

Democratic Socialist Republic of Sri Lanka - 2017

The audit of financial statements of the Democratic Socialist Republic of Sri Lanka for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of financial performance , 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(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka. The Management Audit Report for the year under review was issued to the Secretary to the Ministry of Finance and Economic Affairs on 02 November 2018.

1.2 Management's Responsibility for Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles 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

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 risks assessments, the auditor considers internal control relevant to the 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 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.

2. Financial Statements

2.1 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2.2 Comments on Financial Statements

2.2.1 Qualified Opinion

In my opinion except for the effects of the matters described under the Basis for Qualified Opinion in this report, the financial statements give a true and fair view of the financial position of the Democratic Socialist Republic of Sri Lanka as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

2.2.2 Financial Statements of the Republic

Even though the above financial statements had been titled as financial statements of the Republic, those had been solely confined to the transactions of the Consolidated Fund. Accordingly, transactions and events and assets and liabilities of the Provincial Councils, Local Government Authorities, Public Enterprises and other institutions owned by the Republic or functioning under the control of Government had not been incorporated in these financial statements. Therefore, the title of this set of financial statements is inappropriate to the requirements of the Fiscal Management (Responsibility) Act No,3 of 2003 and the content of the above financial statements.

2.2.3 Accounting Deficiencies

The following observations are made.

- (a) According to the financial statements of the Republic, the balance of debts payable by the Government as at 31 December 2017 amounted to Rs.9,588,101 million, whereas according to the following matters observed at the audit test check, the aforesaid balance of debts had been understated by Rs.803,555 million in the financial statements.
 - (i) The accounting policy related to the Treasury Bonds included in the financial statements of the Republic had been corrected with effect from the year 2016 and accordingly, in the issuance of Treasury Bonds, instead of their net value, accounting at their face value had been initiated. Nevertheless, due to failure in further adjusting the face value of the Treasury Bonds issued before the year 2016 to the accounts, the total liability applicable to the Treasury Bonds as at 31 December 2017 had been understated by Rs.433,097 million in the financial statements.
 - (ii) The debt balance of Rs.330,221 million remained as at 31 December 2017 relating to 08 loan agreements entered into by the Government under the contractual agreements had not been included in the financial statements of the Republic (Details appear in Annexure 01). Of the debt balances included in the aforesaid 08 loan agreements, a sum of Rs.150,730 million represented the

balance payable for the loans obtained by the Sri Lanka Government for the construction of Hambantota Port. The approval of the Cabinet of Minister for the Cabinet Memorandum No. MPS/SEC/2017/32 dated 20 August 2017 named “Hambantota Port Relief Agreement” presented by the Ministry of Port and Naval Affairs in this connection, had been granted on 04 August 2017. Accordingly, the General Treasury had held the responsibility of the settlement of remaining balance of the loans obtained by the Sri Lanka Government for the construction of Hambantota Port so as to be effective from the date of enforcement of the said Relief Agreement. Nevertheless, the above loan balance had not been included in these financial statements of the Republic. Likewise, the above loan balance had been eliminated from the financial statements of the Sri Lanka Ports Authority as at 31 December 2017.

- (iii) Out of the debt balances included in the aforesaid 08 loan agreements, the value of the installments settled during the year under review relating to the loans obtained for the construction of Coal-fired Power Station, Puttalam under 03 foreign loan agreements had not been included in Note 30 (Foreign Loan Balance Statement) of the financial statements. Accordingly, a difference of Rs.14,386 million was observed between the financial statements and the Notes thereof relating to the payment of foreign loans. Details appear below.
 - (iv) Foreign loans amounting to Rs.40,237 million realized during the year 2017 relating to 65 loan agreements had not been included in these financial statements.
- (b) According to the financial statements of the Republic, the Government had granted on lending amounting to Rs.181,368 million to various Government and private institutions. It was observed during the course of audit test check carried out in this connection that the value of on lending had been understated by Rs.7,490 million.
- (i) According to the Note No.20 of the financial statements, 2017, the value of on lending granted during the year 2017 amounted to Rs.25,152 million, whereas a sum of Rs.19,043 million only had been brought to accounts as on lending under the Object No.2302 in the final report of the Department of State Accounts (Table 33). Accordingly, a difference of Rs.6,109 million was observed between the financial statements and the final report of the Department of State Accounts (Table 33).
 - (ii) Although sums totalling Rs.7,490 million comprising Rs.4,990 million in the years 2015 and 2016 and Rs.2,500 million in the year 2017 had been granted on recovery basis to the Ministry of National Policies and Economic Affairs under Object No.2302 to settle the payments of Golden Key depositors according to a Supreme Court decision, it had not been included as on lending in the financial statements of the Republic. Further, agreements had not been entered into for the payment of above on lending even by the end of the year under review.

- (c) When comparing the capital contribution made to the National Water Supply and Drainage Board as per the Treasury books and the direct balance confirmations made available to Audit, it was observed that a sum of Rs.23,509 million had been understated in the financial statements as specified below.

