaken by the staff.</p> <p>Develop a specialist forensic audit capability.</p> <p>Develop a specialist IT audit capability.</p> <p>Change the audit orientation from transaction to risk-based systems. The audit should not aim to correct instances of misuse of government funds; it should be aimed at reporting on the adequacy of the system of control, then recommending action to correct the system. It is the responsibility of the managers to correct instances of misuse of government funds.</p> <p>Audits should be aimed at identifying the inadequate behavior of managers in applying the system of controls rather than the inadequate behaviors of individual officers in managing specific transactions. Both approaches involve the examination of transactions but the systems approach looks more thoroughly at each transaction selected on the basis of materiality in order to form conclusions about the system including the role of the managers in that system.</p>

	<p>of accounting to conduct valid certification and systems-based audits.</p> <p>An audit methodology should clearly outline:</p> <ul style="list-style-type: none"> • audit confidence level (usually 95% confidence) • minimum requirements for an audit, including how audit planning, audit work papers, and the audit summary is documented • how audit materiality is determined and what is an acceptable level of audit risk and confidence, along with how these factors are documented • how to develop an appropriate <i>mix of audit work</i>, in order to adequately address the audit risks identified <p>The <i>mix of audit work</i> would include:</p> <ul style="list-style-type: none"> • documentation of key accounting and management information systems • the identification of key controls in and around those systems, with audit walkthrough tests to verify the systems and controls in operation • evaluation of the information systems control environment • overall assessment of the control environment • combination of audit compliance and substantive testing (key item testing, analytical review, and sampling) procedures that are necessary in order to form a view on key account balances and transactions • how audit errors are recorded, summarized and evaluated against audit materiality 	<p>Aim to equip all audit staff with laptop computers to enable the introduction of electronic work papers. An electronic work paper package would:</p> <ul style="list-style-type: none"> • enable standardization of all planning and reporting documents and audit work papers • ensure work papers are reviewed properly and consistently • eliminate the need to create hard-copy files • provide for nationwide electronic storage and retrieval of audit files • enable planning and work papers to be rolled forward from year to year • enable the assimilation of sector-wise issues collection and reporting where appropriate • support review action
<p>(9) Quality Assurance</p>		
<p>34. The SAI should have the quality assurance programs in place to ensure audit performance and results. Written quality control policies and</p>	<p>There is no quality assurance program. Audit supervision is expected to ensure quality. Currently however, the audit is not timely, many findings lack</p>	<p>An Audit Manual prepared in accordance with the methods described in the IDP is needed. A manual prepared by consultants during the 1990s lacked</p>

<p>procedures should be communicated to the audit personnel in a manner that provides reasonable assurance that the policies and procedures are understood and implemented. (ISA 220.7).</p>	<p>materiality, and the audit programs, which focus on compliance and financial (attestation) audits, are not on par with international best practices.</p> <p>There has been some improvement in the recent past. A quality assurance program would help to implement an adequate standard across the board.</p> <p>There is no Audit Manual. Such a manual is needed to outline the single layer of supervisory review to be undertaken on audits, prescribe what has to be covered by this review, and set down the supporting quality assurance program.</p>	<p>acceptance in the AG Department. The new manual should be prepared and written by the AG staff, in full consultation with external consultants who will be providing guidance and support only, and not actually writing the manual.</p>
<p>35. Quality control procedures should cover:</p> <ul style="list-style-type: none"> • <i>Direction.</i> Assistants with delegated work need appropriate direction. • <i>Supervision.</i> the functions that must be covered during the audit include (a) monitoring progress of the audit, (b) becoming informed of and addressing significant accounting and auditing issues, and (c) resolving any differences of professional judgment between personnel and considering the level of consultation that is appropriate. • <i>Review.</i> The work performed by each assistant needs to be reviewed by personnel of at least equal competence. (ISA 220.8-220.17). 	<p>The AG Department does apply quality control through audit supervisors.</p>	

B. Assessment of Public Sector Auditing Standards and Practices

Results from the audits should hold the executive to account for its fiscal and expenditure policies and their implementation.

