NIHAL SRI AMERESEKERE F.C.A. F.C.M.A.
BUSINESS & MANAGEMENT CONSULTANT

BY COURIER / HAND

24th August 2006

Dr. P.B. Jayasundera
Secretary, Ministry of Finance
& Secretary to the Treasury
The Secretariat
Colombo 1.

Dear Dr. Jayasundera,

I just completed examining the Report of the Auditor General on the *'Special Project Audit on the Management of Government Tax Revenue'*, published recently as Parliamentary Series No. 2, in terms of Article 154(6) of the Constitution, which reads thus;

> "154(6) The Auditor-General shall within 10 months after the close of each financial year and as and when he deems necessary report to Parliament on the performance and discharge of his duties and functions under the Constitution."

Such *'Special Project Audit on the Management of Government Tax Revenue'*, admittedly in view of its gravity and, national and public importance, the Auditor General had deemed, that he stands bounden in duty to necessarily report such matter to Parliament.

I draw your attention to the following *extracts* from the said Report of the Auditor General, with **emphasis** added on certain *extracts*.

"WEAK MANAGEMENT OF THE GOVERNMENT TAX REVENUE

Introduction

- **According to test checks carried out during the course of audit it was observed that the annual loss of the Government Tax Revenue is extraordinarily large. According to audit test checks the computable value of the loss of Government Tax Revenue and the failure to collect in accordance with the legal provisions during the last few years amounts to about Rs.389 billion while the amount that cannot be computed is extremely large.**

    - I annex as *Appendix 'A'* the Computation of the Rs. 388.9 billion given in the said Special Audit Report of the Auditor General to Parliament

- The audit coverage is very much limited due to limitations of time and resources and as such the possibility of the prevalence of large scale irregularities and weaknesses in the wider areas which were not covered in audit cannot be ruled out.

2. Executive Summary

    - Even though the Tax Revenue represents about 90 per cent of the overall Government Revenue, a sound and efficient management had not been maintained for the management of the Tax Revenue.

    - Even though the contribution of the Value Added Tax represented about 42 per cent of the Government Tax Revenue, its management is replete with serious deficiencies

- The co-ordination of the flow of information and confirmations which should be in operation among the major Government institutions dealing in matters relating to the Tax Revenue had been at an extremely weak level.

- The inter-division co-ordination within the Government institutions responsible for the management of the Tax Revenue had also not been maintained adequately.

- The institutions dealing with the Tax Revenue had not maintained an adequate tax management co-ordination with their supervisory institutions that is, the General Treasury and the Ministry of Finance.

- The responsibilities devolving on the Secretary to the relevant Ministry in terms of the provisions in the Constitution, and on the Secretary to the Treasury and the respective Heads of Departments as the Accounting Officers through the Financial Regulations had not been discharged properly.

- *The reliability of statistics published as the Government Tax Revenue and Exports are uncertain to a considerable extent.*

- *The risk of uncertainty over the future economic plans exists due to the inability to utilize accurate data as a basis for planning.*

- Questionable responses made instead of taking the immediate steps necessary to be taken even after serious lapses are brought to the notice of the institutions concerned by audit, pose problems.

5. Summary of Audit Findings

The audit test checks of the Department of Inland Revenue, Sri Lanka Customs, Department of Motor Traffic and the Department of Imports and Exports Control carried out in addition to the audit relating to VAT carried out in relation to the Department of Inland Revenue revealed a large number of serious deficiencies and shortcomings connected with the overall Management of the Government Revenue. The structural weaknesses of the institutions, neglect of duty by the higher management, weaknesses relating to the internal controls, weaknesses prevailing in the systems and controls as well as the conceptual problems relating to the State Audit are brought to light through this report.

5:1 Weaknesses of the Higher Management

In pursuance of provisions in Article 52(2) of the Constitution of the Democratic Socialist Republic of Sri Lanka the overall responsibility in this area is devolved on the Secretary to the Ministry of Finance.

The Constitutional provision that "The Secretary to the Ministry shall, subject to the direction and control by his Minister, exercise supervision over the departments of Government or other institutions in the charge of his Minister" surpasses all other provisions.

