

## **Customs Officers' Management and Compensation Fund – 2018**

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### **1.1 Qualified Opinion**

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The audit of the financial statements of the Customs Officers' Management and Compensation Fund for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(3) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be presented in Parliament appear in this report.

In my opinion, except for the effects of the matters described in the Paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the Fund as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

### **1.2 Basis for Qualified Opinion**

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My opinion is qualified based on the matters described in paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements**

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Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standard and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

The related parties are responsible for overseeing the Fund's financial reporting process.

As per Sub-section 16(1) of the National Audit Act No. 19 of 2018, the Fund is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared.

## 1.4 Auditor's Responsibilities for the Audit of the Financial Statements

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My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of

information to enable a continuous evaluation of the activities of the Fund, and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Fund has complied with applicable written law, or other general or special directions issued by the governing body of the Fund ;
- Whether the Fund has performed according to its powers, functions and duties; and
- Whether the resources of the Fund had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

## 1.5 Financial Statements

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### 1.5.1 Internal Control over the preparation of financial statements

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The Fund is required to “devise and maintain” a system of internal accounting controls sufficient to provide reasonable assurance that , transactions are executed in accordance with management’s general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards , and to maintain accountability for assets, access to assets is permitted only in accordance with management’s general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. Issues with regard to maintenance of key accounting records such as General Ledger, Journal and Journal vouchers, payment vouchers etc. may include under this heading.

### 1.5.2 Non-compliance with Sri Lanka Public Sector Accounting Standards

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Non-compliance	Comments of the Management	Recommendation
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Sri Lanka Public Sector Accounting Standard 01 Presentation of Financial Statements		
(i) In terms of the Standard, if assets of any entity consider as assets of that entity, those assets should be controlled by the entity itself and be useful for the achievement of objectives of the entity. Even though, the carrying amount of non-current assets had been reported as Rs.82,186,416 in the financial statements of the Fund as at 31 December of the year under review, it was observed that those assets were being used by the Sri	One of the objectives of the establishment of Custom Officers Management and Compensation Fund is to incur expenditure for the provision of facilities as the Director General of Customs deems necessary for the enhancement of the effectiveness of the management of the	(i) This Fund should be considered as an entity separated from Sri Lanka Customs.  (ii) The assets used for the benefits of the Fund only should be brought to account under that Fund.  (iii) The assets required for the Sri Lanka Customs should be purchased by the provisions received under the Head of <b>Expenditure.</b>

Lanka Customs for operating activities thereof instead of utilizing for achieving objectives of the Fund. However, an expenditure of Rs.31,627,556 had been brought to account as depreciation of those assets relating to the year under review.

Customs. Accordingly, since the non-current assets purchased spending funds are used for the improvement of the effectiveness of the management of the Sri Lanka Customs, expenditure thus brought to account is not in compliance therewith.

(iv) The assets used by the Sri Lanka Customs should be included in the financial reports of the Sri Lanka Customs.

(ii) In terms of Standard 21 (d), the Cash Flow Statement is a one of components required to be presented together with a set of financial statements. Nevertheless, a Funds Flow Statement had been presented instead.

Since a separate cash book and a bank account is not maintained in respect of the transactions of this Fund, preparation of a Cash Flow Statement is found difficult.

As required by the Standard, a Cash Flow Statement should be presented together with the financial statements.

### 1.5.3 Accounting Deficiencies

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<b>Audit Observation</b>	<b>Comments of the Management</b>	<b>Recommendation</b>
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(a) In recording transactions of the Management and Compensation Fund, the double entry system is not totally used and one entry of the inter ledger transactions is made in the ledger accounts of this Fund whilst the other entry is made in the main cash book of the Customs. Accordingly, it was observed that in entering transactions of the Management and Compensation Fund, the relevant entries were made without being prepared a control account which connects the main cash book of the Customs.	It has been found difficult to maintain a control account according to a large number of daily transactions and the transactions of the Management and Compensation Fund are compared with the Treasury Printouts monthly.	(i) A control account which connects the main cash book should be maintained. (ii) It is reported that the accounting affairs of the Fund have been prepared in accordance with the Sri Lanka Public Sector Accounting Standard and as such, a set of accounts books separately recording all the transactions of the Fund should be maintained and financial statements should be prepared accordingly.

