Co-operative wholesale Establishment -2012

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1. Financial Statements

1.1 Adverse Opinion

In my opinion, because of the matters described in paragraph 2.2 of this report, the financial statements do not give a true and fair view of the financial position of the Co-operative Wholesale Establishment as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Going Concern of the Establishment

In view of the diminution of the net assets to a negative value of Rs.7,418,347,555 by 31 December 2012 as the Establishment had incurred losses continuously from the year 2000 to the year under review, and the existence of a long term bond liability of Rs.4,397,000,000 and continuously increasing current liabilities of Rs.2,419,101,639, it is indicated that an uncertainly appears in the going concern of the Establishment without the Treasury or other Government financial assistance.

1.2.2 Sri Lanka Accounting Standards

The following observations are made.

(a) Sri Lanka Accounting Standard 01

Even though income and expenditure should not be set off against each other unless otherwise allowed or authorized by the Accounting Standards, the finance income of Rs.5,239,174 had been set off against the finance expenditure of Rs.348,757,315 and the net value only had been shown in the financial statements.

(b) Sri Lanka Accounting Standard 08

Even though the non-current assets costing Rs.241,593,577 fully depreciated had been in use continuously as the useful life of the non-current assets had not been reviewed annually, action had not been taken to revise the estimated error.

(c) Sri Lanka Accounting Standard 40

Even though a sum of Rs.186,576,358 had been shown as the lease rent income in the income statement, the buildings related to earning income had not been recognized as the investment property in the Statement of Financial Position.

1.2.3 <u>Accounting Deficiencies</u>

The following observations are made.

(a) In view of the following weaknesses existing in the accounting system, it was not possible to ascertain the accuracy of the data and information included in the financial statements.

(i) In the preparation of the financial statements of the Establishment, the financial year ends on 31 December while in the preparations of the financial statements of its Subsidiary Companies, the financial year ends on 31 March. In the preparation of the financial statements of the Group as at 31 December 2012, due attention had not been paid to the period related to the financial year of the income, expenditure, assets and liabilities included in the financial statements of Subsidiary Companies of the Establishment prepared as at 31 March 2013 audited by the Private Auditors.

(ii) The payment vouchers and receipts had not been posted to the cash book systematically and as such the non-existence of any receipts and payments not brought to account cannot be ruled out in audit.

(iii) An examination of the trial balance for the year under review revealed that the debit balances totalling Rs.27,584,061,602 related to 168 Assets and Expenditure Accounts and the credit balances totalling Rs.30,129,471,178 related to 110 Liabilities and Income Accounts did not agree with the financial statements. This position would have an impact on the balancing of the financial statements.

(b) Action had not been taken to repay the loan of Rs.275,000,000 granted by the General Treasury in the year 2006 for the commodity purchase and that had been included in the Restructure Reserve, instead of being shown as a loan repayable.

(c) Instead of showing the accrued audit fees up to 31 December 2012 amounting to Rs.10,174,170 , a sum of Rs.1,871,000 only had been shown as a balance payable under the current liabilities in the balance sheet. Accordingly, current liabilities amounting to Rs.8,303,170 had been omitted from the financial statements for the year under review.

(d) Even though the profit from the sale of motor vehicles amounted to Rs.5,101,356, it had been shown in the financial statements as Rs.5,892,489. As such, the profit from the sale of motor vehicles had been overstated by a sum of Rs.791,133 in the financial statements.

(e) According to the letter dated 13 October 2014 of the Manager of a State Bank in connection with a short term loan obtained by the Establishment from a State Bank, a penalty of Rs.29,504,364 payable as at 31 December 2012 was revealed and the total interest payable on the loan and the interest related to the year amounted to Rs.151,697,824 and Rs.27,166,711 respectively. Action had not been taken either to account for or adjust this expenditure in the year under review.

1.2.4 Unexplained Differences

The following observations are made.

(a) The total quantity of white sugar received by the Packing Division up to 31 December 2012 amounted to 883,951 kg and the quantity packeted up to that date had been 713,832 kg. The reasons for the difference of 170,119 kg had not been revealed.

(b) According to the statement of the Chairman dated 21 February 2013, the total quantity of sugar packeted up to 31 December 2012 had been 717,788 and the number of packets furnished according to the lines had been 694,274. As such a difference of 23,514 packets was observed.

(c) The charges receivable for packeting sugar by 31 December 2012 should have been Rs.882,879 (packets 717,788 x Rs.1.23) whereas according to the invoice issued that amount was to Rs.864,429.

(d) According to the financial statements of the Paddy Marketing Board for the year 2012, a sum of Rs.1,587,080,892 payable by the Establishment to the Paddy Marketing Board had been disclosed. Nevertheless, the amount payable disclosed in the financial statements of the Establishment amounted only to a sum of Rs.962,585,013. Action had not been taken to identify and settle this difference.