Apart from that, a huge responsibility and a duty are devolved on him in terms of Financial Regulations as the Secretary to the relevant Ministry who is the Chief Accounting Officer and as the Secretary to the Treasury whose foremost responsibility is the maintenance of the financial control and administration of the Government.

A summary of the responsibilities of the Secretary to the Treasury in terms of Financial Regulations is given below.

- Financial Regulation 124(1) provides that the Minister of Finance is charged with the raising of Revenue and the collection of other Government monies as well as with the general oversight of all the financial operations of Government. *He (or the Treasury on his behalf) therefore lays down the broad framework within which departmental financial transactions of all kinds may be undertaken.*

- Control and supervision of the Treasury is given in Financial Regulation 126(1). Accordingly the chief function of the Treasury is to maintain control and supervision over the Government finance. ***It is, therefore, the duty of the Treasury to set up a system of financial administration satisfactory in all respects specially with regard to accounting, security and responsibility.***

- According to Financial Regulation 126(2), the responsibility of the Treasury under 126(1) above is not curtailed by the Statutory assignment of any financial function.

  Therefore, the responsibility of the Treasury for the overall management of the public finance including the management of Tax Revenue is a responsibility which cannot be evaded. According to Financial Regulation 127 which shows the general responsibilities of Chief Accounting Officers, a Chief Accounting Officer is responsible to the Minister of Finance for the adequacy of the financial administration of all the departments within the Ministry.

In accordance with this Financial Regulation, the Secretary to the Ministry of Finance, as the Chief Accounting Officer, is responsible to ensure that -

- Each Accounting Officer under his supervision has planned the financial work with propriety and has evolved a system which provides adequate control over expenditure and the collection of revenue.

- The expenditure of the institutions under his control is closely examined in the Ministry from the point of view of economy and efficiency.

- All case of doubt or difficulty are referred to him so that he may bring his own administrative experience and judgement to bear on them.

- The important variations between the estimates and the actuals of the institutions under his supervision are critically examined by him personally, and

- The collection of Revenue or other Government dues for which Accounting Officers are responsible is closely watched and examined by the Ministry.

  The Secretary to the Ministry of Finance, in furnishing further explanations, has stated that he believes the determination of Rs.389 billion as a loss to Government revenue is erroneous and would create a wrong opinion on the Tax Administration, about those institutions and the overall State Tax Management.

  When the explanations received in connection with each individual observation referred to in paragraph 4 are taken into consideration, the simple situation that clearly emerges is the weakness of the State Tax Revenue Management.

  Had the higher management acted with understanding and adequate professional competence, specially with regard to the estimation, collection and refund of Tax Revenue and the determination of the quantum of tax, the possibility of the loss from taxes remaining without being collected in accordance with regulations, of such an erroneous amount of revenue could have been minimised."

I annex as *Appendix 'B'* a Schedule of the **'Sub-section Headings'** of **Section 4** of the aforesaid Audit Report, which **'Sub-section Headings'**, are themselves, self-explanatory, and re-inforce, underscore and validate the findings reported upon and opinions expressed by the Auditor General in the said Special Audit Report to Parliament.

The foregoing is a severe castigation and a damning indictment on you, as the Secretary, Ministry of Finance and the Secretary to the Treasury, which said Offices, you have held for several years, except for the 2 years, 2002 and 2003.

All those who hold public office are accountable, not only to the Auditor General, but also to the public themselves, inasmuch as, particularly in this instance, it is the management of funds of the public that are involved, **and which funds are held in trust on behalf of the people by the government**. To express a view that reporting by the Auditor General will demoralise the public service has no place, whatsoever, in the sphere of good governance in contemporary civilised societies. *On the contrary, is one to entertain the idiocy that tolerance of bribery, corruption and inefficiency will incentivise and motivate the public service ?*

