

Customs Officers Reward Fund – 2018

Qualified Opinion

The audit of the financial statements of the Customs Officers Reward Fund for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including 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 reported to Parliament, appear in this report.

In my opinion, except for the effects of the matters described in paragraph 1.4 of this report, the financial statements give a true and fair view of the financial position of the Fund as at 31 December 2018, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.1 Basis for Qualified Opinion

My opinion is qualified on the matters described in paragraph 1.4 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.

1.2 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as management determines 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 matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

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.

1.3 Scope of Audit (Auditor's Responsibility for the Audit of the Financial Statements)

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

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

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

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

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Fund and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Fund has complied with applicable written law, or other general or special directions issued by the governing body of the Fund;
- Whether the Fund has performed according to its powers, functions and duties; and
- Whether the resources of the Fund had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.4 Financial Statements

1.4.1 Internal Control over the Preparation of Financial Statements

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. Issues with regard to maintenance of key accounting records such as General Ledger, Journal and Journal vouchers, payment vouchers etc. have been included under this heading.

1.4.2 Non-Compliance with Sri Lanka Public Sector Accounting Standards

Non Compliance with the reference to particular Standard	Comments of the Management	Recommendation
Sri Lanka Public Sector Accounting Standard - 01		
(a) Even though it had been reported that the financial statements of the Fund had been prepared in terms of Sri Lanka Public Sector Accounting Standards, a policy of accounting the revenue from penalties imposed and confiscations on cash basis had been followed	In the preparation of account pertaining to the Reward Fund with the complicated functions performed in the various Divisions of the Department of Customs, the said functions are being commenced after concluding the customs investigations and receiving the relevant reward files to the Finance Division. Subsequently, the	As it had been reported that the accounts were prepared in terms of Sri Lanka Public Sector Accounting Standards, the financial statements should be prepared on accrual basis.

by the Department, contrary to the Standard.

financial statements are being prepared based on the amounts to be paid and amounts paid relating to each reward file. As the payment relevant to a reward file prepared, is not made mostly during the financial year in which the said file was prepared, the value to be brought to account as revenue during a year is shown by this method more accurately.

(b) Even though the Cash Flow Statement is one component out of the components that should be furnished along with a set of financial statements in terms of Paragraph 21(c) of the Standard, instead of the Cash Flow Statement, a statement on receipts and payments of funds had been furnished with the set of financial statements of the Fund.

The audit observation is correct. As a separate cash book and a ledger account is not being maintained in respect of the Fund, it is difficult to prepare a Cash Flow Statement.

In terms of Sri Lanka Public Sector Accounting Standards, a Cash Flow Statement should be furnished along with the financial statements.

1.4.3 Accounting Deficiencies

The following observations are made.

<u>Audit Observation</u>	<u>Comments of the Management</u>	<u>Recommendation</u>
(a) Out of a sum of Rs.671,975,900 recovered by installments pertaining to 91 Case Files of which the investigations were concluded as at the end of year under review, the contribution of 50 per cent amounting to Rs. 335,987,950 for the Customs Reward Fund had omitted from accounts.	The financial statements relating to this Fund are being prepared based on the reward registers and information available in the Finance Division. The information requested by the Audit could not be found out as per the registers existed in the Finance Division and having found out the sources from which the said information was obtained and if the accuracy thereof is confirmed, the possibility of including such values in the financial statements will also be looked into.	As it had been reported that the financial statements were prepared in terms of Sri Lanka Public Sector Accounting Standards, the accounts should be prepared on accrual basis.

- (b) In terms of provisions, out of the income from penalties and sales, 50 per cent and 20 per cent should be contributed to the Customs Reward Fund and Management and Compensation Fund respectively. Nevertheless, even though the income of Reward Fund should be Rs.2,212,261,692 proportionate to the income of Rs.884,904,677 identified as the income for the Management and Compensation Fund, a sum of Rs.2,462,038,890 had been identified as the income in the final account. The reasons for the said difference were not explained.
- The manner of identifying the penalties and sales income of goods confiscated has been stated in the statements of accounts.
- The income in the financial statements prepared based on a same source of income should be proportionate.
- (c) Even though the income over expenditure in the statement of comprehensive income had been shown as Rs.122,898,009, it is observed that this is not an income over expenditure and it is a balance arisen due to the failure in paying for sub funds of the Reward Fund.
- In the preparation of financial statements pertaining to the Reward Fund, the sum of Rs.122,898,009 was an income over expenditure as compared to the financial statements of the said entity. As the money is being allocated for other sub funds under appropriations after identifying the income over expenditure, our opinion is that the sum of Rs.122,898,009 is an income over expenditure under the Reward Fund.
- In case of any surplus after being duly paid all monies received during the year under review to the parties due to be received cash rewards and after making necessary adjustments, the manner of appropriation should be disclosed in the financial statements.

