APPLICATION OF SRI LANKA ACCOUNTING STANDARDS AND OTHER REGULATORY REQUIREMENTS BY THE REGIONAL DEVELOPMENT BANKS

by

K H R CHANDIKA

M.Sc. in Management 2013
APPLICATION OF SRI LANKA ACCOUNTING STANDARDS AND OTHER REGULATORY REQUIREMENTS BY THE REGIONAL DEVELOPMENT BANKS

by

K H R CHANDIKA

GS/M.Sc./MGT/2945/06

Thesis submitted to the University of Sri Jayewardenepura for the award of the Degree of Master of Science in Management in 2013
The work described in this thesis was carried out by me under the supervision of Prof. Samanthi Senarathne and a report on this has not been submitted in whole or in part to any university or any other institution for another Degree/Diploma.

.............................................................

K H R Chandika
I certify that the above statement made by the candidate is true and that this thesis is suitable for submission to the University for the purpose of evaluation.

Prof. Samanthi Senarathne
Supervisor

..........................

Date
## Contents

LIST OF ACRONYMS ........................................................................................................................................ iv  
LIST OF TABLES ............................................................................................................................................... vi  
LIST OF FIGURES ............................................................................................................................................. vii  
ABSTRACT ........................................................................................................................................................ viii  
INTRODUCTION .................................................................................................................................................. 1  
  1.1 Background of the Study .................................................................................................................. 1  
  1.2 Problem Statement ........................................................................................................................... 7  
  1.3 Research Objectives ....................................................................................................................... 9  
  1.4 Significance of the Study ............................................................................................................. 9  
  1.5 Limitations .......................................................................................................................................... 10  
  1.6 Chapter Framework .................................................................................................................... 11  
LITRATURE REVIEW ......................................................................................................................................... 13  
  2.1 Introduction ......................................................................................................................................... 13  
  2.2 Sri Lanka Accounting Standards ................................................................................................. 13  
  2.3 Requirement of Accounting Standards .................................................................................. 20  
  2.4 Accounting Standards and its Application ............................................................................. 26  
  2.5 Public Sector Accounting Standards ....................................................................................... 31  
  2.6 Accounting Standards Revision Process .............................................................................. 33  
  2.7 Convergence to IFRS ............................................................................................................... 41  
  2.8 Banking System of Sri Lanka .............................................................................................. 46  
  2.9 Revolution of Banking Industry in Sri Lanka ........................................................................ 50  
  2.10 Companies Act No 07 of 2007 ............................................................................................. 55  
  2.11 Chapter Summary .................................................................................................................. 58  
REGIONAL DEVELOPMENT BANKS .............................................................................................................. 60  
  3.1 Introduction ......................................................................................................................................... 60  
  3.2 Institutional Background .............................................................................................................. 60  
  3.3 Kandurata Development Bank ............................................................................................. 61  
  3.4 Wayamba Development Bank .......................................................................................... 62  
  3.5 Uva Development Bank .................................................................................................. 63  
  3.6 Ruhuna Development Bank ............................................................................................ 63  
  3.7 Rajarata Development Bank ............................................................................................ 64  
  3.8 Sabaragamuwa Development Bank ................................................................................ 65  
  3.9 Authorised Activities of RDBs ............................................................................................ 66  
  3.10 Organisational Structure ................................................................................................. 66  
  3.11 Operations .......................................................................................................................... 68  
  3.12 Chapter Summary ................................................................................................................ 79  
METHODOLOGY .................................................................................................................................................. 80  
  4.1 Introduction ......................................................................................................................................... 80  
  4.2 Scope of the Study ....................................................................................................................... 80  
  4.3 Data and Data Collection ....................................................................................................... 81  
  4.4 Methods of Data Analysis ...................................................................................................... 85  
  4.5 Study Setting ...................................................................................................................................... 87  
  4.6 Unit of Analysis ....................................................................................................................... 87
ACKNOWLEDGEMENT
My grateful thanks to Prof. Samanthi Senaratne, Head, Department of Accountancy, Faculty of Management Studies and Commerce, University of Sri Jayewardenapura for providing me with valuable guidance and advice in carrying out this research successfully. I shall ever remember her kindness and patience, among the burden of her administrational and academic work, for dedicating her valuable time in discussing the research report.

I would also like to extend my gratitude to all the lectures specially for Research Methodology Prof. Henarath H.D.N.P.Opatha, (Professor of Human Resources) and Prof. R.S.Gunathunga, who conducted lectures throughout the two year course of M.Sc. (Management) Programme 2006/ 2007 which helped me to gain the theoretical background of research methodology. Next I pay my gratitude to Dr. P.D.Nimal (Programme Coordinator - M.Sc. Management Programme) for his valuable guidance and encouragement.

I must express my sincere gratitude to all the key officers of six RDBs and the staff members of finance divisions of respective RDBs who completed the questionnaires and returned the same on time enabling me to achieve my target. Further, I must thank the key officers of Bank Supervision Department of CBSL for helping me with providing important information. I also have to specially mention the support given by my superior of Ernst & Young to complete the study on time.

At last but not least a very special thank to my wife and two kids who were extremely helpful and always provided their fullest support by encouraging me to complete the study by sacrificing their enjoyable time.
**LIST OF ACRONYMS**

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>AG</td>
<td>Auditor General</td>
</tr>
<tr>
<td>CBSL</td>
<td>Central Bank of Sri Lanka</td>
</tr>
<tr>
<td>CIGAS</td>
<td>Computerised Integrated Government Accounting System</td>
</tr>
<tr>
<td>CSE</td>
<td>Colombo Stock Exchange</td>
</tr>
<tr>
<td>DIR</td>
<td>Department of Inland Revenue</td>
</tr>
<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Production</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
</tr>
<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
</tr>
<tr>
<td>IASC</td>
<td>International Accounting Standards Committee</td>
</tr>
<tr>
<td>IBSL</td>
<td>Insurance Board of Sri Lanka</td>
</tr>
<tr>
<td>ICAEW</td>
<td>Institute of Chartered Accountants of England and Wales</td>
</tr>
<tr>
<td>ICASL</td>
<td>Institute of Chartered Accountants of Sri Lanka</td>
</tr>
<tr>
<td>IFAC</td>
<td>International Federation of Accountants</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IPSAS</td>
<td>International Public Sector Accounting Standards</td>
</tr>
<tr>
<td>KDB</td>
<td>Kandurata Development Bank</td>
</tr>
<tr>
<td>LIFO</td>
<td>Last in First Out method</td>
</tr>
<tr>
<td>LKR</td>
<td>Sri Lanka Rupees</td>
</tr>
<tr>
<td>LSB</td>
<td>Licensed Specialised Bank</td>
</tr>
</tbody>
</table>
NPL - Non Performing Loans
PaR - Portfolio at Risk
PP & E - Property, Plant and Equipment
PSC - Public Sector Committee
RDB - Regional Development Bank
RrDB - Rajarata Development Bank
RRDB - Regional Rural Development Banks
RUDB - Ruhuna Development Bank
SBE - Specified Business Enterprises
SDB - Sabaragamuwa Development Bank
SEC - Securities and Exchange Commission
SLAASMB - Sri Lanka Accounting and Auditing Standards Monitoring Board
SLAS - Sri Lanka Accounting Standards
SME - Small and Medium Scale Enterprises
UDB - Uva Development Bank
UK - United Kingdom
UNDP - United Nations Development Programme
VAT - Value Added Tax
WDB - Wayamba Development Bank
LIST OF TABLES
Table 1.1 - Regional Development Banks in Sri Lanka 05
Table 1.2 - Composition of Licensed Specialised Banks in Sri Lanka 06
Table 2.1 - Comparison of SLAS with IAS 17
Table 2.2 - Membership of Accounting Standards Committee 29
Table 2.3 - Key Changes of Revised SLAS in 2006 34
Table 3.1 - Branch Distribution of RDBs 68
Table 3.2 - Regional and Sectoral Coverage of RDBs 69
Table 3.3 - Products/ Services of RDBs 74
Table 3.4 - Staff Competent of RDBs 76
Table 3.5 - Consolidated Balance Sheet of RDBs as at April 30, 2010 78
Table 5.1 - Non Compliance of SLAS by Individual Banks 91
Table 5.2 - Common Non Compliances of SLAS by RDBs 95
Table 5.3 - Criteria for Classification of Loans for Provision for Loan Losses 100
Table 5.4 - Non Compliance of CBSL Guidelines and the Provisions of the Companies Act 102
Table 5.5 - Summary of Non Compliances by RDBs 105
Table 5.6 - Awareness of the Staff about Regulatory Requirements 113
Table 5.7 - Maximum Educational Qualifications of Finance Staff of RDBs 115
Table 5.8 - Professional Qualifications of Finance Staff of RDBs 116
Table 5.9 - Academic and Professional Qualifications against Salaries 117
Table 5.10 - Application of Computerised Network Facilities for Banks 119
LIST OF FIGURES

Figure 3.1 - Economic Activity of RDBs' Clients 71
Figure 5.1 - Awareness of the Staff about Regulatory Requirements 113
Figure 5.2 - Maximum Educational Qualifications of Finance Staff of RDBs 115
Figure 5.3 - Professional Qualifications of Finance Staff of RDBs 116
Figure 5.4 - Academic and Professional Qualifications against Salaries 118
Figure 5.5 - Application of Computerised Network Facilities for Banks 119
APPLICATION OF SRI LANKA ACCOUNTING STANDARDS AND OTHER REGULATORY REQUIREMENTS BY THE REGIONAL DEVELOPMENT BANKS

K H R Chandika

ABSTRACT

This study examines the compliance of Regional Development Banks (RDB) with Sri Lanka Accounting Standards (SLAS) and the reasons for non-compliances with SLAS. Further, it investigates the compliance of RDBs with other regulatory requirements such as circulars and guidelines issued by the Central Bank of Sri Lanka (CBSL) and the Companies Act No. 07 of 2007. The study was designed to find out the difficulties and complications faced by the staff members of finance divisions of RDBs when applying SLAS and other regulatory requirements. The researcher has carried out a review of annual reports for a period of five years of all six RDBs. This review was supplemented by a questionnaire survey among 46 staff members of finance divisions of all six RDBs. Further, semi structured interviews were carried out with key officers of finance divisions of RDBs to obtain clarifications and explanations regarding the deviations noted, their views and suggestions for the purpose of the study.

The researcher has identified several instances of non-compliances including deviation from SLAS 16 – Employment Benefits, by not obtaining actuarial valuations of gratuity provisions, and failure to make necessary disclosures required by the Sections of SLAS 23.30, SLAS 18.79, SLAS 16.50, SLAS 30.16, 30.17, SLAS 9.42, SLAS 10.14 and SLAS 23.51. Further, the researcher has identified the difficulties faced by the staff of
RDBs such as lack of technical knowledge about SLAS and absence of proper guidelines and supervision in complying with these requirements. The study recommended a mechanism to overcome the issues recognized during the study. These recommendations include recruiting qualified accountants to the finance divisions, continuous training and development of staff and provision of proper guidelines and supervision of the work of junior officers by responsible officers.
Chapter 01

INTRODUCTION

1.1 Background of the Study

The banking sector provides an invaluable service to the economy of any country and directly contributes towards development activities of the society. The banks are playing a vital role in the business environment and customers are expecting the banking system to maintain the confidence by improving the quality and transparency of financial reporting. Financial reporting is one of the most important ways of providing information about the accountability of banks to the owners and the society. Application of SLAS when preparing financial statements will improve the quality of financial information reported by the banks.

Banks represent a significant and influential sector of business all over the world. Most individuals and organizations make use of banks either as borrowers or depositors. Banks play a major role in maintaining confidence in the monetary system through their close relationship with regulatory authorities and the regulations imposed on them by the government. Hence, there is a considerable and widespread interest in the well-being of banks, and in particular, their solvency and liquidity. The operations, and thus the accounting and reporting requirements, of banks are different from those of other commercial enterprises.

Various users of the bank’s financial statements are referring to such information for purposes as listed below.
Users of Financial Statements and their information needs

- Investors - to make investment decisions such as buying and selling of shares and debt equipment of the entities
- Lenders - to ensure the security for their borrowings and entities ability to meet its future obligations
- Employees - to ensure that they are securing their benefits as a return for their efforts towards the growth of the entity and also job security
- Suppliers – to ensure the ability of recovering their dues on time
- Customers –to ensure that the entity’s ability to continue for a foreseeable future for them to develop long term relationships
- Government authorities – to ensure proper allocation of resources and to determine taxation policies
- Public – to ensure corporate social responsibilities of the entity towards the society

Therefore, it would be very important to improve the qualitative characteristics of the financial statements to fulfil the common needs of most of the users of such financial information. Further, these statements would be a good indicator to measure the stewardship and accountability of the management towards its ownership. The users of financial statements may compare the financial statements of various business entities with the enhanced qualitative characteristics, more transparent presentation of financial position and performance of the entities which had been prepared by following SLAS.
SLAS would provide a strong base for preparation and presentation of financial statements and improve its degree of uniformity throughout the world.

The users of the financial statements of a Bank need relevant, reliable and comparable information, which assists them in evaluating the financial position and performance of the bank to make economic decisions. They also need information which gives them a better understanding of the special characteristics of the operations of a bank. Users need such information even though a bank is subjected to the supervision of the CBSL and provides the regulatory authorities with information that is not always available to public.

The users of the financial statements of a bank are interested in its liquidity and solvency and the risks related to the assets and liabilities recognized on its balance sheet and its off balance sheet items. Liquidity refers to the availability of sufficient funds to meet deposits, withdrawals and other financial commitments as they fall due. Solvency refers to the excess of assets over liabilities and, hence, to the adequacy of bank’s capital. A bank which exposed to liquidity risk and risks arising from changes in interest rates, changes in market prices and from counterpart failures. These risks may be reflected in the financial statements. However, users obtain a better understanding if management provides a commentary on the financial statements which describes the way it manages and controls the risks associated with the operation of the bank.

The Sri Lanka Accounting and Auditing Standards Act, No.15 of 1995, which authorises the Institute of Chartered Accountants of Sri Lanka (ICASL) to issue SLAS, requires "specified business enterprises" (SBE) to present their accounts in compliance with SLAS. This had been done with the objective of presenting a true and fair view of the
SBEs financial performance and condition, and requires their auditors to report whether such accounts are prepared, presented and to specify clearly any deviations along with the reasons.

It is very important to prepare and present financial statements in line with SLAS and other Generally Accepted Accounting Policies and principals (GAAP) in order to ensure the qualitative characteristics of financial statements such as understandability, relevance, reliability, substance over-form, consistency, materiality, completeness and prudence etc. As a SBE, the RDBs are also expected to follow SLAS and GAAP while preparing and presenting its financial statements. Therefore, it would be very important to analyse critically the basis of preparation of financial statements of the RDBs. Even though the RDBs are SBEs, it was assumed that there would be number of deviations from SLAS and other regulatory requirements such as guidelines provided by the CBSL and Companies Act No. 07 of 2007, in preparation and presentation of financial statements. The research was aimed to identify such non compliances and find out the reasons for them.

The RDBs were founded under the Regional Development Bank Act No. 06 of 1997, and functioning as Licensed Specialised Banks (LSB), approved by the Monetary Board of the CBSL. These banks were founded with its main objective to improve and raise the economic level of the respective regions. The banks were intended to pay special attention to develop agriculture, industries, fisheries and commercial activities in their respective areas and thereby raised the living standards of the masses of those regions. Further, it was aimed to provide financial assistance to various projects undertaken by the local authorities who targeted the rural development of the regions. These banks were
formed by transferring the assets and liabilities of number of Regional Rural Development Banks (RRDB) which were amalgamated as six development banks under the above Act. Table 1.1 provides information about the development banks which were incorporated under the Regional Development Bank Act No. 6 of 1997.

Table 1.1 – Regional Development Banks in Sri Lanka

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>Date of incorporation</th>
<th>No. of branches as of April 30, 2010</th>
<th>RRDBs Amalgamated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ruhuna Development Bank (RUDB)</td>
<td>01.07.1998</td>
<td>46</td>
<td>Galle, Matara and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Hambanthota</td>
</tr>
<tr>
<td>Sabaragamuwa Development Bank</td>
<td>01.01.1999</td>
<td>54</td>
<td>Kalutara, Kegalle and</td>
</tr>
<tr>
<td>(SDB)</td>
<td></td>
<td></td>
<td>Rathnapura,</td>
</tr>
<tr>
<td>Uva Development Bank (UDB)</td>
<td>18.03.1999</td>
<td>32</td>
<td>Badulla, Ampara and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Monaragala</td>
</tr>
<tr>
<td>Wayamba Development Bank (WDB)</td>
<td>01.01.1999</td>
<td>37</td>
<td>Gampaha, Puttalam and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Kurunegala</td>
</tr>
<tr>
<td>Rajarata Development Bank (RrDB)</td>
<td>12.11.1998</td>
<td>25</td>
<td>Anuradhapura and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Polonnaruwa</td>
</tr>
<tr>
<td>Kandurata Development Bank (KDB)</td>
<td>28.10.1998</td>
<td>33</td>
<td>Kandy, Matale and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Nuwara Eliya.</td>
</tr>
</tbody>
</table>

Source: Annual reports of respective RDB’s
These development banks were under the control of separate Board of Directors who represents the main shareholders, namely the Government Treasury, Bank of Ceylon, Peoples’ Bank and the National Savings Bank.

The RDBs had been categorised under the LSBs. As per the Annual report published by the CBSL, the total number of LSBs stood as 14 at the end of the year 2008. Their branch network was 423 by end 2008. Table 1.2 shows the composition of LSBs.

Table 1.2- Composition of License Specialised Banks in Sri Lanka

<table>
<thead>
<tr>
<th>Type of LSB</th>
<th>No. of banks</th>
<th>No. of branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regional Development Banks</td>
<td>6</td>
<td>227</td>
</tr>
<tr>
<td>Savings Banks</td>
<td>2</td>
<td>125</td>
</tr>
<tr>
<td>Long term lending institutions</td>
<td>2</td>
<td>18</td>
</tr>
<tr>
<td>Housing Financing Institutes</td>
<td>2</td>
<td>28</td>
</tr>
<tr>
<td>Private Savings &amp; Development Banks</td>
<td>2</td>
<td>33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14</strong></td>
<td><strong>423</strong></td>
</tr>
</tbody>
</table>

Source: Annual report of Central Bank of Sri Lanka -2008

It is not that much difficult to understand the importance of RDBs among LSBs after considering above table 1.2. These RDBs have been playing very important role in the economy since they are providing microfinance facilities to the rural communities aiming at the development in their livelihoods and towards the development of the regions. The Government of Sri Lanka introduced RDBs to the society mainly focusing above factors while discouraging informal money lenders and illegal deposit collectors.
Poor people usually address their need for financial services through a variety of financial relationships, mostly informal. Credit is available from informal moneylenders, but usually at a very high cost to borrowers. Savings services are available through a variety of informal relationships like savings clubs, rotating savings and credit associations, and other mutual savings societies. However, these tend to be erratic and somewhat insecure. Traditionally, banks do not consider poor people to be a viable market.

The RDBs target was specially the poor people in the respective regions and expected to address the shortcomings mentioned in preceding paragraph in their microfinance needs. Therefore, these banks were playing a vital role in the microfinance sector of the country.

1.2 Problem Statement

When we considered the main objective of financial statements, it was pretty clear that those had been prepared to provide information about the financial position, the performance and changes in financial position of an entity that was useful to a wide range of users in making economic decisions.

Financial statements prepared for this purpose meet the common needs of most users. However, the financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.

Even though, RDBs are comparatively large in number and branch network when comparing to other LSBs as described in table 1.2, most of such banks do not have professionally qualified staff in their finance departments. The researcher has analysed the professional and educational qualifications of the staff members of the finance
divisions of all six RDBs as highlighted in table 5.6 and 5.7 in Chapter 5. It was noted that no staff member had obtained full qualifications from recognized professional body and a few staff members had completed basic degrees. However, it was observed that the staff members were not competent enough to perform the duties well with their professional backgrounds. Further, there were several occasions the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) has sent instructional letters to some of the RDBs with copies to the respective auditors highlighting the weaknesses of the SLAS application process. Such letters had highlighted the non-compliances with SLAS and instructed the banks to rectify such weaknesses in future financial periods. In addition to the instructive letters, two of the RDBs and auditors were summoned before the SLAASMB for inquiries. The two banks were instructed to comply with SLAS and rectify the errors in following year’s financial statements. Therefore, there was a serious issue as to the quality of the financial reporting and thereby its impact on decision making of the top management and other stakeholders such as Inland Revenue Department and trade unions etc. The quality of financial statements would depend on proper use of SLAS and GAAPs. Further, the application of SLAS when preparing and presenting financial statements would improve the quality of financial information. Therefore, use of SLAS and GAAPs improve the quality of the financial reporting which may lead to improve the transparency of the results and further it would be helpful to take corrective actions when needed. Unfortunately, still there is a considerable amount of conflicts and poor utilization of accounting standards and GAAPs in many banks when preparing financial reports.
It is important to provide accurate and consistent financial information to users of financial statements. Financial statements must be prepared in line with SLAS and GAAPs in order to ensure the quality of the financial information provided. However, the utilization of these standards/principles would mainly depend on the capabilities of the staff of finance division. The research problem focused here is “To which extent the RDBs have complied with SLAS and other regulatory requirements when preparing and presenting financial statements?”

1.3 Research Objectives

Based on the research issue identified in the previous section, this study focuses on the following objectives.

a) To examine, the extent to which the RDBs have applied SLAS and other regulatory requirements in the preparation and presentation of financial statements.

b) To examine, any difficulties and complications that have been faced by the staff members of finance divisions of RDBs in applying SLAS and other regulatory requirements in the preparation and presentation of financial statements.

c) To recommend a mechanism to overcome these difficulties and complications faced by the staff members and improve the quality of financial reporting of RDBs.

