

Customs Officers Reward Fund - 2019

1.1 Qualified Opinion

The audit of the financial statements of the Customs Officers Reward Fund for the year ended 31 December 2019 comprising the statement of financial position as at 31 December 2019 and statement of comprehensive income, statement of changes in equity and fund 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 and National Audit Act, No. 19 of 2018 read in conjunction with section 153 (2) (b) of the Custom Ordinance Act. (Chapter 235). 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 1.5 of this report, the financial statements give a true and fair view of the financial position of the Fund as at 31 December 2019, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.2 Basis for Qualified Opinion

My opinion is qualified on the matters described in paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

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

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.

1.4 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 skepticism 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.

1.5 Financial Statements

1.5.1 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.

1.5.2 Non-Compliance with Sri Lanka Public Sector Accounting Standard

The following observations are made.

Non Compliance with reference to the particular Standard	Comments of the Management	Recommendation
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<p>(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 No.01, a policy of accounting the revenue from penalties imposed and confiscations on cash basis had been followed by the department.</p>	<p>In the preparation of account pertaining to the Reward Fund with the complicated functions performed in the each Divisions of the Department of Customs, the said functions are being commenced after concluding the customs investigations and receiving the relevant reward files from each division to the Finance Division. Subsequently, the financial statements are being prepared based on the amounts to be paid to this reward</p>	<p>The financial statements should be prepared on accrual basis</p>

fund 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.

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| <p>(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 above Standard (a), 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.</p> | <p>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.</p> | <p>In terms of Sri Lanka Public Sector Accounting Standards, a Cash Flow Statement should be furnished along with the financial statements.</p> |
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1.5.3 Accounting Deficiencies

 The following observations are made.

Audit Observation	Comments of the Management	Recommendation
<p>(a) Out of 113 customs investigation files which the investigations were concluded at the end of the year under review, a sum of Rs.652,704,559 had been received as penalties relating to the 90 investigation, the contribution of 50 per cent amounting to Rs. 326,352,280 for the Customs Reward Fund had been omitted from accounts.</p>	<p>Even if the investigation is completed, 50 per cent of the amount due to the Custom Officers Reward Fund will be identified at the time of payment of the reward. Therefore the amount in the query is not included in the accounts.</p>	<p>In terms of Public Sector Accounting Standards, financial statements should be prepared on accrual basis.</p>

- (b) In terms of provisions included in the section 153 of the Customs Ordinance Act, 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 50 per cent contribution of Reward Fund should be Rs.1,823,406,470 proportionate to the 20 per cent contribution of Rs.729,362,588 identified as the income for the Management and Compensation Fund, a sum of Rs.1,843,013,865 had been identified as the income in the financial statement. Accordingly, the reasons for the Rs.19,607,395 differences had not been explained.
- (c) Even though the income over expenditure in the statement of comprehensive income had been shown as Rs.105,045,877, 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.
- Even though the funds are distributed through a reward file as 50 per cent for Customs Reward Fund and 20 per cent for Management Compensation Fund, when paying in installments on a priority basis and only for allowance of informants the Reward Fund Register of the custom officers will be recorded. However, in the latter case the correct ledger will be used on both the relevant ledgers when paying the full reward file.
- Accounting should be done in such a way that there is a proportional income between the financial statements prepared based on a same source of income.
- Rs.105,045,877 is the amount received after deducting the payments from fund receipts.
- Properly accounting the all money received during the year and showing the net balance of the fund by making payments to the officers who are to be received the cash rewards and making payments from sub-funds.

1.6 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.15,535,028,822 had been paid for officers as cash rewards and sum of Rs. 1, 872,960,149 for the informants during the 21 years from the year 1999 to 2019.	Benefit scheme under the provisions of the Customs Ordinance Act has been in operation for a long time in the history of custom. Section 153 of the Customs Ordinance promulgated in 1956 specified the mechanism of payment of rewards. Accordingly half of the penalty's or receipts will be paid to the Deputy Secretary to the treasury and the other half will be paid to the officers or informants who seize the goods or paid to the both parties in such a manner as can be prescribed by the person who makes collection. This scheme should have been approved by the Hon.Minister of Finance but that approval cannot be found at present. As the regulations have been promulgated under section 153(a) 2, it is expected that the payment method had been approved in Departmental order 118 of the same year.	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.105,045,877 as compared with the corresponding surplus of Rs.122,898,009 for the preceding year. Accordingly, a decrease of Rs.17,852,132 was observed in the financial result.