(b) Out of Rs. 671,975,900 recovered in instalments from the penalties imposed relating to 91 files, the inquiries of which had been finalized by the end of year under review, contribution of Rs.134,395,180 or 20 per cent relating to the Management and Compensation Fund had been omitted from the accounts.

Entries are made in the Customs Officers Rewards Ledger and the Fund Ledger maintained in the Financial Division only on the rewards files received by that Division from among the rewards files, the inquiries of which have been completed by the end of the year under review. Since there is no possibility to obtain more accurate information regarding the files not received by the Financial Division, the above step is taken.

If the financial statements are prepared in terms of Sri Lanka Public Sector Accounting Standards, accounts should be prepared on accrual basis.

(c) A sum of Rs. 862,279 of 06 Objects had been brought to account under another accounts instead of the relevant accounts.

Audit observations are correct. Action will be taken to correct this errors.

The relevant expenditure should be accounted under the correct Objects.

#### 1.5.4 Unreconciled Control Accounts or Reports

<u>Item</u>	<u>Value as per the Financial Statements</u>	<u>Value as per the Corresponding Reports.</u>	<u>Difference</u>	<u>Comments of the Management</u>	<u>Recommendation</u>
	Rs.	Rs.	Rs.		
(a) Statement of Comprehensive Income and Ledger Accounts.	174,697,212	173,594,558	1,102,654	When reconciling Statement of Comprehensive Income with the Ledger Account of the Fund, this difference was observed. Action has been taken to correct the differences indicated herein.	In case any difference occurred relating to the data in the preparation of financial statements, the financial statements should be presented by reconciling those differences.
(b) Statement of Comprehensive Income and Ledger Accounts.	15,274,686	16,377,522	(1,102,836)		

(c) Schedule of Monthly Penalty Income and Ledger Accounts	176,594,909	149,340,099	27,254,810	There is a error in the classification of penalties, sales and income, whereas it had not posed an impact on the total income. Nevertheless, in the presentation of Accounts, 2019 by rechecking the income, action will be taken to restate the balances of the year 2018.	In case any difference occurred relating to the data in the preparation of financial statements, the financial statements should be presented by reconciling those differences.
(d) Monthly sales income schedule and Ledger Account.	85,674,178	112,928,988	(27,254,810)		
(e) Monthly other income schedule and Ledger Accounts.	1,617,956	1,448,219	169,737		
(f) Opening balance as per the Treasury Books and the Departmental Books	6,052,428,678	6,050,093,129	2,335,549	Action has been taken to prevent the differences from occurring by way of reconciling the monthly transactions according to the Departmental Books and the Treasury Books. The difference of the cumulative balance of the Fund as at the beginning of the year under review according to the Treasury Books and the Departmental Books has decreased from Rs. 2,335,549 to Rs. 1,921,269.	In case any difference occurred relating to the data in the preparation of financial statements, the financial statements should be presented by reconciling those differences.
(g) closing balance as per the Treasury Books and the Departmental Books.	6,736,774,748	6,734,853,479	1,921,269		

## 2. Financial Review

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### 2.1 Financial Results

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According to the financial statements presented, the operations of the Fund for the year under review had resulted in a surplus of Rs. 652,931,695 as compared with the corresponding surplus of Rs. 728,808,304 for the preceding year, thus indicating a deterioration of Rs. 75,876,609 in the financial result. The decrease in the penalty income by Rs. 263,025,305 and increase in the expenditure on foreign trainings by Rs. 41,815,692 and local training by Rs. 15,716,464 had been the main reason for the above deterioration.

### 3. Operating Review

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#### 3.1 Management Inefficiencies

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The following observations are made.

