

**Special Report of the Auditor General on the effect to the  
Government Revenue made by holding over of issue of automated  
assessment reports by the Revenue Administration Computer System  
of the Department of Inland Revenue**

**AUDITOR GENERAL'S DEPARTMENT**



**Content**

| <b><u>Chapter</u></b> |   | <b><u>Page</u></b> |
|-----------------------|---|--------------------|
| 1                     | Executive Summary   | 35                 |
| 2                     | Background and Nature of issuing the Audit Report   | 36                 |
| 3                     | Methodologies followed  | 36                 |
| 3.1                   | Examination of Registers, Books and Records   |                    |
| 3.2                   | Other Examinations  | 37                 |
| 4                     | Limit of the Scope  | 37                 |
| 5                     | Introduction the Process of Tax Administration Computer System (Legacy System)                                    | 38                 |
| 6                     | Effect of holding over of issue of automated assessment reports for outstanding Tax on Return since 01 April 2012 | 40                 |
| 7                     | Weaknesses in Systems   | 42                 |
| 8                     | Recommendations   | 43                 |
| 9                     | Conclusion  | 44                 |
| 10                    | Annexuers   | 45-75              |



**Table Content**

| <b><u>Table</u></b> |   | <b><u>Page</u></b> |
|---------------------|---|--------------------|
| 1                   | Unrecovered/unsettled balance of outstanding tax of VAT and NBT                       | 41                 |
| 2                   | Penalties computed on unrecovered/unsettled balance of outstanding tax of VAT and NBT | 41                 |



**Special Report of the Auditor General on the effect to the Government Revenue made by holding over of issue of automated assessment reports by the Revenue Administration Computer System of the Department of Inland Revenue**

**1. Executive Summary**

Sri Lanka Government Revenue consists of tax and non-taxable revenue and the Department of Inland Revenue can be identified as one of the parties responsible for administration of revenue from tax. Out of the revenue from tax collected by the Department of Inland Revenue, approximately 65 per cent is collected from Indirect Revenue from Tax and the VAT and NBT included in the said Indirect Revenue from Tax are highly significant. Hence, in case payments of VAT and NBT are defaulted by tax payers, the decrease in the revenue from tax thereby to the Government is inevitable. Therefore, earning maximum revenue from tax for the Government is the responsibility of the Department of Inland Revenue and with a view to achieving that, a procedure in issuing automated assessment reports on outstanding Tax on Return had been implemented from the year 2002 to 31 March 2012.

Through issuance of these automated assessment reports, several important tasks such as reporting in case of a default, imposing of penalties on outstanding tax and indicating outstanding tax in the computer system had been performed and the Department of Inland Revenue had held over the issuance of automated assessment reports from 01 April 2012 and commenced the process of carrying it out through officers manually. As a result of holding over the automated assessment system as mentioned above, this report reveals a tax balance of VAT and NBT amounting to Rs.15,283 million to be recovered / settled as at 31 December 2015 and that the penalty recoverable on those tax according to computations of the Audit amounts to approximately Rs.9,237 million. Moreover, this system comprised of a large number of outstanding balances of tax with less values. Hence, only the outstanding balances of tax exceeding the value of Rs.1000 had been considered in the preparation of this report.

## **2. Background and Nature of issuing the Audit Report**

In instances where Value Added Tax (VAT) and Nation Building Tax (NBT) are not paid on the due date by the relevant parties, a methodology of issuing automated assessment reports through the Legacy System of the Department of Inland Revenue had been implemented up to 31 March 2012. The Department of Inland Revenue had the authority to recover the outstanding taxes revealed in terms of provisions in relevant Acts. However, due to holding over of the process of issuing automated assessment reports from the period of tax commenced from 01 April 2012, there were instances where necessary steps had not been taken in respect of tax payers who had failed to pay Tax on Return as due. It was observed that a number of about 31,586 outstanding tax balances so unrecovered, were included in the Legacy System and this report is issued by me, based on the matters observed during the audit examination carried out thereon.

## **3. Methodologies followed**

The following methodologies were followed.

