Co-operative Wholesale Establishment – 2014

The audit of financial statements of the Co-operative Wholesale Establishment for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 and the comprehensive income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 20(1) of the Co-operative Wholesale Establishment Act (Cap 126) amended by the Co-operative Wholesale Establishment (Amendment) Act, No.12 of 1969. My comments and observations which I consider should be published with the Annual Report of the Establishment in terms of Section 14(2)(c) of the Finance Act, appear in this report.

1.2 Management's Responsibility for the Financial Statements

The Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI-1000-1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Establishment's preparation and fair presentation of the financial statements 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 Establishment's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and the extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 Basis for Adverse Opinion

Had the matters described in paragraph 2.2 of this report been adjusted, many elements in the accompanying financial statements would have been materially affected.

2. Financial Statements

2.1 Adverse Opinion

In my opinion, because of the significance 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 2014 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Going Concern of the Establishment

Since the Establishment sustained continuous losses from the year 2000 up to the year 2013, net assets had diminished to a negative value of Rs.7,710,099,424 as at the end of the preceding year and the negative value of net assets had decreased to Rs.2,213,886,674 due to the profit of Rs.5,780,204,145 generated as a result of revaluation of assets carried out in the year under review. It is observed according to the financial statements that since the existence of a long term bond liability totalling Rs.4,397,000,000 and current liabilities of Rs.1,881,384,478, the going concern of the Establishment without the Treasury or other Government financial assistance is uncertain.

2.2.2 Sri Lanka Financial Reporting Standards and Sri Lanka Accounting Standards

(a) **Sri Lanka Financial Reporting Standard 10**

Preparation of financial statements of the Establishment is carried out for the financial year ended 31 December and preparation of financial statements of its subsidiaries is carried out for the financial year ended 31 March. In the preparation of financial statements of the Group in the years 2012, 2013 and the year under review, consolidated financial statements had been prepared without adjusting the interference of the financial reporting period of the Corporation and Subsidiaries.

(b) Sri Lanka Accounting Standard 02

The Corporation had not carried out a physical stock verification for the stock valued at Rs.4,143,032 and identified the net realizable value as at the end of the year under review. As such, it was not possible to be satisfied with regard to the value of that stock shown in the financial statements.

2.2.3 Accounting Deficiencies

The following observations are made.

(a) Instead of maintaining separate accounts for the Project on Mobile Sales Vehicles named "Gamata Saviya Sathosa Badiya" commenced in the year 2014 and identifying and accounting for the overall effect of the Project, the difference of Rs.140,730,116 between the value of the goods issued to sales vehicles by the Establishment and the value of goods returned to the Establishment by them had been identified as the income.

(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 purchase of trading commodities and that amount had been included in the Restructure Reserve and shown in the accounts instead of disclosing as a repayable loan.

(c) In respect of an accrued audit fees up to 31 December 2014 amounting to Rs.8,847,374, only a sum of Rs.3,860,592 had been shown as audit and tax consultation fees payable under current liabilities in the balance sheet. Accordingly, current liabilities of Rs.4,986,782 had been omitted from the financial statements of the year under review.

(d) Action had not been taken even by the end of the year under review to recover a sum of Rs.71,381,640 receivable from the Lanka Sathosa Company as annual lease rental and foreign liquor license fees for the year 2011 or to make provisions for bad debts.

(e) It was revealed from the letter of the Manager of a State Bank dated 03 September 2014 that the loan of Rs.155,058,221, the accrued penalty thereon amounting to Rs.39,444,946 and the accrued interest thereon amounting to Rs.188,975,005 remained payable as at 30 June 2014 on account of a short term loan obtained by the Establishment from a State Bank, and the interest computable for ensuing six months of the year 2014 amounted to Rs.11,678,242. However, action had not been taken either to account for or adjust this loan amount, accrued penalty and interest thereon during the year under review.

(f) The Establishment had invested a sum of Rs.171,928,690 in the Sathosa Retail Company in the year 2002 and that Company had been liquidated in the year 2013. However, the value of that investment had been further indicated in the financial statements of the Establishment.

