

Sri Lanka Handicrafts Board – 2017

The audit of financial statements of the Sri Lanka Handicrafts Board for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of comprehensive income, 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 the Section 13(1) of the Finance Act, No.38 of 1971 and Section 64(3) of the National Crafts Council and allied Institution Act No,35 of 1982. My comments and observations which I consider should be published with the Annual Report of the Board in terms of Section 14(2)(c) of the Finance Act appear in this report. A detailed report in terms of Section 13(7)(a) of the Finance Act was furnished to the Chairman of the Board on 12 October 2018.

1.2 Management's Responsibility for the Financial Statements

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 judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Board'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 Board'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 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 position of the Sri Lanka Handicraft Board as at 31 December 2017 and its financial performance and its cash flows for the year then ended do not give a true and fair view of the affairs of the Board in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standard - 16

The following observations are made.

- (a) Even though, the total value of plant and machinery existed in the Katubedda and Keselwatta Projects belonged to the Board had been assessed at Rs.14,639,740 and brought to accounts during the year 2016, action had not been taken to depreciate such assets from the date of revaluation up to the year under review in terms of accounting standard 16.
- (b) Even though, Property, Plant and Equipment should be disclosed in the financial statements by a separate note in terms of paragraph 73(f) of the standard such disclosures had not been made in respect of fixed assets totalling Rs.63,037,977, in the project Division at Katubedda of the Board.

2.2.2 Accounting Deficiencies

The following observations are made.

- (a) Instead of debiting the audit fees of Rs.924,194 paid during the year under review in respect of the previous year to the audit fees payable account, it had been posted as an expenditure of the year under review. Similarly, a sum of Rs.863,669 irrelevant to the audit fees had been posted as audit fees and the audit fees payable by a journal entry and as a result, audit fees of the year under review and the audit fees payable accounts had been overstated by Rs.1,787,863. A provision for audit fees for the year under review had also not been made.

- (b) (i) Rent income of Rs.800,029 received for the year 2016 from the building rented out to a private company on rent basis and a sum of Rs.133,890 recovered as its electricity charges had been brought to accounts as rent income of the year under review and as such, the year's rent income had been over accounted by Rs.933,919.
- (b) (ii) As the relevant company had not included the Value Added Tax (VAT) when paying rent for the year under review, the Board had provided a sum of Rs.1,385,905 as VAT on that income.
- (c) As provision for economic service charges of 0.5 per cent of the total income of the Board had not been made for the year under review, the economic service charges payable had been under accounted by Rs.3,108,214.
- (d) An advance of Rs.1,000,000 paid in December 2017 for the purchase of 4,000 T-shirts from a private company by the Board had been debited to the creditors account, instead of being debited to the advance account and as such the creditors account and the advance account had been understated by that amount in the financial statements as at 31 December 2017.
- (e) According to the rent agreement of the Katunayaka Showroom, the total rent payable by the Board for the year 2017 amounted to Rs.25,146,620 but according to the financial statements it was stated as Rs.28,160,340, thus overstating the rent expenditure by Rs.3,013,720. Even though a concession fee on the basis of sales of the showroom, should have been paid monthly in terms of the rent agreement, such fee payable relevant to the month of December 2017 had not been identified and accounted.
- (f) According to the stock verification reports of the Board, the value of stock as at the end of the year under review at weighted average cost method amounted to Rs.435,641,415, but it had been stated at Rs.457,642,667 in the statement of financial position and as such the value of closing stock was overstated by Rs.22,001,252.
- (g) Even though a balance of Rs.1,010,827 had existed in a saving account as at 31 December 2017 it had not been disclosed by the Financial Statements.
- (h) Instead of being adjusted and corrected the stock shortages and excesses to the stock account, a sum of Rs.85,854,835 had been adjusted through the suspense account.

2.2.3 Lack of Evidence for Audit

As evidence stated against the following items of accounts was not made available for audit, they could not be satisfactorily vouched or accepted in audit.

Item	Value	Evidence not made available for audit
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	Rs.	
(a) Cash Book	37,818,555	25 related journal entries
(b) Cash in hand in 13 showrooms	4,673,263	Confirmation letters of cash in hand balances from showroom managers and evidence to substantiate in banking the money on the following day.
(c) Credit card Account and Sales Account	337,822,018	Approval for the journal entry and information to establish the correctness.
(d) Non-Trade Advances	5,120,760	schedule and Written evidence to check the balance.
(e) Plant, Machinery and Equipment at Katubedda Project	10,645,350	Physical verification reports
(f) Light Engineering Training equipment at Panadura Keselwatta	3,988,500	Physical verification reports.
(g) Benevolent Fund – Current Account	2,500,000	Bank reconciliation statements and bank statements of the year 2017.
(h) Ministry of Rural Industries (Creditors)	6,571,317	Creditor's file and letters of confirmation
(i) Deposit Receivable	17,834,050	Letters of confirmation.
(j) Rent Receivable	1,133,557	Schedules, letters of confirmation evidence and detailed files.
(k) Retention money- Katubedda)	12,002,564	Sufficient written evidence to establish the balance.
(l) Trade Creditors	30,695,360	Creditors schedules and creditors files.
(m) Stock in Trade (in 13 stores)	28,649,747	Stock verification reports to ensure the existence of stock physically.

