

## **Customs Officers' Management and Compensation Fund - 2020**

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### **1. Financial Statements**

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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 2020 comprising the statement of financial position as at 31 December 2020 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, 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 2020, 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 intend to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance 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 of the Fund.

#### **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, it materiality 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 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. However, future events or conditions may cause the Institute 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;
  - 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 Audit Observations over the preparation of financial statements

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### 1.5.1 Internal Control over the preparation of financial

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Entities are 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. The audit observations with regard to maintenance of key accounting records such as General Ledger, Journal and Journal vouchers, payment vouchers etc. may include under these headings.

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

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Non-compliance with Reference to the Relevant Standard	Comments of the Management	Recommendation
Sri Lanka Public Sector Accounting Standards No. 01- In terms of the Standard, assets of the entity 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 recorded as Rs. 49,509,055 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 Lanka Customs for	As stated in Section 153 (a) (1) of the Customs Ordinance, which includes the management provisions relevant to this fund, 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 Customs.. Accordingly, since the non-current assets purchased spending money of this Fund is used to the improve the effectiveness of the management of the Sri Lanka	This fund is a separate entity as it is reported that the financial statements have been prepared in accordance with the Sri Lanka Public Sector Accounting Standards. Therefore, only the assets used for the utilization of the Fund should be brought in to accounts under that fund.

its' operating activities instead of utilizing for achieving objectives of the Fund. An expenditure of Rs. 6,03,725 had been brought to account as depreciation of those assets relating to the year under review.

Customs, thus the expenditure brought to account is in compliance therewith.

Your attention is drawn to paragraph 4.2 of Public Finance Circular No. PF / 423 dated 22.12.2006 issued by the Department of Public Finance on Statutory Funds, Trust Funds and Departmental Fund Management. It has been informed that if a separate bank account is not maintained for the receipts of the Fund as per sub paragraph (b) of the said paragraph, the money should be deposited in the official bank account of the department and reported to the Treasury through monthly account summaries. Further, it is also stated that the accounts of the Fund should be compared with the Treasury accounts on monthly basis if the transactions of the Fund are done monthly through account summaries with other transaction of the Department.

### 1.5.3 Accounting Deficiencies

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#### Audit Observation

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Due to non payment of the contribution of 20% to the Customs Officers' Management and Compensation Fund, i.e. the amount of Rs. 145,853,082.20 out of Rs. 729,265,411 received for 98 files relevant to 127 customs offenses of which investigations had been completed by the end of the year under review, it had not been brought into accounts as income of the fund.

#### Comments of the Management

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According to the current system, even if the investigation is completed, the 20% contribution is not credited to the Customs Officers' Management and Compensation Fund until the payments are made for the award files. In particular, receipts for these award files are the receipts for the previous year or several years in advance, and payments are not made as soon as a payment file is completed, since payments are made taking the existing balances into account at the time of payment. Further, if any expenses have been incurred for these customs inquiries, the amount is deducted and only the

#### Recommendation

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Accounts should be prepared on accrual basis if the financial statements are prepared in accordance with the Sri Lanka Public Sector Accounting Standards.

balance is shared. Also, 20% contribution relevant to that amount is not credited to this fund at the time of making spies' payments and advance payment on priorities taking special needs into account, and the balance relevant to this fund is not transferred at the time of making full payment for those files. Due to the above matters, the entire contribution of 20% of the penalty amount collected is not transferred to this account.

**1.5.4 Unreconciled Control Accounts or Reports**

<b>Audit Observation</b>	<b>Comments of the Management</b>	<b>Recommendation</b>
A difference of Rs. 21,998,802 was observed between the cumulative balance of the fund and the departmental books according to the treasury books as at the last day of the year under review. The reasons for those differences were not explained.	The difference of the cumulative balance of the fund between the departmental books and the treasury books is descended for several years. It is noted that action will be taken in this regard to make necessary adjustments in due course.	If there were any discrepancies among the data in the preparation of the financial statements, the financial statements should be submitted comparing those differences.

**1.5.5 Lack of written evidence for audit**

<b>Subject</b>	<b>Comments of the Management</b>	<b>Recommendation</b>
One file out of 127 files related to income from penalty arrears had been misplaced in the customs premises.	Management has not responded.	A necessary control system should be set up so that files will not misplace in the customs premises.

**2. Financial Review**

**2.1 Financial Outcome**

The operating result of the year under review amounted to a surplus of Rs. 445,228,992 and the corresponding surplus in the preceding year amounted to Rs. 517,183,257. Therefore a deterioration amounting to Rs. 71,954,265 of the financial result was observed. The main reasons for the deterioration are the decrease in the penalty income by Rs. 171,203,443 and increase in the miscellaneous expenditure by Rs. 23,432,544.