(1) Planning

<p>36. The planning process should collect information about the audited entity and its organization in order to identify important aspects of the environment in which the audited entity operates; develop an understanding of the accountability relationships; determine whether appropriate action has been taken on previously reported audit findings and recommendations; assess risk; and determine materiality. (IFAC ISA 300.6-300.9).</p>	<p>Most of the AG audits are aimed at identifying regulatory breaches. The reports of these audits are of minimal assurance value to either the preparers or users of the financial reports, or wider stakeholders. Nor are they of much value to those responsible for managing systems of internal control.</p> <p>Planning involves stating a number of person-days for various areas of audit examination. There can also be some examination by audit supervisors of annual reports and other entity data to identify some particular areas of testing.</p> <p>Only the full financial attest audits provide any assurance value and utility. The work in these audits in the AG Department largely revolves around examining the compilation of the financial reports and substantively testing in order to form a view on the existence assertion.</p>	<p>The new Audit Methodology Manual should introduce more comprehensive planning requirements based on the specific objectives of the audits.</p>
<p>37. The planning process should identify the scope of the audit and specify the audit objectives and the tests necessary to meet them. (ISA 300.10-300.12).</p>	<p>Audit planning is not sufficiently tailored to the audit client – that is, there is no documented formality in the following points of an assessment of the auditee’s:</p> <ul style="list-style-type: none"> • management control environment • accounting and management information systems • key controls • issues and risks • size and scale of business • financial statements and key account balances 	<p>The audit methodology and supporting working papers should be more precisely defined in a manual of procedures.</p>

<p>38. The planning process should review the internal audit of the audited entity and its work program, identify key management systems and controls, and carry out a preliminary assessment to identify both their strengths and weaknesses, and determine the approach to be adopted in the audit. (ISA 300.9).</p>	<p>This is not done.</p>	
<p>39. The planning process should highlight special problems foreseen when planning the audit. (ISA 300.10).</p>	<p>This is done.</p>	
<p>40. The planning process should prepare a budget and a schedule for the audit, and provide for appropriate documentation of the audit plan and for the proposed field work. (ISA 300.10).</p>	<p>Budgets and schedules are prepared at a broad level.</p>	
<p>41. The planning process should identify staff requirements and a team for the audit. (ISA 300.11).</p>	<p>This is done.</p>	
<p>42. The planning process should familiarize the audited entity about the scope, objectives, and the assessment criteria of the audit and discuss with them as necessary. (ISA 300.7).</p>	<p>The type of audit-compliance is well known to the auditee so this is not done.</p>	
<p>(2) Supervision</p>		
<p>43. The process of supervision should ensure that the members of the audit team have a clear and consistent understanding of the audit plan. (INTOSAI Auditing Standards 3.2.3a).</p>	<p>This is done.</p>	
<p>44. The process of supervision should ensure that the audit is carried out in accordance with the auditing standards and practices of the SAI. (INTOSAI Auditing Standards 3.0.3b).</p>	<p>Working paper practices were poor. No working papers were signed-off as evidence of review. Generally the supervision handled the preparation of report paragraphs.</p>	
<p>45. The process of supervision should ensure that the audit plan and action steps specified in that plan are followed unless a variation is authorized. (INTOSAI Auditing Standards 3.0.3c).</p>	<p>This is done.</p>	
<p>46. The process of supervision should ensure that working papers contain evidence adequately</p>	<p>Mostly the audit evidence is contained in the original vouchers and supporting papers in the department.</p>	

<p>supporting all conclusions, recommendations, and opinions. (INTOSAI Auditing Standards 3.0.3d).</p> <p>The process of supervision should ensure that the auditor achieves the stated audit objectives. (INTOSAI Auditing Standards 3.0.3e).</p> <p>The process of supervision should ensure that the audit report includes the audit conclusions, recommendations and opinions, as appropriate. (INTOSAI Auditing Standards 3.0.3f).</p> <p>The process of supervision should ensure that the audit report includes the audit conclusions, recommendations and opinions, as appropriate. (INTOSAI Auditing Standards 3.0.3f).</p>	<p>They are not copied, documented, filed, and referenced. Mostly files relate to the audit findings that are carried forward through to reporting.</p> <p>Some brief review of working papers indicated that even where there were manuals of audit procedures, working paper rules were not followed.</p> <p>Without a more comprehensively structured working paper system, the audit cannot attain the following normal audit objectives regarding the validity of transactions:</p> <ul style="list-style-type: none"> • Existence • Measurement • Completeness • Measurement • Presentation and Disclosure • Regularity 	
<p>(3) Internal Controls</p> <p>47. The auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and sufficient to design and perform further audit procedures. (ISA 315.2).</p> <p>After obtaining an understanding of the accounting and internal control systems, the auditor should obtain a sufficient understanding of control activities to assess the risks of material misstatement at the assertion level and to design further audit procedures responsive to assessed risks. (ISA 315.90).</p> <p>The auditor should document in the audit working papers: (a) conclusions reached about susceptibility</p>	<p>The general budget sector audits examine transactions against the rules established by the Financial Regulations. Their reports therefore indicate where controls have not been applied. They do not approach the audit from the perspective of material misstatement of an accounting figure but rather the failure of a transaction to comply with the rules.</p> <p>The effect of this approach is that there is no pressure on the system to improve as all of the effort goes into argument about the transaction, not the system of control. The 2003 AG Activity Report notes that past audit reports had been merely post mortem examinations often delayed from 5 to 15 years, and that by and large the issues were not significant.</p>	<p>Introduce an updated Audit Methodology Manual.</p>