1.5 Non-compliances with Laws, Rules, Regulations and Management Decisions

Reference to Laws, Rules, Regulations etc.	Non-compliance	Comments of the Management	Recommendation
Section 153(2)(b) of the Customs Ordinance No.17 of 1968	Even though a suitable methodology should be prepared for the distribution of rewards from the Rewards Fund by obtaining the approval of the Minister of Finance, evidence that the approval of the Minister of Finance being obtained for the Department Order No.PL 118 of 28 January 1988 which was issued for the distribution of custom rewards by the Department, had not been furnished to audit. However, a sum of Rs.16,007.5 million had been paid as cash rewards during the 20 years from the year 1999 to 2018.	I agree with the audit observations. The Section 153(2)(b) of the Customs Ordinance No.17 of 1968 applies to the payment of cash rewards. It is assumed that the necessary approval has been obtained for the issuance of Department Order No.118 of 1988 and it should be looked into this matter further.	Payments should be made after being confirmed that the approval of the Minister of Finance has been obtained for the method prepared for the distribution of cash rewards in terms of Section 153(2)(b) of the Customs Ordinance No.17 of 1968.

2. Financial Review

2.1 Financial Results

The operating result for the year under review had been a surplus of Rs.122,898,009 as compared with the corresponding surplus of Rs.25,457,489 for the preceding year, thus indicating an improvement of Rs.97,440,520 in the financial result. Increase in the income from penalties by Rs.142,882,565 and decrease in the payment of penalties for Custom Officers by Rs.23,009,730, increase in the payment for informants by Rs.127,874,978 and non-payment of money allocated for sub-funds had been the main reasons therefor.

3. Operating Review

3.1 Management Inefficiencies

The following observations are made.

<u>Audit Observation</u>	<u>Comments of the Management</u>	<u>Recommendation</u>
<p>(a) In the investigations conducted on customs offences, recovery of minimum tax revenue receivable to the Government on imports under general condition had been disregarded and penalties on customs offences had been imposed including the revenue so deprived of while it had been proposed to pay 50 per cent of the penalties imposed for the payment of rewards to officers. Consequently, a decrease in the revenue receivable to the Government and an increase in the cash rewards distributed among the officers were observed. Further observations in this connection are given below.</p> <p>(i) The necessity of making amendments to the Customs Ordinance as well as to the legal provisions of these Funds in a proper and updated manner in line with the complexity of imports and exports occurred due to the prevailing liberal economic policies at present, is observed in audit.</p>	<p>The possibility of imposing a penalty on a customs offence arises due to the vigilance of officers to reveal the said customs offence. In case of failure to reveal any customs offence due to the lack of vigilance, the total revenue pertaining to the relevant incident is deprived of to the Government. However, the customs offences are revealed due to expertise of officers and 30 per cent of the collected sum is received by the Government, thus a significant contribution is received to the Government revenue and the Custom Officers will be highly motivated to reveal customs offences.</p>	<p>The Custom Ordinance is 51 years old as yet and even though it had been formulated based on the position of imports and exports prevailed at that time, the Act should be amended in compliance with the current position of the imports and exports.</p>

(ii) It was observed that most of the custom investigations proposed for the payment of rewards under this Fund had been conducted on the following customs offences.

- Understatement of the value of goods
- HS Codes being shown erroneously
- Transportation of goods not declared
- Transportation of goods in excess of the goods declared
- Instead of the goods declared, transportation of another goods
- Import and export of the goods banned by Sri Lanka
- Exchange of currency not declared

Even though the officers who were being paid the fixed salaries are engaged in all divisions of the Sri Lanka Customs for the prevention of said customs offences, it was not observed that adequate steps had been taken as yet to control the adverse effect to the Government revenue caused by such customs offences continuously.

(b) Deficiencies 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.

The Customs Ordinance and legal provisions of the Funds have been appropriately amended from time to time and attention will be paid to amend as required in future as well.

It is observed by me that adequate steps has been taken to control the customs offences and it is difficult to prevent the customs offences committed by various individuals continuously.