1.4 Significance of the Study

Financial reporting is the key indicator for measurement of performance and making economic decisions. Therefore, it is important to maintain the quality of financial statements, which is still the main element of financial reporting in any organization. In
this context, the quality of financial statements of RDBs is a key to their success. RDBs, as Government owned financial institutions are playing a vital role in regional development and microfinance industry, which needs close supervision by regulatory authorities and the management of such banks. Therefore, it is very important to provide accurate and high quality financial information for decision makers who will entirely depend on the financial statements.

RDBs play an important role in the economic development. Since 2003, Sri Lanka economy reported a consistent development of Gross Domestic Production (GDP) over 5.5% per year. This growth has been achieved by the country due to special contribution from the Small and Medium Enterprises (SMEs). As per “Small and Medium Enterprise Regional Development Project –Loan Evaluation report” issued by Asian Development Bank (ADB) in November 2007 and project No. 36117, there were more than 30,000 small and medium scale enterprises of which 75% of such SMEs were regional SMEs. However, only 35% of these regional SMEs had access to formal banking and finance facilities. Therefore, it would be very important to provide more financial access to regional SMEs, which could be easily done through RDBs. Therefore, it would be essential to improve the quality of financial information such as understandability, relevance, reliability and comparability of financial statements of such banks by adopting all relevant SLAS and GAAP when preparing financial statements.

1.5 Limitations

The study focused on the staff of financial divisions of all RDBs to gather information. Even though the financial statements are being prepared by the finance divisions, necessary data would be obtained from other divisions such as Credit, Human Resources
and Administration and the branches. Staff members of these divisions were not interviewed for the purposes of this study. Even though, all 46 permanent officials of 6 RDBs had been considered for the questionnaire survey, only a sample of 8-10 key officers had been considered for the semi-structured interviews. This group of persons had been biased by the selection process. Further, it was expected to select the sample of persons in order to represent the entire finance sections who were participating in financial statements preparation process. For the purpose of practicability and manageability, persons and institutions working at finance departments of the head offices of the 6 RDBs had been considered for the study. It had been assumed that the sample selected from the finance department is sufficiently representative when findings are generalized since most of the financial information is processed by a unique set of rules and regulations. As mentioned earlier only the six RDBs had been considered for the study. The rest of the LSBs had not been considered in this research. It is assumed that has not affected the findings of the research. Unavailability of an updated database was an obstacle when conducting the research.

Further, only twelve SLAS which are directly applicable for RDBs have been considered for the purpose of this study. It was also considered as a restriction since the study had not considered the impact of other SLAS on financial statements.

1.6 Chapter Framework

This chapter discussed about the background to the study, research problems and objectives of the study. Further, it has discussed the significance and limitations of the study. The research was mainly focused on to examine to which extent the banks have
complied with the SLAS when preparing and presenting the financial statements of RDBs. Frame work of next chapters is as follows.

Chapter 2 has focused on the literature survey of SLAS and International Financial Reporting Standards (IFRS), which would be also relevant to preparation and presentation of financial statements with effect from January 1, 2012.

Chapter 3 has explained the origin and the expansion of RDBs during last three decades. It has further described the present structure, operations and the financial positions of the RDBs.

Research methodology has been presented in Chapter 4. Data collection and analysis strategies have been presented in this chapter.

Chapter 5 provided the analysis and presentation of findings throughout the study. It included the compliances and deviations from SLAS and other regulations such as CBSL guidelines and Companies Act etc. This chapter has further analysed staff qualifications and competencies etc.

Chapter 6 has focused on discussion of the findings. The issues recognized during the study and recommendations to overcome such issues.

Final chapter had summarised the study with the recommendations for future studies.
Chapter 02

LITRATURE REVIEW

2.1 Introduction

The researcher had searched for the facts which were available regarding the areas of SLAS, IFRS, RDBs, and regulatory authorities, which were responsible for setting up such standards and guidelines etc. This chapter explains the requirement of accounting standards, statutory framework, SLAS, Accounting Standards Committee (ASC), Accounting Standards review process, convergence to IFRS and benefits and issues of such convergence.

2.2 Sri Lanka Accounting Standards

The ICASL is the sole authorized body to setting up accounting standards in Sri Lanka. The Sri Lanka Accounting and Auditing Standards Act, No.15 of 1995 which authorises ICASL to issue SLAS, requires "specified business enterprises" to prepare and present their accounts in compliance with SLAS, with the object of presenting a true and fair view of their financial performance and condition, and requires their auditors to report whether such accounts are prepared and presented and to specify clearly any deviations there from along with the reasons therefore. As per the Act, the main objective of preparation and presentation of financial statements in accordance with SLAS is presenting a true and fair view of financial performance and condition of SBEs in order to enhance the qualitative characteristics of financial statements such as understandability, relevance, reliability and comparability. The Companies Act No. 07 of
2007 requires the auditors of all SBEs to ensure whether the Companies have prepared their financial statements in accordance with SLAS and need to report any deviations from SLAS through the auditors’ report.

SLAS contain basic principles and essential procedures together with related guidance. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provides guidance for their application. The SLASSMB is monitoring whether all specified business enterprises are complying with the requirements mentioned in SLAS in order to ensure the information provided in financial statements are accurate and providing reliable information for decision making. The Board has powers to summon the directors/auditors of specified business entities before them and/or issue directions/guidance for future developments in preparation of financial statements. Further, the directors of respective business entities are responsible for preparation and fair presentation of financial statements and the company auditors are liable to express an opinion based on their audit whether the financial statements are free of material misstatements. The SLAASMB is reviewing financial statements and auditors working papers in order to ensure both parties have performed their duties well. The ICASL reviews the accounting standards from time to time and introduces new standards while revising existing standards to fulfill current requirements.

In the case of RDBs the application of SLAS was in a weak position in some instances as observed by the researcher. There were number of inquiries done by SLAASMB regarding application of SLAS in preparation and presentation of financial statements. Further, auditors in their management letters had highlighted non compliances of SLAS in respect of several RDBs repeatedly in recent financial periods. Limited and/or
qualified human recourses were not available for the RDBs in the field of professional accounting and this might lead to the limited the application of SLAS when preparing financial statements of the banks.

SLAS contains relevant procedures, basic principles and related guidance which need to be utilised when preparing and presenting of financial statements. These standards would ultimately facilitate to maintain the uniformity of financial accounting and reporting process throughout the World. However, it is impossible to present each and every aspect of accounting through standards. Therefore, it is recommended to follow accounting standards as basic principals when preparing and presenting financial statements. It is very important to prepare and present financial statements in accordance with the SLAS and other GAAP in order to fulfil the expectations of users of such financial statements.

Even though ICASL has already introduced above SLAS it was highlighted by several studies about compliance gaps (i.e. the deviation of actual practice from the applicable accounting standards) in several publicly quoted companies and other SBEs. These deviations were recorded by the ICASL and other regulators such as SLAASMB, the Department of Inland Revenue and researchers in recent past. While some financial statements had very high degrees of compliance, there were several instances of accounting policies and disclosures that did not comply with Sri Lanka Accounting Standards. Major non-compliances in the financial statements included the following examples:

- Disclosures - Many companies avoided full disclosure of information in published financial statements, ignoring the SLAS-based disclosure requirements.
• Inventory valuation - Some companies did not follow all requirements related to measuring and disclosing inventories at the lower of either cost or market value.

• Segment reporting - Some companies that apparently had business segments and geographical segments did not disclose information fulfilling the requirements of segment reporting.

• Effects of changes in foreign exchange rates - Some companies did not adhere to the requirement that foreign currency exchange gains or losses arising from balance sheet date revaluations should be reflected in the income statement.

• Related party transactions - Many companies did not disclose the nature and extent of control by related parties in accordance with SLAS requirements.

• Revenue recognition - Some companies did not properly follow the accounting policy on revenue recognition. In case of installment sales, revenue was recognized on a cash basis rather than an accrual basis.

• Property, plant, and equipment - In cases where fixed assets were revalued, detailed SLAS-required disclosures were not made.

• Employee benefits - Some companies disclosed the existence of employee pension benefits but failed to disclose detailed SLAS-required information. In some cases, the liability for employee benefit expenses was not recognized on an accrual basis. Some companies did not disclose as to whether actuarial or any other forms of valuations had been made to quantify outstanding liabilities for employees' post-employment benefits.
• Taxation - Some companies did not disclose the tax effects related to the assets that have been revalued to the amount in excess of the historical costs or a previous revaluation. Furthermore, some companies did not disclose tax losses.

• Accounting for leases - The finance lease valuation was not done on the basis of present value of future cash flows as required by the SLAS 19.

• Risk exposure and loan loss provision - Some banks and finance companies did not present an analysis of risk exposure, maturity groupings, and adequate disclosure on loan loss provisioning.

Table 2.1 – Comparison of SLAS with IAS

<table>
<thead>
<tr>
<th>Status of SLAS in relation to IAS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number</strong></td>
</tr>
<tr>
<td>------------</td>
</tr>
<tr>
<td>IAS 1</td>
</tr>
<tr>
<td>IAS 1</td>
</tr>
<tr>
<td>IAS 1</td>
</tr>
<tr>
<td>IAS 2</td>
</tr>
<tr>
<td>IAS 7</td>
</tr>
<tr>
<td>IAS 10</td>
</tr>
<tr>
<td>--------</td>
</tr>
<tr>
<td>IAS 14</td>
</tr>
<tr>
<td>IAS 17</td>
</tr>
<tr>
<td>IAS 18</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>IAS 21</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>IAS 23</td>
</tr>
<tr>
<td>IAS 25</td>
</tr>
<tr>
<td>Standard</td>
</tr>
<tr>
<td>----------</td>
</tr>
<tr>
<td>IAS 29</td>
</tr>
<tr>
<td>IAS 31</td>
</tr>
<tr>
<td>IAS 32</td>
</tr>
<tr>
<td>IAS 33</td>
</tr>
<tr>
<td>IAS 34</td>
</tr>
<tr>
<td>IAS 36</td>
</tr>
<tr>
<td>IAS 37</td>
</tr>
<tr>
<td>IAS 38</td>
</tr>
<tr>
<td>IAS 38</td>
</tr>
<tr>
<td>IAS 39</td>
</tr>
<tr>
<td>IAS 40</td>
</tr>
<tr>
<td>IAS 41</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
As mentioned in table 2.3, although mostly aligned, gaps still exist between Sri Lanka Accounting Standards and International Accounting Standards. These gaps exist mainly due to the introduction of an alternative method that is not permitted by IAS. For example, some SLAS have allowed an alternative which are not allowed by the IAS. This practice can be found in SLAS 16, Retirement Benefit Costs, based on IAS 19, Employee Benefits. IAS 19 requires an actuarial valuation for the gratuity liability calculation, whereas, parallel to actuarial valuation, SLAS 16 allows an alternative treatment of calculating the gratuity liability on the basis of a half-month salary. Therefore, actuarial valuation is not mandatory for the valuation of the liability, resulting in differences in measurement and disclosure requirements.

2.3 Requirement of Accounting Standards

The users of financial statements have both coinciding and conflicting needs for statements of various types. To meet these needs, and to satisfy the fiduciary reporting responsibility of management, accountants prepare a single set of general-purpose financial statements. These statements are expected to present fairly in all material respects, clearly, understandably, and completely the economic facts of the existence and operations of the enterprise. In preparing financial statements, accountants are confronted with the potential dangers of bias, misinterpretations, inexactness, and ambiguity. In order to minimize these dangers and to render financial statements that can be reasonably compared between enterprises and between accounting periods, the accounting profession has attempted to develop a body of theory that is generally accepted and universally practiced. Without this body of theory, each accountant or enterprise would have to develop its own theory, structure, and set of practices, and readers of financial statements,
would have to familiarize themselves with each company's peculiar accounting and reporting practices. As a result, it would be almost impossible to prepare statements that could be compared.

The accounting professional's effort to establish a body of theory and practice that acts as a general guide has resulted in the adoption of a common set of standards and procedures called GAAP. The term "generally accepted" can mean either that an authoritative accounting rule-making body has established a principle of reporting in a given area or that over time a given practice has been accepted as appropriate because of its universal application. Although principles and practices have provoked both debate and criticism, most accountants and members of the financial community recognize them as the standards and procedures that over time have proven to be most useful.

As per research paper published by Barth M.E. et al, they had examined whether application of International Accounting Standards (IAS) is associated with higher accounting quality. The application of IAS reflects the combined effects of features of the financial reporting system, including standards, their interpretation, enforcement, and litigation. They also found that firms applying IAS from 21 countries generally evidence less earnings management, more timely loss recognition, and more value relevance of accounting amounts than do a matched sample of firms applying non-US domestic standards. Differences in accounting quality between the two groups of firms in the period before the IAS firms adopt IAS do not account for the post-adoption differences. Further, they have highlighted that firms applying IAS generally evidence an improvement in accounting quality between the pre- and post-adoption periods.
In the 10th volume of Research Papers published in Research in Accounting in Emerging Economies it has highlighted the importance of the accounting systems and its roles in various environments. It has further analysed the implications of the increasing recognition of the roles that accounting systems play under the challenges such as Globalisation of capital markets, competition, the emergence of IAS and adoption of IFRS.

The Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 provides the framework of institutional arrangements for setting accounting and auditing standards and monitoring the implementation of those standards for the Specified Business Enterprises operating in Sri Lanka. It has empowered the ICASL to issue SBE-applicable accounting and auditing standards. SBEs include all publicly traded, insurance, and finance companies; banks; stock exchanges, public corporations engaged in sale of goods and services; group companies, and other companies falling under the purview of any of the five criteria: (a) yearly turnover exceeding Sri Lanka Rupees (LKR) 500 million, (b) shareholders equity exceeding LKR100 million, (c) gross assets exceeding LKR300 million, (d) liabilities to banks and other financial institutions exceeding LKR100 million, and (e) the number of employees exceeding 1,000.

The Act provides for the formation and functioning of the Accounting Standards Committee and Auditing Standards Committee that make recommendations to the ICASL in adopting accounting and auditing standards. It had also established the Sri Lanka Accounting and Auditing Standards Monitoring Board to monitor and enforce compliance with Sri Lanka accounting and auditing standards. The Act has an indemnity provision for the Monitoring Board and its officials with regard to their action against non-compliances. Although the Act had given power to the Monitoring Board for monitoring auditors' activities, confusion exists
in the country among the auditing community with regard to its jurisdiction over monitoring
the professional activities of the auditors. The SLAASMB operates with limited resources
under the purview of the Ministry of Finance.

The Companies Act No. 17 of 1982 and The Companies Act No. 07 of 2007 provide basic
requirements relating to financial reporting of all companies incorporated in Sri Lanka. The
Companies Act provides requirements for preparation, presentation, and publication of
financial statements, disclosures, and auditing. It is mandatory for group companies
incorporated in Sri Lanka to prepare consolidated financial statements. The Act requires that
the financial statements of the companies should be audited annually. The Companies Act
had not specified effective sanctions against errant preparers and auditors of financial
statements.

The Companies Act had spelled out obligations of company directors with regard to
preparation of annual financial statements. Further it included provisions on auditors’ duties
and responsibilities. Company directors are responsible for ensuring timely preparation and
filing of annual financial statements with the Registrar of Companies. Directors are also
responsible for making these financial statements available to all shareholders at the annual
general meeting. Even though there are enough provisions for punishments, in reality,
effective punitive action is hardly ever taken to enforce compliance with these requirements.

The Securities and Exchange Commission (SEC) of Sri Lanka monitors accounting and
reporting issues in regulating publicly traded companies. Publicly traded companies in Sri
Lanka are required to comply with SEC requirements as outlined in the Securities and
various rules, in order to protect investor interests, including accounting and auditing
requirements and the listing requirements that specify routine and non-routine disclosures
applicable to publicly traded companies. Through a Memorandum of Understanding with the
Monitoring Board, the SEC had agreed to refer cases of noncompliance with Sri Lanka Accounting Standards to the Monitoring Board.

The Banking Act No. 30 of 1988, amended by Act 33 of 1995 authorizes the Central Bank of Sri Lanka to regulate financial reporting by banks. The accounting and auditing requirements outlined in the Banking Act are in addition to the requirements set by the Companies Act. The CBSL, empowered by the Banking Act, had prescribed formats for balance sheets and income statements, including the disclosure requirements, in line with SLAS 23 that each bank must follow. All commercial banks must publish audited financial statements within five months of the end of the financial year. Mandatory reporting requirements under the Act is to provide monthly statement of assets, liabilities, and liquidity ratios; quarterly statements on nonperforming assets exceeding LKR500,000; risk-based capital calculations; and year-end financial statements, including detailed notes and accounting policies. The financial statements of the banks must be audited by the selected qualified auditor from the list maintained by the Director of the CBSL’s Supervision Department. The list contains both large and small firms. The CBSL had issued guidelines relating to auditor’s statutory duties focusing on various issues, such as audit planning, scope of audit, evaluation of internal control, and review of financial statements. These guidelines are broadly in conformity with the ICASL pronouncements. The CBSL has authority to enlarge the scope of audit work, requiring the auditors to comply with additional requirements.

According to the CBSL rules it is compulsory to publish banks’ summarised financial statements in newspapers on quarterly basis. Through a circular issued in 2003, the Central Bank’s Supervision Department had made it mandatory for all commercial banks and specialized banks operating in Sri Lanka to publish their quarterly unaudited financial statements within two months of the closure of each quarter. However, these financial
statements, which are published in newspapers, do not have any accompanying notes or disclosures of the relevant accounting policies.

The Insurance Board of Sri Lanka under the Regulation of Insurance Industry Act No. 43 of 2000 regulates the financial reporting practices of insurance companies. Insurance companies must comply with the requirements of the Insurance Board of Sri Lanka (IBSL) in preparing and presenting their financial statements. The auditors of insurance companies' financial statements must be selected from the list of IBSL-approved auditors. The Act requires that these audited financial statements should be submitted to the IBSL; however, it had not stipulated any specific time frame for such submission. The Act requires that an actuary certify whether the reserves of the insurer are adequate to meet all liabilities.

The Finance Companies Act No. 78 of 1988 regulates the finance companies in Sri Lanka and sets their accounting and reporting requirements. The Act lays down the disclosure requirements for finance companies operating in Sri Lanka. Among requirements in the Act were that companies should disclose the market value of investments in their balance sheet. The audited financial statements are required to be published within six months of the financial year-end.

Section 8 of the Colombo Stock Exchange (CSE) Listing Rules requires presentation of interim financial statements. As a listing requirement, the publicly traded companies are required to prepare and submit interim financial statements to the CSE. This requirement includes two submissions: (a) quarterly financial statements by enterprises listed on the Main Board within two months of the end of the quarter and (b) half yearly financial statements by the enterprises listed on the Second Board and Debt Securities Board within two months of the end of the half year. Additionally, the listing rules require the disclosure in the financial statements of a full list of investments held by the enterprise (quoted and unquoted) held
outside the group and names of the 20 largest equity holders, including the number of securities and the percentage of each of their capital holdings.

The Inland Revenue Act No. 10 of 2006 requires all companies to submit audited annual financial statements with their tax returns. The Act requires the companies to submit their annual tax return to the Department of Inland Revenue (DIR) in a prescribed format by November 30 of each calendar year, together with the audited financial statements. The companies compute corporate income for tax purposes after adjusting relevant figures from their general-purpose financial statements, as per applicable provisions and allowances under the Inland Revenue Act.

Article 154 of the Sri Lanka Constitution empowers the Auditor General (AG) to undertake audits of public corporations. Public corporations must submit their annual financial statements to the AG for auditing within four months of the completion of the corporation’s financial year. Article 154 of the Sri Lanka Constitution mandates the AG to conduct audit functions with respect to public corporations and report the findings to the Sri Lankan Parliament. Thus the financial statements of the specified business enterprises, falling under the purview of public corporations, would require auditing by the AG. The AG would typically appoint an audit firm to carry out the audit functions for the specified business enterprise. The AG signs the completed audit report, which does not mention the name of the audit firm that actually conducted the audit.

2.4 Accounting Standards and its Application

It is very important to adopt accounting standards when preparing and presenting financial statements since it would directly increase the quality of financial statements with improved characteristics. Before 1970, Sri Lankan financial reporting requirements were based upon the prescriptions of the Companies’ Ordinance of Ceylon, contemporary
United Kingdom (UK) legislation and the recommendations of Institute of Chartered Accountants of England and Wales (ICAEW). On 1 April 1970, ICASL issued the first SLAS, SLAS 1: The treatment of dividends which was to present it duly grossed in the balance sheets and appropriation statements of companies. However, the use of SLAS was not legally mandated, other than for publicly quoted companies, financial institutions and insurance companies.

A number of Sri Lankan finance companies collapsed in the late 1980s and early 1990s. Many small depositors lost their savings and significant fiscal costs were incurred in bailouts. In response, the Government established the Presidential Commission on Finance and Banking to investigate and strengthen financial sector arrangements. Among other things, the Commission recommended that international accounting and auditing standards to be adopted to improve financial disclosure. As a precautionary measure, the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 was developed by government officials, the accountancy profession, and representatives from the commercial and financial sectors. Together with subsidiary regulations, the Act defines certain enterprises as SBEs and governs the preparation, presentation and audit of financial statements of SBEs for periods commencing on or after 1 January 1999.

The Act requires all SBEs to prepare and present financial statements in accordance with SLAS. It also empowers ICASL to adopt suitable accounting standards from time to time. These standards have legal effect once they have been published in the Gazette. SLAS relating to banks must have the concurrence of the Banking Supervision Department of the CBSL. The ASC, an ICASL committee, was established to undertake the accounting-standard-setting process. The Act also established the independent SLAASMB to monitor
SBEs' compliance with SLAS. The Sri Lankan regime for formulating accounting standards, and monitoring compliance with these standards, is a world leader. It is particularly appropriate for application in developing and transitional markets, which tend to lack effective investee monitoring. In this respect, other developing and transitional countries should be encouraged to examine the Sri Lankan model with a view to strengthening their financial reporting and disclosure practices.

ICASL established the Accounting Standards Committee (ASC) in accordance with the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995. This Committee is responsible for making recommendations and assisting the Institute to develop and promulgate SLAS.