<p>to material misstatement due to error or fraud; (b) the understanding obtained of the entity's accounting and internal control systems; and (b) the assessment of control risk. (ISA 315.122-123).</p> <p>The auditor should perform tests of controls to obtain sufficient appropriate audit evidence that the controls were operating effectively at relevant times during the period under audit. (ISA 330.23).</p> <p>When the auditor cannot obtain sufficient appropriate audit evidence as to a material financial statement assertion, the auditor should express a qualified opinion or a disclaimer of opinion. (ISA 330.72).</p> <p>The auditor should make management aware in writing, as soon as practical and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems that have come to the auditor's attention. (ISA 315.12).</p>	<p>The AG intended to move toward a performance-based audit approach. This has involved supervisors looking for more significant issues to specify for examination of their audit planning. This was apparent in the study but to be effective, the overall methodology needs to change and be supported by a manual of audit procedures.</p>	
--	---	--

<p>(4) Compliance with Laws</p>	<p>48. The auditor should obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry and how the entity is complying with that framework. (ISA 250.15).</p> <p>The auditor should perform testing and other procedures to help identify instances of non-compliance with those laws and regulations where non-compliance should be considered when preparing financial statements. (ISA 250.18-250.19).</p> <p>Generally, management is responsible for establishing an effective system of internal controls to ensure compliance with laws and regulations. In designing steps and procedures to test or assess compliance, the auditor should evaluate the entity's internal controls and assess the risk that the control structure might not prevent or detect noncompliance. These evaluations should be used to report to management on defects in the system of internal controls and the steps that should be taken to improve the system. (ISA 250.17).</p> <p>The auditor should obtain written representations that management has disclosed to the auditor all known actual or possible non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (ISA 250.23)</p> <p>The SAI should use regularity audit to make sure that the State budget and accounts are complete and valid. The audit procedure may result, in the absence of irregularity, in the granting of a "discharge". If not, other processes are needed to resolve irregularities.</p>	<p>The AG Department uses most of its resources for this type of audit. It is an important issue as to whether or not the audits are effective in dealing with instances of non-compliance. In other countries in South Asia, for example Pakistan, the audit reports log large numbers of transactions for pursuit of recovery and these continue to be monitored until the matter is resolved, either by the Public Accounts Committee or the Auditor General.</p> <p>In the local government area, the AG does have the power to disallow items of the accounts that are contrary to law and surcharge the responsible officer. There was no indication that this is done effectively. The 2003AG Activity Report states that recoveries of surcharges were small, with more than half the outstanding surcharges uncollected for more than four years.</p>	<p>Introduce a system of recommendations and methods to monitor that the recommendations are implemented. Report on the process in the AG Activity Report.</p> <p>Introduce a system to ensure that 172 (3) of the Pradesiya Act (and any similar provisions in other laws) are met effectively. Report on the process in the AG's Activity Report.</p>
--	---	--	---

<p>(5) Evidence</p>	<p>49. When obtaining audit evidence from tests of control, the auditor should consider the sufficiency and appropriateness of the audit evidence to support the assessed level of control risk. (ISA 500.10).</p> <p>When obtaining audit evidence from substantive procedures, the auditor should consider the sufficiency and appropriateness of audit evidence from such procedures together with any evidence from tests of control to support financial statement assertions. (ISA 500.12).</p>	<p>The relevant ISAs on evidence were not generally relevant to the methodology of the audits conducted by the AG Department. It is likely that they were used by the private sector accounting firms that audited the annual accounts of the public corporations, but this review did not have access to these working papers because the AG Department did not have access.</p>	<p>The AG Department should, as per ISA 600 (8), examine on a sample basis some of the working papers of the 'qualified auditors' employed to audit government bodies. ISA 600 (8) states:</p> <p>“The principal auditor should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the principal auditor’s purposes, in the context of the specific assignment.”</p>
	<p>50. When inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting. (ISA 500.5).</p> <p>When in substantial doubt as to a material financial statement assertion, the auditor should express a qualified opinion or a disclaimer of opinion. (ISA 500.18).</p>	<p>These activities were undertaken.</p>	
<p>(6) Analysis of Financial Statements</p>			
	<p>51. In regularity (financial) audit, and in other types of audit when applicable, the auditor should analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. (INTOSAI Auditing Standards 3.6.1).</p> <p>Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on the financial statements. The auditor should ascertain whether:</p>	<p>These appear to have been done for the audit of financial statements.</p>	