2.2.4 Unexplained Differences

Even though existence of a balance of Rs.1,404,922,600 payable to the Paddy Marketing Board by the Establishment had been established by the financial statements of the Paddy Marketing Board of the year 2013, the amount payable to the Paddy Marketing Board had been shown as Rs.955,368,781 in the financial statements of the year 2013 of the Establishment. The amount receivable to the Establishment from the Paddy Marketing Board as lease rentals, the Rice Project and other, amounted to Rs.37,415,169 and no amount whatsoever had been indicated in the financial statements of the Paddy Marketing Board as payable to the Establishment. Action had not been taken even by 30 August 2016 to settle these differences.

2.2.5 Lack of Evidence for Audit

The evidence indicated against the following transactions was not made available and as such, those could not be satisfactorily vouched or accepted in Audit.

(a) Lack of evidence for 8 balances of Current Assets Accounts totalling Rs.508,343,750, six balances of Current and Non-current Liabilities Accounts totalling Rs.9,597,973,086 and balances of Income Accounts amounting to Rs.15,737,320 shown in the financial statements.

(b) Information for specific identification of 17 balances of accounts totalling Rs.183,602,957 shown under current liabilities as payables.

2.3 Accounts Receivable and Payable

Out of the trade and other receivables as at 31 December of the year under review totalling Rs.951,269,114, a sum of Rs.389,467,293 or 41 per cent had been shown in the financial statements as provision for impairment without taking adequate action to recover them.

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

In terms of Section 2.2 (a) of the Co-operative Wholesale Establishment (Amendment) Act, No.31 of 1991, the funds of the Corporation could be invested only in the existing public companies. Contrary to that, 02 State Private Companies had been established by investing Rs.10 in a nominal share, and 04 officers drawing salaries from the Establishment had been deployed in the service.

2.5 Transactions not supported by Adequate Authority

The Establishment had sold canned fish valued at Rs.8,660,782 in two preceding years on credit basis without proper approval. The Establishment had failed to recover a sum of Rs.4,362,320 of that amount even by 20 August 2016.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Establishment for the year ended 31 December 2014 had been a deficit of Rs.310,874,332 as compared with the corresponding deficit of Rs.283,494,766 for the preceding year, thus indicating an increase in the deficit by Rs.27,379,566 in the year under review as compared with the preceding year. Even though the gross profit had increased by Rs.48,750,483, the decrease in the profit received from the Rice Processing Project and other income by Rs.27,611,171 and Rs.14,098,915 respectively and the increase in the administrative expenditure by Rs.34,023,656 had been the main reasons for the increase in the deficit.

3.2 Legal Action Initiated Against / by the Corporation

Thirty seven institutions and persons had filed cases in the Courts against the Establishment by the end of the year under review claiming compensation of Rs.43,779,466 and the Establishment had paid a compensation of Rs.3,483,122 therefor during the year under review. Further, the Establishment had filed cases in the Courts against 11 Institutions and persons claiming compensation of Rs.79,721,967 and out of that, a sum of Rs.20,475,250 had been recovered in the year under review.

4. Operating Review

4.1 Performance

Action had not been taken even to commence 3 activities planned to be commenced and implemented during the year under review and out of 08 "Farm Shops" planned to be established in the year under review, the number of shops commenced during the year had been only 01. Moreover, 100 mini Lorries for which provisions had not been made from the budget and not included in the Action Plan of the year under review, had been purchased at a cost of Rs.145,308,000 on lease basis.

4.2 Management Activities

The following observations are made.

(a) Thirty two trade stalls and store buildings owned by the Establishment had been transferred to the Lanka Sathosa Company Ltd. a State Company, on rental basis and a report of the Government Valuer had not been obtained on the building rent.

(b) The Establishment had transferred assets valued at Rs.54,722,228 to the Lanka Sathosa Company Ltd. whereas no proper agreement had been entered into for obtaining money or shares of the Company in lieu of them.

(c) Even though the Establishment had invested a sum of Rs.9,923,710 in a private Company in the year 1999, no dividends whatsoever had been received from the year 1999 to the year 2014 due to losses sustained continuously by the Company.

4.3 Transactions of Contentious Nature

The following observations are made.

(a) Recruitment had been made in the year 2011 for a post of Working Director for which provisions had not been made in the Incorporating Act of the Establishment or by any other law and not included in the approved staff of the Establishment and salaries and allowances amounting to Rs.5,781,732 had been paid from the year 2011 to 31 March 2016.

