Co-operative Wholesale Establishment - 2010

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1. Financial Statements

1.1 Opinion

In view of my comments and observations appearing in this report, I am unable to express an opinion on the financial statements of the Co-operative Wholesale Establishment for the year ended 31 December 2010 presented for audit.

1.2 Comments on Financial Statements

1.2.1 Presentation of Financial Statements

(a) The Committee on Public Enterprises had directed the Chairman of the SATHOSA on 13 October 2011 to prepare anew the financial statements for the year 2010 and submit to audit. Such financial statements prepared anew had been presented to audit on 05 January 2012.

(b) The cost of sales had not been included in the financial statements and the manner of computation of the cost of sales had not been disclosed in the financial statements by way of an adequate Note.

1.2.2 Sri Lanka Accounting Standards (SLAS)

Instances of non-compliance with the Sri Lanka Accounting Standards are given below.

(a) SLAS 03

Even though the preparation and presentation of the financial statements of the Establishment should be done in accordance with the guidelines in Sri Lanka Accounting Standard No. 3, the Income Statement and the Balance Sheet of the SATHOSA had not been prepared and presented in relation to the following.

- Non-disclosure of the cost of sales on the face of the Income Statement.
- Non-presentation of the Income Statement on the standard format.
- Subsequent adjustment of other income to the operating results.

(b) SLAS 05

Even though the policy on the recognition, accounting and disclosure of stocks had been disclosed, the evidence in support of action taken in compliance thereof had not been furnished to audit.

(c) SLAS 09 & 18

(i) The profit on the sale of fixed assets had been overstated by a sum of Rs.192,889 in the Cash Flow Statement and a numeric reconciliation which was incomplete and contrary to accounting principles had been made in the reply.

(ii) The revaluation of assets should be determined through an evaluation carried out by a professionally qualified Assessor and the basis of revaluation and the nature of indicators for the determinations of replacement lost should be disclosed in the financial statements. Contrary to such provisions, the motor vehicles had been revalued based on the evaluations made by the Manager of the Transport Division.

(d) SLAS 36

(i) Even though the test checks revealed that a sum of Rs.1,043,768 had been paid as legal expenses a sum of Rs.1,393,797 had been shown as legal expenses in the final accounts. Nevertheless, the Management had shown a sum of Rs.741,840 in the Schedules of Legal Expenses for the year 2010. As such no disclosure had been made in respect of expenses amounting to Rs.651,957.

(ii) Five cases had been filed against the Establishment demanding compensation amounting to Rs.3,895,235 for the non-payment of the [illegible] Rs.3.8 million disclosed in Note No. 18 to the financial statements in connection with this contingent liability had been shown as an estimated value of Rs.2.7 million in the reply submitted to the audit. The reasons for the difference and the basis of estimating had not been furnished to audit.

1.2.3 Overstatements and Understatements in the Accounts

Two motor cycles and a trailer valued at Rs.97,000 had been sold on 01 February 2010. But the cost of those amounting to Rs.97,000 and the depreciation provision of Rs.12,000 thereon had not been eliminated from the accounts.

1.2.4 Unreconciled Control Accounts

(a) According to the summarized schedule presented with the final accounts, the value of furniture and office equipment amounting to Rs.51,744,688 as at 31 December 2009 had been shown as Rs.51,937,589 as at 01 January 2010. Action had not been taken to reconcile the differences of Rs.8,211,421 and Rs.8,116,617 between the detailed schedule and the summarized schedule relating to the Furniture and Equipment Account and the Provision for Depreciation Account as at 31 December 2009. Even though the management had informed the audit that the adjustments were made in the year 2010, the management had failed to furnish the evidence in support of the adjustments made.

(b) Differences totaling Rs.2,268,498,943 were observed between the comparative figures of 07 items of accounts for the year 2009 shown in the financial statements for the year 2010.

(c) A reconciliation of the value of account balances shown in the financial statements for the year 2010 with the value of account balances shown in the trial balance, differences totaling Rs.2,838,392,254 in 43 account balances were observed. Even though the reasons for such debtors were furnished to audit, adequate evidence in support, reconciliation statements, schedules etc, had not been furnished to audit.

