

Co-operative Surplus Fund - 2015

The audit of financial statements of the Co-operative Surplus Fund for the year ended 31 December 2015 comprising the balance sheet as at 31 December 2015, and the income statement 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(3) of the Constitution of the Democratic Socialist Republic of Sri Lanka. My comments and observations which I consider should be published with the Annual Report of the Fund 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 Public Sector 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 Fund'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 Fund'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.

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 Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2:2 of this report.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effect of the matters described in paragraph 2:2 of this report the financial statements give a true and fair view of the financial position of the Co-operative Surplus Fund of the Department of Co-operative Development as at 31 December 2015 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

2.2 Comments on Financial Statements.

2.2.1 Sri Lanka Public Sector Accounting Standards

The following observations are made.

(a.) **Sri Lanka Public Sector Accounting Standard 01**

The statement of changes in equity had not been presented along with the financial statements.

(b.) **Sri Lanka Public Sector Accounting Standard 07**

It had not been revealed as to whether the computers and printers costing Rs. 1,840,569 shown under Property, Plant and Equipment with the net value of zero, had been classified for disposal.

2.2.2 Accounting Deficiencies

The following observations are made.

- (a.) Computer software costing Rs. 189,001 that had remained disused by the end of the year under review, had been shown under intangible assets in the balance sheet.
- (b.) Allocations for doubtful debts amounting to Rs. 507,671,763 in respect of Co-operative Societies had been understated by a sum of Rs. 1,349,763 as at 31 December, 2015.
- (c.) When cancelling the fixed deposit produced as the surety relating to the repayment of the loan granted to the Consumer Association of Sri Lanka, the interest amounting to Rs. 207,296 with respect to the period from 01 January, 2014 to 06 March, 2014 had been credited to the current account of the bank. Nevertheless, the said value had been shown in balance sheet as at 31 December, 2015 as a balance further receivable.

2.2.3 Unexplained Differences

The following observations are made.

- (a.) A difference of Rs. 86,662,204 was observed when the loan balance of the Co-operative Societies shown under sundry debtors, had been compared with the ledger and the schedule.
- (b.) A sum of Rs. 10,353,918 had been shown as adjustment of cumulative funds under operating activities of the cash flow statement. Nevertheless, how it was adjusted to the cash flow statement, was not explained.
- (c.) According to Note 05 of the balance sheet, and the Schedule 01 as at 31 December, 2015, a difference of Rs. 164,157 was observed in the cost of fixed assets.

2.2.4 Suspense Account

Action had not been taken to settle the balance of the Suspense Account amounting to Rs. 6,041 continued over a period of more than 10 years.

2.2.5 Lack of Evidence for Audit

Evidence shown against the following items of account had not been furnished to audit.

<u>Item of Account</u>	<u>Value</u> Rs.	<u>Evidence not Made Available</u>
Loans and interest of the Co-operative Societies	573,120,858	} Confirmation of balances
Sum receivable from the Co-operative Fund	5,029,486	
General Deposit Account	2,645,004	General Deposit Ledger
Loans on the surety of fixed deposits	99,049,481	Loan files and Confirmation of balances
Dishonoured cheques	768,971	Register of dishonoured cheques / Bank statements
Winding up account	2,620,473	A copy of the Winding Up Account prepared.
Treasury Fund payable	150,000	} Confirmation of balances, and detailed Schedules
National Trust Fund payable	<u>3,871,256</u>	
	<u>687,255,529</u>	

2.3 Accounts Receivable and Payable

The following observations are made.