The ICASL promulgates SLAS in accordance with Sections 2(1) and 8(1) of the Act. In keeping with the recommendations of the Presidential Commission on Finance and Banking, SLAS are directly based on the IAS promulgated by the International Accounting Standards Board (IASB). It is a condition of ICASL's International Federation of Accountants (IFAC) membership that the Institute works towards implementation of IASs. The first Committee under the Act was established in June 1996. Within six months it had reviewed the IAS Framework and all IASs (up to IAS 27), and published a book of Sri Lankan Accounting Standards. The ASC comprises 12 members, who are drawn from professional accountancy bodies, regulatory bodies, and user groups (Table 2.1).

Members are appointed for four-year terms under Section 10 (2) of the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995. In 1995, the Presidential Commission on Finance and Banking recommended that resources should be appropriate
to ICASL to support ASC’s activities. However no action was taken and the ASC’s activities are funded entirely by ICASL (In contrast to the SLAASMB).

**Table 2.2- Membership of the Accounting Standards Committee**

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Members</th>
<th>Nomination and appointment</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICASL</td>
<td>6</td>
<td>President and five other members nominated by the council</td>
</tr>
<tr>
<td>Institute of Chartered Management Accountants of Sri Lanka (CIMA)</td>
<td>1</td>
<td>Nominated by CIMA</td>
</tr>
<tr>
<td>Registrar of Companies</td>
<td>1</td>
<td>Nominated by Registrar of Companies</td>
</tr>
<tr>
<td>The Central Bank of Sri Lanka (CBSL)</td>
<td>1</td>
<td>Nominated by Governor of CBSL</td>
</tr>
<tr>
<td>Securities and Exchange Commission (SEC)</td>
<td>1</td>
<td>Nominated by Director General of SEC</td>
</tr>
<tr>
<td>Ceylon Chamber of Commerce</td>
<td>1</td>
<td>A Company director or other person with extensive senior management experience in a specified business enterprise, nominated by the Ceylon Chamber of Commerce.</td>
</tr>
</tbody>
</table>
The ASC's standard-setting process is broadly similar to that of the IASB and the US Financial Accounting Standards Board, except that the process focuses on reviewing IASs for adoption in Sri Lanka. Although the Committee aims to achieve complete consistency between SLAS and IASs, modifications are sometimes made to reflect country-specific factors. The ASC's standard-setting process is as follows:

- The ASC invites interested parties to comment on the targeted IAS.
- The ASC appoints a subcommittee, chaired by an ASC member, to study the IAS.
- The subcommittee studies the IAS, taking into consideration any comments from interested parties.
- The subcommittee prepares a draft SLAS, modified as necessary, and presents it to the ASC.
- The ASC conducts a public seminar, to explain the proposed SLAS, and to obtain further public comments.
• The subcommittee reviews the draft SLAS, taking into consideration any further public comments, and recommends the SLAS for adoption to the ASC.

• The ASC discusses the proposed standard with the subcommittee Chair and determines the nature and contents of the final standard that it will recommend to the ICASL Council for adoption. Under ASC rules, at least three-quarters of members must support a standard, before it is recommended to the ICASL Council for adoption.

• The ICASL Council then adopts the SLAS in accordance with Section 2 of the Sri Lanka Accounting and Auditing Standards Act No.15 of 1995.

• The adopted SLAS must be published in the Gazette. It becomes effective from the date of publication, or from a later date as specified in the SLAS.

• In order to be gazette, the SLAS must be translated into Sinhala and Tamil. The first batch of 28 SLAS was translated with the assistance of Asian Development Bank (ADB) under the Financial Management Training Project.

The first set of SLAS promulgated through this process was published in Gazette Extraordinary No.1056/19 (2 December 1998). These standards applied to financial reporting on financial periods commencing on or after, 1 January 1999.

2.6 Public Sector Accounting Standards

Sri Lankan government organizations can be categorized into: (i) Ministries, Departments and Constitutional bodies, such as the AG's Office; (ii) nonrevenue-earning statutory bodies and public enterprises; and (iii) revenue-earning statutory bodies and public
enterprises. The Sri Lankan Accounting and Auditing Standards Act No. 15 of 1995 require that the latter group report in accordance with SLAS. Groups (i) and (ii) are required to report in accordance with the Financial Regulations 1992 issued by Ministry of Finance and Planning’s Public Finance Department. These groups prepare cash-based budgets and financial reports.

The Financial Regulations do not prescribe accounting standards in this respect. The Government is considering to introduce accrual budgeting and accounting as part of the Public Expenditure Management Reform Programme.

In 1996, the Public Sector Committee (PSC) of IFAC initiated a project to prepare a set of International Public Sector Accounting Standards (IPSASs). The benefits of improved governmental financial reporting and the corresponding improvement in transparency were recognized by international and regional organizations, including the Asian Development Bank (ADB), the World Bank, the International Monitory Fund (IMF) and the United Nations Development Programme (UNDP), all of which provided funding for the public sector accounting standards project.

In May 2000, IFAC formally released the first IPSASs. They were the first set of accounting standards applicable to public sector reporting and are intended to meet the needs of governments, ministers, taxpayers and credit-rating agencies. The standards apply to all levels of government and would provide governments with a platform on which to base improvements in their financial management and reporting practices. Further IPSASs are currently being developed.

The PSC recognizes that many Governments may not yet be in a position to adopt the accrual-based IPSASs. To assist these governments, the PSC has also developed
Financial Reporting under the Cash Basis of Accounting as ED-9. The ED-9 sets out the requirements for the presentation of the primary financial statement under the cash basis of accounting, as well as the statement’s structure and minimum content requirements. The requirements that are likely to emerge in this standard should lead to transparency where governments remain on the cash basis of reporting.

Although public corporations report largely in accordance with SLAS, there are no accounting standards for Sri Lankan public sector budgeting and reporting. Although the Government has stated its intention to adopt the accrual-based IPSASs as the basis for government budgeting and accounting, this is likely to take some years to achieve. In the interim, the requirements of the ED-9, which calls for preparation of a standard cash flow statement (i.e., where flows are categorized into cash flows from operating, investing and financing) could be met by the existing Computerized Integrated Government Accounting System (CIGAS), with few modifications.

All Sri Lankan companies must prepare SLAS-compliant financial statements. Adjustments are then applied to these financial reports to derive corporate income for taxation purposes.

2.7 Accounting Standards Revision Process

Accounting Standards used in Sri Lanka are revised from time to time in order to be in line with the movement towards improvement and timeliness and accuracy of financial reporting under IFRS. Further, new accounting standards are being introduced continuously by the ICASL in order to improve the quality of financial reporting of the country.
A key revision of SLAS had been carried out by the ICASL in 2005 and such changes had been effected with effects from January 2006. Below mentioned is a summary of key changes to SLAS done in 2005 as per researcher’s analysis.

**Table 2.3 Key Changes of Revised SLAS in 2006**

<table>
<thead>
<tr>
<th>SLAS</th>
<th>Title of the Standard</th>
<th>Key Changes</th>
<th>Effective date</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Presentation</td>
<td>• Changes to the presentation of income statement and balance sheet</td>
<td>January 2006</td>
</tr>
<tr>
<td></td>
<td>of Financial Statements</td>
<td>• No extraordinary items</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Income applicable to minority to be disclosed in the income statement</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Minority interest to be shown under the equity in the balance sheet</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Disclosure of the results from operating activities is not required.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Inventory</td>
<td>• LIFO method of measurement removed</td>
<td>January 2006</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Entity specific net realizable value defined</td>
<td>2006</td>
</tr>
<tr>
<td>10</td>
<td>Accounting policies, changing in accounting estimates and errors</td>
<td>• Concept of fundamental error removed and prior period errors introduced</td>
<td>January 2006</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Impact of pending accounting standards require disclosure</td>
<td>2006</td>
</tr>
<tr>
<td>Events after the balance sheet date</td>
<td>Disclosure of dividends declared after the balance sheet date restricted to a note in the financial statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------------------</td>
<td>------------------------------------------------------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Income Taxes</strong></td>
<td><strong>Significant changes to the method of calculating deferred taxes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Deferral method and partial provisioning not allowed</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Liability method changed to a balance sheet liability method of calculating deferred taxes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Deferred tax to be calculated for all temporary differences</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Deferred tax to be computed on consolidated financial statements</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td><strong>Component method of accounting</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Annual assessment of useful life, residual value and indicators of impairment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Replacement costs, significant inspection charges can be capitalized after removing unamortized costs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Depreciation charged until de-recognition even if asset is idle</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Page</td>
<td>Section</td>
<td>Description</td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>---------</td>
<td>-------------</td>
<td></td>
</tr>
</tbody>
</table>
| 19   | Leases  | - Lease rights of land operating leases which are January 2006 investment properties can be fair valued and recorded as investment properties  
      - More guidance on initial classification of financial and operating leases  
      - Land operating leases which are not investment properties cannot be recognized as PP&E |
| 21   | The effects of changes in foreign exchange rates | - Selection of functional currency and presentation currency January 2006  
      - An operation which uses a different functional currency is a foreign operation  
      - Single method of translation from functional to presentation currency |
| 25   | Business combinations | - Definition of “Business” has been expanded June 2005  
      - Only purchase method of accounting allowed  
      - A fair value balance sheet is required when accounting for an acquisition  
      - No amortization of goodwill. Goodwill subject to annual impairment testing  
      - Negative goodwill should be re-assessed and any excess should be written off to the income statement immediately |
| 26 | Consolidated | • Exclusion of subsidiaries from consolidation and restricted. Expanded definition of a subsidiary 2006 |
|    |             | • Investment in subsidiaries to be shown at cost in separate financial statements |
|    |             | • Uniform accounting policies to be used |
|    |             | • Potential voting rights also taken into account to determine control |

| 27 | Investments in associates | • Equity method of accounting for Associates in primary financial statements mandatory 2006 |
|    |                           | • Investment in associates to be shown at cost in separate financial statements |
|    |                           | • Goodwill not separated when accounting for acquisition of an associate |
|    |                           | • Uniform accounting policies to be used |
|    |                           | • Recognition of associate losses under equity method expanded |

<p>| 30 | Related party disclosures | • Expanded scope and disclosure requirements January 2006 |
|    |                           | • Non executive directors, close family members of key management also included in disclosure |
|    |                           | • Compensation to key management require disclosure |</p>
<table>
<thead>
<tr>
<th>Page</th>
<th>Section</th>
<th>Details</th>
</tr>
</thead>
</table>
| 31   | Interests in joint ventures | - Investment in JV to be shown at cost in separate financial statements January 2006  
- Proportionate consolidation is the preferred method in consolidated financial statements  
- If using equity method SLAS 27 should be followed |
| 34   | Earnings per share | - Potential ordinary shares which could have a dilutive effect should be considered in the calculation of dilutive EPS January 2006  
- Guidance on calculation of dilutive & basic EPS  
- Dividends on cumulative preference shares to be reduced irrespective of declaration when calculating EPS  
- EPS on income from assets or disposal group held for sale (SLAS 38) to be disclosed |
| 38   | Noncurrent assets held for sale and discontinued operations | - Specify conditions to classify assets or disposal groups held for sale January 2006  
- Items held for sale should be carried at the lower of carrying amount or fair value less cost to sell  
- Separate disclosure required in the financial statements  
- EPS on held for sale income/loss should be disclosed |
- No depreciation on assets classified as held for sale

40 Investment property

- Investment property to be disclosed separately
- A fair value or cost model should be selected
- If fair value model is used, increase/decrease in fair value should be charged to the income statement.
- Fair value should be determined annually. Once in every three years a professional valuation should be carried out. Directors can determine the value for the intervening years.
- If cost model is selected, annual depreciation should be charged. All SLAS 18 requirements will apply other than revaluation which is not permitted

41 Impairment of assets

- Indefinite life intangible assets and goodwill subject to impairment testing
- PP&E, investments and intangible assets with finite life subject to annual impairment review and testing if conditions are presents
- All impaired assets should be carried at the higher of the fair value less costs to sell or value in use
Investors make capital allocation decisions based on global opportunities. Globalisation of capital markets has helped to fuel demand for a common worldwide accounting framework. Use of different national accounting standards makes it more difficult and costly for an investor to compare opportunities and to take financial decisions.

Differences in accounting standards also impose additional costs on companies that must prepare financial information based on multiple reporting models in order to raise capital in different markets, as well as creating potential confusion as to which are the “real numbers.”

Kieso et al (2007) defined generally accepted accounting principles (GAAP) as those principles that have substantial authoritative support. To the question “Why one set of documents are more authoritative that others?” Two sets of explanations were given by Kieso et al (2007) and these are: (1) that the body issuing the pronouncements are recognized by the Securities and Exchange Commission (SEC) and (2) prior to the issuance of the standard, its contents are: (1) debated in a public forum, (b) exposed in writing to the public for comments, and (2) approved by the Board.

Generally accepted accounting principles (GAAP) vary from country to country due to differences in the legal system, levels of inflation, culture, degrees of sophistication and use of capital markets, and political and economic ties with other countries (Spiceland et al, 2007). These differences cause huge problems for multinational companies. Companies doing business in other countries experience difficulties in complying with multiple sets of accounting standards to convert financial statements that are reconciled to
the GAAP of the countries which they are dealing with. As a result, different national standards impair the ability of companies to raise capital in the international markets.

In response to the problem, the International Accounting Standards Committee (IASC) was established in 1973 to develop international accounting standards. In 2001, the IASC created a new standard setting body called International Accounting Standard Board (IASB). The objective was to identify the best accounting standards to be followed in the financial accounting and reporting of all countries around the world. The IASB’s objectives were (1) to develop a single set of high quality, understandable global accounting standards, (2) to promote the use of these standards, and (3) to bring about convergence of national and international accounting standards. The IASC issued 41 Accounting standards (IAS) which were endorsed by the IASB in 2001. In addition, the IASB revised and issued eight standards of its own called the IFRS while the IASB had no authority to enforce these standards. Since compliance was voluntary, many countries based their national standards on IAS (Spiceland et al, 2007).

2.8 Convergence to IFRS

Even though just 3 years had passed from adoption of above revised standards, the council of the ICASL decided to fully converge with IFRS and thereafter to adopt all pronouncements issued by IASB. Accordingly the SLAS in this proposal with effect from January 1, 2012 are based on corresponding IFRS and IAS formulated by IASB. It seems to be that Sri Lanka is comparatively rich in financial reporting and in par with developed economies of the world where early adoption of IFRS was done for country’s financial reporting practices. Accordingly following accounting standards would be used for
preparation and presentation of financial statements for the periods starting on or after
January 1, 2012.

- Framework for the Preparation and Presentation of financial Statements
- SLFRS 1-First-time Adoption of International Financial Reporting Standards
- SLFRS 2-Share-based Payment
- SLFRS 3-Business Combinations
- SLFRS 4-Insurance Contracts
- SLFRS 5-Non-current Assets Held for Sale & Discontinued Operations
- SLFRS 6-Exploration for and Evaluation of Mineral Resources
- SLFRS 7-Financial Instruments-Disclosures
- SLFRS 8-Operating Segments
- LKAS 1-Presentation of Financial Statements
- LKAS 2-Inventories
- LKAS 7-Statement of Cash Flows
- LKAS 8-Accounting Policies, Changes in Accounting Estimates & Errors
- LKAS 10-Events after the Reporting Period
- LKAS 11-Construction Contracts
- LKAS 12-Income Taxes
- LKAS 16-Property Plant & Equipment
- LKAS 17-Leases
- LKAS 18-Revenue
- LKAS 19-Employee Benefits

42
As the business environment becomes increasingly global and companies are listed on the stock exchanges in many countries, the need for consistent worldwide reporting standards has become more apparent. IAS clearly addresses this issue. Its objective is to create comparable, reliable, and transparent financial statements that would facilitate greater
cross-border capital raising and trade. Deloitte & Touche (2003) summarized the perceived benefits associated with convergence to the IAS:

- For companies: reduced costs of capital and the ease of using one consistent reporting standard from subsidiaries in many different countries,
- For investors: better information for decision-making, leading to broader investment opportunities,
- For national regulatory bodies: better information for market participants in disclosure based-system.

Consistent application of accounting standards that are the same for companies around the world would result in better comparability of financial information resulting in more informed decision-making. For regulators, the confusion associated with the need to understand various accounting standards would be reduced. For auditors, a single set of accounting standards would enable international auditing firms to standardize training and better assurance of the quality of their work on a global basis.

However, the impact of convergence is not limited to financial accounting and reporting. It also applies to areas such as financial and tax planning, business development, risk and control. Therefore, senior management’s commitment for convergence and timely preparation of employee training, system alignment etc would be vital.

Banks and financial institutions are required to prepare their financial statements in accordance with the IFRS worldwide. The adoption of IFRS has created the demand for comprehensive, expert and, above all, practical advice.
It was observed that a number of barriers existed for the implementation of IFRS in Sri Lanka. Listed down below are some of such barriers recognized.

- There are disagreements in some countries with the requirements of certain significant IFRS (such as financial instruments and other standards based on fair value accounting). In addition, there is tension between the capital markets orientation of IFRS and the tax-driven nature of some national accounting regimes.

- The complicated nature of some IFRS is perceived as a barrier to convergence in about half of the surveyed countries. Consequently, countries may be limiting implementation of IFRS to listed companies. The result of this approach would be a widening of the gap between IFRS and the national accounting standards utilised by small and medium-sized entities (SMEs).

Further, it was found that there are number of challenges to the managements of all entities with respect to convergence of IFRS in January 2012.

- The coverage of IFRS in the education and training of professional accountants needs to be increased.

- Timely national language translations of IFRS, including interpretations, need to be made available.

- Adversity in system requirements and changes

- Difficulties in giving timely communication of the changes to stakeholders (i.e., volatility, performance reporting, investor relations, key performance indicators)

- Synchronization of management and external reporting
• Chronic accounting issues and interpretations needed on implementation of IFRS conversion
• Competency of company personnel
• Accessibility and understanding of required disclosures
• Lack of comprehensible guidance on the tax implications of the changes in standards

2.9 Banking System of Sri Lanka

Sri Lanka has a fairly well diversified banking system. There are 22 commercial banks – eleven local and eleven foreign. In addition, there are 14 local specialized banks. The Central Bank is responsible for supervision of all banking institutions. It has driven improvements in banking regulations, provisioning, and public disclosure of banking sector performance. Credit ratings are mandatory for all banks operating in Sri Lanka. The Central Bank has accepted the Basel II standardized approach framework. The CBSL also has developed a road map for the implementation of International Accounting Standards on Financial Instruments for banks by January 1, 2012. Nevertheless, the CBSL still suffers from lack of autonomous authority, especially with regard to the large state-owned banks.

Total assets of Commercial Banks stood at LKR 2,502 billion as of December 31, 2009. The two State-owned Commercial banks, Bank of Ceylon and People’s Bank, with assets of LKR 547 billion and LKR 501 billion respectively, are still important players, accounting for over 40% of all assets.
The two state banks are inefficient and have accumulated extensive bad debt. However, as these banks are implicitly guaranteed by the state, their problems have not harmed the credibility of the rest of the banking system. Both these banks have significant exposure to the State and State-Owned Companies, which are treated as performing loans. Like the rest of the banking sector, the State banks experienced deterioration in asset quality in 2009. Non-performing loan ratio was 5.8% at Bank of Ceylon and 6.7% at People’s Bank.

The RDBs were possessing LKR 40.8 billion worth assets as at April 30, 2010 which was closer to 2% of the total assets of commercial banks operates in the country. The banks presence in rural areas throughout the country would be more beneficial to the economy for its development.

Private commercial banks and foreign banks operating in Sri Lanka generally follow more prudent credit policies and, as a group, are in better financial shape. Foreign banks tend to make provisions in line with international best practices, as most foreign bank branches are subject to host country supervision in addition to that of the CBSL of Sri Lanka.

The regulatory and supervisory framework for Banks is specified in the Banking Act, Monetary Law Act and Exchange Control Act. The CBSL issues banking licenses for two categories of banks, namely Licensed Commercial Banks and LSBs (which are savings and development banks). The main difference between a Licensed Commercial Bank and a LSB, is that the former is permitted to accept demand deposits from the public (operate current accounts for customers) and is an authorised dealer in foreign exchange which
entitles it to engage in a wide-range of foreign exchange transactions, whereas the LSB is not.

The laws empower the CBSL to undertake the following:

* Grant approval for establishing and closing of banks, branches and other business outlets of banks

* Issue prudential directions, determinations and orders to banks, under the statutes.

* Conduct off-site and on-site examination of banks and the enforcement of regulatory actions and the resolution of weak banks

The regulatory and supervisory function relating to banks licensed by the Monetary Board is carried out by the Bank Supervision Department of the CBSL. The supervision of banks is based on the internationally accepted standards for bank supervision set out by the Basel Committee for Banking Supervision. Under the off-site surveillance system, the financial condition of Licensed Commercial Banks and LSBs is monitored on the basis of periodic information provided by banks on their operations. The periodic information includes weekly interest rates of deposits and advances, monthly returns on selected financial information, assets and liabilities, statutory liquid assets, quarterly returns on income and expenditure, capital adequacy, non-performing advances, classified advances and provisioning for bad and doubtful advances, investments in shares, accommodation granted to bank directors, their close relations and concerns in which a director has a substantial interest, interest spreads, half-yearly return on share ownership of the banks and annual audited financial statements.
It was reviewed whether all the banks have complied with the CBSL Guideline 02/04/004/0002/001 which provides a prescribed formats for preparation and presentation of bank’s financial statements. Any non compliance has been notified under the chapter 5 of this study.

In terms of the provisions of the Banking Act and the Monetary Law Act, all Licensed Commercial Banks and LSBs are subject to statutory examinations, at least once in two years. A new approach to on-site supervision has now been adopted - the risk based examination process, which focuses on identification of banking risks, the management of these risks and the assessment of adequacy of resources to mitigate these risks. This is supplemented by examination based on the internationally accepted CAMEL model (Capital Adequacy, Asset Quality, Management, Earnings and Liquidity). In addition, a bank’s compliance with statutory requirements, applicable laws and regulations, internal controls and the standards of corporate governance are assessed. Matters relating to non-compliance with prudential requirements and any weaknesses and deficiencies in the financial condition, controls and systems of a bank are brought to the notice of its Board of Directors, by the CBSL to ensure that corrective action is taken by the bank.