Detail	Balance as at 01 January 2017	Investments during the year 2017	Balance as at 31 December 2017
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	Rs. Millions	Rs. Millions	Rs. Millions
According to the Balance Confirmations	68,810	8,702	77,512
According to the Treasury Books	53,890	113	54,003
Difference	14,920	8,589	23,509
	=====	=====	=====

- (d) According to the financial statements of the Republic, the Government liability (excluding public debts) stood at Rs.35,340 million as at 31 December 2017. Nevertheless, it was observed according to the audit test check carried out in this connection that the liabilities amounting to Rs.53,188 million had been understated in the financial statements.
- (i) Out of the loan of Rs.7,550 million obtained by the Ministry of Defence from 04 commercial banks for the construction of Secretariat of Personal Identification, the value of the loan installments and the interests further remained payable as at 31 December 2017 amounted to Rs.7,396 million and the above balance had not been stated as a liability in the financial statements.
- (ii) Of the loans obtained by the Department of Pensions from 03 Government banks for the payment of pension gratuity from the year 2014, the balance further remained payable as at 31 December 2017 amounted to Rs. 45,792 million and that balance had not been shown as a liability in the financial statements.
- (e) In the sale of 82 motor vehicles purchased for the Commonwealth Heads of Government Meeting, a loss of Rs.400 million had been sustained during the year 2014. Nevertheless, action had not been taken to write off the above loss from the books even by 31 December 2017 and that value had been further included in the Suspense Account in the financial statements. Similarly, negative balances of Rs.127,384 million shown under the Note. 30 in the financial statements had been adjusted in the Operating Account for the Government Departments and presented, whereas adequate explanations had not been made thereon.

- (f) According to the financial statements, 2017 of the Republic, the Non Financial Assets as at 31 December 2017 totalled Rs.814,336 million. However, that value had included revalued amounts as well as value computed on cost basis. In this connection, when comparing the balances according to the “Non Current Assets Movement Report” included in the Note No.01 of the Appropriation Accounts of the year 2017 relating to 77 institutions selected on sample basis out of Non Financial Assets balances included in the Note No.16 of the financial statements with the balance of non current assets existed as at that date, the following differences were observed.
- (i) Value of the assets under 05 categories of assets shown in the Non-Current Assets Movement Report furnished to Audit together with the Appropriation Account relating to the year under review by the selected institutions amounted to Rs.69,935 million. The value of assets relevant to those institutions as stated in the Note.16 of the financial statements of the Republic amounted to Rs.260,893 million. Accordingly, the value of assets shown in the financial statements had been overstated by Rs.190,958 million than the value stated in the Appropriation Account.

Category of Assets	Asset	Balance as at 31.12.2017 according to these financial statements	Balance as at 31.12.2017 according to the Appropriation Account	Overstatement in the financial statements
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		Rs.Millions	Rs. Millions	Rs. Millions
9151	Building and Constructions	196,818	51,031	145,787
9152	Machinery and Equipment	6,294	4,200	2,094
9153	Lands	26,480	2,289	24,191
9160	Work-in-progress	6,756	1,369	5,387
9180	Leasing assets	24,545	11,046	13,499
	Total	260,893	69,935	190,958
		=====	=====	=====

- (ii) Value of the assets relevant to several selected institutions out of the institutions specified under the Note No.16 of the financial statements for the year under review had been shown as Rs.77,265 million under 04 categories of assets. Nevertheless, that value had been shown as Rs.246,028 million in the Non-Current Assets Movement Report furnished to Audit together with the Appropriation Accounts by those selected institutions. Accordingly, a sum of Rs.168,763 million had been understated in the financial statements than the value of assets stated in the Appropriation Accounts by those institutions. Details appear below.

Category of Assets	Assest	Balance as at 31.12.2017 according to these financial statements	Balance as at 31.12.2017 according to the Appropriation Account	Understatement in the financial statements
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		Rs.Millions	Rs.Millions	Rs.Millions
9151	Building and Constructions	9,544	47,445	(37,901)
9152	Machinery and Equipment	59,356	130,473	(71,117)
9153	Lands	1,699	21,098	(19,399)
9160	Work-in-progress	6,666	47,012	(40,346)
	Total	77,265	246,028	(168,763)
		=====	=====	=====

2.2.4 Non-compliance with Laws, Rules and Regulations

The following instances of non-compliance with Laws, Rules and Regulations were observed during the course of audit test checks.

- (a) It is specified in Paragraph 3 (a) of the Fiscal Management (Responsibility) Act, No.3 of 2003 that the reduction of Government debt to prudent levels, by ensuring that the budget deficit at the end of the year 2006, shall not exceed five per cent of the estimated Gross Domestic Product and to ensure that such levels be maintained thereafter, is an objective with responsibility that forms the basis to the financial management which is required to be followed by the Government.

Nevertheless, it had not been possible to maintain the buget deficit in the year 2017 and during the period of preceeding seven years in a manner not to exceed five per centum of the estimated Gross Domestic Product related to those years. Accordingly, the estimated budget deficit stood at 7.89 per cent of the estimated Gross Domestic Product and the actual budget deficit stood at 5.70 per cent of the Gross Domestic Product during the year under review. Details appear in the Annexure 02.

- (b) In terms of Fiscal Management (Responsibility) Act No,3 of 2003 as amended by the Fiscal Management (Responsibility) Amendment Act No.15 of 2013, the maximum value of liabilities at the end of a certain year shall not exceed 80 per cent of the estimated Gross Domestic Product of that year. Even through the records of the Ministry of Finance demonstrate that the Ministry had complied with the above limitations, when taking into consideration the liabilities relevant to various public enterprices which had been brought to account outside the statement of financial position included in the financial statements of the Republic, the relevant limitation had been exceeded. Details appear below.

Liability	Value of Liability as at 31 December 2017*
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	Rs. Millions
Bank Overdraft	150,539
Central Bank Advances	199,801
Public Debpt	9,588,101
Liabilities not accounted in the financial statements.	
- Foreign loans accounted outside the Balance Sheet.	330,221
- Understating the balance of Treasury Bonds in the accounts	433,097

Total Liability	10,701,759
	=====
Gross Domestic Product	13,289,000
Total Liability as a percentage of the Gross Domestic Product	80.53

* The value of guarantees and letter of comfort amounting to Rs.652,214 million granted to the banks in respect of the loans obtained by the public enterprises upon the guarantees of the General Treasury and values included in the statement of liabilities in the Appropriation Accounts had not been included in the above liabilities.