- (n) Damaged Stock 19,851,107 Physical verification reports.

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) Of the total trade debtor balances as at the end of the year under review amounting to Rs.45,383,909, total balances less than 01 year, '01' to 3 years and above amounted to Rs.33,046,747, Rs.3,545,631 and Rs.8,791,531 respectively. Action had not been taken to recover those outstanding debts.
- (b) Of the total trade and other creditors amounting to Rs.376,117,747 as at the end of the year under review, balances totalling Rs.186,583,251, Rs.73,547,495, Rs.24,329,151 and Rs.91,657,850 had remained for less than 01 year, 1 to 2 years 2 to 3 years and over 3 year respectively. Action had not been taken to pay and settle those outstanding loan balances.

2.4 Non-compliance with laws, rules, regulations and management decisions

Non-compliances with Laws, Rules, Regulations and management decisions observed in audit are as follows.

Reference to Laws, Rules, Regulations etc.

Non-compliance

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| (a) Section 21(1) of Chapter III of the Value Added Tax Act No.14 of 2002. | VAT returns on rent income of the year 2017 had not been sent to the Department of Inland Revenue. |
| (b) Financial Regulations of the Democratic Socialist Republic of Sri Lanka. | |
| (i) Financial Regulations 231(i) and 237(b) | In making payments to suppliers by using 37 paid vouchers totalling Rs.3,207,503, invoices and goods received notes (GRN) had not been presented along with vouchers. |

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| (ii) Financial Regulations 257 and 264 | Payments totalling Rs.56,579,468 by using 312 paid vouchers had been made during the year under review without being certified individual vouchers and without a formal receipt. In making payment of Rs.23,692,235 by using 131 paid vouchers, orders for goods and goods received notes had not been presented along with vouchers. |
| (c) Public Enterprises Circular No.PED/12 of 02 June 2003 Section 4.2.6 | Even though the performance report should be reviewed by the Board of Directors and it should be submitted to the Department of Public Enterprises and the Treasury before 30 days after the end of a quarter it had not been complied with. |

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Board for the year under review had resulted in a net profit of Rs.24,862,164 as compared with the net profit of Rs.3,917,020 for the preceding year, thus indicating an improvement of Rs.20,945,144 in the financial results of the year under review as compared with the financial result of the preceding year. Even though, the revenue had decreased by Rs.29,684,492 as compared with the preceding year, increase of Treasury grants for recurrent expenditure by Rs.25,000,000 and decrease of establishments and administrative expenses by Rs.24,063,991 had mainly attributed to this improvement.

In the analysis of financial results of the year under review and the preceding 4 years, net profits had generated from the year 2013 to 2014 and a net loss had sustained in the year 2015 but it had again become a net profit in the years 2016 and 2017. However, employees remuneration and depreciation on non-current assets had been adjusted to the financial results, the contribution of Rs.112,348,260 of the Board in the year 2013 had gradually increased annually up to Rs.162,199,937 in the year under review.

3.2 Analytical Financial Review

The current assets ratio of the Board for 4 years from 2014 to 2017 had indicated 1.41, 1.03, 0.96 and 0.89 respectively. The increasing percentage of current liabilities had been more than that of the increasing percentage of current assets had mainly attributed to decrease the current ratio. The quick assets ratio from 2014 to 2017 had been 0.36, 0.24, 0.23 and 0.24 respectively and current assets depicted a very large percentage of closing stock had caused to decline the quick assets ratio and it was observed that the short term liquidity position of the Board had been at a low level.

4. Operating Review

4.1 Performance

4.1.1 Planning

The following observations are made.

- (a) In terms of Public Finance Circular No.01/2014 of 17 February 2014, a corporate plan should be prepared at least for a period of 3 years, enabling to manage business activities with a short term and long term vision. However, the Board had prepared a corporate plan for a period of 01 year of 2017 and it had been approved on 08 December 2017.

- (b) According to the Section 5(2) of the Public Finance Circular No.01/2014 of 17 February 2014, the action plan should be prepared based on the Corporate Plan but the plan for the year 2017 had not been prepared based on the Corporate Plan. Provision for each objective and targets had not been included in the human resources development plan shown in the action plan prepared.

4.1.2 Operations and Review

In terms of Section 45 of the National Crafts Council and Allied Institutions Act No.35 of 1982, the following observations are made in the achievement of powers and functions of the Board.

