

TOWARDS AN IMPROVED NATIONAL AUDIT LEGISLATION



A CRITIQUE OF THE PROPOSED NATIONAL AUDIT ACT

INTRODUCTION - PUBLIC AUDIT IN INSTITUTIONAL CONTEXT

The control of public finance is vested in Parliament under Article 148 of the Constitution, which provides that the Central Government is accountable to Parliament for collecting and spending public money. In addition, Provincial Councils, local authorities and State Owned Enterprises (SOEs) exercise limited financial control in terms of their respective legislation.

Parliamentary control of public finance is exercised in two ways – ex ante accountability and ex post accountability. Ex ante accountability is exercised through the requirement of Parliamentary approval of the annual Budget and the Appropriation Bill, which sets out the Government's expenditure estimates for the coming year. Ex post accountability is exercised through Parliamentary scrutiny of the actual results of Government financial operations against what had been budgeted, and whether the objectives were realised.

Public audit, exercised through the office of the Auditor-General, plays a key role in the area of ex-post financial accountability. Ex post Parliamentary control of finance is based on reports from the Auditor General. Similarly, the Auditor General audits the accounts of Provincial Councils, local authorities and SOEs with the notable exception of Government-owned Companies.

2. Impact of public audit on economy and business

Public audit has a strong impact on economic development and on the business sector in particular. In a recent World Bank and ADB survey (2004), 544 urban enterprises and 1,882 rural enterprises in Sri Lanka were asked to rank the "major or severe" constraints to doing business in this country. The number one constraint identified by the urban enterprises was electricity, which mostly related to the cost and reliability of supply. In the case of rural enterprises, the foremost constraint identified by them was transport – encompassing the poor quality of roads and lack of transport.

The State plays a major role in the electricity and transport sectors. Therefore, public audit, by highlighting inefficiency and waste in public expenditure in general, can play an important role in improving these two critical sectors that have been identified by domestic businesses. The electricity and road sectors in particular have received many charges of large-scale inefficiency, waste and corruption.

Public audit can also exert a very important influence on economic development through the role it plays in identifying corruption. Economic growth is spurred on by new investment and by more efficient utilization of existing investment. Mauro (1996) has found that corruption may have considerable, adverse effects economic growth, largely by reducing private investment. He tentatively finds that a one standard deviation improvement in corruption indices causes investment to rise by 5 percent of GDP and the annual per capita GDP growth rate to rise by half a percentage point.

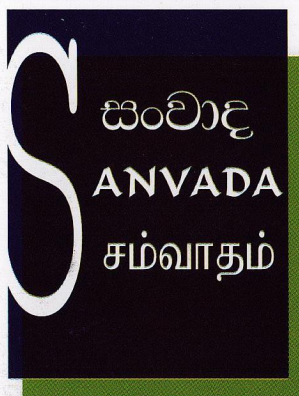
Similarly, by highlighting mismanagement and waste, public audit can also help to improve the efficiency of existing investment in the public sector, also leading to higher growth.

Control of corruption may also help Sri Lanka to attract Foreign Direct Investment (FDI).

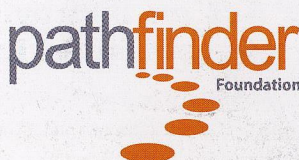
A study on FDI cited in World Bank (2006) has estimated that corruption is the equivalent of a 20% tax to foreign investors. Therefore, other things being equal, foreign investors will prefer to invest where corruption is less prevalent.

Deficiencies in present institutional framework of public audit

The main problem faced by public audit in Sri Lanka is in relation to its



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independence. The public audit function is vested in the Auditor General's Department (AGD), headed by the Auditor General (AG). However, the powers, functions and duties of the AG have not been elaborately spelt out in any law passed by Parliament to date. The AG's position and role are traceable to a few provisions of the Constitution. This has not made the position of the AG strong and stable when it comes to effectively discharging his role. Therefore, it has become necessary to clearly identify the role, functions and powers of the AG with regard to the disbursement of public finance in the country. Although the functional independence of the AG is guaranteed by the Constitution, the AG has not been granted financial or administrative independence. The AGD depends on the Treasury for its budget, and the resource allocation for the department is not linked to fiduciary risks. Furthermore, the AG does not have control of appointments, promotions, transfers, disciplinary issues, and overseas training of staff. The AGD is also subject to all administrative regulations of the Government set out in the Establishments Code and Official Secrets Act

In terms of Art.154 (3) of the proposed Act, discretion is granted to the AG to audit "any person or body of persons". There is not much guidance as to how his discretion should be exercised in selecting the person or body of persons for subjecting to his audit. This leaves the possibility of the power being used, at the AG's discretion, to audit non-governmental person/individual or body of persons/individuals.