- (a.) Interest on loans amounting to Rs. 81,871,370 recoverable from the Treasury, and a sum of Rs. 6,017,550 payable to the Surplus Fund, had remained unsettled for a period of 04 years, whilst balances of 05 liability accounts payable totalling Rs. 1,020,235 had remained unsettled for a period of more than 05 years.
- (b.) Of the loan amounting to Rs. 143,919,037 granted to the Sri Lanka Consumer Cooperative Societies Federation Ltd during the period 1992 – 2014, a sum of Rs. 119,027,924 remained recoverable as at 31 December, 2015. Furthermore, of the loan totalling Rs. 12,000,000 granted by the Fund to the said Federation in the years 2010, and 2011 for the establishment of 04 Co-op City Super Markets, loan installments amounting to Rs. 3,786,400, along with interest thereon amounting to Rs. 1,517,520 had not been recovered as at 31 December, 2015.
- (c.) The loan amounting to Rs. 19,550,000 granted to the Sri Lanka Co-operative Sales Association in the year 2006, and the loan amounting to Rs. 3,600,000 granted to the Rubber Co-operative Society Ltd that had been taken over by the Sri Lanka Co-operative Sales Association, had not been recovered up to 31 December, 2015.
- (d.) A loan amounting to Rs. 100,000,000 had been granted on 26 September, 2012 to the Kurunegala Co-operative Hospital Society Ltd for construction of a new building complex. In terms of the loan agreement, the loan should have been repaid by 26 September, 2015. However, only a sum of Rs. 1,000,000 had been received even up to 31 December, 2016 as loan installments and interest.
- (e.) An interest free loan amounting to Rs. 4,000,000 had been granted to the Nikaweratiya Development Co-operative Society Ltd on 17 January, 2014 for the construction of a building. Despite being agreed in terms of the loan agreement, that the loan would be fully repaid either from the income received after completion of the contract within a period of 03 months, or the funds collected by the Co-operative Society, whichever occurs first, a loan balance of more than Rs. 2,300,000 had remained further recoverable as at 31 December, 2016.
- (f.) A loan amounting to Rs. 50,000,000 had been granted for constructing the hospital of the Galle Co-operative Hospital Society on 03 April, 2013. The loan should have been repaid before a period of one year as per the loan agreement. However, no loan installment whatsoever had been recovered up to 31 December 2015. The monthly reports relating to the construction of the building had not been received as well in terms of the agreement whilst no follow up action had been taken.

- (g.) Of the loan amounting to Rs. 10,000,000 granted on 05 April, 2013 for renovating a fuel station belonging to the Kebeigane Co-operative Society, loan installments totalling Rs. 4,374,999 should have been recovered relating to the period from April, 2014 to December, 2015 in terms of the loan agreement. Nevertheless, only a sum of Rs. 1,104,510 had been recovered. As such, despite the loan installments in arrears totalling Rs. 3,270,489, another loan amounting to Rs. 7,000,000 had been granted on 10 October, 2014 for the same purpose. That loan should have been recovered in monthly installments amounting to Rs. 150,000. However, only a sum of Rs. 368,170 had been recovered up to 31 December, 2015.
- (h.) A loan amounting to Rs. 19,500,000 had been granted to the Nikaweratiya Development Co-operative Society Ltd on 31 January, 2013 for purchasing a Motor Grader machine. In terms of the loan agreement, the total of the installments that had remained recoverable as at 31 December, 2015, amounted to Rs. 6,175,000, but only a sum of Rs. 1,300,000 had been recovered as at that date. In terms of the loan agreement, a report should have been submitted to the Department of Co-operative Development once per 03 months in respect of the daily profits expected from the purchase of the machine, and the activities relating to the maintenance, but no such report had been received according to the file.
- (i.) An agreement had not been entered into in respect of the loan amounting to Rs. 25,000,000 granted on 10 November, 2014 for construction and renovation of the auditorium of the Department of Co-operative Development. The loan remained recoverable in full.
- (j.) Of the loans granted during the period 1990 – 2009 to 12 Co-operative Societies identified as being idle by the Department of Co-operative Development, a loan balance totalling Rs. 22,354,358 had remained unrecovered as at 31 December, 2015, and the interest receivable thereon totalled Rs. 8,728,473.
- (k.) Of the loan amounting to Rs. 45,500,000 granted to the Co-operative Development Fund in the year 2011, a loan balance of Rs. 40,000,000 had remained recoverable even as at 31 December, 2015.
- (l.) Action had not been taken even after 09 years to settle the assets and 05 balances of liabilities totalling Rs. 15,880,475 transferred to the Co-operative Surplus Fund after winding up of the Treasury Fund Account in the year 2006.

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

The performance report for the year under review along with a statement showing the variations of the Cumulative Fund, had not been furnished to the Auditor General with a copy to the Director General of Public Finance within a period of 02 months after the closure of the year of accounts in terms of Section 4:3 of the Public Finance Circular, No. PF/423, dated 22 December, 2006.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the operating activities of the Fund for the year under review was a surplus of Rs. 89,477,486 as compared with the corresponding surplus of Rs. 40,735,573 for the preceding year, thus an improvement of Rs. 48,741,913 was observed in the financial results of the year under review as compared with the preceding year. The increase in the income from the loan interest of the Co-operative Societies by a sum of Rs. 16,716,069, and the decrease in the payment of assistance, depreciations, other expenses, and doubtful loans by a sum of Rs. 14,911,506 had mainly attributed to that improvement.