- (a) Even though the local sales of handicrafts items in the year 2016 amounted to Rs.773,477,578, sale of those goods in the year under review amounted to Rs.721,155,156. Accordingly, it had dropped by Rs.52,322,422.

- (b) It was planned to reach a targeted sale of Rs.45,000,000 under special orders during the year under review but the actual sales amounted to Rs.26,419,508. As such, only 58.7 per cent of the target sales could be achieved.

- (c) A decreasing tendency was observed in purchasing manufactured goods from Local Handicrafts manufactures after 2013. The value of such purchases amounting to Rs.354,146,791 in the year 2016 had dropped up to Rs.341,162,863 in the year 2017 by Rs.12,983,928.

- (d) According to the action plan, it was planned to repair and open Nuwaraeliya and Matala showrooms, opening new 3 showrooms in Mirissa, Pasikuda and Jaffna areas, open 2 regional purchasing centres in the Northern and Eastern Provinces and to open 2 shops in 2 foreign countries for sales promotions. Nevertheless, such activities had not been fulfilled due to existing financial difficulties of the Board.

4.2 Management Activities

The following observations are made.

- (a) Due to non -payment within the specific periods, Value Added Tax amounting to Rs.3,786,954, Nation Building Tax amounting to Rs.24,834,476 and Economic Service charges amounting to Rs.19,646,612 had to be paid by the end of the year under review.
- (b) As the previous management of the Board had not maintained a proper financial management system, long terms loan of Rs.364,484,163 obtained from the Treasury and 2 state banks had to be repaid in the year under review. In addition, a short terms loan of Rs.175,449,133 had also been obtained during the year under review. Similarly, a sum of Rs.68,609,778 as the interest of these loans and a sum of Rs.1,430,334 as interest on overdrafts obtained in addition to that, had to be paid during the year under review.
- (c) The total rates payable to the Colombo Municipal Council as at 31 December 2017 in respect of the showromm at Thunmulla and Laksala Building at Colombo Fort amounting to Rs.3,381,840 and Rs.9,485,849 respectively. Even though, it was informed that those arrears of rates should be paid and if not paid, action would be taken to recover same in terms of the Municipal Council Ordinance, the management had not complied therewith.
- (d) Five inactive bank current accounts of the Board as at 31 December 2017 had existed. Of these, a total favourable balances of Rs.228,369 in 3 accounts an overdraft balance of Rs.986,112 in one account and a nil balance of another bank account had existed as at 31 December 2017. The management had not taken to close down those inactive bank current accounts.
- (e) A contract had been awarded to a private entity in the year 2014 for the modernization of Colombo Fort Laksala Building without being complied with the procurement procedure. According to a report issued by the Construction Industries Development Authority to the Board relating to this construction, it was stated that an overpayments totalling Rs.30,069,309 had been made to the contractor by the Board. Even though the Attorney General's Department had issued a letter of Demand on 02 June 2017 to recover this overpayment, payment of this money had been rejected by the contractor. This matter had been referred to the Attorney General's Department by now for taking future action.
- (f) Despite, the buildings at Katubedda carpentry project Division were being idle, buildings had been obtained on rent basis from another entity during the year under review to operate the Accounts Division and some other divisions of the Board. A sum of Rs.9,000,000 had been paid as building rent during the year under review therefore.

4.3 Operating Activities

The balance Textile and textile related products valued at Rs.789,574 unsold at the Trade fair held in the Thummula showroom premises and the balance of T-shirts and other textile materials totalling Rs.303,500 unsold and sent to the Katubedda store had been stored in the Katubedda Store.

4.4 Transactions of contentious nature

According to the decision of the Cabinet of Ministers of 14 November 2012, the land and building, 01 acre and 30.6 perches in extent where Galle Unawatuna Salusala Branch was located approval was granted to transfer legally to the Handicrafts Board. The Board had paid a sum of Rs.15,248,575 as the purchase consideration therefor to the Public Resources Management Corporation Ltd. on 12 December 2012. The purpose of acquisition of this land had not been finalised even by August 2018, the date of audit on legal grounds. This paid amount had been erroneously debited to the Fort Laksala Land Account by the Board.

4.5 Idle and Under -utilized Assets

The following observations are made.

- (a) As the training activities of carpentors had been stopped since the year 2011, the land, 2 acres and 21 perches in extent located at No.282 Galle Road, Katubedda, Carpentry Training shop, 11,200 square feet in extent which could be trained 80 students at a time, and equipment fixed thereto, teaching equipment, timber store with 2090 square feet and 2 storied hostel with 4680 square feet in extent, consisting of 40 double beds had remained as idle assets for periods more than 6 years.
- (b) Light Engineering equipment, the total value of which amounted to Rs.3,988,500, two storied building where 30 students could be trained at a time, old building and a land, 01 rood and 2 perches in extent belonged to the Panadura Keselwatta Light Engineering Training Institute had become idle as it had not been used for light Engineering Training for more than 8 years since 2010. A total sum of Rs.1,045,969 had to be paid as a security charge to protect those properties.