(e) Even though the balance of the short term loan obtained by the Establishment from a State Bank, as at the end of the year under review amounted to Rs.207,050,943 whereas according to the confirmation sent by the Bank, the balance amounted to Rs.207,097,942. The difference had not been identified and settled.

1.2.5 Lack of Evidence for Audit

The following transactions could not be satisfactorily vouched or accepted in audit due to the non-submission of evidence related thereto.

(a) The documents related to disposals, title deeds, Registers of Fixed Assets, lease agreements, investment certificates and the confirmation of balances relating to the balances of 10 Assets Accounts totalling Rs.2,010,153,232 , balances of 5 Liability Accounts totalling Rs.8,971,636,580 , balances of 5 Revenue Accounts totalling Rs.54,843,226, Reserves amounting to Rs.1,781,563,583 and the disposal of fixed assets amounting to Rs.240,761,731 appearing in the financial statements.

(b) The audited financial statements as at 31 December 2012 and related schedules in support of income amounting to Rs.106,955,071, non-current assets amounting to Rs.414,802, Current assets amounting to Rs.41,262,131 equity amounting to Rs.11,031,768 , current liabilities amounting to Rs.30,645,165 , gross profit amounting to Rs.86,931,993 and the net profit of Rs.10,785,423 appearing in the accounts relating to the other Companies of the Group.

(c) The management had failed to identify specifically the balances of 16 accounts totalling Rs.183,599,926 appearing under the current liabilities in the Statement of Financial Position of the Establishment as accounts payable.

(d) The particulars of Security Officers and the Duty Rosters relating to the payment of Rs.167,900 made to the Sathosa Economic Services (Private) Ltd relating to the security services provided to the different Divisions of the Establishment in October 2012.

1.3 Accounts Receivable and Payable

The following observations are made.

(a) Action had not been taken even by 30 March 2016 for the recovery of money for the assets valued at Rs.126,156,746 that existed in the stores complex at Welisara and transferred to the Lak Sathosa.

(b) Action had not been taken even by the end of October 2015, the date of audit, for the recovery of rent income receivable by the Establishment from 149 institutions and persons amounting to Rs.77,257,552 remaining receivable over periods exceeding 4 years.

(c) The bid security loan amounting to Rs.207,050,943 granted to the Establishment by a State Bank in the years 2004 and 2005 on Treasury bonds for the import of rice and wheat flour remained outstanding even by 31 December 2012.

(d) The packeting charges amounting to Rs.864,429 receivables in respect of 4 months ended 31 December 2012 had not been recovered from the Lak Sathosa even by 28 February 2016.

(e) Action had not been taken even by the end of the year under review either for the recovery or for adjustment in the accounts the sum of Rs.71,561,640 recoverable from the Lanka Sathosa Company as the annual lease rent and the foreign liquor licence fees.

1.4 Non-compliance with Laws, Rules, Regulations and Management Decisions

Non-compliances with the following laws, rules, regulations and management decisions were observed.

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a) Section 2.2(a) of the Co-operative Wholesale Establishment (Amendment) Act, No. 31 of 1991	Investment of the money of the Establishment can be made only in the existing public companies. Nevertheless, a State Company called Sathosa Economic Centres Services (Private) Ltd had been established by making a nominal investment of Rs.10 and officers drawing salaries from the Establishment had been deployed.
(b) Public Enterprises Circular No. PED/12 of 02 June 2003	
(i) Section 6.5.1	Even though action should have been taken to furnish a Draft Annual Report together with the financial statements, it had not been so done.

(ii) Section 8.3.9	Expenditure totalling Rs.1,366,958 had been incurred on behalf of the Line Ministry and 03 other institutions, contrary to the provisions in the Circular.

2. Financial Review

2.1 Financial Results

According to the financial statements presented, the net loss of the Co-operative Wholesale Establishment for the year ended 31 December 2012 amounted to Rs.661,602,751 as compared with the corresponding net loss of Rs.313,605,785 for the preceding year. Accordingly, the net loss of the Establishment had increased by Rs.347,996,966 or 111 per cent. Even though the other operating income for the year under review had increased by Rs.50,645,942 or 36 per cent as compared with the preceding year, the operating expenditure had increased by Rs.404,172,306 or 78 per cent and that had been the reason for such increase in the net loss. The impairment loss of Rs.378,003,569 had been the reason for the increase in the operating expenses and that represented 94 per cent of the increase in the operating expenditure.

2.2 Analytical Financial Review

(a) Comprehensive Income Statement

Certain significant ratios according to the Comprehensive Income Statement presented are given below.