(b) Two stores of the Department of Food Commissioner had been obtained on rental basis and 02 paddy mills had been constructed at a cost of Rs.78,978,504 by the Establishment without the approval of that Department.

4.4 Uneconomic Transactions

Despite having four Accountants engaged in the service of the Establishment, a sum of Rs.1,843,980 had been paid on the approval of the Board of Directors to a firm of Chartered Accountants for the preparation of financial statements of the years 2012, 2013 and 2014.

4.5 Restructuring Transactions

Restructuring of the Establishment had been commenced in the year 2003 and having reached an agreement with commercial Banks to settle Rs.4,397 million out of the loan of Rs.5,493 million payable to 6 commercial Banks as at 01 December 2003, Treasury Bonds maturing in 13 years had been issued thereon to the relevant commercial Banks.

Accordingly, a sum of Rs.4,597 million had been shown in the financial statements as total liabilities payable to the Treasury as at the end of the year under review, comprising a sum of Rs.4,397 million payable to the Treasury for the Treasury Bonds and Rs.200 million paid to the creditors of the CWE Retail Company and 03 Commercial Banks.

The bond interest liability amounting to Rs.3,453,793,134 payable to the Treasury as at the end of the year under review, had been stated as " Payable Interest for CWE Bonds" under non-current liabilities in the financial statements. The Management had failed to obtain confirmation from the Treasury whether a sum of Rs.200 million out of the sum of Rs.4,597 million payable, is actually receivable by the Treasury and it is clear that the transaction of restructuring had not been properly disclosed or adjusted by stating a sum of Rs.66,363,460 as restructurings under other Creditors. This value of restructuring had been indicated as bookkeeping in the financial statements of the year under review.

4.6 Staff Administration

The following observations are made.

(a) The total approved staff of the Corporation stood at 316 posts comprising 20 posts of the Management Grade, 51 posts of the Management Assistant Level and 245 posts of the Primary Level and the excess cadre and the number of vacancies as at the end of the year under review, had been 172 and 26 respectively.

(b) As the increments had been given to an officer recruited during the year 2012 contrary to the relevant laws and rules, a sum of Rs.159,390 had been overpaid during the year under review and the amount so overpaid from the year 2012 to 01 March 2016, had been Rs.589,490.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

Even though the financial statements of the Establishment should be furnished to audit within 60 days after 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 pertaining to the year under review had been furnished to audit only on 09 May 2016.

5.2 Corporate Plan

Even though a Corporate Plan had been prepared to achieve the vision and the mission of the Establishment so as to cover the years from 2013 to 2016 in terms of the Public Finance Circular No. 01/2014 of 17 February 2014, it had not been timely reviewed.

5.3 Action Plan

Even though the Action Plan for the year under review had been prepared in terms of the Public Finance Circular No. 01/2014 of 17 February 2014, the Human Resources Development Plan, Plan for Repayment of Loans and the Internal Audit Plan had not been included therein.

5.4 Internal Audit

Even though there was an Internal Auditor in the Establishment, his supporting staff had not been appointed and as such, an adequate audit had not been carried out in the Establishment. Neither an internal audit query nor a report had been furnished to audit during the year under review.

5.5 Unresolved Audit Paragraphs

Unresolved audit paragraphs are given below.

Reference to the Audit Report	Paragraph
(a) Paragraph 4.2-2011	Misplacement of electric motors of 12 “Container Machines” valued at Rs.5,097,455.
(b) Paragraph 4.8-2011	One hundred and forty rice processing machines valued at Rs.14,501,998 imported by the Establishment in September 2006 had remained idle even by 30 August 2016.

6. Systems and Controls

Deficiencies 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.

Areas of Systems and Controls		Observations
(a)	Accounting	(i) Non-use of code numbers for the Ledger Accounts. (ii) Non-use of accurate Notes for Journal Entries. (iii) Improper attachment of Supporting Documents with vouchers.
(b)	Stock Control	Failure to conduct annual physical verification of stocks and to compute the current value of the stock.
(c)	Recovery of Rent income	Failure in taking adequate steps for the recovery of outstanding lease rent.
(d)	Staff Administration	Failure to fill vacancies.