4.6 Court cases filed against the Board

As the payment for contracts undertaken by the previous management during the periods 2010 to 2014 and other payment had not been made appropriately, a total sum of Rs.672,342 had been paid as legal and lawyers' fees during the year under review for court cases filed against the Board.

4.7 Personnel Administration

The following observations are made.

- (a) In terms of cadre approval Letter No.DMS/G3/60/2 dated 21 December 2012 of the Department of Management Services, the approved cadre was 194, consisting of 127 permanent staff and 67 contract basis staff. The actual permanent cadre by the end of the year 2017 was 82 out of which 47 employees had been employed in posts not approved. The actual contract basis employees were 76 and it was observed that 21 employees of them had been engaged in posts not approved by the end of the year under review.
- (b) Showroom Managers for 7 showrooms out of 12, operated by the Board Island wise during the year under review had not been recruited on permanent basis and all responsibilities of those showrooms had been entrusted to the officers recruited on contract basis.

5. Sustainable Development

5.1 Attainment of Sustainable Development Goals and targets

Every Public, entity should act in accordance with the 2030 Agenda of the United Nations on Sustainable Development. The Sri Lanka Handicrafts Board was aware about how to perform its functions in respect of activities coming under the scope of the Board. The following matters were observed in that regard.

- (a) Provision made for the purchase of arts creations of the rural traditional Handicrafts creators and the actual expenditure incurred had dropped in the year 2017 as compared with that of the year 2016. As such, the expected purchases of the products made by local Artists had dropped under the achievement of Sustainable Development Goals and Targets.
- (b) According to the expected sustainable development targets, action should have been taken to increase the registered suppliers and active suppliers from whom purchase of goods were made by all divisions. However, a decrease of number of suppliers from whom goods were purchased during the year under review, was observed.

6. Accountability and Good Governance

6.1 Presentation of Financial Statements

In terms of paragraph 6.5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the financial statements should be presented to the Auditor General within 60 days after the closure of financial year but the financial statements for the year under review had been presented to audit only on 02 August 2018.

6.2 Procurement and Contract Process

6.2.1 Procurements

A contract had been awarded to a private entity for the supply and installation of Light Boards and Light Boxes inside and outside of the Thummulla showroom in the year 2016 for a sum of Rs.2,332,074. An agreement in terms of guideline 8.9.1(a) of the procurement guidelines had not been entered into with the contractor and action had not been taken to obtain a bid bond as well in terms of guideline 5.3.11.

6.3 Budgetary Control

The following observations are made.

- (a) Excesses totalling Rs.40,959,557 in 10 expenditure objects ranging from 31 per cent to 469 per cent between the budgeted expenditure and the actual expenditure in the year under review had existed.
- (b) Even though, the Board had incurred a sum of Rs.2,227,093 relating to 2 capital expenditure objects during the year under review, provisions therefor had not been made in the budget.
- (c) In comparing the estimated sales income of the year under review, with the actual sales income, diminution of actual sales income of 6 sales outlets had ranged from Rs.4,967,251 to Rs.10,464,526 or 19 per cent to 43 per cent.

6.4 Tabling the annual reports

In terms of paragraph 6.5.3 of the Public Enterprises Circular No.PED/12 of 02 June 2003, Annual reports with audited accounts should have been tabled in Parliament in tri Lingual within 150 days after the closure of financial year but action had not been taken to table the annual reports for the year 2015 and 2016 in Parliament.

7. Systems and Controls

Weaknesses in systems and controls observed in audit were brought to the attention of the Chairman of the Board from time to time. Special attention is needed in respect of the following areas of control.

Areas of systems an control

Observations

(a) Accounting

(i) Passing journal entries without proper control and approval and existence of journal entries without numbers.

- (ii) The trial balance and the financial statements not prepared through the computerized Accounting System and as a result of special ability to account transactions to the computerised accounting system back dating those transactions at present, there would be a risk of pre auditing account balances.
- (iii) Cash book not maintained in written form, non-posting corresponding ledger account relating to payments to the cash book, non- posting vouchers in sequence order.

- (b) Stock Control
It had been taken about 7 months for the physical count of stock, goods in showrooms not sold but action not taken to modernize them.
- (c) Personnel Administration
Sixty per cent of the staff of the Board recruited on contract basis and action had not been taken to get the cadre approved and to recruit them on periodical requirement.
- (d) Marketing Management
Lesser attention was paid in respect of handicrafts products for which sales had dropped in the local market in the long run and foreign sales.
- (e) Advances Control
The advance register maintained by the Board had not been maintained in compliance with Financial Regulations 371 and 372.