3 Financial Review

3.1 Financial Performance

The financial performance in terms of the financial statements of the Republic for the year ended 31 December 2017 has been compared with that of the preceding year as follows.

Revised Budget of the year 2017	Description	Actual	
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Rs. Millions	-----	2017	2016
		-----	-----
		Rs. Millions	Rs. Millions
	Revenue		

308,000.0	Income Tax	274,561.6	258,856.8
1,052,360.0	Domestic Goods and Services Tax	1,024,280.5	840,563.9
389,390.0	Tax on international trade	371,336.1	364,268.1
		-----	-----
1,749,750.0	Tax revenue	1,670,178.2	1,463,688.8

163,900.0	Non-tax revenue and others	174,839.1	235,066.3
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1,913,650.0	Total Revenue (a)	1,845,017.3	1,698,755.1
	Less: Expenditure		
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472,299.7	Salary, wages and other service benefits	463,872.5	452,700.7
188,833.1	Other goods and services	164,446.0	148,955.5
602,248.7	Assistance, grants and transfers	580,556.0	557,162.9
761,152.1	Payments of interests	735,565.7	610,894.6
2,149.4	Other recurrent expenditure	1,134.8	1,168.0
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2,026,683.0	Total recurrent expenditure (b)	1,945,575.0	1,770,881.7
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113,033.0	Revenue deficit (a) - (b)	100,557.7	72,126.6
935,529.4	Government investments	657,530.0	594,012.7
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1,048,562.4	Budget Deficit	758,087.7	666,139.3
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	Financing of Budget deficit		
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270,325.0	Foreign borrowings	601,305.6	574,248.7
(220,052.2)	Payment of foreign debts	(219,349.6)	(145,119.3)
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50,272.8	Net foreign borrowings	381,956.0	429,129.4
8,000.0	Foreign grants	8,031.1	7,496.0
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58,272.8	Total foreign financial contributions	389,987.1	436,625.4
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1,829,861.5	Domestic borrowings	856,671.1	1,041,541.3
(678,053.5)	Payment of domestic debts	(648,133.9)	(596,429.3)
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1,151,808.0	Net domestic borrowings	208,537.2	445,112.0
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1,210,080.8	Total foreign financial contributions and net domestic borrowings	598,524.3	881,737.4
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16,250.0	Recovery of debts	16,418.0	18,619.5
100.0	Sale of capital assets	144.1	407.2
-	Divestiture Proceeds	44,677.0	-
-	Net variation of deposit accounts and liabilities.	113,470.0	(202,654.9)
-	Increase/(Decrease) in cash and cash equivalents	(15,145.7)	(31,969.9)
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1,226,430.8	Total financing	758,087.7	666,139.3
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Payment of domestic debts installments **	2,340	2,073	2,265	1,584	1,696	1,980
Payment of foreign debts installments **	219	145	187	107	95	153
Payment of interests on domestic debts**	597	510	450	376	401	351
Payment of interests on foreign debts	138	101	77	107	95	153
Total of the payment of installments and interests of debts	3,294	2,829	2,979	2,174	2,287	2,637
Government Revenue	1,845	1,699	1,394	1,128	1,066	997
Loan installments and interests further remained payable after deducting the total Government revenue from the payment of loan installments and interests	1,449	1,130	1,585	1,046	1,221	1,640
Public debt balance as at 31 December ***	9,776	8,861	7,830	6,721	6,106	5,520

payment of installments and interests of debts: Percentage Percentage Percentage Percentage Percentage Percentage

- Public revenue as a percentage of total payment of loan installments and interests	56.0	60.1	46.8	51.9	46.6	37.8
- Total payment of loan installments and interests as a percentage of total debts of the year	104.5	91.3	89.0	88.9	96.9	100.6
- Total payment of loan installments and interests as a percentage of total Public revenue	178.5	166.4	213.7	192.6	214.5	264.5

* The total borrowings obtained during the year included the loan obtained through the issuance of Treasury Bills. (Herein, the net borrowings obtained by the issuance of Treasury Bills had been excluded) Eg:-

	2017	2016
	-----	-----
	Rs. Billions	Rs. Billions
Domestic borrowings	857	1,042
Net borrowings through the issuance of Treasury Bills	68	(159)
Total borrowings through the issuance of Treasury Bills	1,624	1,635
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	<u>2,549</u>	<u>2,518</u>

** Payments of installments of domestic debts included the payments made for the Treasury Bills.

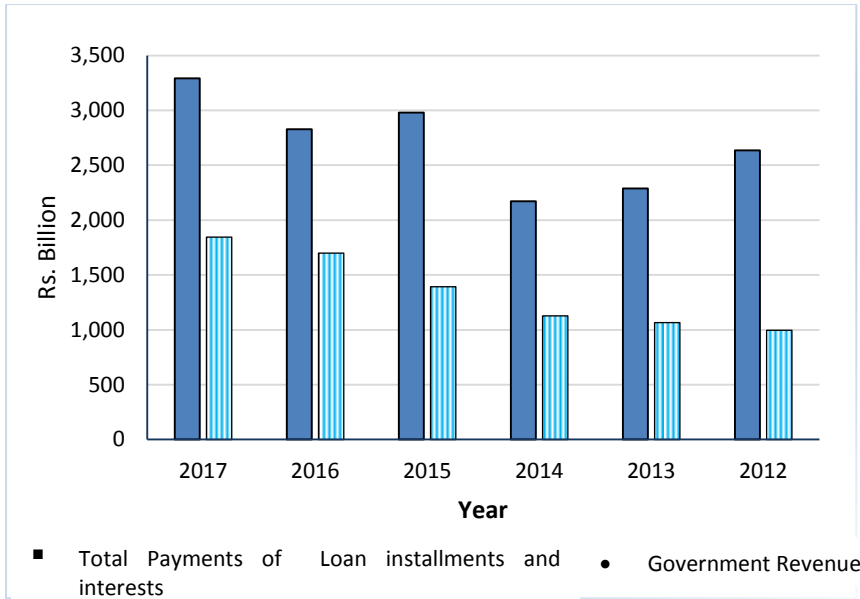
	2017	2016
	-----	-----
	Rs. Billions	Rs. Billions
Payment of domestic debts	648	597
Payment debts obtained through the issuance of Treasury Bills	1,692	1,476
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	<u>2,340</u>	<u>2,073</u>

*** In the computation of balance of the Public debt, lease hold creditors had been excluded and the Central Bank advances had been included.