You are aware, that over the recent years, I have acted with concern and strenuously litigated, *vis-à-vis*, the management of raising public revenue. In fact, the incumbent government came into power aggressively campaigning denouncing the perverse 'Tax Amnesty' of 2003. One of the first pieces of legislation to have been enacted by the incumbent government was the repeal of the perverse 'Tax Amnesty', with a cognisable majority in Parliament. In such circumstances, it was even more onerous upon the incumbent government to have arduously ensured the improvement in the revenue administration and collection. **It is with sheer distraught that it is noted, that arrears of Tax Revenue over the last 2 years have nearly doubled from a level reckoned to have been around Rs. 200 Billion, now to about Rs. 400 Billion.** *Therefore, in the foregoing facts and circumstances, I cannot be a silent spectator.*

Regretfully, my initiatives, endeavours and actions to arrest and reverse such situation, were neither appreciated, nor acted upon, but I believe, on the contrary, thwarted. Reference is drawn, *inter-alia*, to my Letter dated 10.6.2005.

You are well aware, that the Supreme Court of this country, both, in an Opinion pronounced, and in a Determination made and conveyed to Parliament, *inter-alia*, had determined that **it is to be borne in mind that public revenue is held in trust for the People of Sri Lanka, who cannot be denied its benefit, and that the 'Tax Amnesty' of 2003 had defrauded public revenue, causing extensive loss to the State.**

You also are aware, that I raised the issue of cognisable non-repatriation of export proceeds, since 1993/1994 by the non-enforcement of repatriation and surrender requirements for export proceeds, compatible with policies and procedures, which had been enforced by other IMF Article VIII Status countries, whose economies are much larger and sounder than ours. Such countries in the region included, India, Pakistan, China, Malaysia, Thailand, South Africa, South Korea, etc. We even obtain foreign currency loans from some of these countries. Ironically, whilst we had not enforced export proceeds repatriation and surrender requirements, such countries had. Whilst the IMF endorsed my stance, I was surprised to learn that you were unaware of the prevalent international practices.

Export incentives, such as import duty concessions and tax holidays are extended, not merely to have exports 'reported', but to have the realisation of much needed foreign exchange. Such incentives granted at the cost of public funds, create and cast a contractual obligation on the part of exporters to have repatriated export proceeds to the country, thereby having a beneficial impact on the foreign exchange position and the foreign currency rates, having a direct bearing on the cost of living.

As a result of my perseverance and endeavour, the Controller of Exchange was caused to carry out a voluntary reporting 'survey' of the exports for the quarter ended September 30, 2004, to ascertain, as to whether export proceeds had been repatriated back to the country by December 31, 2004. The answers to 'questionnaires' from the exporters were 'unauthenticated', in that, *they were devoid of bank certifications.* **Nevertheless, the report of the Controller of Exchange dated May 5, 2005 of such 'survey' revealed that only 81.1% of the export proceeds had been repatriated, whilst 10.7% had voluntarily been admitted to have been expended abroad, whilst 10% of the exporters were revealed to be 'fictitious', a fact corroborated by the aforesaid Report of the Auditor General.**

Knowingly suppressing the reported revelations of such 'survey', at a Meeting chaired by His Excellency the President, as the then Hon. Prime Minister, with the participation of the other Leaders of the Parties, constituting the government, the then Governor of the Central Bank, in the presence of other Officials of the Central Bank, and you, a Member of the Monetary Board, misled His Excellency the President and those others, by intimating that the 'leakage' of export proceeds was under 1%. I reliably came to know that the Central Bank had significantly endeavoured to subsequently investigate, *as to how I came to be in possession of the said 'survey' report, since it had given the lie to the aforesaid 1%.*

Based upon such 'survey' by the Controller of Exchange, the loss of foreign exchange to the country from 1993 to 2005 could be reckoned to be in the region of US $ 10,000 Mn., subject to actual ascertainment, warranting investigation. ***If not for the foreign exchange remittances amounting to US $ 14,380 Mn. from 1993 to 2005 from the poor Sri Lankans working abroad, particularly in the Middle East under going hardship, together with other attendant social trauma, what would have been the foreign exchange position of the country and the foreign currency rates today ?***

Would not the proper management of export proceeds repatriation have had a beneficial impact on the foreign currency reserves and the foreign borrowings of the country, and on the foreign currency rates, thereby having a direct bearing on the cost of living, which affects the wide spectrum of the poor people of the country ?