Audit Observation	Comments of the Management	Recommendation
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(a) A sum of Rs.1,125,496 out of the Custom Officers Management and Compensation Fund had been spent relating to the foreign trainings of three officers during the year under review and the above officers had obtained Rs.8,333 for serving in the Department during the course of conducting the said foreign workshops.	The relevant overtime attendance registers had been approved by the Directors in charge of each Division while indicating that the officers referred to in the audit query who had participated in the foreign training programmes (on duty), had engaged in the overtime service during the period of their staying abroad. The explanations thereon have been called for from the relevant Directors at present. Similarly, action has been taken to recover, forthwith, the overtime allowance paid for the officers participated in the foreign trainings relating to the aforesaid period.	(i) In the payment of overtime allowances, desirable supervision should be exercised by the Management regarding the arrival and departure of the officers. (ii) The suitability of the payment of overtime should be established before making relevant payments. (iii) The overtime payment process should be executed under a better internal control system. (iv) In case overtime had been obtained by carelessly signing the relevant registers, steps should be taken thereon in accordance with provisions in the Establishments Code.

(v) Necessary action should be taken to maintain a streamlined control system while drawing attention on the existing areas of systems and controls.

(b) The deficiencies in system and control observed during the course of audit were brought to the notice of the Director General of Customs from time to time. Special attention is needed in respect of the following areas of control.

<u>Areas of Systems and Controls</u>	<u>Observations</u>	<u>Comments of the Management</u>	<u>Recommendation</u>
(i) Foreign Trainings	Selection of officers for the foreign training programmes without adopting a formal procedure.	Attention has been drawn on further improvements required to be carried out for the minimization of deficiencies pointed out by the Audit.	A written procedure should be maintained to establish that each officer had been selected for foreign trainings under a formal methodology.
(ii) Collection of Revenue	Absence of a proper methodology to reconcile the revenue receivable to and received by the Fund.	Attention has been drawn on further improvements required to be carried out for the minimization of deficiencies pointed out by the Audit.	Action should be taken to maintain a streamlined control system while drawing attention on the existing areas of systems and controls
(iii) Accounting	Non-compliance with the Sri Lanka Public Sector Accounting Standards in accounting and preparing financial statements.		

(iv) Preparation of Reconciliation Statements.	Failure to carry out comparison of account balances with the schedules relevant thereto	}	do	do
(v) Non Preparation of Control Account	Failure to carry out transactions through a control account connected with the main account of the Sri Lanka Customs.			

### 3.2 Performance

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The following Observations are made.

#### Audit Observation

- (a) Since specific criteria and expenditure on intended future objectives had not been accurately planned for enhancing the effectiveness of management of the Customs Officers and for the payment of compensation to officers, a tendency for continuous increase in the cumulative balance of the Fund was observed annually. Moreover, it was observed that the cumulative balance of the Fund, which was Rs. 6,164 million as at 31 December 2017, had increased by Rs. 653 million or 11 per cent up to Rs. 6,817 million by 31 December 2018. It was accordingly observed that almost 89 per cent of the income of the year under review had accumulated in the Fund.

The following matters, too, had given rise to continuous increase in the accumulated balance of the Fund.

#### Comments of the Management

Since it had not been possible to correctly estimate the local and foreign trainings and workshops provided for the enhancement of management effectiveness of the Customs Officers and the incidents that may lead to pay the compensations to the officers in advance, this situation has emerged. Further, the amount annually accumulates to this Fund cannot be correctly estimated in advance. Accordingly, due to spending an amount less than the provisions allocated for the Fund annually, the Fund increases annually.

#### Recommendation

- (i) The Customs Ordinance is as old as 51 years by now and it had been formulated taking into consideration the import and export conditions prevailed at that time. Nevertheless, it should be amended to suit to the current requirements by taking into account the present dynamic situations.
- (ii) By way of making a practical arrangement capable of minimizing the duty frauds, Government Revenue should be secured by preventing the growth of the funds.
- (iii) A methodology to suit to present conditions should be introduced for the enhancement of the effectiveness of the officers.
- (iv) In consultation with

the General Treasury, an appropriate methodology should be formulated on the excess funds