(d) The Establishment had furnished the hard copy of the General Ledger for the year only on 02 February 2012 and as such it was not possible to reconcile the amounts appearing in the financial statements for the year 2010 with the closing balances in the ledger and transactions and establish the accuracy.

(e) A difference of Rs.147,358 between the total expenditure shown in the amended financial statements presented subsequently and the financial statements presented previously and differences totaling Rs.742,961,051

(b)	Section 4 of the Co-operative Wholesale Establishment Act, No.47 of 1949 as amended by Section 3 of the Amendment Act No, 38 of 1966	When the Sathosa enters into an agreement by placing its official seal, it should be signed by the Chairman and a director named by the Board of Directors. Nevertheless 02 agreements entered into for the renting out of buildings to the Lak Sathosa Company Limited had not been signed by the Chairman. Even though the management informed me by letter dated 24 July 2009, that action in terms of Section 3 of the Act No. 38 of 1966 will be taken in the future, there was no evidence that it had been so done even up to the date of this report. Even though the Chairman informed the audit that the Board of Directors had approved the transactions relating to the 02 agreements after those were signed by the Director, the supporting documents were not furnished to audit.
(c)	Public Enterprises Circular No. PED/12 of 02 June 2003 --	
	(i) Section 5.1.2	The non-formal Corporate Plan for the year 2007 to 2010 not approved by the Board of Directors presented to audit on 09 December 2009 did not include the Strategic plans for the year 2010, targets to be achieved and the responsibilities of the management in clear and specific terms.

(h) Financial Regulations of the Democratic Socialist Republic of Sri Lanka

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(i) Financial Regulation 103	The motor vehicles of the Establishment had met with accidents in 09 instances and a sum of Rs.85,085 had been spent on carrying out repairs in 05 of those instances and the management had informed the audit that the loss had been covered by insurance. Nevertheless, action in terms of Financial Regulation 103 had not been taken. As such there were difficulties in obtaining the evidence relating to loss to motor vehicles and the settlement of the loss. No evidence thereon whatsoever was made available to audit.
(ii) Financial Regulation 103(i)	Action in terms of the relevant provisions had not been taken on the losses. Out of the 12 conveyers purchased at a cost of Rs.5,097,455 the electric motors of 11 conveyers had been misplaced. Action had not been taken to determine the loss and recover from those responsible for the loss. The Chairman had informed the audit that despite conducting an investigation, the identification of the persons responsible could not be done practically as the responsible officers had left under the Voluntary Retirement Scheme.

(iii) Financial Regulation 133	An Internal Audit had not been carried out by establishing an Internal Audit Unit.
(iv) Financial Regulations 137, 138, 228 and 245(1)	(i) Two mobile telephones costing Rs.60,160 had been purchased for 02 officers contrary to the provisions and without calling for quotations.
	(ii) Even though the need for furnishing the copies of documents relating to the administration and structural changes of the Establishment to the Auditor General was pointed out to the management over a number of years, disregarding such requests action had not been taken to furnish to the Auditor General.
(v) Financial Regulation 225(4)	The officers preparing and checking vouchers had not placed their initials on them.
(vi) Financial Regulations 245(1) and 257	The Certifying Officer had not certified the vouchers
(vii) Financial Regulation 261(3)	Money adequate for payments should be available and for such purpose, the transactions in the cash book, should be totaled duly and the balance available should be ascertained. But action in terms of that provision had not been taken. The management informed that payments had made in the basis of the Bank balance.

2. Financial and Operating Review

2.1 Financial Review

2.1.1 Financial Results

(a) After taking into account the other income of the Establishment including the non-operating income for the year under review, the net profit amounted to Rs.2,300,113 as compared with the corresponding net profit of Rs.46,000,886 for the preceding year. Nevertheless, the results of the operating activities of the Establishment had been a net loss of Rs.184,325,627 as compared with the net loss of Rs.195,717,615 for the preceding year, thus indicating a decrease of Rs.11,391,988 in net loss. This position had been due to the increase of the trading profit resulting from an increase of 208 per cent in sales and the decrease of operating expenses by 3.2 per cent and the decrease of finance cost by a sum of Rs.2,840,131 in the year under review.