The Report to Parliament by the Committee on Public Enterprises (COPE) in 2005, in dealing with the Central Bank of Sri Lanka, *inter-alia*, reported as follows:

> "The Auditor General and the Department of Public Enterprises have highlighted the following in their reports ......"
>
> - "Decline in the remittances of export earnings to the country as the Bank did not monitor the remittances of such export proceeds to the country and the foreign exchange loss to the country."
>
> "Your Committee in conclusion recommends the following:"
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> - "Carry out investigations on the nonrepatriation of export proceeds to Sri Lanka and take corrective action appropriately to avoid drain of foreign resources."

Even in the face of the foregoing, you, as Secretary, Ministry of Finance and Secretary to the Treasury, and being a Member of the Monetary Board, did not take or cause warranted action to be taken in regard the foregoing; *further notwithstanding that the reporting to COPE had also been made by the Department of Public Enterprises, which came directly under your direction and control.*

From 1995 you had functioned as a Member of the Public Enterprises Reform Commission of Sri Lanka (PERC), prior to its incorporation on January 1, 1996, initially as an Alternate Member for the then Secretary to the Treasury, and subsequently, in your own right. Thereafter, you had functioned as Chairman of PERC from January 1997 upto December 2002, and had continued as Senior Advisor of PERC upto February 2004, and had resigned therefrom, after the dissolution of Parliament.

Public and worker confidence in the privatisation processes had completely eroded, to the extent that the government today is unable to even initiate restructuring processes, even where restructuring is warranted with the changing environment. I believe that such erosion of public and worker confidence had been caused by the questionable manner in which privatisation transactions had been carried out over the several years, *sans* requisite *'safety nets'* and *sans* any focus on developing a constituency of public and worker confidence in the processes of privatisation, resulting also in a host of post-privatisation issues, some detrimental to the public interest. **Some of the transactions had been questionable and dubious, even causing loss and detriment to the government i.e. the public. Some have even been deemed to be fraudulent.**

This is not the occasion to dwell upon the aforesaid transactions. **I can substantiate the foregoing, including certain other material issues, at any public forum, inasmuch as I did so recently in the public domain in relation to a certain complex transaction.**

Nevertheless, it is pertinent to state that over 8 ½ acres of valuable State Land in an unique location in the Colombo City, reckoned to be worth over Rs. 4,500 Mn., had been intriguingly caused to be transferred outright, without valuable consideration, to a renowned corporate, propounding policies of corporate social responsibility, and without having obtained a valuation from the Chief Valuer as mandated. This had been effected without my knowledge and concurrence, whilst I, as then Chairman, PERC, was in the process of examining the multi-faceted ramifications of this transaction, the Agreement pertaining to which had been censured by the Court of Appeal in respect of one of the undertakings given therein by the government.

In the foregoing grave and serious facts and circumstances detrimental to the interests of the country and public, moreso particularly in the face of the severe castigation and damning indictment on you by the Auditor General in his aforesaid Special Report to Parliament, which he admittedly had deemed that he stood bounden in duty under the Constitution to report to Parliament, in view of the gravity and, national and public importance of the matters reported upon, *you ought to resign forthwith as the Secretary, Ministry of Finance and Secretary to the Treasury.*

Notwithstanding the personal relationship, my conscience has compelled me to address this Letter to you, since my consideration for the interests of the country and its people, transcends such personal considerations.

Yours truly,

Nihal Sri Ameresekere

cc: Secretary to His Excellency the President
Auditor General
His Excellency the President / Minister of Finance

Hon. Chairman, Public Accounts Committee, Parliament of Sri Lanka
Hon. Chairman, Committee on Public Enterprises, Parliament of Sri Lanka
Hon. Leader of the House, Parliament of Sri Lanka
Hon. Leader of the Opposition, Parliament of Sri Lanka

Appendix "A"