### **3.1 Examination of Registers, Books and Records**

The following Acts, reports and registers were examined in this audit.

- 3.1.1 Value Added Tax Act, No.14 of 2002 and relevant amendments
- 3.1.2 Nation Building Tax Act, No.9 of 2009 and relevant amendments
- 3.1.3 Inland Revenue Act, No.10 of 2006 and relevant amendments
- 3.1.4 Department Manual on Value Added Tax
- 3.1.5 Information on outstanding tax balances included in the computer soft copy prepared by the computer system of the Department of Inland Revenue and presented by the Commissioner General of Inland Revenue to Audit
- 3.1.6 Reports on Arrears of Revenue for the year 2016 presented to the Auditor General



### **3.2 Other Examinations**

In addition to the examination of registers, the following examinations were carried out.

- 3.2.1 Perform s test of control on how matters such as submission of Tax Returns and making payments by tax payers and issue of assessment reports to tax payers, imposing penalties and being recorded as outstanding tax, is carried out through the Legacy System.
- 3.2.2 In terms of provisions in the relevant Acts, analysis of data on the information obtained by Audit and carrying out computations.
- 3.2.3 Obtaining information for using the computer system after discussions with the officers of the Department of Inland Revenue.

## **4. Limit of the Scope**

In reaching conclusions by the observations highlighted by this report, it is emphasized that my scope was subjected to the following limits.

- 4.1 The changing of the programmes in the Legacy System had been carried out in the year 2012 and the lapse over a period of 05 years by the year 2017 after making that change, in which this audit examination had been carried out.
- 4.2 The information inquired by the Letter No. PUR/D/IR/INFO/17/58 of 13 October 2017 of calling for information in respect of changing computer programmes had been provided by the Department on 19 April 2018. However, they had neither been material nor objective. (Annexure – 1 )
- 4.3 Failure in providing adequate facilities and guidance to Audit in a manner of obtaining a report on outstanding balances of VAT and NBT on return directly through the computer system relating to the period from 01 April 2012 to 31 December 2015.

- 4.4 Carrying out this special audit examination based on information obtained from the computer softcopy prepared through the computer system and given to Audit by the Department, delay in providing that information requested by the Letter No. PUR/D/IR/INFO/2016/65 of 27 December 2016 up to 15 May 2017 by the Department and failure to reveal the changes occurred in outstanding balances of taxes by this report after providing such information. (Annexure – 2, 3 )

## **5. Introduction the Process of Tax Administration Computer System (Legacy System)**

- 5.1 The revenue from tax collected by the Department of Inland Revenue stands at approximately 37 per cent of the entire Government Revenue and Value Added Tax (VAT) and Nation Building Tax (NBT) make up 55 per cent and 9 per cent out of the revenue from taxes respectively. When there are outstanding Tax on Return, a Legacy System from which automated assessment reports are issued, was implemented by the Department of Inland Revenue up to 31 March 2012 for the prevention of defaulting the payment of these taxes which have a significant value. The registered tax payers, Units of the Head Office by which tax files are maintained, Data Processing and Revenue Administration Unit (DPRAU), Computer Development Unit (CDU), Banks by which taxes are collected and Department of Customs involve in this System. Moreover, types of taxes of VAT and NBT on productions and other services are administered by this System while taxes on imports and financial services are not administered.
- 5.2 When there are outstanding balances of said types of taxes administered by this System, an automated assessment report is issued to the tax payer by the Legacy System (Annexure –4). Further, functions such as entering data on tax returns, updating information on payments, issue of assessment notices, computation of penalties for delay in payments, transfer of journals and transfer of payments and enable the obtaining of information on customs are carried out through this System.

- 5.3 After submission of tax returns to the Commissioner General of Inland Revenue on or before the date of submission of tax returns by tax payers of VAT and NBT (Annexures V, and VI ), the Data Login Numbers (DLN) are issued for the purpose of entering information into the System by the Data Processing and Revenue Administration Unit and subsequently, the file is updated by recording the tax payable by the tax payer for the relevant period.