Licensed Commercial Banks and LSBs are also required to publish their quarterly and annual audited financial statements, including key performance indicators, in the newspapers, in all three languages, within two months of the end of each financial reporting period.
Common Banking Forum - The Governor holds monthly meetings with the Chief Executive Officers of Licensed Banks, which serves as a forum for the exchange of views on issues and policies relating to banking operations and the financial sector.

Public Awareness - The CBSL conducts a public awareness programmes on the banking and financial system and regular notices are published in the newspapers to advise the public to assess and to be cautious of the risks and returns on their transactions with financial institutions.

2.10 Revolution of Banking Industry in Sri Lanka

Traditionally, in Sri Lanka the economic activities were aligned focusing on the agricultural activities in the economy. Later in 1940’s the above-stated focus has been shifted towards the industrial sector in reflection to the industrial revolution. However, since the beginning of 1990’s the focus on industrial activities were getting diluted as a result of the development of knowledge-based resources which are recognized as strategically important.

The Financial system includes financial institutions, financial markets and financial instruments that facilitate payments of real sector transactions.

The financial system in Sri Lanka consists of major financial institutions, such as the CBSL, LCBs, LSBs, registered finance companies, specialized leasing companies, primary dealers, provident funds, insurance companies, merchant banks, unit trusts and thrift and credit co-operative societies.
The CBSL is a statutory body that is established under the Monetary Law Act initially enacted by Act No. 58 of 1949. It is the monetary authority, which has powers and functions and responsibilities necessary for the purpose of establishment, administration and regulation of the monetary system of Sri Lanka. The two core objectives of the Central Bank, as stipulated in the Monetary Law Act, are: achieving of the economic and price stability and the financial system stability of the country through effective monetary policy and prudential supervision and regulation of banking institutions. It differs from the commercial banks as it is being the monetary authority is at the apex of the financial system functioning as a banker to commercial banks. It provides reserves to the system. Commercial banks are banking institutions with power to maintain current accounts and providing all commercial banking services to their customers. There are a total of 12 local commercial banks and 12 international commercial banks and 9 LSBs that are operations in Sri Lanka. They are all governed by the CBSL.

Overall, banks play a significant economic role in Sri Lanka as indicated by the ratio of total banking sector assets to real GDP. Banks also account for significant shares of government and private borrowings. The cumulative lending to private and government institutions is greater than the deposits to GDP ratios. This reflects the key intermediation function banks perform in Sri Lanka. The Sri Lankan banking market is highly concentrated and dominated by the two large domestic banks. The three largest banks account for 64 percent of the total banking sector assets. This domestic bank dominance is because most foreign banks have centered their operations in the major cities and operate limited branch networks. These foreign bank branches were mainly located in the capital city, Colombo, and constitute approximately 7 percent of Sri Lanka’s banking
sector assets. Overall, bank penetration as measured by the number branches per 1,000 km\(^2\) and number of branches per 100,000 km\(^2\) has improved over the years and as of the end of 2008, compares favorably against other South Asian countries as per CBSL report in 2009. With regard to supervision, Sri Lanka's financial sector is regulated by multiple agencies with bank regulation under the direct control of the Central Bank of Sri Lanka.

With regards to regulatory and structural changes, Sri Lanka's financial sector reforms started with the introduction of liberalized economic policies in 1977. Before then, the Sri Lankan financial sector was highly regulated and controlled. The state-owned banks dominated the deposit mobilization and loan production. There were rigid controls on credit disbursement; for example, state-owned banks were discouraged from making loans to the private sector. A two-tier interest rate structure existed: the market rate and a subsidized rate used to channel credit to priority sectors. Foreign direct investments were restricted and discouraged. These excessive controls distorted the market mechanism and led to a stagnated financial system. As a part of the overall economic liberalization process introduced in 1977, specific financial deregulatory measures were initiated to correct these distortions. For example, in 1977, state-owned savings banks and commercial banks were allowed to revise their interest rates upward in line with market rates to ensure a positive real rate of return to savers. The credit limits on bank loans to finance companies were relaxed while credit limits on bank loans to state-owned enterprises were completely removed.

To better monitor non-bank financial institutions, the Control of Finance Companies Act No. 27 of 1979 was introduced.
In 1980, the Resident Non-National Foreign Currency Account Scheme was introduced and as a result the commercial banks were given more freedom to deal in foreign currency. In 1983, all remaining credit ceilings were abolished and commercial banks were allowed to establish foreign currency banking units to provide off-shore banking facilities to foreign investors in the export processing zones.

The government also introduced the Regional Rural Development Bank Act No. 15 of 1985 to formalize the rural banking sector. The Banking Act No. 30 of 1988 was then enacted and new directions and guidelines on commercial banks were issued. The Central Bank of Sri Lanka was given wider powers in terms of the Control of Finance Companies Act No. 78 of 1988 to regulate finance companies and establish a new department for non-bank financial institution supervision.

To broaden the institutional infrastructure of the financial system, approval was granted in 1990 for the establishment of merchant banks. Similarly, to strengthen the debt recovery process of commercial banks, specific legislation was introduced: Debt Recovery (Special Provision) Act No. 2 of 1990, Mortgage (Amendment) Act No. 3 of 1990 and Recovery of Loans by Banks (Special Provisions) Act No. 4 of 1990. In 1993, new capital adequacy standards based on Basel guidelines were introduced for all commercial banks. As a result, the then capital-strapped two state-owned banks were recapitalized to restore their financial viability. The state-owned National Development Bank’s capital was also enhanced through a public share issue. Since 1995, commercial banks were allowed to obtain foreign loans without CBSL’s approval.

The government also brought savings banks and development banks under CBSL’s supervision to streamline the regulatory function.
The banking sector in Sri Lanka comprises LCBs and LSBs. Sound and effective banking system in Sri Lanka is very important to create a healthy economy. Therefore, the efficiency of the financial system depends on the soundness of the financial institutions, especially the commercial banks.

The banking system should be hassle free as well as be able to meet new challenges posed by the technology and any other external and internal factors. For the past three decades Sri Lanka's banking system had several outstanding achievements.

The systemic importance of the LSB sector is comparatively lower than of LCBs in terms of size and influence on the financial system of Sri Lanka.

Many reforms were introduced in the country in the early 1990s, which included most of the elements of a modern financial system the world knows today. The commercial banks of Sri Lanka are active in almost all aspects of financial services. The reforms introduced in Sri Lanka in the 90s were responsible for the development of the financial sector in the country along with some technical assistance from other countries. The government also focused on the minimum intervention in the financial sector in order to allow the private institutions to work on market mechanism as direct government intervention increases the risk of reducing the flow of finance and investments and efficiency of the financial sector.

Progress in the financial sector depends on improvements in the law and formalities for financial services, development of infrastructure, and making prudential norms strong. At
the same time the state owned institutions are very important, which consume resources through inefficiency and protect other institutions from cut throat competition, which may harm the economy.

The financial sector comprising commercial banks, specialized development banks and other institution has led to universal banking, as the institutions now offer an entire array of banking services.

The banks now offer consumer banking, investment banking, fee based activities, venture capital, fund management, stock broking and bank assurance.

In the past few decades, there have been many mergers and acquisitions in the banking sector. Mergers and acquisitions indicate that there is over capacity in the banking industry and a weak bank which merges with comparatively a stronger bank could harm the performance of the stronger bank unless the merger is managed efficiently.

With all these developments over decades the banking network increased to 6,122 outlets including 12 overseas outlets and 2,240 automated teller machines by 2011.

2.11 Companies Act No 07 of 2007

All the companies incorporated under the Registrar of Companies will be governed by the Companies Act No. 7 of 2007 (the “Act”). The Act marks a significant milestone in the development of the company law in Sri Lanka for many reasons. Firstly, it results in a significant paradigm change in the foundation of company law by moving away from its
traditional affiliation to the company law in England and aligning itself to a legal system based on a model that exists in Canada and New Zealand.

Secondly, it introduced several crucial changes by eliminating some fundamental concepts that had formed the essence of our company law, and substituting other concepts in their place. Thirdly, it results in modernizing company law in Sri Lanka, and at least theoretically, placing it ahead of its counterpart laws in the rest of South Asia. Though there are positive aspects to the law, it is not without defects. The Act has been widely criticized, not only for its content, but also the manner in which it was formulated and adopted. These factors necessitate a critical examination of the substance of the Act and the process by which it was adopted.

Company law in Sri Lanka has traditionally been based on the law of England. In 1982, Sri Lanka adopted the Companies Act No. 17 of 1982. This law was, however, based on the English Companies Act of 1948, thus resulting in the adoption of a law which was outdated by at least four decades, even at birth. In the late 1980’s and the early 1990’s there was a marked increase in the commercial and economic activity in the country, resulting in intense pressure being made on the resurrection of its dormant capital and financial markets.

Although the Government took several measures to improve the operational and regulatory infrastructure to facilitate such development by means of encouraging the restructuring of the Colombo Stock Exchange, the establishment of the Securities and Exchange Commission and other complementary bodies such as the Sri Lankan Accounting and Auditing Standards Board, and the implementation of an aggressive privatization program, no corresponding developments were made in respect of company
law. This often led to problems for the private sector i.e., the “engine of growth”. Though forced to compete for financing on commercial terms, the private sector was required to be innovative in formulating modern financing techniques. Additionally, the law was also required to provide adequate comfort to the investors that their interests would be preserved. However, the law often proved to be lacking in these respects.

Eventually, in or around 1993, the government was compelled to address this problem by commissioning the formulation of a new Companies Act.

The Companies Act No. 7 of 2007 marks a significant milestone in the development of the company law in Sri Lanka. Many of its features are improvements to what existed previously. This is particularly true in respect of what has been introduced in relation to the treatment of capital, directors duties and stakeholders rights. However, at the same time there are certain features in the law that could be cause for concern and therefore would deserve further examination. For instance: The law has, by design or by inadvertence, failed to recognize some essential practices that had been previously adopted by companies.

A clear example of this is the treatment given to the issuance of bonus shares. Even though it is clear that the intent of those drafting the law was not to exclude the possibility of issuing bonus shares, the inadvertent exclusion of a provision that exists in corresponding laws to empower and facilitate companies in issuing bonus shares has made it impossible to make such issues without exposure to legal risks.

The Act has imposed several responsibilities on directors which appear onerous in the context of the economic climate of Sri Lanka. For instance, sections 219 and 220 of the Act require directors to resolve whether or not to liquidate companies when they are
faced with solvency issues. Though these requirements are laudable in that they ensure good governance and protection of stakeholders, widespread concerns have been expressed that boards of a large number of companies in Sri Lanka may have to resolve to liquidate companies under the present circumstances. Had our law provided efficient restructuring processes, such a situation could have been better managed. However, the absence of such mechanisms, and the dearth of a pool of qualified persons to perform functions as directors appears to make this requirement unnecessarily burdensome on the corporate sector.

Sections 148-153 of the Act has emphasis the requirement for keeping accounting records, obligation to prepare individual and/or group financial statements, basic contents of the financial statements and other related provisions.

Certain measures would necessarily have to be in the form of amendments to the Act. Additionally, several measures will be required to harmonize various regulations, such as the rules of the Stock Exchange and the Central Bank, with the provisions of the Act. Unless these measures are taken without delay, the full benefit of the Act will not be realized.

2.12 Chapter Summary

There is an active and fairly competent accounting profession, based on the British model. The source of accounting standards is the ICASL, and they are constantly updated to reflect current international accounting and auditing standards adopted by the IASB. In addition, Sri Lanka follows the worldwide move to adopt IFRS for financial reporting purposes set by the IASB. The proposed full convergence is expected for financial periods on or after January 1, 2012. A significant change is also expected with full
convergence. Due to the lack of an adequate enforcement mechanism, problems with the quality and reliability of financial statements still exist. The Companies Act and the CBSL guidelines are the other governing tools of companies/ banks in addition to the SLAS.

As per Muhammad Jahangir Ali at el (2009) that there are very few studies on application of accounting standards by banks in Sri Lankan context as well as all over the world. Therefore the researcher has concluded the literature survey by limiting to SLAS and IFRS and related issues of application of such standards in the banks and other companies in the country.

The literature survey created a path for the researcher to march towards the targets of the study. The next chapter discusses about the RDBs, one of the important subject topics of the study. It would be able to find out more facts and findings about RDBs by reading next chapter.
Chapter 03

REGIONAL DEVELOPMENT BANKS

3.1 Introduction

With a thorough knowledge acquired in relation with the SLAS, IFRS, Companies Act and the CBSL regulations over the banks and other companies, which are operating in Sri Lanka, are now need to find out more information about the specific bank under the review of this study. Accordingly, it was examined the history and current position of the RDBs and this chapter explains the institutional background of RDBs, description of six RDBs, authorized activities, organizational structure, ownership, regulation and supervision, audit, decision making process and operations of the banks.

3.2 Institutional Background

Commencing in 1985, the Government of Sri Lanka established 17 Regional Rural Development Banks (RRDB) through an Act of Parliament. Financed entirely by the Government, these institutions were given the task of reaching remote rural areas and smallholders without access to financial services from commercial banks. The RRDB covered all districts of Sri Lanka with the exception of the North and East. However, their success was limited by internal structural weaknesses and excessive geographical fragmentation, which prevented them from reaching a critical mass.

In addition, the banks lacked sound lending and monitoring policies, and operations were difficult to improve and standardised. A significant restructuring and recapitalisation took place in 1998-1999 and the RRDB were consolidated into six RDBs. This involved granting RDBs more autonomous management, allowing a broader ownership base, and
having Board Members appointed by shareholders, all with the purpose of increasing the professionalization of operations and, thus, their viability and sustainability in the long-term.

All the development banks provide financial and non-financial services to its customers as mentioned below.

- Financial Services: All six RDBs offer loans, savings and pawnng facilities. Four RDBs provide short term credit and three provide leasing. Two RDBs offer pension schemes (RUDB and WDB).
- Non-financial Services: Financial advisory services, training and skills development are offered by all five RDBs that offer non-financial services, while three RDBs also assist in group formation and provide marketing assistance to their clients.

The details of six development banks are given below.

3.3 Kandurata Development Bank

The introduction of Regional Development Banks in to the Banking system was engineered in 1997 by an act of parliament. Keeping in line with the objectives of the said Act of the Parliament and the economic thinking of that period, the Monetary Board of the CBSL established the RDBs for specified regions by providing financial assistance for the development of agriculture industry, trade, commerce and other development activities in the region, vesting the business of RRDB situated in such regions. With the above objectives KDB was established and commenced its business on 28th October 1998
and the operations of the Bank advocated a more development oriented, efficient and customer conscious institution which was also a cost effective delivery mechanism. The Banks as financial intermediaries were also being called upon to act as instruments of correcting economic, social and regional imbalances. As a State owned RDBs, this role was further de-centralized to provide a device for implementing Government policy of rural development and had launched a series of rural financial innovations with a view to catalyzing the development of the rural sector, which accounted for more than 70% of the population of the Central Province. Therefore, the KDB being an arm of financial services delivery was able to device ways of dealing with the differing demand of commercial financing and development financing. However, there were yet to evolve appropriate banking culture, staffing patterns, skills, training, promotional criteria and introduction rural financial innovation to cope with their demands.

3.4 Wayamba Development Bank

The WDB was established in 1999 under the Regional Development Bank Act No.06 of 1997, by amalgamating the RRDB existing at that time in the districts of Gampaha, Puttlam and Kurunagala. Since then the Bank had achieved a rapid expansion within its jurisdiction of the districts of Gampaha, Puttlam and Kurunagala. The activities of expansion were carried out through 37 branches controlled under 03 Zonal offices. Due solely to the excellent service provided to the rural community, the number of the deposit holders of the Bank had exceeded 563,000.
Because of the various savings schemes and credit facilities offered by the Bank, it had been able to grant a larger amount of loans for agricultural, livestock farming fisheries, and other various small scale projects.

The present loan balance exceeds rupees 6250 million. A unique feature was that, even under the minimum human resources as a development bank, it had been able to maintain the non performing loan ratio below 3.5 percent. This was the result of the good relationships the bank maintains with the customers. Their main objective as a development bank was the socio-economic development of the rural community living under the minimum facilities.

3.5 Uva Development Bank

This Bank was established for the development of the Uva province in Sri Lanka consists of three districts which embodied Badulla and Monaragala with the Ampara, in the Eastern Province. This was incorporated under an Act of parliament on 1999.03.18 with the takeover of assets and liabilities of the three RRDB namely Badulla, Monaragala and Ampara. The Bank’s area of operation was covered with a range consists of 12820 square kilometers with a population of 2.0 million approximately. The mission of the Bank was to provide financial assistance for the development and the upliftment of rural masses by identifying available resources in the area.

3.6 Ruhuna Development Bank

Ruhuna Development Bank was established under the Regional Development Banking Act No 6 of 1997. The RUDB was formally known as the RRDBs and such banks (Galle, Matara and Hambanthota) were merged to form the Ruhuna Development Bank in 1999.
The shareholders of the Bank were the General Treasury of Sri Lanka, National Savings Bank, Bank of Ceylon and People’s Bank. The main objective of the bank was, “to be the best microfinance provider of the region” within which it operated, with special emphasis on promoting and developing the agriculture, industry, trade, commerce and fisheries related activities.

The RUDB was the first specialized bank established under the Regional Development Bank Act No. 06 of 1997. The bank was able to successfully overcome the terrible disaster caused by the Tsunami Ttidal wave which occurred in the end of 2004.

3.7 Rajarata Development Bank

The bank was incorporated by the Minister, under recommendation made by the monitory board of the CBSL as it was necessary that a development bank to be established region wise for the purpose of development of the economy of such region under the Regional Development Bank Act No. 6 of 1997. The said Act gave the authority for vesting the business carried out by RrDBs situated in the specified region for the same purposes.

This was the Bank incorporated for the North Central region by vesting the business carried out by RrDBs in North Central province which included Anuradhapura and Polonnaruwa on November 12, 1998. Further, the bank was registered under the Banking Act, No. 30 of 1988 as a LSB.

As per the Act, with the establishment of the said bank for the North Central Region by order published in the Gazette, vested the business carried on by any or all RrDB in the specified region as being the business it had been authorised to carry in the acquiring bank. The mission of the bank to improve the socio economic living standard of the
people of Rajarata by providing excellent banking services through professional banking staff. Further its major activities included to provide for the overall economic development of the region within which it operated, with special emphasis on promoting and developing the agriculture, industry, trades, commerce and fisheries activities and projects of Samurdhi beneficiaries of North Central province and development projects undertaken by the Provincial Councils, Pradeshiya Sabhas and other local authorities in the region.

3.8 Sabaragamuwa Development Bank

The SDB, incorporated on January 1, 1999 by an Act of Parliament was fully owned by the state and operates in the region of Sabaragamuwa covering four districts namely Ratnapura, Kegalle, Kalutara and Colombo. The SDB has licensed as a specialized bank by the CBSL. Main activities included the mobilizing of savings and development lending through microfinance. The prime objective was regional economic development with emphasis on promoting income generating activities by individual and group methodology for enhancing agriculture, fisheries, small and micro enterprises' productivity. Its vision was to be the premier bank for development of microcredit in the region. The bank competed with the other state and private banks in the region for mobilisation of deposits and in development lending. Their main challenge was to increase the depth of their out-reach programmes to cover a larger geographical area by providing mobile banking services of opening up branches. Other challenges included NGO credit culture, natural disasters, competition from commercial banks and other financial institutions, insufficient capital, primary level information system and technology.
3.9 Authorised Activities of RDBs

The LSBs were entitled to carry out the following activities.

➢ The business in which as specified in the schedule IV to the banking Act No 30 of the 1988 and the amended Act No 33 of the 1995 as well as the Act No 06 of the 1997.

➢ The activities, which had been authorized by the Monitory Board of the Central Bank of Sri Lanka.

In 2010, the Government of Sri Lanka decided to merge all six RDBs as one development bank which had a wide capacity to serve the entire nation. This would have the advantage of better capabilities to mitigate regionally specific risks. However, the disadvantage of a less flexible structure was envisaged.

3.10 Organisational Structure

The RDBs were confined to specific regions across the country. With an average of approximately 36 branches per Development Bank, the organisational structure was more decentralized compared to microfinance programmes and institutions which operate nationwide. The organisational structure of all six RDBs was similar, as prescribed through the Regional Development Banks Act.

The RDBs were owned by the Government of Sri Lanka either directly through the Treasury or indirectly through other Government-owned or managed institutions such as the Bank of Ceylon, People’s Bank, and National Savings Bank. They were regulated and supervised by the CBSL. In addition to the supervision carried out by the supervisory
department of the CBSL, a special monitoring department was created within the CBSL for the RDBs.

The RDBs were licensed specialised banks governed by the Regional Development Banks Act No. 6 of 1997. When interviewed, the respondents seemed to be better equipped to identify the supervisory authority than the regulatory one. All the RDBs were supervised by the CBSL. When asked about regulations, two RDBs even stated that they were not regulated at all of the four that declared they were regulated, two named the CBSL as the regulatory authority while the remaining two, respectively, identified the Ministry of Finance and the Government of Sri Lanka. When asked about the supervisory actions taken by the CBSL, the respondents mentioned measures such as inspection/audit of accounts (three RDBs), submitting operational information on a regular basis (three RDBs) and representation on the management Committee or the Board of Directors (two RDBs).

The accounts of all RDBs were audited both externally and internally. The RDBs were required by the law to conduct an external audit. A list of approved auditors was provided by the CBSL, and the shareholders, at the Annual General Meeting, select the external auditor. On the recommendation of the CBSL, all the RDBs are now also being subject to an internal audit.