3. Operating Review

3.1 Management Inefficiencies

Audit Observation	Comment of the Management	Recommendation
(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. Following observations were made in this regard.	Management had not been commented.	The Custom Ordinance is 151 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 and the Custom Ordinance Act should be amended based on the experience of possible offences of customs tax fraud.
(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 in the country is observed in audit.

(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)Collection of Arrears
Penalty Revenue**

- (i) It was observed that Rs.3,351,644,800 accruing from 2017 to 2019 out of the Rs.4,917,293,735 in penalty income which was in arrears as at 31st December of the year under review. No amount had not been recovered from that amount during the year under review. Management had not been commented. Reviewing the methodology for recovery of arrears and obtaining timely solution.
- (ii) Although it has been reported that appeals have been made to the minister of finance from the year 2009 for penalty money of Rs 230,887,320 in 15 instances related to the above arrears, it was observed that only Rs 64,565,588 had been recovered at the end of the year under review. Management had not been commented. Reviewing the methodology for recovery of arrears and obtaining timely solution.
- (iii) It was further observed that, out of 113 files pertaining to penalty arrears income, two files pertaining to Rs.24,550,000 were missing from the customs premises. Management had not been commented. Taking formal action against the responsible parties.

(c) Deficiencies 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.

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| (i) Failure to maintain a ledger accounting system in a proper manner and failure to prepare accounts on accrual basis. | A formal accounting system is maintained. Even if the accounts are prepared on an accrual basis, the revenue can only be identified at the time where the reward files are being presented for 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) 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. | Management had not been commented. | 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) Not documenting the rewards files at the instance of receiving those to the Accounts Branch and not making payments in sequence. | When the reward files are received by the Accounts Division, they are given a serial number and the reward file payments are made in that serial number order. However, in special cases there are instances where payments for reward files are made on a priority basis as per the relevant request. | 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

3.2.1 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 2019 is given below.

Year	Number of Reward Files paid	Total reward money paid	Portion paid for officers	Portion paid for Informants
		Rs.	Rs.	Rs
2012	183	952,882,430	658,519,186	128,208,276
2013	286	1,509,280,909	1,089,268,962	121,281,124
2014	343	1,353,531,889	953,858,131	117,310,035
2015	274	1,252,772,591	1,090,976,365	123,347,553
2016	279	2,371,231,289	1,629,006,445	185,138,406
2017	246	2,316,128,767	1,658,990,867	109,462,461
2018	266	2,462,038,890	1,635,981,137	237,337,440
2019	231	1,843,013,865	1,104,988,629	295,409,615
		14,060,880,630	9,821,589,722	1,317,494,910

Following observations are made in this connection.

Audit Observation	Comments of the Management	Recommendation
(a) A total sum of Rs.11, 139,084,632 had been distributed among the officers and informants from the year 2012 to 2019 and out of that, Rs.9,821,589,722 or 88 per cent had been paid to the officers. Accordingly, no formal system had been prepared for the payment of rewards to customs officers.	The audit observation is correct.	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.1,400 million or by 78 per cent by the year 2019. Also, 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 number of cases where investigations have not been completed was very high. Accordingly, a significant control or decrease in the customs duty frauds was not observed under the reward scheme.
- The answer given in paragraph 1.6 of this report is applicable.
- A suitable methodology should be introduced for the payment of rewards to the officers in line with the present situation.
- (c) A sum of Rs.51, 904,699 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.12, 099 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.555, 279,601 as at the end of the year under review.
- No requests were made for payments under the fuel fund during the year.
- (i) correction of accumulation of large sums due to allocation of funds without determining the correct estimates on demand.
(ii) Inquire from the treasury and being taken appropriate action regarding the surplus of the fund.

- (d) A sum of Rs. 17,624,614 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.5,428,546 had been spent in the year under review.
- Relevant payments have been made for requests made during the year in which the funds relevant to this sub fund have been transferred in accordance with the Department Circulars.
- If there are any payments to be made by the Narcotics prevention Fund to the officers participated in the investigations of raids on drugs, resolve them, discuss with the treasury regarding the surplus and being taken necessary action.
- (e) A sum of Rs. 25,952,366 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.
- Funds related to this sub fund have been transferred as per the departmental circulars and no requests for payments have been presented during the year.
- Inquiring the treasury about the money being accumulated in the fund.