4. Operating Review

4.1 Performance

In terms of Section 44 of the rules for Co-operative Societies published through the Gazette Notification, No. 93/5, dated 10 January, 1974, the Surplus Fund should be used by the Financial Registrar on the following activities.

- (a.) To purchase shares of any registered primary Co-operative Society, or otherwise as directed by the Registrar, or to render assistance to such a Society.
- (b.) To render assistance to a Co-operative Society registered in the district with a surplus, to purchase a fixed asset.
- (c.) To render assistance to the liquidator for relief against cases instituted against him.
- (d.) To render assistance to another institution established to provide assistance for the registered Societies established in terms of Sections 3(1) (c), and (d) of the Co-operative Societies Act.

According to the rules, loans from the Co-operative Surplus Fund can be granted only to the Co-operative Societies. Contrary to that, the Building Materials Corporation had been granted a loan amounting to Rs. 75,000,000 in the year 2013 under the condition of repaying in 08 installments at the interest rate of 16 per cent. This loan had been granted irrespective of the financial feasibility of repayment, and by 31 December, 2015, a sum of Rs. 52,249,999 had remained recoverable.

4.2 Management Activities

The following observations are made.

- (a.) The retention tax amounting to Rs. 848,851 levied by the bank on the interest income earned at the maturity of fixed deposits relating to the period 2011 – 2015, had been shown in the financial statements as retention tax on fixed deposits receivable under the sundry debtors. In the year 2016, a sum of Rs. 452,004 therefrom had been repaid by the bank. Attention of the management had not been brought on the recovery of the sum of Rs. 396,847 that had remained further recoverable from the bank.
- (b.) A sum of Rs. 771,817,006 had been granted as loans to the Co-operative Societies up to 31 December, 2015, but due to poor follow-up action of the Department in that connection, a sum of Rs. 594,333,967 had remained recoverable as at 31 December, 2015 representing 77 per cent of the loan granted. The interest receivable on this loan amounted to Rs. 168,087,855.
- (c.) A loan totalling Rs. 1,500,000 had been granted to the Central Provincial Multipurpose Co-operative Society Ltd in 2 instances in the year 1991, and no sum whatsoever had been recovered therefrom up to 31 December, 2016. Furthermore, the said Society had been revealed to be idle, but only a sum of Rs. 150,000 had been shown in the account as the loan balance receivable.
- (d.) According to the financial statements for the year 2015, the loan balance that remained recoverable from the Udalalatha Multipurpose Co-operative Society Ltd, amounted to Rs. 2,470,000. As it was revealed that the said Society had already been closed down, the recovery of that loan remained doubtful.
- (e.) It was revealed that the Multipurpose Co-operative Societies in Nochchiyagama and Horowpathana, had been closed down. As such, the recovery of loan balances amounting to Rs. 241,666, and Rs. 1,000,000 receivable as at 31 December, 2015 in respect of the loans granted to those Societies respectively, had remained doubtful.
- (f.) The registration of the Association of Co-operative Societies of the Poultry Farmers of Sri Lanka Ltd had been cancelled in the year 2003, and despite a lapse of 12 years since a liquidator had been appointed for liquidation, the liquidation had not been completed. Action had not been taken to recover the sum of Rs. 100,000 recoverable as at 31 December, 2015 from the loan granted to that Society from the Fund, along with the interest amounting to Rs. 172,500 receivable thereon in terms of the agreement.
- (g.) A sum of Rs. 56,901,825 paid in several instances from the year 2007 up to the current year in respect of administrative expenses, arbitrator fees, legal expenses, travel expenses, recreation, meetings, audits and the release of deposits in the year 2010, had been accounted as being receivable under the current assets in the balance sheet, instead of being accounted as expenditure of each year.

5. **Accountability and Good Governance**

5.1 **Internal Audit**

An audit programme had been prepared by the Internal Audit Unit of the Ministry in respect of the Surplus Fund and audits had been conducted. Nevertheless, internal audit reports had not been presented to the Auditor General in terms of Financial Regulation 134 (3).

6. **Systems and Controls**

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Commissioner of Co-operative Development, and the Registrar of Societies from time to time. Special attention is needed in respect of the following areas of control.

Areas of Systems and Controls	Observation
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(a.) Accounting	Failure to prepare and approve journal entries.
(b.) Control of Fixed Assets	Failure to properly maintain the Registers of Fixed Asset
(c.) Control of Loans	(i) Granting loans without examining the financial feasibility of the Co-operative Societies. (ii) Difficulties in the recovery of loans as agreements had not been entered into when granting loans. (iii) Weaknesses in the follow-up action on the loans granted.