Most of the RDBs follow an integrated business approach, which means that all the deposit mobilization and lending activities were not functionally separated from the other activities of the bank. This was understandable against the backdrop of the RDBs perception that, on average, over 85% of their activities are microfinance-related in terms of revenues earned, thus microfinance was their core business and the question of a
separate unit does not arise. Only KDB declared that it had a specific microfinance unit with its own staff and books of accounts. The Board of Directors decided the overall operating policies of RDBs in five of the six RDBs while a management committee decided the overall operating policies of the remaining RDB. All RDBs claimed to establish and follow business development goals, a business plan and strategies for achieving the targets set for their microfinance activities. These goals, plans and strategies addressed interest rates, product design, human resource management and target group orientation, and were mostly designed by, and decided at, the top management level (i.e. a centralised approach). Only one RDB seemed to allow management and staff at the branch level to decide on product design and target group orientation.

3.11 Operations

3.11.1 Branch Distribution

RDBs maintain a total of 227 outlets that offer banking services to clients. Their distribution, by banks is presented in table 3.1.

Table 3.1 – Branch Distribution of RDBs

<table>
<thead>
<tr>
<th>Bank</th>
<th>Outlets (Branches/ Service Centers)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
</tr>
<tr>
<td>Kandurata Development Bank (KDB)</td>
<td>33</td>
</tr>
<tr>
<td>Wayamba Development Bank (WDB)</td>
<td>37</td>
</tr>
<tr>
<td>Rajarata Development Bank (RRDB)</td>
<td>25</td>
</tr>
<tr>
<td>Uva Development Bank (UDB)</td>
<td>32</td>
</tr>
</tbody>
</table>
RDBs maintained a total of 227 outlets that offer banking services to clients. Their distribution, by province and sector, is presented in Table 3.2.

Table 3.2 – Regional and sectoral coverage of RDBs

<table>
<thead>
<tr>
<th>Province</th>
<th>Outlets</th>
<th>Sector</th>
<th>Population density per outlet (Population/No. of Outlets)*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>Urban</td>
</tr>
<tr>
<td>Southern</td>
<td>46</td>
<td>20.3</td>
<td>6 (13.0%)</td>
</tr>
<tr>
<td>Uva</td>
<td>23</td>
<td>10.1</td>
<td>2 (8.7%)</td>
</tr>
<tr>
<td>Sabaragamuwa</td>
<td>31</td>
<td>13.7</td>
<td>7 (22.6%)</td>
</tr>
<tr>
<td>Western</td>
<td>30</td>
<td>13.2</td>
<td>10 (33.3%)</td>
</tr>
<tr>
<td>North Western</td>
<td>30</td>
<td>13.2</td>
<td>4 (13.3%)</td>
</tr>
<tr>
<td>North Central</td>
<td>25</td>
<td>11.0</td>
<td>1 (4.0%)</td>
</tr>
<tr>
<td>Central</td>
<td>33</td>
<td>14.5</td>
<td>11 (33.3%)</td>
</tr>
<tr>
<td>Northern</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Eastern</td>
<td>09</td>
<td>4.0</td>
<td>4 (44.4%)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>227</td>
<td>100.0</td>
<td><strong>45</strong></td>
</tr>
</tbody>
</table>

Note * the source for population per province was the Census of Population and Housing, Department of Census and Statistics – Sri Lanka, 2001. For the Eastern Province, 2001 estimates from the Department of Census and Statistics were used.

The RDBs covered seven out of the nine provinces entirely and the Ampara District in the Eastern Province. The number of outlets per province varied from seven (Eastern Province) to 46 (Southern Province). 78.0% of all the RDB outlets were classified as
rural and only five (i.e. 2.2%) outlets operate in the estate sector. The average population served per RDB outlet was approximately 79,765. The population per outlet was significantly lower than the average in the North Central, Southern, Uva and Sabaragamuwa Provinces. The highest population density per outlet was found in the Eastern Province with 196,660 people per outlet and the Western Province with 179,371 people per outlet. The high population densities per outlet could be explained by the lack of presence of RDBs in the Batticaloa and Trincomalee Districts in the Eastern Province, and, in the Western Province, due to the focus was being on a few disadvantaged locations within the province.

3.11.2 Clients

According to the respondents, the client bases of the RDBs were estimated at 2.18 million people. It had to be noted that the way each RDB defines microfinance had a significant impact on its definition of the customer base. Moreover, only one bank collected data on a client level while the remaining five estimated their client base based on the number of accounts, which very likely overstated the number of clients due to the possibility of multiple accounts. Five of the RDBs focused on specific target groups. These were primarily low-income groups (all five RDBs), however, also women, youth, entrepreneurs and farmers (four of the five RDBs which focused on target groups). Only one RDB explicitly indicated the 'rural population' as being a target group.

The RDBs served both female and male clients. Females, however, represented the majority of clients for four of the six RDBs, with Kandurata Development Bank having more than 75% female customers. Only two RDBs (Uva and Rajarata) had more male than female customers.
Figure 3-1 illustrates the economic activity that the RDBs' clients were engaged in. The client portfolio seemed to be reasonably well diversified, with the largest group of clients involved in agriculture (37.7%), followed by trading (15.8%) and manufacturing (14.3%). This large involvement of clients in the primary sector (agriculture, fisheries and animal husbandry, represented 49.8% of the economic activities of clients of RDBs) was well explained by the fact that almost 80% of the branches of the RDBs were in the rural sector.

Figure 3-1 Economic activity of RDBs’ clients

3.11.3 Lending Methodology

The RDBs declared that they were mainly engaged in individual lending (90.5% on average, percentages range from 80% to 97%), while group loans were also offered (3%-
19%, on average 8.8%). In addition, RUDB and UDB provided wholesale loans to other intermediaries on a rather limited scale (1%-3%, on average under 1%).

3.11.4 Loan Processing Time and Approval Procedure

On average, loans were processed in 26 days. The average processing time for a loan varies from institution to institution and was between seven and 60 days. Only two of the six RDBs indicated an average processing time of less than two weeks. Opening a deposit or savings account normally took one day as does the obtaining a pawning facility. The processing time for lease applications varied from three to seven days. For all six RDBs, Credit Committees were involved in the approval process, either for all loans or when loan approval limits were exceeded. Four of the six RDBs interviewed had a rather decentralised loan approval process in place, whereby branch managers had loan approval powers subject to value limits. In certain cases, two of the RDBs declared that they involved the Board of Directors in the loan approval process but this was also likely to be applicable in the case of loans above a certain value.

3.11.5 Loan Monitoring and Provisioning

All six RDBs managed their microfinance operations using a mix of manual and computerised records. This had an impact on the monitoring measures performed. All RDBs used computerised statements and records filed by field officers to track the quality of their loan portfolio. Log books and manual records and entries were also used by five of the RDBs in addition to computerized statements. While all RDBs declared that they measure Portfolio-at-Risk (PaR) in relation to their loan portfolio, when asked to define it, some of the RDBs provided an age analysis of non-performing loans, or declared the overdue installments to be at risk. A proper understanding of the concept
was apparent only in the response of two of the RDBs. PaR should be based on outstanding debt and not only the installments overdue. Loans were subjected to an age analysis and classified as non-performing (NPL) based on the number of overdue installments or months (over three months in arrears). NPLs were further broken down into four categories as overdue (between 3 and 6 months), sub-standard (between 6 and 12 months), doubtful (between 12 and 18 months) and loss (over 18 months). Loan loss provisions were calculated according to regulations set by the CBSL, based on age analysis and the classification of the loan portfolio. Each loan category carried its individual provisioning rate – 20% for sub-standard, 50% for doubtful and 100% for loss. Additionally, a statutory general provision of 1% on total performing loans and the overdue loans category net of loans and advances secured by cash deposits, gold and government securities was introduced in December 2006. The RDBs had three years to progressively reach the required level of general provision.

3.11.6 Products and Markets

RDBs had a rather diversified product portfolio that includes savings/ deposits, loans, pawning, leasing and pension schemes. The first three types of products were offered by all RDBs, while the remaining two were offered by three and two RDBs, respectively. An overview of the product portfolio in terms of volumes outstanding, number of accounts and interest rates is given in Table 3-3.
Table 3.3 Products/Services of RDBs

<table>
<thead>
<tr>
<th>Product/Service</th>
<th>Volume outstanding (Rs. ‘000)</th>
<th>No. of Accounts</th>
<th>Average outstanding balance (Rs.)</th>
<th>Annual interest rate %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings and Deposits</td>
<td>32,168,305</td>
<td>5,108,562</td>
<td>6,297</td>
<td>3-11</td>
</tr>
<tr>
<td>Loans</td>
<td>20,311,147</td>
<td>702,582</td>
<td>28,909</td>
<td>6-24</td>
</tr>
<tr>
<td>Pawning</td>
<td>9,858,692</td>
<td>804,231</td>
<td>12,259</td>
<td>14-18</td>
</tr>
<tr>
<td>Leasing</td>
<td>141,308</td>
<td>1,934</td>
<td>73,065</td>
<td>13-17</td>
</tr>
<tr>
<td>Pension Products</td>
<td>98,435</td>
<td>18,697</td>
<td>5,265</td>
<td>6.5-9</td>
</tr>
</tbody>
</table>

Source: Consolidated net assets statement as of April 30, 2010

3.11.6.1 Loan Products

Each RDB had, on average, 117,000 microfinance loan accounts with an average volume outstanding of Rs. 3.3 billion. Interest rates were set by four of the RDBs at a rate that maintains a desired margin above the deposit rate. In the remaining two RDBs, rates were set based on Central Bank rates and on the rules and regulations of funding agencies where specific loan schemes were involved. Interest rates for loans were calculated on a declining balance basis. Two RDBs applied penalty interest rates for late payments, and three granted interest rate reductions for early payments. All six RBDs had a compulsory savings scheme as a condition for obtaining a loan, and five charged service charges for
processing the loan. The minimum repayment period ranged from 1 to 6 months and the maximum period ranged from 36 to 60 months.

3.11.7 Human Resources

The collective staff strength of the RDBs was 2,304. However, there were quite wide variations across the individual banks. The largest RDB in terms of staff, RUDB, employs 468. The RrDB, the smallest RDB in terms of staff, had only a little over a third of the staff of the RUDB. On average, the RDBs employed approximately nine staff per branch. It had to be noted also that two of the RDBs (the WDB and the RrDB) had a large number of trainees (266 and 78 respectively) who had been excluded from the total staff figures considered in this report. These trainees were school leavers who joined the RDBs to obtain work experience until they started University. Despite their large number, due to the short period that they were with the bank and their lack of qualifications, they were not considered to be playing an important role in the operations of the bank, resulting in an average of approximately nine staff per RDB branch. Regarding the composition of the staff employed, a breakdown is provided in table 3-4 together with the minimum qualifications required for employment. With regards to the experience required to fill the respective positions, 67% of the RDBs reported that experience was not a must for recruitment, while the remaining 33% considered it essential. 94% of the RDB staff were permanent, while 6% were time bound contract staff.
Table 3.4 Staff Competent of RDBs

<table>
<thead>
<tr>
<th></th>
<th>Total Staff</th>
<th>Managerial staff</th>
<th>Credit/field staff</th>
<th>Clerical staff</th>
<th>Support staff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absolute number - %</td>
<td>2,304</td>
<td>486</td>
<td>978</td>
<td>587</td>
<td>253</td>
</tr>
<tr>
<td>Minimum qualifications required</td>
<td>Graduate (68%)/A/L passed (19%)</td>
<td>A/L passed (64%)/O/L passed (21%)</td>
<td>A/L passed (60%)/O/L passed (26%)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3.11.8 Recruitment Challenges

Two of the RDBs (the RUDB and the KDB) had not reported any difficulties in recruiting staff. For all levels of staff, the remaining four RDBs mentioned similar difficulties in recruiting suitable staff for bank’s operations. Interference, nepotism and political issues, as well as the absence of a pension system, were mentioned by two RDBs. The lack of skilled people and people with previous experience were cited by one RDB. In addition, the unattractive locations and the fact that microfinance was not considered an attractive career option were reported.

3.11.9 Staff Retention

The most important retention issue mentioned was the difficult nature of field operations. Other issues mentioned were inadequate incentives, the turnover of highly qualified staff and the fact that bank’s operations and market segment was not considered an attractive career option. Once again, only the RrDB and the KDB stated that they did not have staff retention issues.
3.11.10 Incentives

The RDBs claimed to offer their staff a wide range of incentives but these incentives appeared to be inadequate in retaining good employees. All the RDBs stated that they offered performance related rewards, staff training opportunities and reimbursement of medical costs. Five of the six RDBs had remunerative incentives and payment of overtime. Four RDBs provided incentives in the form of distribution of revenue.

3.11.11 Staff Training

On average, managerial staff received five training courses during 2010, followed by clerical staff (four training sessions), credit and field officers (four training sessions) and support staff (three training sessions). All the RDBs reported that they had offered training for managers covering the following areas: project management, marketing/promotional, costing, business planning, credit evaluation, risk management and profitability monitoring. All the RDBs offered clerical staff training on record keeping and five RDBs, on accounting skills development. For credit and field officers, five RDBs offered training on group mobilisation, project management, record keeping, language, accounting skills development, and credit evaluation. The researcher concluded that managers should undergo a more comprehensive training than other categories of staff, covering all relevant areas. Training for credit and field officers were focused on technical skills (accounting, appraisal) and language skills.

3.11.12 Financial Performance

Table 3-5 presents the consolidated balance sheet as at April 30, 2010. Financial data presented here reflected the entire business of the RDBs. Total net assets of the all six
RDBs were LKR 3.148 billion, which was a considerable equity when comparing with other LSBs. It was noted that only LKR 0.846 billion out of the equity was stated capital balance LKR 2.3 billion was the accumulated reserves and retained earnings during a short period of 10-15 years. Even though the history of the RDBs turning back to 1985, it was noted that these banks commenced to make profits after late 1990s. The RDBs were having more than LKR 3.2 billion as customer deposits which had been mainly collected by the rural households out of which more than LKR 3.0 billion had been advanced to the development requirements of the regions. It was not difficult to recognize the importance of these regional banks towards strengthening of the national economy.

**Table 3-5 RDBs-Consolidated Balance Sheets as at April 30, 2010**

<table>
<thead>
<tr>
<th>REGIONAL DEVELOPMENT BANK</th>
<th>30.04.2010 Consol. $m</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASSETS</td>
<td></td>
</tr>
<tr>
<td>Cash and Short Term Funds</td>
<td>547,552,794</td>
</tr>
<tr>
<td>Treasury Bonds and Other Securities Eligible for Rediscounting with Central Bank</td>
<td>4,235,844,349</td>
</tr>
<tr>
<td>Other Investments</td>
<td>3,375,012,600</td>
</tr>
<tr>
<td>Loans and Advances</td>
<td>30,311,147,176</td>
</tr>
<tr>
<td>Lease Rentals Receivables</td>
<td>36,617,615</td>
</tr>
<tr>
<td>Bills Purchases</td>
<td>66,550,792</td>
</tr>
<tr>
<td>Non-Current Assets held for Sale</td>
<td>171,810</td>
</tr>
<tr>
<td>Interest Receivables</td>
<td>1,351,019,450</td>
</tr>
<tr>
<td>Property, Plant and Equipments</td>
<td>375,798,487</td>
</tr>
<tr>
<td>Other Assets</td>
<td>392,814,191</td>
</tr>
<tr>
<td>Intangible Assets</td>
<td>1,703,028</td>
</tr>
<tr>
<td>Deferred Tax Assets</td>
<td>142,703,644</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>40,836,935,933</td>
</tr>
</tbody>
</table>
**LIABILITIES**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits from Customers</td>
<td>32,168,305,882</td>
</tr>
<tr>
<td>Borrowings</td>
<td>2,809,186,749</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>2,474,770,661</td>
</tr>
<tr>
<td>Deferred Government Grants</td>
<td>724,219</td>
</tr>
<tr>
<td>Other Deferred Liabilities</td>
<td>55,376,476</td>
</tr>
<tr>
<td>Debentures</td>
<td>180,560,907</td>
</tr>
</tbody>
</table>

**NET ASSETS**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,148,011,038</td>
</tr>
</tbody>
</table>

**NET ASSETS REPRESENTED BY**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stated Capital</td>
<td>846,291,530</td>
</tr>
<tr>
<td>Statutory Reserve Fund</td>
<td>303,324,885</td>
</tr>
<tr>
<td>Reserves</td>
<td>1,758,619,085</td>
</tr>
<tr>
<td>Retained Profit</td>
<td>239,775,538</td>
</tr>
</tbody>
</table>

**Source:** Net Assets Computation Based on the audited balance sheets as at April 30, 2010 – RDBs

**3.12 Chapter Summary**

This chapter discussed the important aspects of the structures and operations of the RDBs, in which context; the quality of financial statements had to be assessed. Further, it had highlighted the importance of RDBs towards the national economy and the capacity of the bank in terms of its financial position as of April 30, 2010. The study was focused to examine to which extent these RDBs had complied with SLAS when preparing and presenting the financial statements and the difficulties and complications, the staff members faced with while doing this compilation exercise.
Chapter 04

METHODOLOGY

4.1 Introduction

Planning and designing needed to be considered as the most important part of a project. Accordingly, this chapter explained the methodology of conducting the research which includes the samples selected for the study, research design, research method, such as survey method, data collection, etc. and methods of data analysis. This further included the questionnaire development and the structure of the questionnaire as well.

4.2 Scope of the Study

This study examined the application of SLAS by the RDBs when preparing and presenting financial statements. All six RDBs as listed below were selected for the study.

- Ruhuna Development Bank
- Uva Development Bank
- Sabaragamuwa Development Bank
- Wayamba Development Bank
- Rajarata Development Bank
- Kandurata Development Bank

All six development banks were selected for the study due to almost similar structures and objectives of all the RDBs. This research examined the extent which the RDBs had applied SLAS for preparation and presentation of financial statements. Further, this study had considered the quality of financial information provided in the annual reports by the
way of reviewing earnings quality, credit ratings provided by independent qualified agencies etc.

In order to operationalisation it was necessary to use sampling techniques. “Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate” (Sekaran, 2007, p.265). “A sample is subset of population. Sampling is the process of selecting a sufficient number of elements from the population, so that a study of the sample and an understanding of its properties or characteristics would make it possible for us to generalize properties or characteristics to the population elements” (Sekaran, 2007, p. 266-7). All the relevant staff members of finance departments had been interviewed in order to collect the relevant data. Further, the selected members from the top management had also been interviewed in order to verify the information collected from junior officers.

4.3 Data and Data Collection

The data were collected from both primary and secondary sources. The primary data were gathered through the research questionnaire and from the interviews with the key financial officials of the RDBs.

Only finance divisions of RDBs were considered in the study, as such divisions were directly involved with the preparation and presentation of financial statements of the banks. It was noted that only 46 permanent employees were there in the finance divisions of all six RDBs except for the trainees who were working under short-term training contracts and office assistants who were not involving with the financial statement preparation process. These 46 officials were provided with the research questionnaire (annex I) in order to gather primary information mainly focused on the difficulties and
complications faced by the finance division staff when using SLAS for preparation and presentation of financial statements. The questionnaire was redistributed among 10 selected officials out of 46 officials to retest the accuracy of data gathered after two weeks interval. It was reported 100% response as the researcher had personally distributed the questionnaire and collected the same after completion. In addition to the research questionnaire, semi-structured interviews were done with the heads of financial divisions of each RDB to gather additional information and clarifications. It was noted that the CBSL was also regulating the RDBs through CBSL circulars and guidelines. In order to check the compliance and reporting requirements of the CBSL, the researcher had met one of the Assistant Directors of Bank Supervision Department of the CBSL.

All the Assistant General Managers and/or Chief Managers of Finance divisions of the RDBs were interviewed separately in order to gather primary data since they were the responsible officers for preparation and presentation of financial statements of the bank. These interviews were scheduled for 30 minutes to one and half hour time duration depends on the importance and roll of each person for the study. During these interviews, sometimes unstructured questions also had been used in order to obtain further information as necessary.

Secondary data were collected through review of audited financial statements of all six RDBs for a period of five years from 2005-2009. Altogether 30 annual reports of all six RDBs were reviewed to examine the compliance of such banks with SLAS and other regulatory requirements. This review was done to find out to which extent the banks had complied with the SLAS and other regulatory requirements in the preparation and presentation of financial statements. Accordingly, the RDBs were regulated by the CBSL.
guidelines and Companies Act No. 07 of 2007. Further, clarifications and explanations regarding the deviations observed relevant information were gathered from the authoritative and key persons of all six RDBs as well as from the issued annual reports and other important documents publicly available for use in the banks such as newsletters, magazines etc.

For the purpose of this study, below mentioned SLAS had been considered which were directly applicable for the RDBs.

- SLAS 03- Presentation of Financial Statements
- SLAS 09- Cash Flow Statements
- SLAS 10- Accounting Policies, Changes in Accounting Estimates and Errors
- SLAS 12- Events after the Balance Sheet Date
- SLAS 14- Income Taxes
- SLAS 16- Employee Benefits
- SLAS 18 -Property, Plant and Equipment
- SLAS 19 –Leases
- SLAS 23 – Revenue Recognition and disclosures in the financial statements of the banks
- SLAS 30 – Related Party Disclosures
- SLAS 44 – Financial Instruments – Presentation
- SLAS 45 – Financial Instruments – Recognition and Measurement

The study had examined the application of above SLAS, when preparing and presenting financial statements since those were more important and relevant to the banks.
In order to obtain general statistical data, the Census and Statistics Department’s reports and Central Bank Reports were used.

The researcher followed the deductive method of reasoning attempts to visualize the causality of the research problem. The SLAS were regularized by the ICASL and the researcher attempted to test the applicability of selected such SLAS in the case of RDBs. The research was primarily qualitative since outcome of the study was verbal. This research had been conducted using case study approach since it was based on RDBs. As per Yin (1993) a case study was appropriate when the phenomena under investigation were not readily separated from the context. It was characterised by an in-depth study of one organisation, or perhaps two to three departments within one large organisation.