The reports of the AG have also been subject to several limitations. A World Bank 2003 report has identified that "quality, relevance, and timeliness of audit information reported need significant improvement." One of the main problems in the past has been the long delay in publishing the reports, although this has improved much in recent years. The reports also tend to focus mostly on compliance with government rules and attestation of the financial statements. They lack information on the outputs and outcomes of government expenditure, and do not address systemic or organizational issues. Furthermore, defence expenditure is presently not audited on national security grounds, while Government-owned Companies are outside the purview of the AG.

The power of the AG to obtain assistance from any person or institution for any technical, professional or scientific problem relevant to any audit carried out by him is not that salutary. It leaves room for unnecessary lapses. When one compares Art.154 (5) of the proposed Act with the present constitutional provision, the existing one presents a better, detailed and structured provision minimizing conflict of interests and abuse. It cannot be at his discretion that he should be authorized to enlist the services of persons or institutions having technical, professional or scientific capacities. There should be a body of qualified personnel in these different areas with expertise to help him conduct functional audits.

The composition of the Constitutional Audit Council, which is restricted to seven Members of Parliament, seems very restrictive and not broad based. It is also necessary to consider whether non-Members of Parliament drawn from professional organizations and private sector institutions be included in the membership of the Council. Given the political affiliations of the members, it is not salutary to confer appellate power to this Council against decisions of Chief Accounting Officers to impose surcharges on his officers on the recommendation of the Auditor General.

Finally, there have been minimal steps taken since independence to upgrade the audit programme (the set of procedures to be followed for

conducting the audit), resources and skills of the AGD in line with international standards and the evolving needs of the government and the economy.

When dealing with the institutions which are subject to the audit of AG, there is a glaring omission of the Presidential Secretariat in the listed institutions. There is no reason why the President's Office and Presidential Secretariat should not be referred to expressly in Art. 154 (1) of the proposed Act.

The Draft National Audit Act 2007

The Draft National Audit Act 2007 was prepared to specify the duties, powers and responsibilities of the AG, define more clearly his/her scope of work, and provide for greater financial and administrative independence. It is useful to compare the Act with the different models of Supreme Audit Institutions (SAIs) followed in the world. There are three main models of SAI (DFID, 2004), the Westminster, Judicial and Collegiate or Board Model.

The foremost feature of the Draft Act is that public audit is no longer financially and administratively dependent on the Executive. However, the corresponding authority on these matters has not been vested in the AG as in the Westminster model, but in the Audit Council and Commission, which follow the collegiate model. In this regard, since the AG (and not the Commission/Audit Council) is vested with the responsibility of carrying out the audits and reporting to Parliament and the audited entities, it is suggested that the AG may also be given the necessary financial and administrative authority over the organization of his/her department as well.

The 2005 Draft of the Act also gave the AG the power to surcharge, which is a feature of the Judicial model, i.e. that relevant government official/s are held personally liable for the sum/s involved should an unauthorised or illegal payment is made. However, under the present (2007) Draft, the AG only has the power to recommend the imposition of a surcharge to the Chief Accounting Officer (CAO) of the audited entity. It is the CAO who has the power to impose a surcharge. Given that CAOs are subject to the influence of their Ministers, it would be preferable that this power is given to the AG.

The Draft Act addresses some other main shortcomings in the system of public audit highlighted above. The scope of audit now specifically includes economy, efficiency and effectiveness in the use of resources and sustainable use of resources. State-owned Companies have also been brought within the purview of the AG. The issue of timeliness of reporting is also addressed by setting out time frames for transmission of audited entities' annual accounts to the AG, and for reporting thereon by the AG.

However, there are also some issues of concern. For example, it is provided that the AG may in his discretion audit "any person or body of persons" in the private sector, where it is necessary to "assist Parliament in the exercise of control of public finance." The scope of this provision is unclear. For example, all businesses liable to tax may be said, for that reason, to have an impact on public finance. This provision is likely to have a chilling effect on business activity, and on FDI in particular.

Impact of the Act on improving public financial management in Sri Lanka

The changes made by the Draft Act represent a major step forward in addressing the institutional and organizational shortcomings of public

audit in Sri Lanka. However, public audit is one link in the process of public financial management. Two other important links are the capacity of the audited entities and Parliamentary oversight

Ex post Parliamentary control of finance is exercised by the standing Committee on Public Accounts (COPA) and Committee on Public Enterprises (COPE) based on the reports from the Auditor General. COPA/COPE scrutiny is hampered by lack of sufficient technical capacity of its members and the absence of a professional support staff. There is no process to effectively follow up on the AG's findings and recommendations, and COPA/COPE deliberations are not open to the media and public.