Profitability Ratios	2012	2011
- Gross Profit Ratio (Percentage)	16	21
- Net Profit Ratio (Percentage)	(305)	(246)

It was observed that in view of the decrease of the gross profit for the year under review as compared with the preceding year by 5 per cent and the increase of the net loss by 59 per cent the financial results of the Establishment had deteriorated.

(b) Statement of Financial Position

Certain significant ratios according to the Statement of Financial Position presented are given below.

Liquidity Ratios	2012	2011
- Current Ratio	0.54:01	0.48:01
- Quick Assets Ratio	0.42:01	0.40:01

(i) As the Current Ratio and the Quick Assets Ratio of the Establishment for the year under review had been 0.54:01 and 0.42:01 respectively, existence of the inability to settle the short term liabilities or liquidity crisis was reflected.

(ii) The retained earnings had converted to a negative value due to the continuous losses incurred by the Establishment. The equity capital had eroded continuously resulting in a high gearing situation.

3. Operating Review

3.1 Management Inefficiencies

(a) Even though the Embilipitiya shop had earned a sum of Rs.27,668 as commission from the sale of plastic baskets during the first 06 months of the year 2012, loss of Rs.108,628 had been incurred due to the cost of salary alone in that connection being Rs.136,296.

(b) Even though 32 shops and stores buildings belonging to the Establishment had been leased out to a State Company called Lanka Sathosa Ltd, a valuation report in regard to the building rent had not been obtained from the Government Valuer.

(c) Even though the Establishment had transferred asssets valued at Rs.51,718,227 to the Lak Sathosa Ltd, by 03 November 2010, the recoveries in that connection had not been settled.

(d) Even though electric motors of 12 container machines valued at Rs.5,097,455 had been misplaced, action had not been taken for determining the custody of assets and assignment of responsibilities, identification of the parties responsible by conducting a formal inquiry and taking legal action against them.

(e) Even though the Establishment had invested a sum of Rs.9,923,710 in the Ingrin Institute of Printing and Graphics Company in the year 1999, the Company had been dissolved in accordance with a Courts decision dated 23 October 2006 due to the continuous losses incurred by the Company. As such, there was an uncertainty in the recovery of the money invested.

(f) Even though the Establishment had invested a sum of Rs.171,928,690 in Sathosa Retail Company in the year 1999, the Establishment had not received any dividends whatsoever during the years from 1999 to 2012.

3.2 Operating Inefficiencies

Even though the income of the Packeting Division for the period ended 31 December 2012 amounted to Rs.864,429 , a sum of Rs.2,101,077 had been paid as salaries and allowances to the employees of the Division for the year under review.

3.3 Transactions of Contentious Nature

The following observations are made.

(a) Salaries and allowances amounting to Rs.1,139,279 and Rs.1,311,943 had been paid in the preceding year and the year under review respectively for the post of Working Director for which no provision had been made in the Act of incorporation of the Establishment or any other written law and not included in the approved cadre of the Establishment. That amount had increased to Rs.4,691,272 by the date of audit in August 2015.

(b) Two Rice Mills costing Rs.78,978,504 had been constructed in 2 stores of the Department of Food Commissioner situated in Hingurakgoda and obtained on rent basis, without obtaining the approval of the Department of Food Commissioner.

3.4 Apparent Irregularities

The following observations are made.

(a) Payment for goods valued at Rs.105,725 purchased in the years 2010 and 2011 from the Buildings Materials Corporation Ltd, had been made in installments on 12 November 2012 and 03 December 2012 based on the photocopies of invoices without ensuing that the goods had been received by the Establishment.

(b) Salaries and overtime had been paid for the first 06 months of the year 2012 to 3 Security Officers deployed for the private residence of the Chairman of the

Establishment, thus causing a loss of Rs.656,311 to the Establishment. Action for the recovery of that amount had not been taken even by 28 February 2016.

(c) A sum of Rs.131,670 had been overpaid to a newly recruited officer due to the grant of salary increments contrary to the prevailing rules and regulations. That amount had increased to Rs.506,000 by the date of audit in September 2015.

(d) A sum of Rs.25,000 had been given in January 2012 to the Officer in charge of the Wholesale Store at Ratnapura as a petty cash advance without identifying the daily expenditure requirements. The expenditure incurred up to 09 August 2012 amounted to Rs.6,251 and the officer keeping the money in custody failed to produce the balance sum of Rs.18,749 to the Audit Officers at the cash Verification. The management had failed to inform the course of action taken in this connection to the audit even by November 2015.

(e) A Stores Assistant recruited outside the recruitment procedure in the year 2011 on contract basis had been appointed for stores work. Even though the stock operations of the store concerned had been ceased by the end of the year 2012, salaries for the year 2012 amounting to Rs.210,480 at the rate of Rs.17,540 per month had been paid to the officer even though he had not reported for duty.