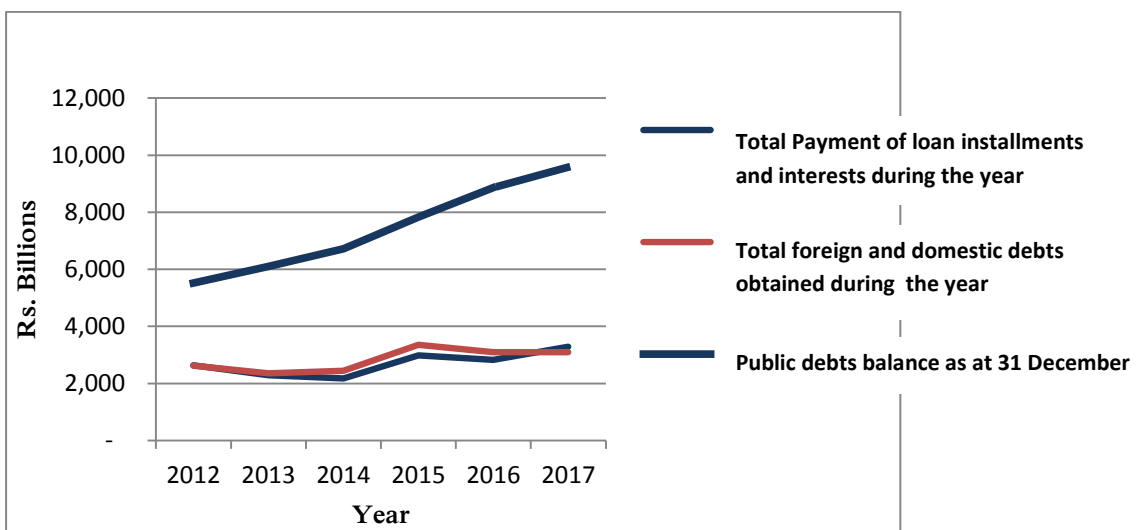
	2017	2016
	-----	-----
	Rs. Billions	Rs. Billions
Public debt as at 31 December	9,588	8,794
Advances from the Central Bank	200	83
Lease hold creditors	(12)	(16)
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	<u>9,776</u>	<u>8,861</u>

The following observations are made in this connection.

- (a) For the payment of loan installments and interests payable from the year 2012 to the year under review, the Government revenue collected in that year had been inadequate. Even though the total of Government revenue had increased by Rs.146,262 million during the year under review in relation to the preceding year, that total Revenue had been sufficient only to settle 56 per cent of the total loan installments and interests payable during the year under review. Payment of loan installments and interests in relation to the Government revenue is given in the following graph.



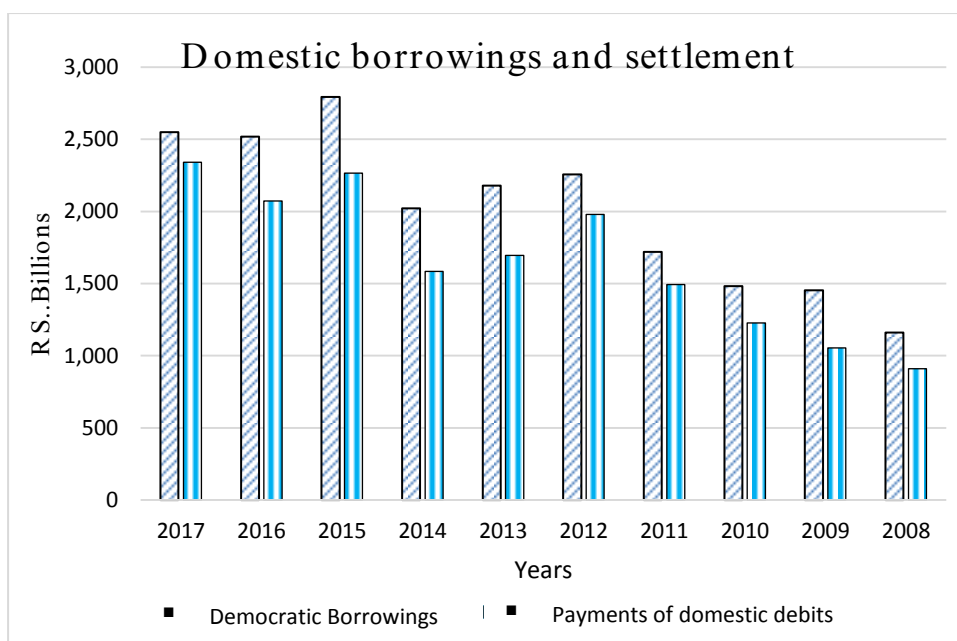
(b) Since the Government revenue was insufficient to settle the installments and interests of loans existed from the year 2012 to 2017, domestic and foreign loans had to be obtained in the respective years. Accordingly, the Government revenue being insufficient to pay loan installments and interests in the year under review, 44 per cent or Rs.1,449,990 million of the value of payable loan installments and interest had to be settled from the loans obtained during the year under review. Out of the total borrowings obtained in the preceding year, 91.3 per cent had been sufficient to settle the installments and interests of loans payable in that year. Nevertheless, the loans obtained during the year under review had been inadequate to settle the total loan installments and interests payable in that year. That is, the value of payable loan installments and interests had been 106 per cent of the loans obtained. Accordingly, the total Public debts balance had ceaselessly increased over a number of years by the end of the year under review. Details appear in the following graph.



