

## **Customs Officers' Management and Compensation Fund of Sri Lanka Customs - 2016**

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The audit of financial statements of the Customs Officers' Management and Compensation Fund of the Sri Lanka Customs for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the statement of comprehensive income, statement of changes in equity, cash flow statement 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. My comments and observations which I consider should be published with the Annual Report of the Department appear in this report.

### **1.2 Management's Responsibility for the Financial Statements**

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The management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements whether due to fraud or error.

### **1.3 Auditor's Responsibility**

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My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000-1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **1.4 Basis for Adverse Opinion**

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Had the matters described in paragraph 2.2 of this report been adjusted, many elements in the accompanying financial statements would have been materially affected.

## **2. Financial Statements**

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### **2.1 Adverse Opinion**

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In my opinion, because of the significance of the matters described in paragraph 2.2 of this report, the financial statements do not give a true and fair view of the financial position of the Customs Officers' Management and Compensation Fund of the Sri Lanka Customs as at 31 December 2016 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

### **2.2 Comments on Financial Statements**

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#### **2.2.1 Sri Lanka Public Sector Accounting Standards**

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The following observations are made.

(a) Sri Lanka Public Sector Accounting Standard 01

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- (i) In terms of the Standard, the assets of an entity should be controlled by the entity itself and those assets should be useful for the achievement of objectives of the entity. Nevertheless, the non-current assets of which the carrying amount totalled Rs.111,881,167 as at 31 December of the year under review as reported, had not been utilized for the achievement of objectives of the Fund whereas it was observed that the said assets were being utilized for the operating activities of the Department of Customs. Further, the depreciation amounting to Rs.30,807,693 pertaining to those assets for the year under review had been brought to account as an expenditure of the Fund.
- (ii) In terms of 21 (e) of the Standard, when the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statements or as a budget column in the financial statements should be shown. Nevertheless, the information of budget had not been disclosed in the financial statements of the Fund for the year under review.

(b) Sri Lanka Public Sector Accounting Standard 07

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- (i) In terms of paragraph 13 of the Standard, computer software valued at Rs.500,000 had been brought to account under the computer accessories without being separately classified as intangible assets.
- (ii) Even though the depreciation of an asset begins when it is available for use in terms of paragraph 69 of the Standard, contrary to that, it had been reported in the financial statements that the depreciation from the date of purchase was the policy of the Fund. Accordingly, provision for depreciation had been made contrary to the instructions of the Standard and as such, the

depreciation of the year under review had been overstated by Rs.15,682,137 while the carrying amount of non-current assets had been understated by a similar amount.

### **2.2.2 Accounting Policies**

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A fair accounting policy for the identification of income in respect of the Fund had not been identified and disclosed in the financial statements.

### **2.2.3 Accounting Deficiencies**

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The following observations are made.

- (a) A sum of Rs.25,403,067 which should be credited to the Fund pertaining to 11 files of custom investigations had omitted from accounts while the income of this Fund pertaining to 39 files of investigations had been understated and overstated by Rs.38,257,023 and Rs.28,307,806 respectively.
- (b) Out of the stationery valued at Rs.3,618,928 purchased in the year under review for the use of Sri Lanka Customs and this Fund , the cost of stationery required for the purposes of the Fund and the cost of stock as at the end of the year had not been separately identified while the total cost had been brought to account as an expenditure of the Fund.
- (c) A sum of Rs.182,397 paid in respect of 02 motor vehicles obtained on monthly hire basis had been brought to account under expenditure on foreign training and a sum of Rs.255,439 paid for a local training programme had been brought to account under expenditure on foreign training. Further, Warm Clothing allowances totalling Rs.42,832 paid for foreign tours had been brought to account as expenditure on local training while expenditure on hiring motor vehicles amounting to Rs. 371,367 had been shown as expenditure on commemorative plaques in the comprehensive income statement.
- (d) A sum of Rs.11,332,185 spent for the maintenance of machinery and office equipment had been brought to account as purchase of assets , thus the cost of non-current assets had been overstated by similar amount while the expenditure on maintenance of machinery and office equipment had been understated by similar amount.
- (e) Furniture and office equipment valued at Rs.7,058,000 had been shown under the computer accessories, thus the depreciation of the year under review had been overstated by Rs.2,031,379.
- (f) A Control Account had not been maintained for recording the inter ledger transactions of the Sri Lanka Customs and the Management and Compensation Fund.
- (g) The value of unclaimed rewards totalling Rs.720,114 relating to the month of October 2016 had not been brought to account as income.