### 3. Operating Review

#### 3.1 Management Inefficiencies

<b>Audit Observation</b>	<b>Comments of the Management</b>	<b>Recommendation</b>
(a) It was observed that an amount of Rs.1,031,961,201 out of the penalty income of Rs.2,059,507,428 ,outstanding due as at 31 December of the year under review, is a value that is accumulating from year 2017 to 2020.	Since it has been noticed that there are issues regarding the collection of arrears of penalty revenue, a committee consisting of seven officers of the department has been appointed to review the process of collection of penalty revenue and formulate a formal methodology for the collection of arrears of penalty revenue. Action will be taken to find solutions to the issues of collecting penalty revenue in due course.	Establish and implement a proper control system to collect arrears penalty revenue.
(b) Even though it was reported that appeals had been lodged with the Minister of Finance from year 2009 for a fine of Rs. 10,000,000 relevant to one incidence within the above mentioned arrears, it was observed that by the end of the year under review, only Rs. 600,000 out of it had been charged by the end of the year under review.	-do-	-do-
(c) Even though it was reported that reminders had been sent from year 2018 for recovery of a fine of Rs. 498,524,278 relevant to 38 instances relevant to the above mentioned arrears, it was observed that only Rs. 92,061,351 had been recovered by the end of the year under review.	-do-	-do-

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| (d) | Even though it was reported that an appeals had been lodged since year 2008 to the Presidential Secretariat for a fine of Rs. 20,000,000 relevant to one instance relevant to the above mentioned arrears, it was observed that only Rs. 500,000 had been recovered by the end of the year under review. | -do-  | -do-   |
| (e) | Even though reminders had been sent, no amount out of Rs. 52,540,000 had been recovered from the aforesaid arrears on 06 occasions since the year 2016.  | -do-  | -do-   |
| (f) | Even though the fine should be recovered within 02 years according to section 18 (2) of the Customs Ordinance, an income of Rs. 38,441,954 had been lost by the government on 05 occasions due to delays in taking further action to recover.  | -do-  | Action should be taken in accordance with the Customs Ordinance. |
| (g) | An amount of Rs.10,974,502 had been spent contrary to the objectives of the Fund in terms of the section 153 (a) (1) of the Customs Ordinance.   | Pursuant to the section 153 (a) (i) of the Customs Ordinance, expenses may be incurred by the Director General of Customs to provide visible facilities to enhance the effectiveness of Customs Management. The World Customs Day mentioned in the report is commorated with the objective of introducing the criteria recommended and introduced by the World Customs Organization and the generally accepted best practices to the officers.<br>The provisions required for such expenditure are clearly stated in the Gazette Notification No. 792 dated 05.11.1993 issued by the Director General of Customs with the approval of the Minister of Finance.<br>Further, the food and drink is provided to the officers on gate | Action should be taken in accordance with the Customs Ordinance. |

duty at the Hambantota Port considering the difficulties prevailing in the area, and since a limited number of officers have been deployed in the service as well as with the objective of enhancing efficiency of service and motivating. All these expenses are in line with the objectives of the Fund.

Depreciation of fixed assets and bringing into accounts is not an expense, but only an adjustment of accounts.

