

Co-operative Surplus Fund – 2016

The audit of financial statements of the Co-operative Surplus Fund for the year ended 31 December 2016 comprising the balance sheet as at 31 December 2016, and the income expenditure 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 as at 31 December 2016 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**

Net Assets / 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 disclosed in financial statements 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 up to the year under review, had been shown under intangible assets in the balance sheet.

(b) When cancelling the fixed deposit produced as the surety relating to 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, 2016 as a balance further receivable.

2.2.3 Unexplained Differences

The following observations are made.

(a) A difference of Rs.86,618,052 was observed when reconciling the ledger and the schedule of the Co-operative Societies loan balance shown under sundry debtors by the end of the year under review.

- (b.) A difference of Rs.163,663 was observed in the value of property plant and equipment of the balance sheet and the schedule balance as at 31 December 2016.
- (c.) A difference of Rs.131,104 was observed on the investment of treasury bills of the balance sheet and the schedule as at 31 December 2016.
- (d.) A sum of Rs.6,257,342 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.

2.2.4 Suspense Account

There was a credit balance of Rs.9,475,735 in the suspense account since 1997 by the end of the year under review.

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>
(i) Loans given to the Co-operative Societies and interest	579,288,575	} Confirmations of balances
(ii) Sum receivable from the Co-operative Fund	5,029,486	
(iii) General Deposit Account	7,444,158	General Deposit Ledger and detailed Schedule
(iv) Loans on the surety of fixed deposits	58,918,112	Loan files and Confirmation of balances
(v) Winding up account	2,620,473	A copy of the Winding Up Account
(vi) Treasury Fund payable	150,000	} Confirmation of balances, and detailed Schedules
(vii) National Trust Fund payable	3,871,256	

2.3 Accounts Receivable and Payable

The following observations are made.

- (a.) Interest on loans amounting to Rs. 81,871,370 payable by Deputy Secretary Treasury, and a sum of Rs. 6,017,550 payable to the Surplus Fund, had remained unsettled for a period of 04 years, whilst an amount totalling Rs.1,020,235 of five liability accounts had remained unsettled for a period of more than 05 years.

- (b.) Of the loan amounting to Rs.157,221,330 granted to the Sri Lanka Consumer Co-operative Societies Federation Ltd during the period 1992 – 2014, a sum of Rs. 130,398,674 of loan balance and interest thereon Rs.51,898,908 had remained further recoverable. From that, a loan amounting Rs.107,721,330 given by 5 instances, no loan installment whatsoever had been recovered.
- (c.) Of the loan granted totalling Rs.284,119,496 to the 9 Co-operative societies during the period of 1992 to 2014, no sum whatsoever had been recovered there from up to 31 December 2016 and the interest receivable thereon was Rs.41,383,507.
- (d.) Of the loan amounting to Rs. 18,249,750 had been granted to the Sri Lanka Milk Producers' Co-operative Society Limited for construction of a super milk shop in the land belonging to the Co-operative Wholesale Establishment in the year 2007, Rs. 16,549,750 had remained recoverable by the end of the year under review, but it was revealed that the said society had already been idle, the recovery of that loan remained doubtful.
- (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 contract. 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. 1,000,000 had remained further recoverable as at 31 December, 2016.
- (f.) 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, and amount totalling Rs.2,613,932 of interest had not been recovered up to 31 December 2016. Another loan amounting to Rs. 7,000,000 had been granted on 10 October, 2014 for the same purpose by recovering in monthly installments amounting to Rs. 150,000 from December 2014 onwards. Therefore, a sum of Rs. 3,600,000 should have been recovered as at 31 December,2016, only a sum of Rs. 1,104,510 had been recovered.
- (g.) Of the loans granted during the period 1990 – 2009 to 12 Co-operative Societies identified as being idle at the present by the Department of Co-operative Development, a loan balance totalling Rs. 22,354,358 and the interest totalling Rs.8,728,473 had remained recoverable.
- (h.) 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 respectively receivable as at 31 December, 2016 in respect of the loans granted to those two Societies respectively, had remained doubtful.
- (i.) A loan amounting to Rs.14,408,121 had been granted to the Milk Producers' Co-operative Society Ltd which was idle by the year under review, had been brought forward under the other debtors of the financial statements from the year 2008 to the year under review. The Commissioner of Co-operative Development and Registrar had been mentioned an answers for the draft audit report of the year 2015 that this

loan had been granted under the programme of free milk shops for schools and this loan may not be recovered and an agreement had not been made as it was a grant.