The RDBs also could be considered as departments of a large organisation and therefore the research strategy would be a case study approach. Handling research data was very important since all research methodology was a means to end. That end was improved understanding. It was important since it might be the development of a new conceptual framework that made a contribution to management theory. In the process of conversion of data into information, it was necessary to follow methodology. “Data rarely speaks for itself”. Morgenstern (quoted in Jantsch, 1967) expressed this idea as mentioned below.

“Data in itself is silent, it is the use to which it is put, in terms of inferring, interpreting, projecting, analyzing, manipulating, computing, and decision making, that is important” (Jantsch, 1967, p.95.). Required information such as the background information about the RDBs, such as the origin and history, ownership and control, sizes in terms of employees and assets, purpose and ideology, recourses, financial position and other relevant information had been gathered from the secondary data such as annual reports,
newsletters, management reports and other publications of the RDBs. Other important information such as perception and attitudes of the employees, the quality of the financial information used for the preparation and presentation of financial statements, the levels of training and technological knowledge of employees had been tested through primary data by using interviews, questionnaire and observation techniques.

4.4 Methods of Data Analysis

A self administrative questionnaire was administered by the researcher with purpose of gathering information needed for measuring the level of competencies of the staff with respect to application of SLAS when preparing and presenting financial statements. The survey method was versatile in its greatest strength being the only practical way to gather various types of information and most economical way in many situations (Emory, 1980). Therefore, the survey methods were characterized by questionnaire and the interview method was selected as methods of data collection in this study. Therefore, the survey method was found to be more suitable to collect required original data because of its comparative advantages position in terms of time and cost.

4.4.1 Questionnaire Development

One of the main forms of data collection was the survey questionnaire, along with the covering letter presented to respondents. The questionnaire was conceived through a pre-study done by researcher through discussion with a few staff members of finance divisions of the selected RDBs on the issues that they perceived as important in relation to usage of SLAS when preparing financial statements. The main objective of the questionnaire was to find out the difficulties and complications faced by the staff members of the RDBs when applying the SLAS. Therefore, the questionnaire was
designed with 16 closed ended questionnaires in order to collect the exact answers for some of the questions. This questionnaire consisted of 20 questions and estimated time to complete the questionnaire was 20-30 minutes depend on the views of the respondents. The questionnaire included 5 questions to find out the position, experience, educational and professional qualifications of the respondents and another 3 questions to assess the training requirements and the opportunities to participate for such trainings. Further, 4 questions had been developed to check the awareness of staff members with relation to SLAS, IFRS, CBSL guidelines and tax laws. Another 4 questions were used to evaluate the satisfaction of staff members with their salaries and other fringe benefits, the facilities provided/available for the operations, customers expectations etc. Final 4 open ended questionnaires to obtain respondents’ views about the improving the knowledge and the relationships with the regulators. Important factors found in the literature review also were used in designing questionnaire. Semi structured interviews (which were questionnaires based on predetermined and standardized or identical set of questions) were used to obtained data from the finance staff. Some negotiations were in any case possible and the interview was arranged at a time when least pressure. Credibility might also be promoted through the supply of relevant information to participants before the interview, providing participants with a list if interview themes before events, where this was appropriately helped this aim. The survey instrument contained several preliminary questions on such areas as technical knowledge, working experience, supervision and statutory obligations etc. It was used the logical analysis/matrix analysis method where tables, charts and written descriptions utilized for analysis. Collected data had been properly retested and validated before being analysed to make sure the reliability of the
data. Collective graphs/ data tables had been provided for the information collected which was inter-related under the data analysis and the presentation chapter.

4.4.2 Level of Measurement

4.4.2.1 Nominal Scale

Most of questions which lead to test the position, qualification, experience and capabilities in part I were measured in nominal scale.

4.4.2.2 Ratio Scale

Some questions in the questionnaire were measured in ratio scale such as number of accounting professional, number of years of experience etc.

4.4.2.3 Interval Scale

Some of the information in this study was measured by using interval scale.

4.5 Study Setting

This study had been conducted in a natural environment where all the things and events occur under normal circumstances and therefore this study was none contrived. “As we have just seen, organizational research can be done in the natural environment where work proceeds normally (that is in noncontrived settings) or in artificial, contrived settings correlational studies are invariably conducted in noncontrived settings” (Sekaran, 2007, P. 129).

4.6 Unit of Analysis

The researcher had considered only six RDBs for the purpose of study. As per Sekaran, (2007, p 132) the unit of analysis referred to the level of aggregation of the data collected during the subsequent data analysis stage. Therefore, Unit of analysis was a RDB in the study.
4.7 Validity
This research had been performed based on a literature review which included various publications and articles published in developed and developing countries representing several areas, standards and text books relating to usage of accounting standards for preparation and presentation of financial statements of the Companies. Hence, the researcher was in a view of that this research consisted of adequate content validity.

4.8 Reliability
4.8.1 Stability of Measures
The researcher had utilized the test-retest method to check the stability of the study. The same questionnaire had been forwarded and collected to selected officers who participated earlier after two weeks interval to confirm the stability of the data. After that the correlation was tested between collected questionnaires at two different occasions from the same officers.

4.9 Chapter Summary
This chapter had discussed the framework for the study which provided better guidelines for the conducting the study more systematic way. It had described the way forward with the research design, research techniques, questionnaire development and other related technical background for the purpose of analysis and presentation of the findings and the discussion of findings.
Chapter 5

ANALYSIS AND PRESENTATION OF FINDINGS

5.1 Introduction

The background to the study and methodology of conducting the study presented in the in the previous chapters provided a sound knowledge about the RDB’s, regulatory framework governing them and the ways and means of conducting the research in order achieve the objectives of the study. Accordingly, it explained analysis and presentation of data collected throughout the study including qualifications and competent of the staff of Finance divisions of the RDBs.

5.2 Compliance with SLAS and Other Regulations by the RDBs

SLAS 23 highlights the importance of the banks towards economy as follows. “Banks represent a significant and influential sector of business. Most individuals and organisations make use of banks, either as depositors or borrowers. Banks play a major role in maintaining confidence in the monetary system through their close relationship with regulatory authorities and the Government and the regulations imposed on them by the Government. Hence, there is considerable and widespread interest in the well-being of banks, and in particular their solvency and liquidity and the relative degree of risk that attaches to the different types of their business. The operations and thus the accounting and reporting requirement, of banks are different from those of other commercial enterprises. This Standard recognises their special needs. It also encourages the presentation of a commentary on the financial statements which deals with such matters as the management and control of liquidity and risk.”
The annual reports of all six development banks were analysed for a period of five years to identify the extent of compliance with the SLAS. The analysis has been conducted in order to find out compliances of RDBs with SLAS and other regulations in preparing and presenting financial statements. Semi-structured interviews were also carried on with selected members of key management of each bank for further clarifications in relation to the findings through annual reports and to search for extra findings.

5.3 Deviations from SLAS and Other Regulations by the RDBs

The researcher had conducted a review of audited financial statements of all six development banks for a period of five years ended December 31, 2009 and noted following observations during the review. It was noted that the banks had complied with majority of the requirements of SLAS, the CBSL regulations and the requirements of the Companies Act No. 07 of 2007 even though the staff members had not possessed a thorough knowledge about SLAS as described in “Discussion of Findings” chapter of the study. The main reason behind this was the auditors’ guidance in preparation and presentation of financial statements. It was noted only top five accounting firms of Sri Lanka had been involved with the audits of the RDBs in last decade. Further, it was learnt that auditors were actively guiding the preparation of financial statements of the RDBs even though it was a responsibility of the management. It was observed instances of non-compliances with SLAS, the CBSL guidelines and the provisions of the Companies Act No. 07 of 2007 by the RDBs. These non-compliances had been categorized under three categories as mentioned below.

1. Non-compliances of SLAS by individual banks (Table 5.1)
2. Common non-compliances of SLAS by the RDBs (Table 5.2)
3. Non-compliances of the CBSL guidelines and the Companies Act provisions

(Table 5.4)

Table 5.1: Non-Compliances of SLAS by individual banks

<table>
<thead>
<tr>
<th>Bank</th>
<th>Financial Year</th>
<th>Observation</th>
<th>Deviations from compliance with SLAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>KDB</td>
<td>2005</td>
<td>Bank overdraft had been presented under favourable cash and cash equivalent balances as a negative figure. This should be presented as a current liability without net off against current asset.</td>
<td>SLAS 3.57 and 3.60 required to separate current assets and current liabilities which the bank has violated.</td>
</tr>
<tr>
<td>KDB</td>
<td>2005</td>
<td>Cash proceeds from disposal of fixed assets had not been disclosed separately in the cash flow statement.</td>
<td>SLAS 9.20 highlighted that the bank had to disclose gross cash receipts and gross cash payments from major class of transactions separately.</td>
</tr>
<tr>
<td>KDB</td>
<td>2005</td>
<td>Cash paid for acquisition of PP &amp; E not in agreement of PP &amp; E required to provide a</td>
<td>SLAS 18.73 (e)</td>
</tr>
<tr>
<td>Bank</td>
<td>Period</td>
<td>Details</td>
<td>Reconciliation of PP &amp; E, which had not been provided by the bank.</td>
</tr>
<tr>
<td>-------</td>
<td>------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------</td>
</tr>
<tr>
<td>KDB</td>
<td>2005-2008</td>
<td>Deferred tax liability had not been disclosed on the face of balance sheet separately as required by SLAS 3 and SLAS 14</td>
<td>SLAS 3.68 (m), SLAS 14.69 and 14.70 needs to disclose the Deferred Tax Liability on the face of balance sheet.</td>
</tr>
<tr>
<td>WDB</td>
<td>2005-2009</td>
<td>Investment in shares of CRIB had been disclosed under other investments and not provided required information such as number of shares, directors' valuation and cost etc.</td>
<td>SLAS 22.50 (a) disclosure of essential information regarding investments in shares irrespective of whether quoted or unquoted.</td>
</tr>
<tr>
<td>WDB</td>
<td>2008</td>
<td>The bank had acquired motor vehicles worth Rs.8.2 million</td>
<td>SLAS 9.42 and 9.43 required disclosing</td>
</tr>
<tr>
<td>Bank</td>
<td>Year</td>
<td>Description</td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>------</td>
<td>-------------</td>
<td></td>
</tr>
<tr>
<td>WDB</td>
<td>2007</td>
<td>The bank failed to disclose dividends paid and proposed during the year.</td>
<td></td>
</tr>
<tr>
<td>SDB</td>
<td>2005-2009</td>
<td>The bank had disposed its PP &amp; E in continuous basis. However, the bank failed to prepare a reconciliation of PP &amp; E at the beginning and end of the period including assets classified as held for sale.</td>
<td></td>
</tr>
<tr>
<td>SDB</td>
<td>2008</td>
<td>The opening balance of loans granted to key management personnel was not the closing balance of same asset in the previous year. No reconciliation had provided.</td>
<td></td>
</tr>
</tbody>
</table>

Under finance lease agreements, non cash transactions had not been separately disclosed under PP & E note as required by SLAS 9.

SLAS 3.95 and 3.125 highlighted to disclose the dividends paid during the year.

SLAS 18.73 (e) ii SLAS 38 required disclosing the assets held for sale separately.

SLAS 30.17 required disclosing the facts regarding loans granted to key management personnel including the conditions of
<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Note</th>
<th>SLAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>SDB</td>
<td>2006</td>
<td>The bank had adjusted final proposed dividend of Rs.1.10 per share in the balance sheet as a liability which was not allowed as per SLAS 12.11 and 12.12 required recognizing the dividends declared after the balance sheet date as a disclosure and not to record as liability in balance sheet.</td>
<td>12.11 and 12.12</td>
</tr>
<tr>
<td>RUDP</td>
<td>2006</td>
<td>The bank failed to disclose details prescribed in SLAS 3.95 and 3.125 required details of dividends declared during the year.</td>
<td>3.95 and 3.125</td>
</tr>
<tr>
<td>RUDP</td>
<td>2006-2008</td>
<td>Relevant information regarding Government grants such as unfulfilled conditions and other contingencies attaching to the Government grants had not been provided by the bank.</td>
<td>24.39 (b) and (c)</td>
</tr>
<tr>
<td>RrDB</td>
<td>2006-2008</td>
<td>The bank did not disclose detailed information requested</td>
<td>31.54, 36.86</td>
</tr>
</tbody>
</table>
regarding commitments and contingencies. 36.92 needed to disclose the legal and other contingencies under financial statements.

It was noted common non compliances of SLAS by more than one bank in several instances. These common deviations were found sometimes in consecutive years in the same bank without rectification. Such deviations had been listed in table 5.2.

**Table 5.2 - Common non-compliances of SLAS by the RDBs**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Financial Year</th>
<th>Observation</th>
<th>Deviations from compliance with SLAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>WDB/UDB</td>
<td>2005-2009</td>
<td>It was necessary to disclose deposits under sub categories of deposits from non-bank customers, deposits from banks, deposits from other financial institutes and other deposits. However the bank failed to fulfill this disclosure requirement throughout five year period under review.</td>
<td>SLAS 23.30 and 23.32 had clearly highlighted the minimum disclosure requirements about deposits on the face of balance sheet or under the notes. The bank failed to fulfill the same.</td>
</tr>
<tr>
<td>RUDB/SDB</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Code</td>
<td>Year</td>
<td>Issue</td>
<td>Details</td>
</tr>
<tr>
<td>-----------</td>
<td>------</td>
<td>-------</td>
<td>---------</td>
</tr>
<tr>
<td>SDB/WDB/UDB/KDB/RUDB/RrDB</td>
<td>2005-2009</td>
<td>The banks failed to disclose fully depreciated assets, temporary idle assets and assets retired from actual use and held for sale under PPE note.</td>
<td></td>
</tr>
<tr>
<td>WDB/RUDB/UDB/SDB</td>
<td>2006-2008</td>
<td>Defined benefit plan-Gratuity had to be valued by an actuary as per provisions of SLAS 16. However, the bank was failed to fulfill the requirement until 2009.</td>
<td></td>
</tr>
<tr>
<td>SDB/RUDB/UDB/WDB</td>
<td>2009</td>
<td>Actuarial valuation assumptions with relevant to gratuity such as discount rate assumed, rate of return on assets, further salary increasing rate and medical cost trend rate etc. had not disclosed in the report.</td>
<td></td>
</tr>
<tr>
<td>SDB/RUDB</td>
<td>2006</td>
<td>The bank failed to disclose the details of short/long term</td>
<td></td>
</tr>
<tr>
<td>RUDB</td>
<td>2006-2007</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SLAS 18.79 (a) (b) and (c) required to disclose the details of fully depreciated assets as of balance sheet date.

SLAS 16.50 (i) and (h) required the banks to disclose the details of actuarial valuation of defined benefit plan.

SLAS 16.50 (h) required the disclosures of key assumptions used by actuaries for valuation. The banks failed to fulfill this.

SLAS 30.16 And 30.17 needed
<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Event Description</th>
<th>Related Disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>RrDB</td>
<td>2006-2009</td>
<td>employment benefits paid to key management personnel and other transactions with them such as loans granted etc. even though it was mentioned that the bank had adopted SLAS 30</td>
<td>complete disclosures of transactions with key management personnel. The banks had made incomplete disclosures.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Related Party Disclosures (Revised 2005)</td>
<td></td>
</tr>
<tr>
<td>RUDB</td>
<td>2006</td>
<td>Cash proceeds used for purchase of PPE was not agreed with the amount disclosed in cash flow. Further, no reconciliation or requested information had been provided.</td>
<td>SLAS 9.42 needed to disclose gross cash payments and this amount should be in agreement with the disclosures provided under SLAS 18 which was not the case in this scenario.</td>
</tr>
<tr>
<td>RrDB</td>
<td>2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UDB</td>
<td>2006</td>
<td>The bank had not disclosed the revised accounting standards applied during the year.</td>
<td>SLAS 10.14, SLAS 10.17 and SLAS 10.19 required the disclosures regarding changes to accounting policies.</td>
</tr>
</tbody>
</table>
The researcher was able to find out additional information and findings regarding violation of accounting standards and Corporate Governance requirements. However, these facts should be investigated further since some of the facts were detected through informal sources of communication. Further, it was used the informal relationships of the researcher to confirm some of the findings. One of the big four accounting firms was the auditors of four RDBs for several years. The researcher directly contacted the relevant audit team members to verify the information recovered from the interviews had with the officers of the RDBs. However, there were several instances where published information also available (i.e. news paper articles, posters etc.) to confirm below mentioned circumstances.

1. The UDB had issued new loans to settle the old loans of bank. The researcher observed that these loans were released to staff members and customers of the bank and main objective behind this situation was to maintain better performance
at branch level of the bank which would lead to decide annual bonus and performance evaluation criteria. The branch managers attempted to maintain the branch’s NPL ratio at a minimum rate as it was used by the bank as a key performance measure. This was observed in UDB financial statements for the year ended December 31, 2005 and 2006 which was violating section 9 of SLAS 23.

2. The UDB had not separately disclosed the Land and Buildings in the financial statements for the financial years ended December 31, 2005, 2006, 2007 and 2008. Therefore, the land had been depreciated from the inception whereas the value of the land had been appreciating over time. Further, the land was originally granted by the Government of Sri Lanka and the management was unable to forward the title deed of the land. As explained by the management, though the legal ownership of the land was vested with a third party, the Bank was currently showing the land as a fixed asset in the Balance Sheet as of December 31, 2008 which violated the SLAS 18. Further, it was noted that they have not accounted for value of lands as per SLAS 24- Government Grants. It was found that such lands were not properly valued for the purpose of accounting.

3. The banks were required to classify its NPL as per directions provided by the Monitory Board under the powers conferred in section 76 (J) 1 of the Banking Act. Accordingly all NPL to be classified as mentioned in Table 5.3.
Table 5.3: Criteria for Classification of Loans for Provision for Loan Losses

<table>
<thead>
<tr>
<th>Facility Type: Credit facilities, repayable in monthly installments</th>
<th>Determinant</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 installments or more but less than 6 installments, principal and/or interest are due and unpaid.</td>
<td>Special Mention (Overdue)</td>
<td></td>
</tr>
<tr>
<td>6 installments or more but less than 12 installments, principal and/or interest are due and unpaid.</td>
<td>Sub-standard</td>
<td></td>
</tr>
<tr>
<td>12 installments or more but less than 18 installments, principal and/or interest are due and unpaid.</td>
<td>Doubtful</td>
<td></td>
</tr>
<tr>
<td>18 installments or more, principal and/or interest are due and unpaid.</td>
<td>Loss</td>
<td></td>
</tr>
</tbody>
</table>

As per SLAS 23 it was essential to categorize NPL as per the guidelines provided by the CBSL. However, it was observed that the Branches of all the banks were not adhering to the specified requirements in full where the branch management had attempted to keep up their profitability up without providing for NPL.
4. As per paragraph 23 of SLAS 23 the management had to comment on average interest rates of the bank during the year. SLAS 23 says "Net interest is a product of both interest rates and the amounts of borrowing and lending. It is desirable for management to provide a commentary about average interest rates, average interest earning assets and average interest-bearing liabilities for the period. The government may provide assistance to banks by making deposits and other credit facilities available at interest rates which are substantially below market rates. In these cases, management's commentary often discloses the extent of these deposits and facilities and their effect on net income." However, no commentary had been found in the most of the annual reports under the financial statements. It was noted that some of the directors' report contains this information in some financial periods.

5. As per SLAS 16, an entity shall determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements had not differed materially from the amounts that would be determined at the balance sheet date. For this purpose a service of qualified actuary must be obtained to determine the present value of defined benefit obligations. It was noted that all six banks failed to adhere with this requirement in the financial periods ended December 31, 2007 and 2008. All six development banks obtained actuarial valuation to determine the present value of defined benefit obligations in the year 2009. This was a serious violation of SLAS where auditors of the Banks also highlighted this fact in their reports.
6. Although it was necessary to disclose all the related party transactions as per SLAS 30, some banks had failed to disclose accurate related party transactions as a whole due to the influence of top management. Accordingly, some of the loans obtained by key management personal, short-term employment benefits enjoyed by them were not disclosed. Some of the key management personal specially, full time employees of the bank enjoyed number of additional monitory and non-monitory benefits without the knowledge of the Board of Directors in some scenarios.

In addition to the violation of SLAS, it was noticed several instances of deviations from the CBSL guidelines and the Companies Act No. 07 of 2007. Such deviations were also considered as serious violations in some instances as those also critically affected the quality of financial information presented. Such deviations recognized during the review of the RDBs financial statements had been listed in table 5.4.

**Table 5.4: Non-compliances of the CBSL guidelines and the provisions of the Companies Act**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Financial Year</th>
<th>Observation</th>
<th>Deviations from compliance with the CBSL guidelines/the Companies Act No. 07 of 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>RUDP</td>
<td>2006-2009</td>
<td>Dividend income received during the year had not been disclosed separately under CBSL Guideline 02/04/004/0002/001</td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td>Time Period</td>
<td>Description</td>
<td>CBSL Guideline</td>
</tr>
<tr>
<td>-------</td>
<td>--------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td>UDB</td>
<td>2005-2009</td>
<td>Sector wise analysis of loan portfolio had not been provided.</td>
<td>02/04/004/0002/001</td>
</tr>
<tr>
<td>KDB</td>
<td>2005/2006/2007</td>
<td>Lease rentals receivables had not been disclosed separately on the face of balance sheet.</td>
<td>02/04/004/0002/001</td>
</tr>
<tr>
<td>KDB</td>
<td>200-2009</td>
<td>It was compulsory to disclose the investment in government or other securities under “quoted” and “unquoted” categories. Even though bank had declared a dividend income, respective investment had not been disclosed either in the balance sheet or notes to the financial statements</td>
<td>02/04/004/0002/001</td>
</tr>
<tr>
<td>WDB</td>
<td>2005-2009</td>
<td>The bank had failed to disclose the maturity of borrowings of the bank. It must be categorized under “due within 1 year”, “1-5 years” and “after 10 years”</td>
<td>02/04/004/0002/001</td>
</tr>
<tr>
<td>Company</td>
<td>Period</td>
<td>Description</td>
<td>Guideline/Act</td>
</tr>
<tr>
<td>---------</td>
<td>--------</td>
<td>-------------</td>
<td>---------------</td>
</tr>
<tr>
<td>KDB</td>
<td>2005-2007</td>
<td>It was compulsory to disclose the risks associated with the bank’s operations such as credit risk, foreign exchange risk, interest rate risk, liquidity risk and other material risks associated with banks operations and the bank has failed to fulfill the requirement.</td>
<td>CBSL Guideline 02/04/004/0002/001 and SLAS 23</td>
</tr>
<tr>
<td>KDB</td>
<td>2005-2009</td>
<td>Dividend income received during the year had not been disclosed separately under “quoted” and “unquoted”</td>
<td>CBSL Guideline 02/04/004/0002/001</td>
</tr>
<tr>
<td>WDB/RUDB</td>
<td>2006-2007</td>
<td>It was necessary to prepare and present the financial statements in accordance with Companies Act No. 07 of 2007 and disclose whether the company had complied with the requirements by signing the financial statements by</td>
<td>Companies Act (Section 152 (1) (b))</td>
</tr>
<tr>
<td>UDB</td>
<td>2006</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
chief financial officer as requested in Sec. 152 (1) (b) of the Companies Act. The bank failed to fulfill the requirement.