<ul style="list-style-type: none"> • financial statements are prepared in accordance with acceptable accounting standards; • financial statements are presented with due consideration to the circumstances of the audited entity; • sufficient disclosures are presented about various elements of financial statements; and • the various elements of financial statements are properly evaluated, measured, and presented. (ISA 200.2-200.12) 		
--	--	--

(7) Reporting on Financial Statements		
<p>52. The auditor should provide an opinion paragraph in the audit report. (ISA 700.4).</p> <p>There should be a reference to the financial reporting framework used to prepare the financial statements (including identifying the country of origin of the financial reporting framework when the framework used is not International Accounting Standards). (ISA 700.12-15).</p> <p>The opinion paragraph should contain an expression of opinion on the financial statements stating the auditor's opinion as to whether the financial statements give a true and fair view (or are presented fairly) in all material respects. (ISA 700.17).</p>	<p>By and large these requirements are met. However, the audit scope and audit opinion paragraphs for the Consolidated Financial Statements 2004 do not contain the degree of detail set by ISA 700 in paragraphs 12 to 15. This leaves some uncertainties as to the auditing standards used for the work, and whether the audit provides a reasonable basis for the opinion, and that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement. The scope statement notes the limitations of staff, other resources, and time available. This would normally be read by a user of the accounts as an indication that the audit opinion on the accounts is thereby qualified by the limitations on the work that has been done as per ISA 700.36-37.</p> <p>The reference to the reporting framework used to prepare the accounts is by way of the notes to the financial statements and these are somewhat unclear as to whether Cash Basis IPSAS, Part I, has been fully adopted.</p> <p>For the audits of government business entities, the sample of audits examined showed that the audit reports are in conformance with ISA 700.</p>	<p>The requirements of ISA 700 should be adopted in full when the audit methodology allows. It is apparent that the audit methodology used is not sufficiently precise to draw the audit conclusions that are needed to follow the requirements of ISA 700 for the audit report. In the meantime the wording of the report should be in accord with ISA 700 as far as is possible and the limitations should be set out in specific terms at the relevant part of the report.</p> <p>It would be preferable for the audit opinion to make explicit reference to the Cash Basis IPSAS, Part I, as required by that standard if the accounts have been prepared in accordance with the standard. Any exceptions can be mentioned.</p>
<p>53. The SAI should provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion. Reports should be made where weaknesses exist in systems of financial control or accounting. (ISA 700.17).</p>	<p>This is done. The study reveals a number of weaknesses in the success of the present reporting system, e.g. lack of depth, irrelevance, lack of brevity, etc. Although the AG submits a supplementary report in respect of statutory boards and corporations, no serious attempt seems to have been taken by the boards of such institutions for improving controls and management of resources.</p>	<p>Improve the effectiveness of the audit report by stronger enforcement of corporate governance requirements through the audit committees.</p>

(8) Reporting on Fraud		
<p>54. The SAI should report fraudulent practices or serious irregularities discovered by the auditors. (INTOSAI Auditing Standards 4.0.7) ISA 240 establishes standards and provides guidance on the auditor's responsibility to consider fraud and error in an audit of financial statements. The standard requires that, when planning and performing audit procedures and evaluating and reporting the results thereof, the auditor considers the risk of material misstatements in the financial statements resulting from fraud or error.</p>	<p>Much of the AG Department work relates to these issues, but most findings are not characterized as fraudulent. Mostly they are classified as contentious; uneconomic; noncompliant; or lacking authority, records, or verification. The 2004 AG Activity Report summarizes a few instances of local government transactions considered to be fraudulent.</p>	
(9) Reporting on Compliance		
<p>55. With regard to regularity audits, the auditors prepare a written report, which may either be a part of the report on the financial statements, or a separate report, on the tests of compliance with applicable laws and regulations. (INTOSAI Auditing Standards 4.0.7).</p>	<p>This procedure is followed.</p>	