- (c) Provisions amounting to Rs.277,999 million had been made for the Government investments during the year under review while increasing the above provision by Rs.63,517 million or 11 per cent in relation to the preceding year. Nevertheless, 30 per cent of the above provisions made during the year under review had been saved without being utilized.
- (d) As compared with the preceding year, the budget deficit had increased by Rs.91,948 million or 13.8 per cent during the year under review. Nevertheless, net borrowings (domestic and foreign) had decreased by Rs.283,748 million and recovery of loans had decreased by Rs.2,201 million.
- (e) The total Public debt balance of Rs.9,776 billion as at 31 December 2017 amounted to 73.5 per cent of the Gross Domestic Product of Rs.13,289 billion. Accordingly, a considerable amount of the loans obtained by the Government over a long period of time had been utilized for the settlement of loan installments and interests and it had resulted in failure to make an adequate investment in the development projects as expected. Value of domestic borrowings relating to the year under review and 07 preceding years and the position of the payment of installments of domestic debts are given in the following table.

	2017	2016	2015	2014	2013	2012	2011	2010
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	Rs.Billions	Rs.Billions	Rs.Billions	Rs.Billions	Rs.Billions	Rs.Billions	Rs.Billions	Rs.Billions
Domestic borrowings	2,549	2,518	2,793	2,020	2,178	2,256	1,719	1,483
Payment of domestic debts	2,340	2,073	2,265	1,584	1,696	1,980	1,494	1,227
Net domestic borrowings	209	445	528	436	482	276	225	256
Payment of domestic debts as a percentage of domestic borrowings	91.8	82.3	81.1	78.4	77.9	87.8	86.9	82.7

According to the above information, 92 per cent of the total domestic borrowings of the year under review had been used for the settlement of domestic debts and the net domestic borrowings had represented 8 per cent of the total domestic borrowings. Accordingly, the investment possibility upon the domestic borrowings had remained at extremely lower position. Details appear in the following graph.



- (f) In comparing the total Public debts as at 31 December 2017 with the mid-year population, the per capita debts stood at Rs.455,885 and it was Rs.417,865 in the preceding year. Accordingly, it had increased by Rs.38,020 as compared with the per capita debts in the preceding year. Similarly, as a result of 45 per cent of the Public debt balance containing foreign debts and the devaluation of Rupee, the actual value of the per capita debts will further increase. The mid-year population in the year under review and 05 preceding years and the per capita debts are specified in the following table.

Description	2017	2016	2015	2014	2013	2012
Public debt balance as at 31 December (Rs. Billions)	9,776	8,861	7,830	6,721	6,106	5,520
Midyear population ('000)	21,444	21,203	20,966	20,771	20,585	20,425
Per capita debt (Rs.)	455,885	417,865	373,462	323,576	296,624	270,257

3.3 Financial Position

According to the Financial Statements of the Republic, a comparison on the assets and liabilities of the Democratic Socialist Republic of Sri Lanka as at the end of the year under review and four preceding years is given below.

Description	2017	2016 (Revised)	2015	2014	2013 (Comparative figures)	2013*
	Rs.Millions	Rs.Millions	Rs.Millions	Rs.Millions	Rs.Millions	Rs.Millions
Non-financial assets	814,336	346,655	21,287	-	-	-
Financial assets						
Loans to Public Officers	27,428	23,032	22,327	23,396	23,012	23,012
Advances for Government Departments	15,088	16,093	9,878	9,679	9,230	9,230
Membership Fees	3,517	3,517	3,517	3,517	3,517	3,517
Lending	181,368	169,547	174,196	207,966	370,618	370,618
Government contributions in the Government owned businesses.	578,481	526,907	492,130	397,837	212,976	212,976
Investments on borrowings	-	-	7,684,954	6,577,431	5,996,496	-
Stamp Stock Account	1,305	1,275	1,315	1,244	971	971
Lease rent and mobilization advances	750	229	-	-	-	-
Total Financial assets	807,937	740,601	8,388,317	7,221,072	6,616,821	620,325
Total assets	1,622,273	1,087,255	8,409,604	7,221,072	6,616,821	-
Statutory Funds and other Funds						
Consolidated Fund	(285,571)	(187,247)	(403,026)	(356,665)	(312,477)	-
Contingencies Fund	500	500	100	140	140	140
Foreign Loans Revolving Fund	31,264	23,820	25,748	25,835	22,587	22,587
Funds on investments - SOES	-	-	666,326	605,803	584,215	-
Various Funds	992	1,525	1,397	1,285	1,386	1,386
Non-current Assets						
Reserve Fund	-	-	21,287	-	-	-
Net Assets	(8,013,167)	(7,750,621)	-	-	-	-
Adjustment Account						
Total Funds	(8,265,982)	(7,912,023)	311,832	276,399	295,851	-

Liabilities							
Bank Overdraft	150,539	165,685	197,655	164,348	137,077	137,077	137,077
Advances from Central Bank	199,801	83,307	151,132	143,898	109,272	109,272	109,272
Government borrowings	9,588,101	8,793,959	7,684,954	6,577,431	5,996,496	5,996,496	5,996,496
Deposits and other liabilities	75,121	64,343	63,142	62,724	83,410	83,410	83,410
Operating Account with the Government Departments	(125,941)	(108,635)	277	(4,315)	(4,905)	(4,905)	(4,905)
Various Accounts	633	619	612	587	(380)	(381)	(381)
Total Liabilities	9,888,254	8,999,278	8,097,772	6,944,673	6,320,970	6,344,943	6,344,943
Total Funds and liabilities	1,622,273	1,087,255	8,409,604	7,221,072	6,616,821	6,345,083	6,345,083
Liabilities exceeding financial assets and total of Contingencies Fund	-	-	-	-	-	-	5,724,758
Consolidated Fund-Accumulated net revenue deficit	-	-	-	-	-	-	312,477
Total investments in physical assets and accumulated net revenue deficit	-	-	-	-	-	-	5,412,281
Contingencies and Commitments	652,214	563,337	431,954	519,274	362,923	362,923	5,724,758 362,923

* Statement of Financial Position before altering the format of the financial statements in the year 2013.