KDB/SDB 2005-2009 Directors emoluments had not been analysed further as “fees”, “salaries” and “others” as prescribed in the CBSL guidelines

CBSL Guideline 02/04/004/0002/001

5.4 Overall Summary of Deviations of SLAS and Other Regulations by RDBs

Overall summary of deviations by RDBs has summerised in below table 5.5. This is a summary of the deviations more fully described in tables 5.1, 5.2 and 5.4. Violation/non compliance of SLAS/CBSL Guideline does not mean that the particular bank has fully violated such standard or regulation.

Table 5.5 Summary of Non-compliances by RDBs

<table>
<thead>
<tr>
<th>Bank</th>
<th>Non Compliances/ Violations of SLAS/CBSL Guidelines</th>
</tr>
</thead>
<tbody>
<tr>
<td>KDB</td>
<td>SLAS 3, SLAS 9, SLAS 14, SLAS 18, SLAS 23, CBSL Guideline 02/04/004/0002/001</td>
</tr>
<tr>
<td>RUDB</td>
<td>SLAS 3, SLAS 9, SLAS 10, SLAS 16, SLAS 18, SLAS 23, SLAS 24, SLAS 30, CBSL Guideline 02/04/004/0002/001, Companies Act No.07 of 2007</td>
</tr>
<tr>
<td>UDB</td>
<td>SLAS 10, SLAS 16, SLAS 18, SLAS 23, CBSL Guideline 02/04/004/0002/001, Companies Act No.07 of 2007</td>
</tr>
<tr>
<td>------------</td>
<td>----------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>SDB</td>
<td>SLAS 3, SLAS 12, SLAS 16, SLAS 18, SLAS 23, SLAS 30, SLAS 38, CBSL Guideline 02/04/004/0002/001</td>
</tr>
<tr>
<td>WDB</td>
<td>SLAS 3, SLAS 9, SLAS 16, SLAS 18, SLAS 22, SLAS 23, CBSL Guideline 02/04/004/0002/001, Companies Act No.07 of 2007</td>
</tr>
<tr>
<td>RRDB</td>
<td>SLAS 9, SLAS 18, SLAS 23, SLAS 30, SLAS 31, SLAS 36, CBSL Guideline 02/04/004/0002/001, Companies Act No.07 of 2007</td>
</tr>
</tbody>
</table>

As mentioned in above table all the banks have partially violated at least 4-5 SLAS and prescribed format by CBSL under CBSL Guideline 02/04/004/0002/001 and some terms of Companies Act No. 07 of 2007. The researcher has identified critical violations of SLAS at some instances where the auditors also highlighted such violations in their reports and issued modified audit opinions. However, as a whole all the banks made several attempts to avoid violations of SLAS with the help of respective auditors of the banks. A very good example for this was obtaining actuarial valuation on the balances of defined benefit plans of the banks at a huge cost in 2009.

The regular bodies also have to pay special attention regarding the reporting of this kind of very important institutions since it is badly affected to the country’s economy if such entities fail to maintain the trust of the people. Need to keep up the quality of financial reporting all the times as required by the various Acts and guidelines in order to maintain integrity of the banks.
5.5 Deviations of Tax Laws by RDBs

It was learnt that the RDBs had violated income tax and other tax laws too in several occasions. The banks had to incur huge losses as a result of breach of tax laws in number of separate cases examined by the Inland Revenue authorities. These mistakes/omissions were there due to lack of knowledge of the provisions of the Law by the employees. This error was there due to weaknesses in bank’s recruitment and selection process of employees. The banks were not critically analysed the job specifications before recruiting officers. It was noted that banks have created own issues by recruiting unqualified officers for some subject matters like taxes. Below mentioned were some examples detected through the discussions had with the key financial officers of the banks.

Some banks had used incorrect tax rates to recover Value Added Tax (VAT) from customers. Further, the banks had charged the VAT for some exempted services as well. The main reason behind this was that finance staff has no knowledge about changes in tax laws of the country from time to time. They were used to apply the same principals whatever applied earlier unchanged. It was noted that total impact of these types of mistakes were considerably material when considering the aggregate and bank as a whole. However, there was no corrective action taken in some cases even though such errors had been detected by auditors/tax consultants later on. For example, in the UDB and RUDB the banks had charged the VAT at 15% on other services such as legal fees, stationary charges etc. during whole year of 2009 even though the VAT rate had been reduced to 12% by the National Budget of 2009. Further, it was revealed that the UDB had paid the VAT at 5% on the turnover of pawning auctions throughout the year 2009 irrespective of cancellation of 5% the VAT rate with effect from January 1, 2009. The
applicable the VAT rate for 12% only for imported jewelers on pawning auction income and such income on locally manufactured jewelers were exempted with effect from January 1, 2009. Their customers suffered the additional expenses charged as the VAT or in other means and banks had no effect since they were acting as tax collectors on behalf of the Government. Unlike commercial banks these RDBs were dealing with rural villagers who were having very little or no knowledge about tax rules. Therefore, no inquiries/clarifications raised by the customers and those wrong practices continued throughout the year until auditors detected the errors.

It was revealed that there was some hidden information in some RDBs such as misuse of assets, manipulation of information provided to management and auditors, provision of incorrect information to Inland Revenue authorities etc. This important information was revealed through informal sources such as informal discussions with key management personnel of the banks. It was unable to confirm such facts due to inaccessibility to confidential and internal information of the banks. This information might be discovered by further investigations which were beyond researcher's scope. It was further noted that some of the key management personnel of a few banks were summoned before Committee on Public Enterprises at the Sri Lanka Parliament due to informal petitions sent by staff members of the banks. Further, it was revealed that the staff members had organized number of trade union actions such as strikes, boycott from their duties, picketing, work to rules and reporting sick leaves etc. to protest towards the frauds and corruptions done by the key officers of some banks. Some of the key management personnel were removed from the office due to continued actions taken by banks' trade
unions. It was noticed that the trade unions of these banks were so powerful to remove a Chief Executive Officer of a bank from its office by taking Trade Union action.

It was observed that there were weaknesses in segregation of duties and hence the quality of information reported to the making decisions were also incomplete. Further, it was noted that number of frauds were taken place in branches and head offices due to improper segregation of duties. There was a huge cheque fraud reported in the finance division of the head office of one RDB done by a junior officer. Another massive fraud had been done by an officer of a branch of another RDB in connection with pawned articles of innocent customers. These frauds were done by the officers due to lack of proper internal control mechanism in the banks. Key management personnel of number of banks also accepted that there were some weaknesses in their internal control systems due to the following reasons.

1. Absence of powerful and well defined internal control systems for each and every division of the banks

2. Lack of qualified and experienced staff for all banks and specially in finance divisions

3. Lack of segregation of duties due to insufficient staff of the banks and some officers were intended to perform more duties other than the duties initially allocated to them.

4. Key management personnel obtained the help of some junior officers to commit some of illegal transactions/events where such officers were using those relationships to commit frauds.
5. Over trusting co-workers and ignoring rules and regulations such as dual control of keys of vaults etc. also created path to frauds.

6. Manual and/or semi manual data processing systems used by the banks.

7. Less experience and unwillingness of aged staff to work in a computerized environment.

The management, specially Board of Directors had been taken corrective and legal actions against the corrupted officers after some incidents had been taken place. However, it was noted that proactive measures had not been introduced by the management in several fields where there were enough opportunities to commit frauds by the employees.

Analysing the qualifications and competencies of the staff recruited by head office finance division and it was observed that at least not a single qualified accountant was recruited by any bank and most of the key officers do not possess a financial background or experience. This was happened due to compulsory job rotation of key management of the banks. Due to continuous frauds/corruptions reported in the banking system it was proposed to rotate key officers among the divisions of the bank where an experienced finance manager had to take over duties in credit department and vice versa. This created a problematic situation in several instances where such new officers had failed to perform duties assumed to him/her due to no experience and knowledge in relevant field.

It was identified that the RDBs finance divisions lacked professionally qualified, experienced and competent staff. The banks failed to maintain proper financial information and comply with all regulatory requirements such as preparation and
presentation of financial statements according to SLAS, forward accurate and timely reports to the Central Bank and other regulatory bodies and provided necessary management information for making decisions. Most of the heads of finance departments of banks had expected guidance/instructions from their auditors/tax consultants for preparation and presentation of financial statements as per SLAS and other regulatory requirements such as the CBSL guidelines. Most of the reports forwarded by them were not 100% accurate or complete. There were several instances that warning letters/guidelines/instructions sent by the CBSL, SLAASMB, Inland Revenue Department and other regulators. Further, it was learnt that most of the heads of finance were at least not having an idea about some concepts such as deferred tax adjustment. They revealed that auditors/tax consultants were adjusting deferred tax adjustment on behalf of them. That was a very good example to prove the less technical knowledge of the staff members of finance division including heads of finance. Some of the officers had a willingness to learn these theories and highlighted that the bank had to train finance staff with the experts regarding SLAS and tax laws etc.

There was no link among six development banks since they were controlled under independent managements even though it was owned by same share holders. The only event that they had organized together was annual sports meet of staff members and except for that there was no official link among banks regarding operational matters. The officers of inter banks were communicated to each other very rarely due to unique systems used by separate banks and their unwillingness to learn something from another officer in the same level. As researcher learnt, these issues might be minimized if there was a better communication among the banks and officers to discuss the common issues
such as SLAS and tax regulations. Even though, there were issues regarding staff salaries, fortunately it was a well-known sector for all the employees having a very wide knowledge about their levels and relevant salary scales. They often had a good understanding about the salary scales of senior/junior ranks as well. If the officers had a good understanding about their relevant subjects at least equivalent to their knowledge about salaries, then definitely they could perform the duties assigned to them in much better way.

5.6 Competencies and Qualifications of Staff of Finance Divisions of RDBs

The researcher had analysed the information gathered through research questionnaire (Please refer annexure 1) which were distributed among 46 staff members who were full time in the finance divisions of all six RDBs. All 46 members of staff to whom questionnaires distributed were responded with their views regarding application of SLAS and other regulations by respective RDBs. Analysed data of such questionnaires were presented below.
Table 5.6 Awareness of the Staff about Regulatory Requirements

<table>
<thead>
<tr>
<th></th>
<th>Very High</th>
<th>High</th>
<th>Neither High nor Low</th>
<th>Low</th>
<th>Very Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLAS Changes</td>
<td>0</td>
<td>4</td>
<td>5</td>
<td>15</td>
<td>22</td>
</tr>
<tr>
<td>IFRS Convergence</td>
<td>0</td>
<td>1</td>
<td>3</td>
<td>8</td>
<td>35</td>
</tr>
<tr>
<td>Tax Laws</td>
<td>2</td>
<td>5</td>
<td>12</td>
<td>10</td>
<td>17</td>
</tr>
<tr>
<td>CBSL Regulations</td>
<td>8</td>
<td>10</td>
<td>14</td>
<td>10</td>
<td>4</td>
</tr>
</tbody>
</table>

As mentioned in table 5.5 and figure 5.1 most of the officers were not having a knowledge of technical areas such as SLAS, income tax laws and IFRS. However, they
were comparatively good in CBSL reporting and regulatory requirements. It was noticed that this trend was there due to continuous practice of CBSL reporting (i.e. monthly, quarterly, bi-annually and annually reporting requirements) of the staff. Even without a very good understanding about the reports they were processing, they were able to manage to prepare and submit the reports to CBSL on time with prior experience and speciality of the subject. Further, CBSL had very clearly provided guidelines to prepare such reports with illustrations unlike in SLAS and tax law changes in addition to continuous training programs organised by them.

As per the staff members view to overcome this situation they had highlighted that they need a proper training and continuous guidance about changes in SLAS, IFRS and tax laws etc. to practice those in banks operations. Finally, it was noted that top managements involvement and willingness to provide such training opportunities was far beyond the expectation of staff members.

5.7 Educational Qualification of Staff of Finance Divisions of RDBs

The summary of educational qualifications of the officers of the finance divisions of all six development banks were indicated in the table 5.6 and figure 5.2. It was noticed that all of the employees had passed at least GCE (A/L) and 30% of the employees were graduates out of which only 20% of the graduates were obtained their degrees in Commerce stream which is very important to finance divisions.
Table 5.7 Maximum Educational Qualifications of Finance Staff of RDBs

<table>
<thead>
<tr>
<th></th>
<th>G C E (O/L)</th>
<th>G C E (A/L)</th>
<th>Commerce Graduates</th>
<th>Other Graduates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum Educational</td>
<td>0</td>
<td>32</td>
<td>3</td>
<td>11</td>
</tr>
<tr>
<td>Qualifications</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 5.2 Maximum Educational Qualifications of Finance Staff of RDBs

The above chart evidenced the capacity of the staff members in terms of maximum educational qualifications of finance divisions of all six RDBs. It was noted that even though all of them are graduates, they had graduated in other disciplines except for one officer who possess a degree in commerce. Further, it was noted that technical knowledge of these officers were very little specially in SLAS and tax laws of the country and the RDBs failed to train their staff in respective areas/subjects.
5.8 Professional Qualifications of Staff of Finance Divisions of RDBs

The summary of professional qualifications of the officers of the finance divisions of all six development banks were indicated by the table 5.7 and figure 5.3. It was noticed that more than one half of the employees were not having any professional qualification and no single qualified accountant was present in the finance divisions of RDBs. However, there were 22 staff members (i.e. 48%) who have obtained at least part qualifications in their professional studies which was very important to finance divisions.

Table 5.8 Professional Qualifications of Finance Staff of RDBs

<table>
<thead>
<tr>
<th>Professional Qualifications</th>
<th>AAT Party Qualified</th>
<th>AAT Qualified</th>
<th>CIMA/ACCA/ Partly Qualified</th>
<th>Member of CIMA/CA/ACCA</th>
<th>Banking Exams Partly Qualified</th>
<th>No Professional qualifications</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAT Party Qualified</td>
<td>10</td>
<td>4</td>
<td>8</td>
<td>0</td>
<td>5</td>
<td>19</td>
</tr>
<tr>
<td>AAT Qualified</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CIMA/ACCA/ Partly Qualified</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Member of CIMA/CA/ACCA</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banking Exams Partly Qualified</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 5.3 Professional Qualifications of Finance Staff of RDBs
As highlighted in figure 5.3 more than one third of the staff members who were working in the financial divisions of the six RDBs were not having any professional background. Further, it was noted that there was no qualified accountant in a single bank even though there were a few members who had completed part qualifications in AAT, CIMA, ICASL, ACCA, CMA and Banking Exams. There were four staff members who had completed AAT exams and five others who had partly qualified in banking exams conducted by Institute of Bankers of Sri Lanka. This situation was not suitable for a finance division of a bank where all important decisions were being taken. As per researcher’s point of view “the heart” of the bank was finance division and at least one fully qualified accountant must be there to head the duties where other staff members might follow him under his supervision.

Table 5.9 Academic and Professional Qualifications Against Salaries and Benefits

<table>
<thead>
<tr>
<th></th>
<th>Delighted</th>
<th>satisfied</th>
<th>Neutral</th>
<th>Dissatisfied</th>
<th>Highly Dissatisfied</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Academic Qualifications against Salary and other benefits</strong></td>
<td>0</td>
<td>16</td>
<td>10</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td><strong>Professional Qualifications against Salary and Other Benefits</strong></td>
<td>5</td>
<td>15</td>
<td>16</td>
<td>8</td>
<td>2</td>
</tr>
</tbody>
</table>
As indicated by table 5.8 and figure 5.4, no employee was totally satisfied with their current levels of remuneration when comparing with their educational/professional qualifications. Most of the employees were in the view that salary scales must be in line with educational qualifications. Further, it was noted that some staff members with at least partly qualified in their professional areas of studies were not recognised the bank as senior officers due to less number of years in the service. These banks were running as traditional government institutions where salary scales and all other benefits would be depended on the experience and not on the performance of the employees. Further, it was revealed that some of very talented and educated officers were not fully utilised by the banks. The reason behind that was the doubt of unqualified officers to bring the suitable
staff members to highest levels with a view of that they would lose the present positions and recognition in the respective banks. As the researcher understands if the staff members are satisfied with the remuneration packages offered by the banks they may attempt to learn, understand and apply the SLAS and other regulations as they have overcome with their basic requirement which is expecting from a job.

Table 5.10 Application of Computerised Network Facilities for Banks Operations

<table>
<thead>
<tr>
<th></th>
<th>Always Applied</th>
<th>Applied</th>
<th>neutral</th>
<th>Rarely Applied</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automated network systems</td>
<td>0</td>
<td>0</td>
<td>5</td>
<td>5</td>
<td>36</td>
</tr>
<tr>
<td>Local area networks</td>
<td>10</td>
<td>21</td>
<td>5</td>
<td>10</td>
<td>0</td>
</tr>
</tbody>
</table>

Figure 5.5 Application of Computerised Network Facilities for Banks Operations
The above table 5.9 and figure 5.5 presented data collected from staff members about their views of automated systems used by the banks for its day to day operations. They had highlighted that only Local Area Networks (i.e. computerised network systems within the branch) were being used by most of the banks for its operations. The SDB and the UDB were testing two automated systems to networking their operations and it was not fully tested or recommended by a professionally qualified team in IT field. The main barrier behind not using a fully automated system was the unaffordable cost which was too much for a small bank like RDBs. Most of the key finance officers highlighted that they had already taken the necessary steps to adopt a totally computerised solution once all six banks were merged together.

5.9 Chapter Summary

Number of non-compliances were noted against SLAS, the CBSL guidelines and provisions of Companies Act in the financial reporting of RDBs. The deviations were found through the critical review of the annual reports of RDBs for a period of five years from 2005 to 2009 and questionnaire survey done as a supplementary to the annual report review.

Next step aimed to find out the reasons for non-compliances of regulatory requirements by the banks even though it was very important to adhere with such requirements. The next chapter would discuss the findings with recommendations for overcome the issues.
Chapter 6

DISCUSSION OF FINDINGS

6.1 Introduction

In the preceding chapter, non-compliance with SLAS, CBSL guidelines and Companies Act requirements by RDBs were presented. As per objectives of this study it was necessary to find out the difficulties and complications faced by the staff members of finance divisions of RDBs and recommendation of a mechanism to overcome such issues. Therefore, this chapter aimed to discuss the findings of the previous chapter in line with research objectives. It specifically explained about the problems faced by RDBs when comparing with other LSBs, difficulties and complications the staff faced when applying SLAS, summary of deviations of SLAS and issues recognized regarding proposed IFRS etc.

6.2 Difficulties and Complications Faced by the Staff when Applying SLAS

A main aim of this study is to examine the difficulties and complications faced by staff members when applying SLAS for preparation of financial statements. As per the results of the research questionnaire and semi-structured interviews conducted with key officers of the bank following results had been revealed.

1. A main difficulty faced by many of the staff members of the financial divisions of RDBs when preparing and presenting financial statements in accordance with SLAS was the lack of knowledge about such standards. However, with the guidance of the auditors and by following the last year’s workings they were managed to prepare a set of financial statements up to a satisfactory level.
2. It was learnt that they had a very few or no chance to study or learn SLAS by any method. They had expressed their willingness to study SLAS if such facilities were provided.

3. Further, the employees were highlighted that it was very difficult to understand the technical terms and language used in SLAS without basic knowledge of accounting and finance. Some of the key management personnel who had completed their degrees in Art and having completed banking diploma programs also highlighted the difficulty of learning and understanding the SLAS.

4. According to the responses provided by the staff members in the questionnaire it was found that there is a negative attitude of most of the key management personnel towards the requirement for application of SLAS when preparing and presenting finance statements, due to lack of knowledge and importance of the application of standards.

5. The finance staff of the RDBs had highlighted that SLAS and tax laws with continuous changes creating a lot of difficulties for officers to adhere with. Further, they had highlighted the difficulties and costs of changing their systems and training their officers to follow newly introduced rules and regulations etc.

6. Weak mechanisms used by the respective authorities to introduce new changes to the relevant parties. For example, tax authorities were using only newspaper and gazette notifications to introduce/change tax laws. If the relevant parties have not provided access to the paper notice or gazette notification they were using the previous practice without any change.
6.3 Problems Faced by RDBs when Compared with Other LSBs

The RDBs were providing a crucial service to the regional economies of the country which would directly contribute towards the growth of Sri Lankan economy. It was very important to develop the rural areas of the country since it would enhance the quality of life and productivity of rural community, providing enduring solutions to rural poverty, malnutrition, unemployment and other community related issues. RDBs contribution towards this effort was to ensure the better result of the countries expectation towards development. However, a number of issues had been faced by the RDBs during their march towards achieving the targets as listed below.

1. Capital constrains-RDBs were running with a limited capital and even inadequate to fulfill the minimum capital requirements recommended by the CBSL.