3.5 Uneconomic Transactions

Despite the Establishment had obtained the service of 4 Accountants in the year 2015 and paid a sum of Rs.3,244,869 as salaries and allowances, the services of a Firm of Chartered Accountants had been obtained with the approval of the Board of Directors in the year 2015 for the preparation of the financial statements for the year 2012 for a sum of Rs.613,520.

3.6 Restructuring Transactions

The following matters were observed.

The restructure of the Establishment had been commenced in the year 2003 and the 6 commercial Banks to which a sum of Rs.5,493 million was payable as at 01 December 2003, had agreed to settle that loan by paying Rs.4,397 million. Accordingly, Treasury Bonds to be matured in 13 years had been issued to those commercial Banks thereon.

It had been agreed to settle those Treasury Bonds in the year 2005 from the sale proceeds of assets valued at Rs.1,800 million out of the fixed assets belonging to the Establishment, through the Public Enterprises Reform Commission. It had also been agreed to pay the half yearly interest on those loans and to meet 50 per cent of such interest by the Treasury and to meet the balance 50 per cent from the rent income received by renting out the properties of the CWE to the Sathosa Retail Company Ltd. Nevertheless, no transfer of assets to the Public Enterprises Reform Commission had been made for the settlement of liabilities in respect of Treasury Bonds under the restructure. Even though a decision No. 04/0103/136/007/EPC/710 dated 03 February 2004 had been taken by the Cabinet of Ministers to dissolve and privertise the Establishment, it had been terminated in accordance with the decision No. 04/0892/012/001 dated 11 August 2004 of the Cabinet of Ministers.

Accordingly, a total sum of Rs.4,597 million comprising the net present value of Treasury Bonds amounting to Rs.3,173 million as at 31 December 2012 under the discount factor of 8.5 per cent and a discount value of Rs.1,224 million totalling the maturity value of Rs.4,397 million and a sum of Rs.200 million payable to the Treasury in respect of the payments made by the Treasury to creditors of the Sathosa Retail Company Ltd and three commercial Banks out of the above six Banks for the settlement of loans, had been shown as bond liabilities in the financial statements.

Bond interest liabilities amounting to Rs.2,806,167,798 payable to the Treasury in this connection had been shown as "Payable for CWE Bonds" under the Non-current Liabilities in the financial statements.

Further, the Management had failed to get confirmation from the Treasury that the balance of Rs.200 million out of the payables amounting to Rs.4,597 million was receivable to the Treasury and a sum of Rs.66,363,460 had been shown as Restructures under Other Creditors. As such, it was evident that the restructuring transaction had not been properly disclosed or adjusted. The restructuring value had been shown as Bookkeeping in the Statement of Financial Position.

3.7 Build up of a Fund for the Provisions made for Employees Gratuity

Even though provisions amounting to Rs.33,700,618 had been made for gratuities in terms of the Payment of Gratuity Act, No. 12 of 1983, the provision had not been invested to meet the future payments.

4. Accountability and Good Governance

4.1 Presentation of Financial Statements

Even though the financial statements of the Establishment should be presented to audit within 60 days after the close of the year of accounts in terms of Section 6.5.1 of the Public Enterprises Circular No. PED/12 of 02 June 2003, the financial statements of the Establishment for the year 2012 had been presented for audit only on 05 August 2015, that is, after a delay of 2 ½ years.

4.2 Corporate Plan

Even though a Corporate Plan covering the period 2012-2014 had been prepared with a view to achieving the vision and mission of the Establishment in terms of Section 5 of the Public Enterprises Circular No. PED/12 of 02 June 2003, it had not been periodically reviewed.

4.3 Action Plan

Even though an Action Plan for the year 2012 had been presented to audit, it had not been prepared in terms of the National Budget Circular No.142 of 31 December 2008.

4.4 Internal Audit

An adequate internal audit had not been carried out as the supporting staff of the Internal Auditor had not been appointed. Any copies of Internal Audit Queries or Reports for the year under review had not been furnished to audit.

4.5 Audit Committee

Even though the Audit Committee should meet at least once every in three month in terms of Public Enterprises Circular No. PED/31 of 01 July 2005, only 02 meetings had been held in the year 2012.

4.6 Unresolved Audit Paragraphs

One hundred and forty Rice Processing machines imported in September 2006 by the Establishment at a cost of Rs.14,501,998 remained idle in the Establishment premises even by November 2015

5. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Establishment from time to time. Special attention is needed in respect of the following areas of control.

(a) Accounting
(b) Fixed Assets Control
(c) Stock Control
(d) Recovery of Lease Rental Income
(e) Personnel Management
(f) Internal Audit
(g) Legal Affairs