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| <p>b) A sum of Rs. 4,790 million had been credited to this Fund during the period from the year 2012 to 2018 and the number of Customs inquiries completed during that period stood at 1653. Although Rs. 362.4 million had been allocated for this Fund during the year 2017 it had increased up to Rs. 884.09 million or 144 per cent in the year 2018.</p> | <p>In terms of provisions of the Customs Ordinance, 20 per cent of the sales income and penalties imposed upon Customs inquiries is credited to this Fund. Accordingly, there is a cumulative balance of this nature of this Fund and the current balances accumulate to the Fund annually, thus increasing the value of the Fund. Amidst the increase in the tendency for earning money fraudulently in the present society, it is found difficult to expect a decrease of the duty frauds.</p>            | <p>(i) A planned system capable of minimizing frauds on Customs duty should be introduced.</p> <p>(ii) The Customs Ordinance is as old as 51 years by now and it had been formulated taking into consideration the import and export conditions prevailed at that time. Nevertheless, it should be amended while taking into account the present import and export conditions so as to suit to the current requirements.</p> |
| <p>(c) Since the Government tax revenue deprived in the imposition of penalties for Customs offences had been taken into account as a part of that penalty and rewards of the officers had been decided based on that penalty, cash prices as well as the provisions located to this Fund had increased.</p>  | <p>Since the officers skillfully take measures to discover the Custom offences, it makes room for imposition of penalty on such offences. If any offence is not so discovered, the total revenue relevant to that incident becomes an amount deprived by the Government. However, since 30 per cent of the amount collected by discovering a Customs offence due to skillfulness of the officers is received by the Government, it makes a contribution to the Government Revenue in certain extent and</p> | <p>(iii) If the Customs inspection process is properly set in motion, Customs frauds should exist in a minimum level and the laws and rules should be amended in a manner able to consider the duty lost by the Government relating to the duty frauds as a Government revenue.</p>  |

motivation of the Customs Officers can be retained at a higher level regarding the discovery of Customs offences.

- (d) It was observed that the failure to make amendments properly and timely to the Customs Ordinance and legal provisions of the relevant Funds to suit to the complexity created in the import and export process as a result of present liberal economic policy has mainly attributed to these improvements.
- Attention has been drawn on amending the Customs Ordinance and legal provisions of the relevant Funds.
- The Customs Ordinance is as old as 51 years by now and it had been formulated taking into consideration the import and export conditions prevailed at that time. Nevertheless, it should be amended while taking into account the present import and export conditions so as to suit to the current requirements.
- (e) Even though the payment of compensations to the Customs Officers who victimize to the hazards in the discharge of their duties had been identified as a one of the prime objectives of the Fund, no such payment of compensation had been reported during the examined period of past 05 years. Accordingly, funds had been further collected extraordinarily for the achievement of the above objective.
- Since life threats have been posed on the honest officers who are committed to discover the Customs offenses, the accumulation of a colossal amount of money in a Fund of this nature assures safety to their families as an insurance fund and it encourages the officer to dedicate to their duties regardless of life threats.
- The Customs Ordinance is as old as 51 years by this year and it had been formulated taking into consideration the import and export conditions prevailed at that time and it should be amended to suit to the current requirements by taking into account the present import and export conditions. A methodology to suit to current positions should be introduced for the payment of compensations to the Customs Officers and steps should be taken on the excess funds in consultation with the General Treasury.

#### 4. **Accountability and Good Governance**

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##### 4.1 **Budgetary Control**

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The following Observations are made.

<u>Audit Observation</u>	<u>Comments of the Management</u>	<u>Recommendation</u>
(a) Significance variances ranging from 40 per cent to 87 per cent were observed in comparing budgeted and the actual figures relating to five Items of Expenditure incurred from the Fund during the year under review, thus indicating that the Budget had not been made use of as an effective instrument of management control.	It is found difficult to estimate these expenditure in 100 percent perfectly.	In the preparation of estimates, requirements should be properly identified and provisions should be made accordingly.
(b) Significant differences were observed between the budgeted figures relating to three Items of Expenditure indicated in the Statement of Comprehensive Income of the Fund presented for the year under review and the figures indicated in the estimate prepared by the Budget Department for the year under review.	Replies have not been given.	Estimated amounts should be correctly indicated in the financial statements.