- (h) Library books purchased at a cost of Rs.567,550 in the year 2014, accessories and fittings valued at Rs.1,851,696, the television set costing Rs.468,000 and the depreciation of those assets amounting to Rs.467,952 had omitted from accounts.
- (i) Fines imposed on 81 case files of which the investigations were completed by the end of the year under review amounted to Rs.1,597,390,932 and out of that, 20 per cent of the contributions totalling Rs.319,478,186 had not been brought to account as an income of the Fund. Even though the financial statements of the Fund should be prepared on the accrual basis in terms of the Sri Lanka Public Sector Accounting Standards, the adoption of cash basis had been the reason therefor.

#### **2.2.4 Unexplained Differences**

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The following observations are made.

- (a) Out of the sum of Rs.2,366,174,629 credited to the Custom Officers' Reward Fund for the year under review, 40 per cent or Rs.946,469,851 should have been credited to the Custom Officers' Management and Compensation Fund in terms of the provisions of the Act. Nevertheless, only a sum of Rs.936,815,186 had been credited to that Fund. As such, a difference of Rs.9,654,665 was observed and adequate reasons therefor had not been explained.
- (b) According to the statement of comprehensive income a difference of Rs.2,195,431 was observed between the values of depreciation and ledger accounts and the reasons therefor had not been explained.
- (c) A difference of Rs.9,222,650 was observed between the income from fines shown in the statement of comprehensive income relating to a period of three months of the year under review and the relevant schedule.
- (d) Differences amounting to Rs.91,221,893 and Rs.111,308,874 were observed between the Treasury Printouts and Departmental Books pertaining to the Accumulated Fund as at the beginning and the end of the year respectively and the reasons therefor had not been explained.
- (e) Even though the value of Accumulated Fund as at 31 December 2015 had been reported as Rs.4,731,374,550 in the statement of changes in equity presented for the year under review, the balance brought forward as at 01 January 2016 had been Rs.4,731,468,150, thus a difference of Rs.93,600 was observed.
- (f) Even though the recurrent expenditure amounted to Rs.179,115,489 according to the financial statements, it was shown as Rs.178,785,310 in the schedule of expenditure, thus a difference of Rs.330,179 was observed.

#### **2.2.5 Lack of Evidence for Audit**

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Documentary evidence pertaining to journal entries and prior year adjustments totalling Rs.38,321,939 used for the preparation of financial statements of the Fund had not been made available to audit, thus it could not be satisfactorily verified and accepted in audit.

### **3. Financial Review**

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#### **3.1 Financial Results**

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According to the financial statements presented for the year under review, the operating surplus of the Fund amounted to Rs. 727,612,118 as compared with the corresponding surplus of Rs. 450,789,616 for the preceding year, thus indicating an improvement of Rs. 276,822,502 in the financial result of the year under review as compared with the preceding year. Even though the overall expenditure had increased by Rs.116,355,742 in the year under review, the increase in the income of the Fund by Rs.348,749,758 had been the main reason for the said improvement.

#### **3.2 Analytical Financial Review**

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The expenditure on local training amounting to Rs.5,385,778 of the preceding year had increased by 250 per cent up to Rs.18,832,173 in the year under review. Incurring an expenditure of Rs.7,033,636 in respect of a training programme for the Custom Guards held in Kilinochchi, incurring an expenditure of Rs.3,524,150 for a Diploma Course conducted by the Geologists' Association, incurring an expenditure of Rs.3,833,116 for the Open Competitive Examination for the recruitment of new Custom Officers and Assistant Superintendent of Customs had been the reasons for the unusual increase in the expenditure on local training.

### **4. Operating Review**

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#### **4.1 Performance**

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Fines imposed on various Customs offences and an amount equal to 20 per cent of the sales proceeds of goods confiscated are credited to this Fund and the functions of the Fund in terms of Section 153(b) of the Customs Ordinance had been as follows.

- ❖ Incurring expenditure on providing facilities as appear to the Director-General to enhance the effectiveness of the management of customs
- ❖ Granting compensation to any customs officer who is permanently, totality, partially disabled or temporarily incapacitated
- ❖ Granting compensation in the event of death of any customs officer, to the legal heirs

The following observations are made on the achievement of the said objectives.