COMPUTATION OF THE RS. 388.9 BILLION

Sub-section Number	Item relating to the Test Check	Computable Loss/ Non-collection of Taxes Rs. (Millions)
4.1	Refund of Taxes despite the prevalence of large Discrepancies in Tax Returns	1,873.8
4.2	Inefficiencies in the Collection of Arrears of Tax	22,275.6
4.3	Audit Test Check based on Form "C General 35" on write-off of Taxes	47,549.2
4.4	Refunds of Taxes to those who evaded Taxes in large scale instead of setting off against Arrears of Taxes	1,018.7
4.5	Overstatement of Export Income by Rs. 275 million.	104.8
4.6	Defrauding of Value Added Tax by producing incorrect information by wrong Parties	17.3
4.7	Non-collection of Taxes on Assessments on Value Added Tax issued by the Department as at 31 March 2006.	271,254.2
4.8	Refunds of Value Added Tax (VAT)	3,607.6
4.9	Refunds of Goods and Services Tax	114.6
4.10	Inefficiencies in the Collection of Arrears of Goods and Services Tax (GST)	20,228.9
4.11	Inefficiencies in the Collection of Arrears of Turnover Tax (TT) and Arrears of National Security Levy (NSL)	14,589.8
4:12	Failure to recover Withholding Tax properly	74.8
4:13	Inordinate delays in the banking of Withholding Tax by the Department of Inland Revenue	3.4
4:14	Inordinate Delays in the release of Tax Revenue collected by Banks to the Government Account	43.0
4:15	Scanning and Re-cashing of Cheques for Refunds of Tax	0.0
4:16	Loss resulting from failure to take Action on Dishonoured Cheques	171.0
4:17	Non-compliance with provisions of Acts relating to Taxes by the Department of Inland Revenue itself	--

4:18	Defrauding Taxes by the fraudulent Registration of imported motor vehicles as Trucks	11.4
4:19	Registration of Motor Vehicles on the Production of Fictitious Documents to the Department of Motor Traffic	3.4
4:20	Illegal Registration of motor vehicles without the payment of Customs Duties	--
4:21	Omission of Taxes due to the Computation of the Taxes on an erroneous basis contrary to Provisions in the Excise Duty Act	460.0
4:22	Action on motor vehicles imported for Tsunami Disaster work contrary to Provisions in the Excise Duty Act	66.2
4:23	Non-collection of Tax on locally Manufactured Motor Vehicles contrary to provisions in the Excise Duty Act.	--
4:24	Failure to take action on the manufacture of cigarettes contrary to Provisions in the Excise Duty Act	21.0
4:25	Failure to collect Taxes on the Production of Aerated Water contrary to Provisions in the Excise Duty Act.	2.6
4:26	Loss of Tax on the Manufacture of Liquor	479.9
4:27	Waiver of Taxes contrary to Provision in the Excise Duty Act	130.1
4:28	Waiver of Taxes of Institutions registered under the Scheme for Temporary Imports for Export Purposes	44.9
4:29	Loss arising form the Delays in auctioning of Confiscated Goods	18.8
4:30	Withdrawal of Court Cases on Arrears of Excise Duty.	119.4
4:31	Taxes receivable by the Department of Inland Revenue from the Sri Lanka Ports Authority.	4,108.6
4:32	Tax on Abandoned and Perishable Goods	237.6
4:33	Loss of Revenue arising the Weaknesses in the Customs Supervision over Investment Promotion Zones	--
4:34	Non-payment of Taxes by an Entrepreneurial Investment Company	70.5
4:35	Loss of Government Revenue due to action contrary to provisions taken by the Department of Import and Export Control	204.8
		388.905.9

Appendix "B"

'SUB-SECTION HEADINGS' OF SECTION 4 OF THE AUDITOR GENERAL'S REPORT

4:1 Refunds of Taxes amounting to Rs.1.9 Billion despite the Prevalence of Large Discrepancies among Tax Returns

4:2 Test Check on Collection of Arrears of Tax – Rs. 22.3 Billion

4:3 Audit Test Check on the Write Off of Arrears of Tax According to "C General 35" Reports – Rs.47.5 Billion

4:4 Refundable Taxes which could have been set-off against arrears of Tax, by the Department of Inland Revenue being refunded to individuals / institutions which had committed large scale Tax Evasions. Rs.1,018.7 Billion.