(b) The net sales of the year under review, as compared with the preceding year indicated an increase of Rs.125,383,394 or 208 per cent. Even though the gross profit for the year as compared with the preceding year indicated an improvement, the gross loss ratio of 1.9 per cent in the year 2009 had converted to a gross profit ratio of 1.1 per cent.

(c) The rent income indicated an improvement of 0.8 per cent and rent income of Rs.124.5 million could not be recovered.

(c) The Paddy purchases during the year 2009 had been limited due to the failure of the management to implement the activities according to plans. The paddy purchases and the sale of stocks of rice had decreased in the year 2010 as well.

(d) As a very weak and informal Action Plan had been prepared for the year 2010. the local purchases and the purchases to be made from the foreign market had not been identified. None of the expected targets of the Packing Division, the Transport Division and the Rice Processing Centres had been identified in the Action Plan.

(e) According to the financial statements, the sales income for the year 2010 disclosed an increase of 208 per cent over that of the year 2009. Nevertheless, the Action Plan presented for the year 2010 indicated decreases of the expected sales income by 86.5 per cent and 31 per cent as compared with the years 2008 and 2009 respectively. As such the Establishment had acted outside the Action Plan.

(f) According to the Action Plan, an income of Rs.168,784,500 had been expected from the purchase and sale of two trade commodities in the first three quarters of the year 2010. A gross profit of Rs.20,830,500 had been expected from those transactions. None of those targets had been achieved up to the end of December of the year 2010.

(g) All purchases of the Establishment had been made from the local suppliers in the last quarter of the year 2010 and 10 varieties of goods valued at Rs.262,219,083 had been purchased outside the Action Plan.

The management informed that an Action Plan cannot be furnished due to financial difficulties and that the operating activities connected therewith as well cannot be planned.

recovery, any confirmations in support of the recovery of money was not furnished to audit.

2.2.5 Idle and Underutilized Assets

The following observations are made.

(a) The Pannegamuwa Rice Complex with a plant valued at Rs.25,521,569, a stores complex with capacity for storage of 1,000,000 kilogrammes of paddy and a rice store with a capacity for 350,000 kilogrammes of rice had been idle and underutilized.

(b) Employees of the Establishment had been voluntarily retired due to the transfer of the retail trade to the Sathosa Retail Ltd and decrease in the wholesale trade resulting from the restructure of the Establishment. Fixed assets costing Rs.682,063,488 were observed in audit as lying idle or underutilized since the year 2004 due to such limitations of business activities. Even though the management had, by letter dated 19 March 2009, replied me that appropriate action will be taken for the disposal of the idle assets, no evidence in support of rectification was not made available while documentary evidence in support had also not been furnished.

(c) Out of the 11 companies commenced under the restructure of the Establishment, the Sathosa Retail Ltd. had terminated business activities with effect from June 2005 due to losses incurred. A judgment of the District Court, Colombo dated 23 October 2006 directed the dissolution of that Company. Further, the other 10 companies too exist only in names and as such the current assets valued at Rs.523,821,349 shown in the financial statements as receivable from those companies for the year 2009 had been written off in the accounts in the year 2010. The authority for the write off of those assets and the Journal Entries relating to the accounting had not been furnished to audit.

(d) Out of the fleet of 104 motor vehicles as at the beginning of the year 2010, fifty eight motor vehicles valued at Rs.12,685,000 had been idling. Any confirmation as to whether 03 motor vehicles out of those valued at Rs.125,000 are remaining in the establishment or sold or disposed of had not been furnished to audit.

(e) The Establishment had handed over assets valued at Rs.32,074,662 by 31 December 2007 to the Lanka Sathosa Company Ltd without a revaluation. No agreement had been reached either to obtain money or shares of the Company for such assets. In addition, records on the assets handed over in the year 2008 and 2009 had not been maintained and particulars thereon were not furnished to audit up to 05 July 2012. An incomplete register had been furnished to audit in December 2011.