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Areas of Systems and Control	Observations	Comments of the Management	Recommendation
(i) Accounting	Failure to maintain a ledger accounting system in a proper manner and failure to prepare accounts on accrual basis.	It seems to be that the current system is more realistic than the preparation of financial statements on accrual basis due to the reasons such as, significant number of transactions daily entered into, long period of time taken to conclude the case after taking the final decision on customs offences and to prepare the reward files and make the payment.	Necessary action should be taken to pay attention to the existing areas of systems and controls and to maintain a proper system of control.
(ii) Calculation of Rewards	Failure to follow a practical calculation method in a manner that secures the Government Tax Revenue in calculating rewards, that maintains a control in custom duty frauds and that assures a maximum disadvantage to the parties who commit custom duty frauds.	These calculations are being done as per the Departmental Orders issued in terms of the provisions in Customs Ordinance, thus it should be studied further.	Necessary action should be taken to pay attention to the existing areas of systems and controls and to maintain a proper system of control.
(iii) Payment of Rewards	Not documenting the rewards files at the instance of receiving those to the Accounts Branch and not making payments in sequence.	Rewards files are being kept in sequence of dates received and except the files which are given priority, other files are being paid in sequence of dates received.	Necessary action should be taken to pay attention to the existing areas of systems and controls and to maintain a proper system of control.

3.2 Operating Activities

Performance

In terms of Section 153(2)(b) of the Customs Ordinance, an amount equivalent to 50 per cent of the monies received from penalties imposed on various customs offences and from sales proceeds of the goods confiscated are being credited to the Custom Officers Rewards Fund and this Fund has been established for offering rewards to the officers and informants with the intentions of revealing, control and prevention of custom duty frauds. A summary on the payments made from the year 2012 to 2018 is given below.

<u>Year</u>	<u>Number of Reward Files paid</u>	<u>Amount paid</u>	<u>Average of Payment made per File</u>
		Rs.	Rs.
2012	183	952,882,430	5,207,008
2013	286	1,509,280,909	5,277,205
2014	343	1,353,531,889	3,946,157
2015	274	1,252,772,591	4,572,163
2016	279	2,371,231,289	8,499,036
2017	246	2,316,128,767	9,415,157
2018	266	2,462,038,890	9,255,785

Audit Observation

Comments of the Management

Recommendation

- (a) A total sum of Rs.9,738,686,387 had been distributed among the officers and informants from the year 2012 to 2018 and out of that, Rs.8,716,601,093 or 89.50 per cent had been paid to the officers.
- I agree with the audit observation.
- A suitable methodology should be introduced for the payment of rewards to the officers in line with the present situation.
- (b) Even though the amount paid to the officers and informants had been only Rs.787 million in the year 2012, it had increased to Rs.1,873 million or by 138 per cent by the year 2018. Further, those amounts had been paid in respect of customs offences of which the investigations were concluded in each year and it was observed that the investigations of a substantial number of cases had not been concluded. Accordingly, a significant control or decrease in the customs duty frauds was not observed under the reward scheme.
- The audit observation is incorrect. The payments made to the officers and informants had increased as a result of the increase in the number of investigations revealed due to the vigilance of officers.
- A suitable methodology should be introduced for the payment of rewards to the officers in line with the present situation.

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| <p>(c) A sum of Rs.63 million had been credited to the Fuel Fund being a sub-fund of the Rewards Fund in the year under review. Even though the objective of establishing the said Fund had been stated as to meet the expenditure on fuel required for customs investigations, the cost of fuel incurred on customs investigations has been a burden of expenditure to the General Head of Expenditure of the Department. As such, only an expenditure of Rs.82,180 had been incurred from the said Fund during the year under review. Nevertheless, money had been collected to this Fund continuously disregarding reasonable requirements and as such, the balance therein had been Rs.503 million as at the end of the year under review.</p> | <p>The audit observation is correct.</p> | <p>The objective of establishing the Fund should be identified and the expenditure on fuel should be incurred by the Fund in a manner that the cost of fuel incurred for investigations is not a burden of expenditure to the General Head of Expenditure of the Department.</p> |
| <p>(d) A sum of Rs. 22 million had been credited to the Narcotics Fund being a sub-fund of the Rewards Fund in the year under review for making payments to the officers participated in raids on drugs. Nevertheless, only a sum of Rs.7 million had been spent in the year under review.</p> | <p>The audit observation is correct.</p> | <p>Payments from the Narcotics Fund should be made properly and efficiently to the officers participated in the investigations of raids on drugs.</p> |
| <p>(e) A sum of Rs. 31.5 million had been credited in the year under review to the Fund of 2.5 per cent established for making payments to the officers in Divisions which provide supporting services though not directly participated in investigations.</p> | <p>The audit observation is correct.</p> | <p>The efficiency of the parties who supports customs investigations can be improved by making payments to them without delay.</p> |