The focus is on monitoring spending against the laid down budget and financial regulations, which does not encourage a culture of performance improvement. Internal audit in government is weak, lacking the requisite resources and skills. The situation could be considered even weaker in provincial & local authorities.

Therefore, it is clear that the reforms to strengthen public audit have to be accompanied by action to improve the internal financial management of audited entities and the effectiveness of Parliamentary oversight. In this regard, a promising recent development is the increased collaboration between SAIs and civil society to ensure Government accountability.

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Interaction between SAIs and civil society may take four forms. Firstly, civil society organizations may undertake independent audits that complement formal public audits. For example, in India, a peasant and workers' union – uses public hearing forums to conduct social audits of local government expenditures at village level.

Secondly, civil society organizations could identify entities that should be subjected to public audits. In South Korea, the Board of Audit and Inspection (BAI) introduced the national citizen audit request system under the Anti-Corruption Act of 2001.

Thirdly, civil society groups may support the SAI by demanding follow-up actions to audit findings and put pressure on the government to implement audit recommendations. For example, in Argentina, a human rights organization – successfully filed a lawsuit to obtain the relevant documents which enabled them to highlight the lack of action by the legislators in responding to audit recommendations.

Finally, civil society groups may directly participate in audits with the SAI. As an example, in the Philippines, a participatory audit was successfully conducted as a joint undertaking of the national Commission on Audit (COA) and a nongovernmental organization for Good Government (CCAGG).

As the examples above have shown, citizen participation can exert a strong influence on highlighting mismanagement and corruption and demanding accountability from the Parliament and Government. This is particularly relevant to the Sri Lankan context where as referred to previously financial accountability exercised by Parliament and the Government is very weak. However, working with NGOs may pose a

threat to SAI neutrality. Most NGOs have some or other explicit politico economic objectives, which could compromise the independent audit opinion given by the SAI.

Section 3 of the Draft Act already contains a salutary provision which provides that the AG may in his/her discretion inquire into any matter brought to his/her notice by any member of the public and to report thereon to Parliament if deemed necessary. This can be used by citizen groups to initiate public audit investigations as in South Korea.

However, section 6 provides that the AG and every officer or employee assisting him/her shall be required to agree to maintain secrecy with respect to any information received in the course of the audit except to give effect to the provisions of the Constitution or any other law. This prevents the kind of closer interaction between the SAI and civil society as in the Philippines.

The major impediment in Sri Lanka in the way of civil society organizations exerting financial accountability by carrying out independent audits of public works, as in India and Mexico, is the absence of a freedom of information law. As a result, disclosure is very much the exception while secrecy is the norm, which reduces the ability of civil society to perform this kind of function.

Finally, as mentioned previously, the AG reports to Parliament and the audited entities and not directly to the general public. Therefore, in the past there have been delays in obtaining reports by the public. Furthermore, the sittings of the Parliamentary Committees that receive the AG's reports – COPA and COPE – are closed to the public. As a result, the ability of civil society to bring pressure on these two key Committees to demand follow-up actions to audit findings is severely limited.

Therefore two key requirements to complement the new legislation will be to enact a freedom of information law, and to open the sittings of COPA/COPE to the public and media.

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SANVADA...

This Policy brief is based on two analytical papers prepared by Mr. Naganathan Selvakkumaran & Mr. Amrit Rajapakse and presented at a public Sanvada (Dialogue) held recently.

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The Mission of the Pathfinder Foundation, a non-profit and non-partisan institution, is to play a catalytic role in undertaking, facilitating research, dialogue and advocacy among the Parliamentarians, policy makers, civil society groups and the general public on issues relating to social-economic development in Sri Lanka. The Sanvada (dialogue) Programme of Pathfinder Foundation is aimed at critical analysis and debate on proposed or likely legislative initiatives impacting upon the economy and society of Sri Lanka, in order to enrich the legislative process in the Parliament and outside.

This is the eighth in the series of Sanvada policy briefs and analyses the Draft National Audit Act. The detailed analytical papers which were the basis of this note can be viewed at www.sanvada.org. The views and opinions expressed in this brief do not necessarily reflect the views of the Pathfinder Foundation. We cordially invite your constructive criticisms and/or the feedback on the findings in here.

Let us work together to upgrade the standard of public discussions and debates outside the Parliament, in order to effect positive changes to the process of economic policy making and corporate, economic and political governance in the country.

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