(f) Two rice mills of the Establishment costing Rs.85,110,614 had been idle / underutilized in the year 2010 and as such the labour of the relevant mills had also been idle and underutilized. The management informed the audit that this situation had arisen due to the credit purchase of paddy from the Paddy Marketing Board due to financial difficulties.

2.2.6 Restructuring Transactions

The restructure of the Establishment had 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 revise that loan as Rs.4,397 million. Accordingly, Treasury Bonds had been issued to those commercial Banks for the payment of that amount in 13 years.

It had also been agreed to settle those Treasury Bonds in the year 2005 from the proceeds of the sale of assets valued at Rs.1.8 billion out of the fixed assets belonging to the Establishment, by the Public Enterprises Reform Commission. It had also been

(b) Even though the posting of entries in the Daily Running Charts and Log Books had been done in highly improper manner and not recorded on the specified dates with proper supervision, the Establishment spent Rs.3,970,099 motor vehicles running expenses including travelling expenses and combined allowances in the year under review as well.

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Even though an allocation of Rs.26,193,506 had not been made by the end of the year 2010 in terms of the Payment of Gratuity Act, no. 12 of 1983 for employees retiring or leaving the service, a fund had not been built up to meet the future commitments for the payment of gratuity.

2.2.10 Idle Expenditure

Out of the rice milling expenditure of the Pannegamuwa Rice Complex amounting to Rs.4,190,916 , a sum of Rs.3,200,000 was observed in audit as expenditure incurred on idle time. The Chairman informed the audit that this position had arisen on the bases of mill operation depending on the quantity of paddy supplied by the Paddy Marketing Board.

2.2.11 Irregular Transactions

Even though a gross profit of Rs.1,695,652 had been reflected from the sale of bakery products, according to the information received by the audit, the limits of the non-banking of the sales products not confirmed to audit ranged between Rs.236,880 to Rs.1,321,285 as shown below.

relief village had not been returned to the Sathosa even up to 05 July 2012. Action had not been taken to identify those responsible and recover the loss.

2.2.14 Supplies and Services

The Establishment had paid a sum of Rs.293,040 in the year under review to procure single phase and three phase electricity supply in an irregular manner.

2.2.15 Related Party Transactions with State Companies

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A physical inspection of the Store No. 510 carried out on 27 December 2010 revealed the existence of 197 metric tons of coriander and 42 metric tons of chick-peas belonging to the State Trading (Co-operative Wholesale) Company Ltd.

The Establishment had entered into an unproductive trading activity as a intervene Service Provider by spending a sum of Rs.12,454,923 to meet the expenditure on release of goods of the State Trading (Co-operative Wholesale) Company Ltd due to its financial difficulties and storage of goods of that company in the Sathosa stores without any apparent basis or authority instead of carrying out that as a trading transactions to the benefit of the Establishment.

2.2.16 Contribution of the Establishment to the National Economy

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Even though the management had informed the audit from time to time that the inability of the Establishment to make the contribution expected of it to the national economy had been due to the practical difficulties confronted in carrying out its activities resulting from the financial constraints of the Establishment, the following matters confirm the position that the Sathosa is capable of performing its functions surpassing the role of the Government Companies who are at present performing the functions performed by the Sathosa previously.

(a) The Sathosa has become an institution assisting Government Companies beset with financial difficulties. The expenditure incurred on the release of imported stocks by the State Trading (Co-operative Wholesale) Company Ltd can be cited as an example.

(b) Grant of a loan of Rs.10 million in the year under review to the Building Materials Corporation Ltd on a request made by the Secretary to the Ministry to grant a loan of Rs.25 million.

(c) The possibility of utilizing the underutilized equipment / assets of the Packing Division established with the target of supplying services to the Lak Sathosa Company for the purposes of the Sathosa itself.

(d) The ability of the Establishment at present to meet the daily expenses without Treasury provisions.

(e) Instead of maintaining a transport service to outside institutions including Lak Sathosa Company, reap benefits by promoting a transport service targeted to the main trading activities of the Sathosa itself.

(f) The existence of a recoverable income of Rs.861,725,558.