### 3.2 Operating Inefficiencies

#### Audit Observation

#### Comments of the Management

#### Recommendation

<p>(a) It was observed a trend that the cumulative balance of the fund continued to grow annually by the money collected annually due to improper enhancement of management efficiency of custom officers and planning the precise criteria and the expected targeted expenditure for payment of compensation to officers. The cumulative balance of the fund amounting to Rs. 7,334 million as at 31 December 2019 had been increase by Rs. 445 million or 6% upto Rs.7,779 million by 31 December 2020. i.e. it was observed that 90% of the income of the year under review had been accumulated in the fund.</p>	<p>If there are any expenses incurred from the fines imposed by the sales and penalties of the Customs Inquiry, a 20% will be credited to this fund after deduction of those expenses in terms of the provisions of the Customs Ordinance. Accordingly, the value of the fund increases annually. The account balance was Rs. 7,729 million as at 31.12.2020. It is observed that frauds and irregularities carried out in groups in a well-planned manner using computers and the advances in other technologies have developed all over the world. Accordingly, it is difficult to expect a reduction in customs tax evasion in our country also in the face of such an increasing tendency to earn money fraudulently.</p>	<p>The Customs Ordinance is about 151 years old by now and that Act had been prepared on the basis of the import and export conditions that prevailed at that time. However, it needs to be revised to suit the current situation taking the current dynamics into account.</p>
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- (b) An amount of about Rs. 6,025 million had been credited during the period from the year 2012 to 2020, and the number of customs investigations completed during that period was 2,563. Even though Rs. 729.36 million had been allocated for this fund in the year 2019, it had decreased by 32 percent to Rs. 495.98 million during the year 2020.
- It was observed that the Fund continued to grow due to the fact that a percentage equivalent to 20% of the amount received from the penalty fund imposed for various custom offences, arisen due to not following adequate measures to control customs duty frauds, credited to this fund.
- (c) Even though the amount of rewards paid to officers and in the amount allocated to this fund have been increased due to the government tax revenue lost in the imposition of penalties for customs offenses also being treated as part of that penalty and the reward of officers is decided based on that penalty, it was observed that the government tax revenue was not collected as scheduled.
- do-
- Customs offenses are punishable by a fine due to the subtlety of the officers in detecting that offence. If such an offence is not detected, the total amount of revenue involved in the incident will sometimes be lost to the government. However, the government receives about 30 percent of the proceeds in being able to catch that customs offense based on the skill of custom officers ;therefore, the motivation of officers to catch custom offences can be maintained at high level ,while making a significant contribution to government revenue.
- A system that suits the current situation should be introduced to improve the efficiency of the officers.
- It seems that it is the duty of customs officers to detect customs offenses at an early stage. A review should be carried out in connection with that 70% of the proceeds from the fines obtained by the customs officers after an investigation and the amount received from the sale of confiscated goods are not collecting to the Consolidated Fund, due to non-detection of customs offenses in the first instance.

- (d) It was observed that these developments were primarily influenced by the failure to amend the legal provisions of the Customs Ordinance and related funds in a systematic and timely manner due to the current free economic policies and in line with the complexity of exports. The Customs Ordinance and the Legal Provisions of the Funds have been amended from time to time as appropriate and attention will be drawn to amend them accordingly in due course. The Customs Ordinance is about 151 years old by now and, even though this Act had been prepared based on import-export conditions prevailed during that period, it should be amended to suit the present situation taking present import-export condition into account.
- (e) It is observed that a need to review the past activities of the Fund and to draw the attention of the responsible parties to formulate an appropriate mechanism for obtaining the balances accumulated in the Fund to the Consolidated Fund. Management had not responded. Inquire from the Treasury about excess money and formulate an appropriate methodology.
- (f) Revenue of the Fund during the year under review was Rs. 496 million. Even though the total expenditure was Rs. 51 million, the total expenditure on the Fund's primary objectives was approximately Rs. 40 million. It was 8 percent as a percentage of revenue. Agree with the audit observation. One of the main objectives of the fund is to cover local and foreign training expenses, and this situation has arisen due to the non-deployment of officers for training activities as planned due to the occasional closure of the country in the wake of the corona epidemic situation in the country. The Act should be amended and a methodology suits with the current situation should be introduced to compensate the customs officers and improve the welfare of the employees.
- (g) Even though compensation for disasters to custom officers while performing their duties had been identified as one of the preliminary objectives of this fund, no such payment of compensation had been reported during the period of the last 07 years. Accordingly, it was observed during the audit that the fund was being further abnormally collected to this fund to achieve those objectives. No compensation claims had been received for such disasters during the above 7 years. Further, having such a large amount of money in such a fund for those officers to dedicate to their duties ensures good security for their families like an insurance fund since there are life threats also to honest officers who work hard to seize customs offenses. It -do-

encourages officers to dedicate themselves to their duties despite the risk to their lives.

#### 4. Accountability and Good Governance

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##### 4.1 Budgetary Control

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<b>Audit Observation</b>	<b>Comments of the Management</b>	<b>Recommendation</b>
<p>It was not observed that the budget had been used as an effective management control factor due to observation of a quantitative variation of up to 100 per cent for the 06 objects when compared with the actual figures and the budgeted figures on expenditure of the Fund during the year under review.</p>	<p>Even when estimates had been made based on the needs and other information available at the time, the relevant expenses cannot be predicted 100 percent accurately. The inability to direct officers for training mainly due to the occasional quarantine curfew in year 2020 and other restrictions due to the Covid epidemic has led to variations mentioned in the observation.</p>	<p>When preparing the budget, the needs should be properly identified and the necessary provisions should be made.</p>