- (j.) There was a balance of Rs.1,716,566 of dishonoured cheques had been brought forward since 1999.

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

The Following non compliance were observed.

Reference of Laws, Rules and Regulations etc.	Non Compliance
(a) Financial Regulation of the Democratic Socialist Republic of Sri Lanka Financial Regulation 188(2)	Action had not been taken in terms of the financial Regulation in respect of 02 cheques totalling Rs.106,093 deposited and remaining unrealized relating to the 2003 and 2014.
(b) Public Finance Circular No.PF/423 dated 22 December 2006	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.

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. 103,997,327 as compared with the corresponding surplus of Rs. 89,477,486 for the preceding year, thus an improvement of Rs. 14,519,841 was observed in the financial results of the year under review as compared with the preceding year. Even though the income of interest on Co-operative Societies had been decreased by Rs.6,534,263, the increment of interest on fixed deposits and interest on treasury bills by Rs.17,931,767 and Rs.4,005,058 respectively, had mainly attributed to above improvement.

An analysis of the financial result of the year under review and the four preceding years revealed, surplus of the year 2013 had been decreased compare with the year 2012 while, the financial surplus from the year 2013 to the year 2016 had been increased continuously. Taking into consideration the depreciation for non – current assets, the contribution of Rs.90,258,873 of the year 2012 had been increased to Rs.104,574,614 by the year 2016.

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 money of Surplus Fund should be used for 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 fixed assets.
- (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.

Any grants had not been given to Co-operative Societies in the year under review for the fulfill of the above activities.

4.2 Management Activities

The following observations are made.

- (a.) A sum of Rs. 773,117,004 had been granted as loans to the hundred and six Co-operative Societies but, due to poor follow-up action of the Department in that connection, a sum of Rs. 593,542,978 had remained recoverable as at 31 December, 2016 representing 77 per cent of the loan granted and the amount totalling Rs. 175,002,229 of interest to be recovered.
- (b.) The confirmation of accuracy of a balance of Rs. 56,901,825 paid for liquidating activities of Human Resources Co-operative Society in several instances from the year 2007 to the year 2015 in respect of administrative expenses, arbitrator fees, legal expenses, travel expenses, entertainment, meetings, audit activities and the release of deposits had not been taken from Human Resources Co-operative Society. A sum of Rs.1,244,081 paid for liquidating activities of the said society in the year under review, had been accounted as expenditure of the year under review, instead of being accounted as receivable from the relevant society.
- (c.) There was balance exceeding Rs.3 million in bank current account in each month of the year under review, while action had not been taken to identify excess money and deposit as interest earned.

4.3 Transactions of Contentious Nature

In terms of section 44(iii) of the rules for Co-operative Act No.5 of 1972, 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 06 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, 2016, a sum of Rs. 62,091,327 of loan and a sum of Rs. 15,893,123 of interest had remained recoverable.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

The financial statements of the 2016 should be furnished before 28 February 2017, in terms of section 4.3 of the Public Finance Circular No.PF/423, dated 22 December 2006. However, the financial statements of the Co-operative Surplus Fund had been furnished on 28 August 2017.

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

- (a.) Accounting
- (b.) Fixed Assets
- (c.) Control of Loans

Observation

- Failure to prepare and approve journal entries.
- Failure to properly maintain the Registers of Fixed Asset
- (i) Failure to examine the financial feasibility of the Co-operative Societies.
 - (ii) Agreements had not been entered into when granting loans, failure in proper follow-up action on the loans granted and weakness in the recovery of loans.