- (a) As the money is being credited to the Compensation Fund for several years in terms the Customs Ordinance, the accumulated balance of the Fund as at the end of the year under review had been Rs.5,420 million and as compared to the preceding year, it was an increase of 15 per cent amounting to Rs.689 million. Even though the income of the Fund for the year under review amounted to Rs. 936 million, only a sum of Rs.107 million had been spent for the main objectives of the Fund. Even though provision had been made for

the Fund continuously, it was observed in audit that such funds had not been utilized for the achievement of the objectives of the Fund with a proper forecast and plan. Further, the following reasons had mainly impacted on the continuous improvement of the accumulated balance of the Fund.

- (i) The increase in the number of custom investigations from which the money was received to the Fund during 05 preceding years due to the failure to take adequate action to control the Customs duty frauds and the financial value of Customs offences was as follows.

| Year  | Number of Investigations completed | Amount allocated to the Fund out of the financial value of Customs offences |
|-------|------------------------------------|---|
| ----- | -----                              | -----   |
|       |                                    | Rs.   |
| 2012  | 183                                | 362,419,680   |
| 2013  | 200                                | 592,887,505   |
| 2014  | 258                                | 516,223,741   |
| 2015  | 296                                | 588,065,427   |
| 2016  | 267                                | 936,815,186   |

- (ii) In the imposition of penalties on Customs offences, Government tax income deprived of has also been considered as a part of the penalty, thus an increase in the cash rewards paid to the officers and also an increase in the amount allocated for this Fund were observed.
- (iii) Lack of proper and timely amendments to the Custom Ordinance and legal provisions of relevant Funds appropriate to the complexity of importation and exportation arisen due to the free economic policies prevailing at present.
- (b) Even though the payment of compensation for accidents caused to the Custom officers on duty had been identified as one of the main objectives of the Fund, no such payment of compensation was observed during the period of 5 preceding years subject to the examination. As such, the continuous collection of money in respect of this Fund in an unusual manner was questionable in audit.
- (c) Expenditure had been incurred for the Objects such as purchase of non-current assets, maintenance of machinery and license fees extraneous to the main objectives of the Fund during the year under review as well.

## **5. Accountability and Good Governance**

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### **5.1 Presentation of Financial Statements**

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Even though the Annual Performance Report and financial statements of the Fund should be presented within 02 months after the close of the year of accounts in terms of Public Finance Circular No.PF/423 of 22 December 2006, the amended financial statements of the year under review had been presented to the Audit only on 06 June 2017.

## 5.2 Budgetary Control

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The following observations are made.

- (a) Out of the fines imposed on various Customs offences and sales proceeds of goods confiscated, an amount equal to 20 per cent is credited to this Fund while 50 per cent and the balance of 30 per cent are credited to the Custom Rewards Fund and Consolidated Fund respectively. As the estimated income of the Custom Rewards Fund for the year under review amounted to Rs.1,750 million, the estimated income of the Management and Compensation Fund should be Rs.700 million as a percentage. Nevertheless, it had been considered as Rs.740 million in the preparation of estimates and as such, the estimated income of the Management and Compensation Fund had been observed as an overestimation of Rs.40 million. Accordingly, it was not observed that the preparation of estimates of the Fund was logical.
- (b) Variances ranging between 62 per cent and 1654 per cent were observed between the budgeted amount and the actual amount of five Objects and variances ranging between 57 per cent and 37 per cent were observed between the budgeted amount and the actual amount of 02 Items of income of the Fund. Thus, it was observed that the budget had not been made use of as an effective instrument of management control.

## 6. Systems and Controls

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Weaknesses in systems and controls 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.

| Areas of Systems and Controls | Observations   |
|-------------------------------|--|
| -----                         | -----  |
| (a) Foreign Training          | Failure to follow a proper methodology for the selection of officers for foreign training.   |
| (b) Control of Income         | Lack of a proper methodology for the comparison of investigation files relating to income receivable and income received to the Fund.  |
| (c) Accounting                | <ul style="list-style-type: none"><li>(i) Non-compliance with the Sri Lanka Public Sector Accounting Standards in the accounting and preparation of financial statements.</li><li>(ii) Non-maintenance of a Control Account for the transactions with main Account of the Sri Lanka Customs.</li><li>(iii) Non-reconciliation of account balances with relevant schedules.</li></ul> |