4:5 Test Check on the Value Added Tax (VAT) Fraud Committed by the Overstatement of Export Income by Rs.275 Million - Rs.104.8 Million

4:6 Test Check on Frauds Committed on Value Added Tax (VAT) by Wrong Parties through submission of Erroneous Information - Rs.17.3 million

4:7 Non-collection of Taxes on Assessments on Value Added Tax issued by the Department as at 31 March 2006 - Rs.271,254.2 Million

4:8 Test Check on the Refund of Value Added Tax amounting to Rs.3.6 Billion

4:9 Questionable Payment of Rs.114.6 Million as Refunds of Goods and Services Tax

4:10 Audit Test Check on the Inefficiencies in the Collection of Goods and Services Tax (GST) – (Rs.20.2 Billion)

4:11 Test Check on the Inefficiencies in the Collection of Arrears of Turnover Tax (TT) and Arrears of National Security Levy (NSL) – (Rs.14,589.8 Million)

4:12 Test Check on the Failure to Collect Withholding Tax Properly - Rs.74.8 Million

4:13 Test Check relating to Inordinate Delays in the Banking of Withholding Tax by the Department of Inland Revenue - Rs.3.4 Million

4:14 Inordinate Delays in the Crediting of Tax Revenue Collected by Banks to the Government Account – Rs.43.0 Million

4:15 Scanning and Re-cashing of Cheques for Refunds of Tax - Rs.17,295

4:16 Audit Test Check on the Loss resulting from Failure to take Action on Dishonoured Cheques : Rs.171.0 Million

4:17 Test Check on Non-compliance with the Tax Acts by the Department of Inland Revenue Itself

4:18 Audit Test Check on Defrauding Taxes by Fraudulent Registration of Imported Motor Vehicles as Trucks - Rs.11.4 Million

4:19 Audit Test Checks on the Registration of Motor Vehicles on the Production of Fictitious Documents to the Department of Motor Traffic: Rs. 3.4 Million

4:20 Illegal Import of Motor Vehicles without the Payment of Customs Duties

4:21 Audit Test Check on the Waiver of Tax Contrary to Provisions in the Excise Duty (Special Provisions) Act . Rs.460 Million

4:22 Test Check on Action contrary to Provisions in the Excise Duty Act on Motor Vehicles Imported for Tsunami Disaster Work - Rs.66.2 Million

4:23 Audit Test Check on Action Contrary to Provisions in Excise Duty (Special Provisions) Act in connection with a Company Manufacturing Motor Vehicles Locally

4:24 Audit Test Check on Non-compliance with the Provisions in the Excise Duty (Special Provisions) Act on the Manufacture of Cigarettes – Rs.21.0 Million

4:25 Audit Test Check on Non-compliance with the Provisions in the Excise Duty (Special Provisions) Act on the Collection of Tax on Manufacture of Aerated Waters

4:26 Audit Test Check on the Computation and Collection of Arrears of Tax on Liquor

4:27 Waiver of Duty resulting from the Computation of Excise Duty on an Erroneous Basis contrary to Provisions in the Act

4:28 Audit Test Checks on the Institutions Registered under the Scheme for Temporary Imports for Export Purposes (TIEP)

4:29 Audit Test Check on the Loss resulting from the Auction Sales Delayed until the Finalisation of Court Cases on Seized Goods Confiscated: Rs.18.8 Million

4:30 Audit Test Check on the Withdrawal of Court Cases filed for the Collection of Arrears of Excise Duty : Rs.119.4 Million

4:31 Audit Test Check on the Duty Receivable by the Customs from Sri Lanka Port Authority : Rs.4.1 Billion

4:32 Audit Test Check on Duty on Abandoned and Perishable Goods : Rs.237.6 Million

4:33 Audit Test Check on the Loss of Revenue from Customs Duty to the Government due to Weaknesses in Customs Supervision over Investment Promotion Zones

4:34 Audit Test Check on the Non-payment of Taxes by an Entrepreneurial Capital Investments Company : Rs.70.5 Million

4:35. Loss of Government Tax Revenue due to Action Contrary to Provisions taken by the Department of Imports and Exports Control : Rs.204.8 Million