The following observations are made in this connection.

- (a) Since format of the financial statement of the Republic had been changed during the year under review, an account called "Net Assets Adjustment Account" had been introduced and the following account had been adjusted thereto.

	Rs. Millions
Non-financial assets	814,336
Lending (on lending)	181,368
Government contributions in Government owned businesses	578,481
Lease rent and mobilization advances	750

Total	1,574,935
Less: Government borrowings	(9,588,101)
Net Assets Adjustment Account	<u>(8,013,166)</u>

- (b) In the preparation of financial statements, format of the Statement of Financial Position used in the year 2013 and preceding years had been altered from the year 2014 and it had been changed again in the year 2017. Accordingly, the comparative information in the Statement of Financial Position of the preceding year had been adjusted in accordance with the Format, 2017.

3.4 Operating Review

3.4.1 Government Revenue

The total annual estimated revenue approved for the year under review amounted to Rs.1,913,650 million and the actual revenue amounted to Rs.1,845,017 million. The following observations are made in this connection.

- (a) According to Note 32 of the financial statements of the Central Bank of Sri Lanka for the year ended 31 December 2017, contribution to the Consolidated Fund under the Profit Distribution had been stated as Rs.14,227 million. Nevertheless, the Central Bank had failed to collect that revenue during the year under review.
- (b) According to Note 30 of the financial statements of the Central Bank of Sri Lanka for the year ended 31 December 2016, contribution to the Consolidated Fund under the Profit Distribution had been stated as Rs.6,378 million. Nevertheless, a sum of Rs.5,000 million only had been remitted to the General Treasury by the Central Bank in the year 2016. Accordingly, the Central Bank had failed to collect revenue of Rs.1,378 million receivable relating to the year 2016.
- (c) The net revenue surplus of the National Film Corporation aggregating Rs.112 million comprising Rs.35 million, Rs.37 million and Rs.40 million for the years 2014, 2015 and 2016 respectively should have been remitted to the Consolidated Fund as required by Section 10 (5) of the Finance Act. Nevertheless, action had not been taken accordingly.
- (d) As necessary action had not been taken to implement the provisions in certain Acts and Ordinance enacted by Parliament, there were instances where the taxes timely receivable by the Government had been deprived of or delayed. Several such instances are as follows.
- (i) The Mansion Tax due to be recovered in terms of provisions in the Finance Act No.10 of 2015 had not been recovered during the year under review.
- (ii) The Value Added Tax on the units of textiles supplied to the local market by the textile manufacturing companies registered with the Sri Lanka Board of Investments had been revised from Rs.25 to Rs.75 at unit by the Value Added Tax (Amendment) Act, No.20 of 2016 and the above revision had been enforced from 01 November 2016.

Nevertheless, Sri Lanka Customs had commenced the recovery of that charges from 14 June 2017. Accordingly, the recovery of Value Added Tax to be recovered upon the textile units had not been properly implemented. As such, the Government had been deprived of revenue of Rs.167 million within the period from 01 November 2016 to 14 June 2017.

- (iii) According to the Economic Service Charge (Amendmemnt) Act No.7 of 2017, although 0.5 per cent Economic Service Charge should be charged from the vehicles imported from 01 April 2017, Sri Lanka Customs had commenced the recovery of that charge with effect from 17 June 2017. Accordingly, as a result of failure in properly implementing the recovery of Economic Service Charge, the Government had been deprived of revenue of Rs.153 million which should have been recovered in respect of 17,142 motor vehicles imported within the period from 01 April 2017 to 15 June 2017.
- (e) Seven thousand one hundred and seventy five cheques worth Rs.2,225 million received by the Department of Inland Revenue as revenue from the tax payers as at 31 December 2017 had become dishonoured. Cheques vaued at Rs.1,976 million had become dishonoured during the preceding year. Accordingly, cheques valued Rs.249 million in excess of the preceding year had become dishonoured during the year under review.
- (f) The three main revenue collection institutions- Department of Inland Revenue, Sri Lanka Customs and the Department of Excise had not adopted a formal methodology for timely settling the outstanding tax recoverable from various sources and as such, tax revenue of Rs.345,339 million remained outstanding as at 31 December 2017. The following observations are made in this connection.
 - (i) As the tax in arrears that remained recoverable to the Deptment of Inland Revenue from the tax payers relating to the tax period up to 31 December 2015 had not been timely settled before the introduction of new computer system, the outstanding tax revenue recoverable as at 31 December 2017 totalled Rs.323,732 million. Further, the value of tax in arrears pertaining to the taxes controlled by the new computer system (RAMIS) for the period from 01 January 2016 to 31 December 2017, had not been computed by the Department even by 29 March 2018.
 - (ii) The outstanding tax revenue that remained recoverable pertaining to the revenue collected by the Sri Lanka Customs as at 31 December 2017 had been Rs.19,484 million.
 - (iii) The outstanding tax revenue that remained recoverable pertaining to the revenue collected by the Department of Excise as at 31 December 2017 amounted to Rs.2,123 million.