Tax payers pay taxes through Banks on or before the deadline on which tax should be paid (Annexures 7 and 8 ) and a soft copy on details of taxes paid is sent daily to the Commissioner General of Inland Revenue by the Bank. Data Login Numbers (DLN) relating to the entering of information into the System, are issued based on information received by the Data Processing and Revenue Administration Unit and in the Computer Development Unit, tax files are updated by recording payment of taxes of tax payers in the Legacy System for the relevant period.

Further, soft copies on information relating to tax payers are delivered by the Department of Customs to the Commissioner General of Inland Revenue and that information too are updated through this computer system.

- 5.4 Information on tax returns, information on payments and information on customs(for the confirmation of details on importations indicated in tax returns) entered into the computer system, are subjected to the process of the computer system and it is checked mechanically whether the tax indicated in the return is paid by the tax payer. After so checking, in case of an outstanding balance of taxes payable further, an automated assessment report is issued through this computer system to the tax payer and as a result, the following compliances are observed.

- Issue of assessment reports to tax payers for all balances of Value Added Tax (VAT) and Nation Building Tax (NBT) remained as outstanding Tax on Return.
- In case of tax defaulted in terms of provisions of Tax Acts, recording information thereon.
- Imposing penalties on outstanding tax in terms of provisions of Tax Acts and automatic computation of penalties.

- Indicating as outstanding taxes in the computer system.
- Recording outstanding taxes in Outstanding Revenue Report, submitted half yearly.
- Capability of collecting arrears of revenue by referring procedures for the recovery of outstanding taxes in terms of provisions of Tax Acts. (Examples: Freezing of bank accounts, Transfer of assets, taking legal action)

However, this process of issue of automated assessments through the system had been implemented only up to 31 March 2012.

## **6. Effect of holding over of issue of automated assessment reports for outstanding Tax on Return since 01 April 2012**

- 6.1 Even though the activities mentioned in paragraph 5.3 above, were implemented in the same manner, the process of issue of automated assessment reports for outstanding Tax on Return had been discontinued since 01 April 2012. After doing so, the officers had identified outstanding Tax on Return and commenced the issue of assessment reports manually (Annexure 9 ).

After holding over the system operated automatically, the officers should reveal that there are outstanding Taxes on Return relating to files which are in their custody and an assessment report including penalties for outstanding Tax on Return should be prepared and forwarded to the Data Processing and Revenue Administration Unit. Subsequently, that assessment report is forwarded to the Computer Development Unit by the Data Processing and Revenue Administration Unit and the issue of assessment reports and updating the file of the tax payer are done through the Computer System therein. Accordingly, issue of automated assessment reports for outstanding Tax on Return is discontinued and computation of outstanding taxes and issue of assessment reports are carried out by the officers. As such, it was observed in audit that recovery of certain outstanding balances of taxes / settlement of them are delayed due to failure in issuing assessment reports therefor.

6.2 Accordingly, it was further observed that there are tax payers who had not settled the aforesaid VAT and NBT on Return even up to 31 December 2016, remained from 01 April 2012 to 31 December 2015 and the Department had not taken action even by that date to issue assessment reports to tax payers (Annexure 10). Accordingly, the VAT and NBT totalling Rs.15,283,308,305 which had remained unrecovered /unsettled by 31 December 2016, are shown in the table below.

Table – 1 Unrecovered/unsettled balance of outstanding tax of VAT and NBT

| Type of Tax<br>-----     | Amount of outstanding tax<br>(VAT and NBT)<br>-----<br>Rs. |
|--------------------------|--|
| Value Added Tax (VAT)    | 10,059,345,403   |
| Nation Building Tax(NBT) | 5,223,962,902  |
| Total                    | <u>15,283,308,305</u>                                      |

The Department had reported to the Audit that the unsettled Value Added Tax amounting to Rs.10,059 million revealed by the paragraph, had been settled up to Rs.7,485 million by 04 May 2018. Nevertheless, the mode of settlement had not been stated in detail. (Annexure - 11)

6.3 The Assessment Reports on the said outstanding tax had not been issued through the Legacy System, thus the penalties on outstanding Tax on Return had not been imposed in terms of the provisions in Tax Acts (Annexure –12). The penalties recoverable on outstanding tax were computed by the Audit as follows.