2. Competition from commercial banks and other financial institutions – it was very important to maintain the sustainability of the entity to achieve their targets in long run. Therefore, RDBs also need to maintain profitability in order to sustain in the industry. However, it was noted that there was a huge competition from Commercial Banks and other financial institutes to RDBs due to its comparatively small size. Further, the manual systems used in the RDBs also a limitation for them to provide better services to the clients.

3. Human Resource Limitations – As per employees of the RDBs, they are not receiving attractive remuneration packages and other fringe benefits compared with commercial bank employees. Therefore, opportunities to recruit more talented young generation for RDBs were very limited. It was noted that RDBs had to select the employees from the remaining unemployed workforce after all
other banks and financial companies selected their employment requirement by offering attractive remuneration packages.

4. Technological limitations – Technologically RDBs were very far from Commercial Banks, other development banks and even privately owned other financial companies. All RDBs were not fully computerized and some branches were not having better communication channels. There was no network between inter branches and no ATM or internet related facilities provided by the bank. People were moving towards the modern economy very fast with the globalization and expecting quick and more convenience services from banking system specially.

5. Delays in decision making process – The decision making process of the RDBs was very slow due to manual systems and poor communication methods used by them. Normally, it would take considerable time to get a decision by lower level employees after obtaining the approval from the higher level officers. The banks were still using normal postal service for their communication while all other banks were using private courier services for sending documents throughout the system.

6.4 Summary of Deviations of SLAS and Other Regulations by RDBs

The researcher had found several deviations when applying SLAS by the banks as highlighted in previous chapter. Accordingly, it was found that all six RDBs failed to adhere with SLAS comprehensively when prepare and present their financial statements. There were several instances the banks deviated from SLAS at least
partially. The researcher had identified critical violations of SLAS at some instances where the auditors also highlighted such violations in their reports and issued modified audit opinions. As mentioned in table 5.5 there were number of partial deviations of SLAS and CBSL guidelines by the RDBs. However, as a whole all the banks made several attempts to avoid violations of SLAS with the help of the respective auditors of the banks. As mentioned in table 5.5 there were number of partial deviations of SLAS and CBSL guidelines by the RDBs. A very good example for this was obtaining actuarial valuation on the balances of defined benefit plans of the banks at a huge cost in 2009.

6.5 Recommendation of Mechanism to Overcome the Current Issues Faced by the Staff

It was recommended to apply below mentioned mechanism to solve the issues faced by the officers and to improve the quality of information provided for decision making.

1. It was noted that most of the staff members of finance divisions highlighted that they were not receiving proper guidelines and instructions to perform their duties well. Further, they highlighted that it was very important to recruit at least single qualified accountant for each bank to provide necessary guidance and supervision to the staff. This was very important suggestion that the bank must initiate immediately.

2. It was recommended to appoint at least partly qualified accountant as compliance officer to ensure the banks would comply with all relevant laws and regulations which govern the industry. He should be provided with relevant checklists to fill
in timely intervals in order to ensure the banks would comply with all prescribed laws and regulations.

3. Need to emphasis the requirement for continuous training and development of staff members for the attention of top level management and to prepare annual training and development plans of employees. Further, the bank should recommend a minimum number of hours a year that an employee had to undergo training requirements and recommend the criteria for evaluation employee’s development at the end of each session or in periodical intervals.

4. Need to outsource the training and development function to qualified people if the bank could not maintain a training division separately. It was noted that the staff members were sent to India for training in operational activities. The importance of the finance function also needs to be considered in organising effective training plan to finance staff too.

5. It was recommended to outsource the tax compliance functions to a firm of chartered accountants where the banks might run with minimum errors in tax related matters. It is very important to create very good coordination between the bank staff and outsourced staff in order minimizes unnecessary delays of processing reports and reporting to relevant authorities. For this it is essential to provide predetermined responsibilities of both parties and set deadlines for each activity.

6. The accounting standards and tax laws etc. are changing time to time and need to be in alert to ensure whether the banks are adopting all the changes on time. It
was noted that some of the RDBs were failed to apply changes to tax laws and SLAS on time. The banks may lose the hard earned goodwill due to these weaknesses. It was noted that two banks charged VAT at 15% from its customers for a whole year irrespective of prevailing rate of 12%. Further, three RDBs had paid the VAT on auctioned articles at 5% which was an incorrect rate for total auction turnover even though locally manufactured jewelers were exempted from VAT. Ignorant clients had to bear such additional taxes erroneously charged by the banks. No mechanism was initiated to detect such a huge mistake internally and the RDBs need to introduce new controls to capture all the changes to the tax laws before implement actions of said tax laws. It is strongly recommended to appoint a high level compliance committee to ensure whether the bank is adopting all the tax laws/SLAS changes on time accurately.

7. The top management should make sure that internal audit department consists of qualified accountants to review the compliance thoroughly. It is very important to implement measures recommended by the internal and external auditors. Following up procedures to be performed to ensure all the recommendations made by the internal and external auditors in their reports had been properly implemented by the low level management with the approval from top management.

8. The banks had to select and evaluate a suitable computer program to convert banking operations to a fully automated system. With such a system, the banks would be in position to provide a quick and convenience services to its customers, obtaining management and other relevant reports in a short period of time,
minimizing the decision making time and efforts, minimizing the errors and omissions when processing transactions and reports and saving a considerable time and additional staff costs which they needed to incur on manual processing. However, the selected system must be tested properly before the implementation and proper password controls with the levels of authorization should be introduced. Further, it is very important to continue banks operations subject to a parallel run of both manual and newly introduced computerized system. Backup keeping procedures also to be introduced to ensure data security.

9. The regulatory bodies also have to pay special attention regarding the reporting of this kind of very important institutions since it was negatively affects the country’s economy if such entities fail to maintain the trust of the people. There is also a need to keep up the quality of financial reporting at all times as required by the various Acts and guidelines in order to maintain integrity of the banks.

6.6 Issues Recognised in Proposed IFRSs

The banks as SBEs need to adopt IFRS with its convergence from SLAS to IFRS with effect from January 1, 2012. However, the RDBs had not taken up at least initial steps of evaluating gaps between current SLRS and IFRS before adopting new standards. All the Financial Year ending in December and for accounting periods from 1 January 2012 the time required shifts to 1 January 2011 because the results had to be restated. Some of the legacy accounts would come in to focus when the adjustments were made. With regard to banks there would be differences in interest recognition where the focus is on the effective interest rate and the valuation of listed shares. With 2012 financial statements two aspects would be considered – how the CBSL is going to report and what the IFRS
requires the banks to do, whether to run parallel systems. Rather than wait till 2012 it is necessary to do a half year review. It is necessary to adopt a pragmatic approach so there won't be surprises at the year end. There also should be understanding of the requirements of resources and their training needs. It is necessary to understand the impact of Management-Information-System reporting and budgetary systems.

The role of the governing body and auditors: The transition to IFRS would require thoughtful and ongoing oversight by the Audit Committee and Board of Directors and Committees and Boards would have to focus on the major elements such as what were the implications of making the transition to IFRS. How could the Audit Committee gain comfort that everything is in place? It is imperative that auditors better understand the system and judgment involved in the application of IFRS. Auditors and accountants need to constantly upgrade their skills. Further, it was recognized that there were a number of difficulties of adopting some of the newly introduced IFRS as listed below.

1. **LKAS 16 Property, Plant, and Equipment.** The revaluation model requires the identification of items of property, plant, and equipment whose fair values can be reliably measured usually through market-based appraisal by professionally qualified valuers. This entailed more discussion with appraisers or valuers to ensure that their appraisal measurements are in accordance with the fair value measured under LKAS 16.

2. **LKAS 19 Employee benefits.** Before the adoption of LKAS 19, recognizing an actuarially computed retirement benefit obligation was a rarity. Most entities including RDBs has a defined benefit plan, in order to meet this liability a provision is carried forward in the Balance Sheet, based on half a month's salary of the last month of the financial year of all employees for each completed year of service, commencing from the
first year of service. The resulting difference between the brought forward provision at the beginning of a year and the carried forward provision at the end of a year are dealt within the Income Statement.

The adoption of the LKAS 19 resulted to a significant change in the amounts of retirement obligation recognized. Dual problems were encountered in the application of this standard: (1) many companies (SBEs) were advised to have their actuarial valuation reports which resulted to delays in statutory filing of audited financial statements due to lack of actuaries providing professional services in the country and (2) some actuaries were not familiar with the detailed provisions of LKAS 19, thus, the required disclosures on post employment benefits could not be completed in some situations as described in previous chapter.

3. LKAS 21 Effects of Changes in Foreign Exchange Rates. Companies with functional currencies different from the Sri Lankan Rupees are having difficulty in translating functional currency financial statements to presentation currency, especially for those companies that have a functional currency other than Sri Lankan Rupees however are maintaining their books in Sri Lankan Rupees. There is a strong recommendation that entities should keep their books in their functional currency, however, this is not easy to attain since there arise a number of complications in some entities’ EDP system. The freedom of using a different presentation currency was limited due to SEC requirement to present the functional currency together with the presentation currency.

4. LKAS 27 Consolidated and Separate Financial Statements. Investments in subsidiaries, associates, and jointly controlled entities are now required to be valued
either at cost or at fair value in accordance with LKAS 39 in the separate or legal entity financial statements of a parent company. The net income and stockholders’ equity in the separate statements could now differ from the amounts shown in the consolidated financial statements. The carrying amount of both investments and total stockholders’ equity will be also be reduced by an amount representing the undistributed earnings of the subsidiaries, associates, or jointly controlled entities which were previously included in these accounts under the equity method.

5. LKAS 32 Financial Instruments- Presentation. Companies with mandatory redeemable preferred stock, which are issued by some Philippine companies, would now classify these as debt and not equity. This would result in changes in the debt to equity ratio and may pose problems in compliance with debt covenants.

6. LKAS 39 Financial Instruments: Recognition and Measurement. The use of fair value in accounting for financial instruments could result in volatile earnings. Issues are also being raised relating to the complex accounting for derivatives, fair valuation techniques, required systems changes, and extensive disclosures. Banks, for example, now need to use the effective interest rate method in determining the loan loss provisions. Due to the complex requirements of these standards, local banks required to defer the implementation of some of the provisions of the new international accounting standards because of the additional costs they would have to incur if they were to fully adopt the new system.

One of the reasons why banks are having difficulties adopting IFRS is the cost related to the transition. Banks making the transition will realize that in order to comply with
provisions of IFRS they would need to incur costs such as costs for actuarial valuation report, appraisal report, fair value valuation, training, and other relevant costs.

6.7 Chapter Summary

Under the discussion of findings it was highlighted the issues faced by the RDBs and its staff with their operations and recommended the mechanisms to overcome such weaknesses. Further, it was discussed the forthcoming convergence of IFRS in January 2012 and highlighted the pre preparation of the RDBs which had not been addressed by the management so far. It is too late to conduct a gap analysis between the current SLAS and proposed IFRS which need to implemented in January 2012 since it needs a considerable time for this exercise. Therefore, the top management needs to pay their immediate attention to this matter and take necessary actions to take immediate steps to overcome the issues.

The next chapter summarises the findings and completes the study with concluding remarks which would highlight the reference for future studies.
Chapter 7

SUMMARY AND CONCLUSION

7.1 Introduction

This chapter would summarise the research work in order to revisit the level of success of the study. It was noted that study confirms various non-compliances with SLAS and other regulatory requirements by all RDBs throughout the period under consideration. This chapter attempt to provide a very brief outline of the work done and the recommendations provided in the study at a glance. Further, it provided the implications of the study and the references for future studies as well. Finally the chapter concludes with the limitations of the study which were beyond the control of researcher.

7.2 Summary of the Findings

The ICASL had introduced SLAS under the powers vested by Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 which should be adopted by all quoted public companies and other SBEs for preparation and presentation of financial statements. The uses of the financial statements of a Bank need relevant, reliable and comparable information, which assists them in evaluating the financial position and performance of the bank to make economic decisions. It is essential to comply with SLAS and all other relevant guidelines and regulations when preparing and presenting financial statements in order to maintain the quality of financial information.

The researcher had attempted to find out the application of SLAS by RDBs which founded under the Regional Development Bank Act No. 06 of 1997, and functioning as
licensed specialised banks, approved by the Monetary Board of the Central Bank of Sri Lanka.

The challenge for these RDBs was to capture and adopting all the SLAS and other relevant regulations with the revisions/changes on time and accurate manner. It was found that it was not a simple task to achieve above mentioned challenge with the limited human and monitory recourses of the banks possessed.

If there is any small weakness in the adoption of SLAS/IFRS, other regulations when preparing and presenting the financial statements of the RDBs that would affect to the quality of financial information presented. Therefore, prompt attention should be given to rectify the errors highlighted in the report and to improve the quality of financial reporting of the RDBs.

Financial reporting is the key indicator for measurement of performance and making economic decisions. Therefore, quality of financial statements is very important and it will improve the comparability of such information. Even though RDBs were not publicly quoted, as Government owned financial institutions, they were playing a vital role in regional development and microfinance industry which needed close supervision by regulatory authorities and the management of such banks. Therefore, it is very important to provide accurate and high quality financial information for decision makers who will entirely depend on the financial statements.

The researcher had analyzed annual reports for a period of five years of all six development banks for the purpose of this study. The researcher identified lack of professionally qualified, experienced and competent staff in the banks finance division the banks failed to maintain proper financial information and comply with all regulatory
requirements such as preparation and presentation of financial statements according to SLAS, forward accurate and timely reports to the Central Bank and other regulatory bodies and provide necessary management information for making decisions. Further, the researcher had recognized several other causes for these weaknesses such as unattractive remuneration packages offered by the banks which lead qualified people to keep away from recruitment, poor knowledge about the importance of the SLAS of key management personnel and no opportunities were available for staff members for obtain training and development in this areas etc.

It was also found that there were several instances the RDBs had violated SLAS and other regulations. These findings were highlighted in chapter 6. There were instances where the banks had violated some SLAS seriously while some other minor issues such as deviations from disclosure requirements of SLAS etc. also detected during the review of financial statements of the banks.

7.3 Recommendations at a glance

The researcher has found several weaknesses in the recruitment procedure of RDBs where people had been recruited without required academic and professional qualifications. As a result of above weaknesses the banks had opportunity cost of earning a considerable profit and maximizing returns to the shareholders. Further, the bank had already incurred huge losses on non-compliances and mistakes done by the said staff. All political influences towards the banks operation also needs to be eliminated in order to achieve banks objectives. Further, the researcher had recommended the following measures to minimize the issues found in the study. In order to resolve the issues identified in this study it is recommended to implement steps from 1 to 4 as immediate
measures while step 6 to be implemented as long term solution. Step 5 should be implemented as short term measure as well as need to continue as a long term measure too.

1. To recruit qualified professionals to the finance divisions of each bank to follow the proper financial reporting standards and guidance.

2. Appoint a Compliance Officer for each RDB to ensure that they are complying with all the regulatory requirements including SLAS.

3. It was recommended to get the services of external tax consultants for all types of taxes.

4. Perform gap analysis between current SLAS and proposed IFRS and take immediate actions to adopt IFRS with effect from January 1, 2012 - The ICASL has already proposed to converge to IFRS with effect from January 01, 2012. However, it was revealed that there is no preparation for adopt IFRS for preparation and presentation of financial statements of RDBs which is compulsory. It is necessary to be prepared for this change at least in early 2011 since the banks have to be ready with change of comparative information with IFRS requirements. It was learnt that the banks have not performed at least a gap analysis between current SLAS and proposed IFRS to ensure that they would be ready to adopt new standards on time. Therefore, it is proposed to appoint a special committee for IFRS convergence. This committee should be included members from the Director Board, Key employees of finance division, key employees of IT division and outsourced IFRS experts to take necessary steps to adopt IFRS without a further delay.
5. To provide continuous training and development activities to staff members in order to improve the productivity of the staff.

6. Need to introduce automated solutions and networking systems for banking operations in order to minimize inconveniences and unnecessary losses to customers. Further, this would be helpful for improving the productivity and quality of financial information.

7.4 Recommendations for Future Research

The intention of the current research was to examine the extent which the RDBs had applied SLAS in the preparation and presentation of financial statements. This study only focused on the RDBs, which were a part of the development banking segment of the economy. However, more research is needed to review such applications by other development banks and other LSBs. The six RDBs had been amalgamated as a single bank in April 2010. Therefore, a study could be carried out to investigate how that entity had complied with the regulatory requirements as a more strengthen entity when comparing to individual RDBs. It was recommended to conduct this study on or after 2012, i.e. after the first year of IFRS adoption by RDB to examine how the bank had adopted IFRS.

7.5 Implications of the Study

It has found number of weaknesses of the SLAS and other regulatory requirements when preparing and presenting financial statements of the banks. Regulatory authorities might use this information for further investigation and provide proper guidance to improve the quality of financial reporting of the RDBs. Further Findings and recommendations of this
study helps heads of finance divisions of RDBs, accountants, auditors and users to better understanding and improve performance in order to achieve their objectives.
REFERENCES


Adhikari, P. Mellemvik, F. The Adoption of International Public Sector Accounting Standards in South Asia: A Comparative Study of Seven Countries, Research in Accounting in Emerging Economies, Volume: 10, 2010


Annual Reports (2004-2008) Regional Development Banks


Budget Guidance Reports (2003-2010) Ernst & Young


http://www.state.gov/e/eeb/rls/othr/ics/2011/157361.htm


Emory, J.F. (1980), An analysis of the correlates of body image of the members of the adult health and developmental program at the University of Maryland, University of Maryland


Annexure 1 – Survey Questionnaire

A survey on application of Sri Lanka Accounting Standards by RDB’s

Please read the statements given below carefully. This survey is carried out with a view to obtain your perception with respect to application of accounting standards by RDBs. The ratings appear on the right side help you to determine the level of importance of the statement. Tick off (x) against one of the ratings, which you think appropriately, describes your judgment.

1. Your designation in the organization ...........................................

2. Your service in the organization ................................. years.

3. Your service in the Finance Division, in the organization ........ Years

4. Your academic qualifications ...............................................

   (please mark your highest qualification)

<table>
<thead>
<tr>
<th>GCE O/L</th>
<th>GCE/ A/L</th>
<th>Graduate</th>
<th>Postgraduate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5. Your professional Qualifications

   | AAT     | AAT     | CTMA/ICA | Member of   |
   |         |         |         | CIMA/ICA/CMA|
   | Partly  | Completed| /ACCA/CMA| Partly      |
   | Completed| Completed|          | Completed   |

   |         |         |          |             |
6. Training needs are identified in performance evaluation in your organisation.

<table>
<thead>
<tr>
<th>strongly agreed</th>
<th>Agreed</th>
<th>Neither Agreed Nor Disagreed</th>
<th>Not Agreed</th>
<th>Strongly Not Agreed</th>
</tr>
</thead>
</table>

7. Senior Management allows participating training & development programs.

<table>
<thead>
<tr>
<th>strongly agreed</th>
<th>Agreed</th>
<th>Neither Agreed Nor Disagreed</th>
<th>Not Agreed</th>
<th>Strongly Not Agreed</th>
</tr>
</thead>
</table>

8. When the finance staff requests for Seminars/conferences/workshops the Senior Management facilitate the requirements.

<table>
<thead>
<tr>
<th>Very Frequently</th>
<th>Rarely Agreed Nor Disagreed</th>
<th>Very Rarely</th>
</tr>
</thead>
</table>

9. Awareness of SLAS changes for accounting by the organisation.

<table>
<thead>
<tr>
<th>Very High</th>
<th>High</th>
<th>Neither High Nor Low</th>
<th>Low</th>
<th>Very Low</th>
</tr>
</thead>
</table>

10. Awareness of Finance Staff regarding IFRs.

<table>
<thead>
<tr>
<th>Very High</th>
<th>High</th>
<th>Neither High Nor Low</th>
<th>Low</th>
<th>Very Low</th>
</tr>
</thead>
</table>


<table>
<thead>
<tr>
<th>Very High</th>
<th>High</th>
<th>Neither High Nor Low</th>
<th>Low</th>
<th>Very Low</th>
</tr>
</thead>
</table>
12. Awareness of Finance Staff regarding CBSL Guidelines which are relevant to your bank

Neither High
Very High High Nor Low Low Very Low

13. How satisfied are you

1 with the salary and fringe benefits received in accordance with your professional Qualifications

Neither Satisfied Nor Highly Delighted Satisfied Dissatisfied Dissatisfied Dissatisfied

2 With the salary and other benefits in accordance with your academic qualifications.

Neither Satisfied Nor Highly Delighted Satisfied Dissatisfied Dissatisfied Dissatisfied

3 with salary and other benefits when compared with the competitive banks.

Neither Satisfied Nor Highly Delighted Satisfied Dissatisfied Dissatisfied Dissatisfied
14. How do you think, if you achieved higher academic professional qualifications in the area of finance, you will pave the way for promotion

<table>
<thead>
<tr>
<th>Very</th>
<th>Frequently</th>
<th>Neither</th>
<th>Rarely</th>
<th>Very</th>
<th>Frequently</th>
<th>Nor Rarely</th>
<th>Rarely</th>
</tr>
</thead>
</table>

15. What do you think about application of automated systems for bank processes

<table>
<thead>
<tr>
<th>Always</th>
<th>Applied</th>
<th>Neutral</th>
<th>Rarely Applied</th>
<th>Not At All</th>
</tr>
</thead>
</table>

16. What is your view on application of local area networks?

<table>
<thead>
<tr>
<th>Always</th>
<th>Applied</th>
<th>Neutral</th>
<th>Rarely Applied</th>
<th>Not At All</th>
</tr>
</thead>
</table>

17. I welcome your honest criticism in the working guidelines and supervision you are receiving for day to day work.

18. I welcome your honest views to improve your knowledge about IFRS.

19. I welcome your honest views to improve the knowledge of CBSL Guide lines and requirements of Companies Act regarding financial reporting.

20. Please explain your suggestions to improve quality of financial reporting of the bank

Thank you, for taking your valuable time to complete this document and for the support extended towards my research.