- (g) When comparing the original revenue estimates for the year 2017 of the Public institutions engaged in collecting Revenue with the revised estimates and actual revenue collection, the forecasting and estimating of revenue had not been carried out according to a proper optimum methodology. Information on estimated and actual revenue of two major revenue collecting institutions is as follows.

	Department of Inland Revenue	Sri Lanka Customs
	-----	-----
Number of approved Revenue Codes	36	17
Number of Revenue Codes relating to which Revenue had been collected	26	13
Original Revenue Estimate (Rs. Millions)	798,268	802,280
Revised Revenue Estimate (Rs. Millions)	837,855	757,800
Actual Revenue (Rs. Millions)	792,351	728,271
Difference between the original revenue estimate and the revised revenue estimate (Rs. Millions)	39,587	(44,480)
Difference between the original revenue estimate and the actual revenue (Rs. Millions)	(5,917)	(74,009)
Difference between the revised revenue estimate and the actual Revenue (Rs. Millions)	(45,504)	(29,529)

The following observations are made in this connection

- (i) According to the annual Budget Estimate, 2017, the Department of Inland Revenue should have collected Revenue under 26 Revenue Codes and by way of increasing value of the original revenue estimates prepared for those Revenue Codes by Rs.39,587 million or 4.9 per cent, the original revenue estimates had been revised. Nevertheless, revenue of Rs.792,351 million had been collected during the year under review. Accordingly, a sum of Rs.45,504 million or 5.4 per cent less than the revenue to be collected as per the revised revenue estimate had been collected. Similarly, a sum of Rs.5,917 million or 0.7 per cent less than the revenue indicated in the original revenue estimate had been collected. Accordingly, despite being revised the revenues stated in the original revenue estimates, an optimum result had not been achieved.

- (ii) According to the annual Budget Estimate, 2017, the revenue target set for the Sri Lanka Customs by the original revenue estimate under 13 Revenue Codes had been decreased by Rs.44,480 million or 5.5 per cent through the revised revenue estimates. Nevertheless, the actual revenue of the year under review stood at Rs.728,271 million and it had been a decrease of Rs.29,529 million or 3.9 per cent as compared with the revised revenue estimate. Likewise, revenue had decreased by Rs.74,009 million or 9.2 per cent than the revenue to be collected as per the original revenue estimate.

3.4.2 Government Expenditure

In pursuance of Article 148 of Constitution of the Democratic Socialist Republic of Sri Lanka, Parliament shall have full control over public finance. Provisions required for the Government supplies and services for the year 2017 had been made by the Appropriation Act No.24 of 2016 as amended by the Appropriation (Amendment) Act, No.32 of 2017. Accordingly, provisions amounting to Rs. 3,860,318 million had been made during the year under review for the Government supplies and services and special legal services expenditure. Details appear below.

Source	Capital Provisions	Recurrent Provisions	Total
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	Rs. Millions	Rs. Millions	Rs. Millions
Provisions made by the Appropriation Act for supplies and services	879,681	1,233,229	2,112,910
Provisions made for special legal services	801,402	713,798	1,515,200
Supplementary provisions made for supplies and services	53,000	-	53,000
Supplementary provisions made for special legal services	99,552	79,656	179,208
Total	<u>1,833,635</u>	<u>2,026,683</u>	<u>3,860,318</u>

The following observations are made in this connection.

- (a) Provisions amounting to Rs.3,860,318 million had been made for the Government expenditure according to the revised budget estimate of the year 2017 and when comparing the provisions of Rs.3,898,880 as per the revised budget estimate for the preceding year, a decrease of Rs.38,562 million or 0.98 per cent was observed. Of the total provision made for the year under review, a sum of Rs.3,470,589 million only had been utilised. Accordingly, a sum of Rs.389,729 million or 10 per cent of the total provisions had been saved.
- (b) The following observations are made on the savings after the utilization of provisions made for the recurrent expenditure.

- (i) Out of the provision of Rs.2,026,683 million made for the recurrent expenditure, provisions of Rs.1,945,575 million only had been utilised. Accordingly, provisions of Rs.81,108 million or 4 per cent of the total provisions made had been saved.
- (ii) Total provision of Rs.1,567 million made for 140 Objects of 55 heads of expenditure had been saved without being used for any purpose.
- (iii) Savings after utilization of provisions made for the Recurrent Objects had ranged from 25 per cent to 99 per cent of the total provision made and the value thereof had been Rs.23,292 million. Details appear below.

Range of savings ----- Percentage	Provisions ----- Rs. Millions	Actual Expenditure ----- Rs. Millions	Savings ----- Rs. Millions
More than 75 and less than 100	15,814	708	15,106
50 and more and less than 75	4,400	1,283	3,117
25 and more and less than 50	14,518	9,449	5,069
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Total	<u>34,732</u>	<u>11,440</u>	<u>23,292</u>

- (c) The following observations are made on the savings after the utilization of provisions made for the capital expenditure.

- (i) Provision amounting to Rs.1,833,635 million had been made for the capital expenditure and Rs.1,525,013 million only had been utilised during the year under review. Accordingly, a sum of Rs.308,622 million or 16.8 per cent of the total capital provision had been saved.
- (ii) Provision of Rs.54,528 million had been made for 337 Objects of 91 heads of expenditure and that total provision had been saved without being utilized for any purpose during the year under review. That savings represented 2.9 per cent of the total capital provision.
- (iii) Savings after utilization of provisions made for the Capital Objects had ranged from 25 per cent to 99 per cent of the total provision and the value thereof had been Rs.187,881 million. Details appear below.