Table – 2 Penalties computed on unrecovered/unsettled balance of outstanding tax of VAT and NBT

| Type of Tax<br>-----  | Penalties not imposed on the<br>outstanding tax in the<br>paragraph 6.2 above<br>-----<br>Rs. |
|-----------------------|---|
| Value Added Tax (VAT) | 6,713,546,137   |

|                          |               |
|--------------------------|---------------|
| Nation Building Tax(NBT) | 2,524,123,107 |
|                          | -----         |
| Total                    | 9,237,669,244 |
|                          | =====         |

- 6.4 The unpaid/unsettled balance of outstanding tax and penalties totalling Rs.24,520,977,549 had not been recorded as outstanding tax in the Legacy System and the Department had not taken action to disclose these outstanding balances in the Report on the arrears of Revenue presented to the Auditor General as at 31 December 2016 in terms of the Financial Regulation 128 of the Democratic Socialist Republic of Sri Lanka. Further, these outstanding amounts had not been reported as defaulted tax, thus the Department had not taken action to recover or settle it in terms of the provisions in Tax Acts.

## 7. Weaknesses in Systems

Weaknesses in systems observed during the special audit examination are given below.

- 7.1 It was not observed that a study for the identification of necessity to change the computer programme of issuing automated assessment reports for the outstanding Tax on Return was carried out by the experts in the relevant field and the proposals on the manner of change had not been prepared and approved by the top management of the Department.
- 7.2 It was not observed that log entries including the information on the said change were made and it could not be confirmed on whose instructions the programmes were changed.
- 7.3 Since the holding over of process of issuing automated assessment reports, instructions were given to the officers to carry out the process of issuing assessment reports on outstanding taxes based on the information made available by the officers. Nevertheless, evidence was not made available to Audit to confirm that the Department had not followed a system of control for taking follow up action thereon.

## **8. Recommendations**

- 8.1 Carrying out a proper study for the identification of necessity to change the programmes of the Legacy System before making changes, appointment of a committee comprised of persons representing the technical areas such as taxation and administration of information system and taking necessary action on the recommendations of the said committee. (Reference paragraph 7.1)
- 8.2 Obtaining written approval of the top management of the Department for the changes proposed to be made in the programmes of Legacy System. (Reference paragraph 7.1)
- 8.3 Listing the matters pertaining to the identification of problems in the system and proposals submitted for the changes to be made in the system. (Reference paragraph 7.2)
- 8.4 Maintaining the log entries by the Computer Development Unit including all information (including the details of the approval for changes, the changes made, the officer who made the changes etc.) on every change of programme made in the Tax Administration System. (Reference paragraph 7.2)
- 8.5 Making the officers of the Department aware of the impact of changes made in the Tax Administration System, formulation of a system of control so as to confirm that the officers are taking action in compliance with the changes made and confirmation that the said system is functioning properly. (Reference paragraph 7.3)
- 8.6 Taking action to issue assessment reports and recover /settle the outstanding amounts by making journal entries in respect of the outstanding tax balances amounting to Rs.10,059,345,403 and Rs.5,223,962,902 in VAT and NBT on Return respectively pertaining to the period from 01 April 2012 to 31 December 2015 which were not recovered/settled even by 31 December 2016. (Reference paragraphs 6.1, 6.2 and 6.4)
- 8.7 Taking action to compute and recover all penalties for the outstanding tax balances mentioned in 8.6 above, which has arisen in Tax on Return submitted by the tax payer. (Reference paragraph 6.3)

## **9. Conclusion**

- 9.1** It is concluded that the taxes had not been properly complied with due to the holding over of issuing automated assessment reports through the Legacy System without a proper approval or study.
- 9.2** It is concluded that action should be taken to recover/ settle the outstanding taxes and penalties totalling Rs.24,520 million which were failed to recover/ settle by the Department of Inland Revenue due to the holding over of issuing automated assessment reports.

H.M. Gamini Wijesinghe

Auditor General

14th June 2018