Range of savings ----- Percentage	Provisions ----- Rs. Millions	Actual Expenditure ----- Rs. Millions	Savings ----- Rs. Millions
More than 75 and less than 100	83,071	8,814	74,257
50 and more and less than 75	102,940	40,381	62,559
25 and more and less than 50	138,843	87,778	51,065
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Total	<u>324,854</u>	<u>136,973</u>	<u>187,881</u>

3.5 Implementation of Fiscal Management (Responsibility) Act, No.3 of 2003.

According to the following observations, it was not established at the audit test check that the Ministry of Finance had discharged its functions with adequate professional responsibility in compliance with provisions in Fiscal Management (Responsibility) Act, No.3 of 2003 and the amendments made thereto.

- (a) The estimated annual budget deficit during the period from 2010 up to the end of the year under review had ranged from 7.64 per cent to 12.57 per cent of the estimated Gros Domestic Product. Revenue had been collected exceeding the estimated Revenue during that period. Nevertheless, the Ministry of Finance had taken action to maintain the actual budget deficit within a range from 5.63 per cent to 8.61 per cent of the Gross Domestic Product. (Annexure 2) However, capital expenditure had been incurred less than the estimated capital provision, thus resulting decrease in the total expenditure. As such, the total budget deficit had decreased. Accordingly, as a result of failure in utilising provisions made for the implementation of annual budget proposals, objectives expected from the budget proposals could not be achieved.
- (b) In financing budget deficit referred to in the annual estimates during the period from 2010 up to the end of the year under review, the estimated value had been overstated and understated in certain years. (Annexure 03) The matters used as the basis for the computation of value of the above financing or information regarding the manner in which that value was computed had not been furnished to Audit.
- (c) The limit of debts required to be obtained by the Government relating to each year during the period from 2010 up to the year under review had been stated by Parliament through the Appropriation Act. That debt limit had been insufficient to settle the budget deficit. (Annexure 04) The matter relating to not fixing the limits of debts by the Ministry of Finance so as to be adequate to settle the budget deficit had not been furnished to Audit.
- (d) Financing of annual budget deficit during the period from the year 2010 up to the year under review had been separately estimated according to the way of obtaining debts as domestic debts and foreign debts. Nevertheless, certain instances were observed where debts had been obtained exceeding the limit irrespective of the estimated limits in obtaining actual foreign debts. (Annexure 05)

Further, information had not been made available to Audit to the effect that a formal study was conducted on the basis used in estimating the amount financing as domestic and foreign debts and the impact posed on the economy by resorting to alternatives (obtaining foreign debts instead of domestic debts) in case of inability to reach the estimated positions as expected.

- (e) Clear and specific basis for non-inclusion of some liabilities of certain Public enterprises in the financial statements of the Republic and inclusion of some other liabilities of the same enterprises in the financial statements of the Republic had not been revealed in audit. Accordingly, it was observed that the aforesaid process could be a strategy devised for retaining in the liability limit through the alternative measures. It was further observed that if the above process continues to sharpen, it may result in arising a risk of demonstrating an artificial control over the Government liability.

Foreign debts not included in the Financial Statements of the Republic

Debt No.	Name of the project	Value
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		Rs.
2005045	Puttalam Coal Power Project – Phase i	29,042,412,000
2006045	Puttalam Coal Power Project	17,538,073,769
2007044	Hambantota Port Development Project – Phase i	29,835,688,812
2009027	Puttalam Coal Power Project – Phase ii	108,954,901,440
2010006	Mattala Rajapaksha International Airport Project	23,955,222,334
2012033	Hambantota Port Development Project – Phase ii	91,712,880,000
2013014	Hambantota Port Development Project – Phase i	20,232,225,232
2012032	Hambantota Port Development Project – Phase ii	8,949,698,338
	Total	330,221,101,925
		=====

Budget deficit as a percentage of the Estimated Gross Domestic Product

Description	2017		2016		2015		2014		2013		2012		2011		2010	
	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual
Government Revenue (Rs. Billions)	1,914	1,845	1,971	1,771	1,441	1,394	1,331	1,128	1,192	1,066	1,038	997	933	943	821	826
Budget deficit (Rs. Billions)	1,049	758	1,488	666	1,171	963	777	838	663	643	650	593	563	476	548	473
Estimated Gross Domestic Product (Rs. Billions)	13,289		11,839		11,183		9,785		8,674		7,582		6,543		5,602	
Budget deficit as a percentage of the Estimated Gross Domestic Product	7.89	5.70	12.57	5.63	10.47	8.61	7.94	8.56	7.64	7.41	8.57	7.82	8.60	7.27	9.78	8.44

Annexure 03

Financing of budget deficit (Rs. Billions)

Description	2017	2016	2015	2014	2013	2012	2011	2010
Estimated budget deficit	1,049	1,488	1,171	777	663	650	563	548
Estimated total financing	1,226	1,724	1,192	1,005	615	620	548	472
Difference - Increase/ (Decrease)	177	236	21	228	(48)	(30)	(15)	(76)

Annexure 04

Estimated annual borrowings and approved debts limit (Rs.Billion)

Description	2017	2016	2015	2014	2013	2012	2011	2010
Estimated annual borrowings according to the Republic Account	2,100	2,438	2,023	1,635	1,324	1,188	1,062	901
Annual debts limit according to the Appropriation Act	1,629	1,699	1,780	1,278	1,303	1,139	997	980
Difference - over/ (under) estimate	471	739	243	357	21	49	65	(79)

Annexure 05

Estimated and actual domestic and foreign borrowings (Rs. Billions)

Description	2017		2016		2015		2014		2013		2012		2011		2010	
	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual	Estimated	Actual
Foreign Borrowings	270	601	300	574	321	556	646	423	213	183	242	366	199	287	148	262
Domestic Borrowings	1,830	857	2,138	1,042	1,702	1,187	989	965	1,111	1,090	947	726	863	695	753	640