

Sri Lanka Handicrafts Board - 2012

1. Financial Statements -----

1.1 Disclaimer of Opinion -----

Because of the significance of the matters described in paragraph 1.2.3 of this report, I have not been able to obtain sufficient appropriate audit evidence, to provide a basis for an audit opinion. Accordingly I do not express an opinion on these financial statements.

1.2 Comments on Financial Statements -----

1.2.1 Accounting Deficiencies -----

The following accounting deficiencies were observed.

- (a) Even though the land and buildings situated on York Street, Colombo Fort belonging to the Board had been pledged as security for the Bank Loans obtained by the Board that had not been disclosed in the financial statements.
- (b) Expenditure incurred in the year under review amounting to Rs.1,754,623 had been omitted in the accounts and as such the profit for the year had been overstated by that amount.
- (c) Out of the sum of Rs.100,000,000 received for the construction of a Laksala Showroom at the Museum under a programme implemented by a Ministry, a sum of Rs.10,000,000 had been credited as a recurrent grant to the income of the year under review as such the profit for the year under review had been overstated by a sum of Rs.10,000,000.
- (d) Damaged goods that cannot be sold and goods for repairs (at cost) amounting to Rs.5,810,391 and Rs.1,065,729 respectively totalling Rs.6,876,120 had been erroneously shown as debtors and deposits and payments in advance respectively instead of being shown under the closing stocks.

- (e) A sum of Rs.1,000,000 out of the Welfare Fund invested in fixed deposits had been shown as cash and cash equivalents instead of being shown as investments.
- (f) Property, plant and equipment totalling Rs.63,031,672 of the Katubedda, Waragoda and Keselwatta Projects in operation had not been depreciated for the year under review.

1.2.2 Unsettled Balances

Out of the debtors and the deposits balances amounting to Rs.15,437,106 a sum of Rs.11,971,468 had been balances older than 03 years and action had not been taken for the settlement of those balances.

1.2.3 Lack of Evidence for Audit

The following items shown in the financial statements could not be satisfactorily vouched or verified due to the non-submission of evidence indicated against each item.

Item	Value	Evidence not made available	
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	Rs.		
Fixed Assets	171,754,361	I	Registers of Fixed Assets
		II	Board of Survey Reports
Work-in-progress	123,112,952	I	Security Deposits Payable
		II	Particulars of Expenditure
Current Assets	352,336,944	I	Registers of Assets
		II	Board of Survey Reports
		III	Age Analysis
Expenditure	11,947,638	I	Particulars of Expenditure
	-----	II	Confirmation of Receipt of Cash
	659,151,895		
	=====		

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

 Instances of non-compliance with laws, rules, regulations, etc. observed during the course of audit are given below.

Reference to Laws, Rules, Regulations, etc. -----	Value ----- Rs.	Particulars of Non-compliance -----
(a) National Crafts Council and Allied Institutions Act, No.35 of 1982 Section 44(b)	-	Even though the main objectives of the Sri Lanka Handicrafts Board are the sale and sales promotion of handicraft goods both locally and internationally no goods had been exported to foreign countries in the year under review.
(b) <u>Financial Regulations</u>		
Financial Regulations 177	8,529,795	Two showrooms of the Board had directly spent a sum of Rs.8,529,795 on sundry expenses of the Board without being banked.
Financial Regulations 260 and 385	104,602,088	In making payments for constructions in the years 2012, a sum of Rs.104,602,088 had been paid to the relevant persons directly in cash in several instances. In making such payments, the National Identity Card number had not been recorded in the payment vouchers.

(c) Treasury Circulars

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|---|-------------|--|
| (i) Treasury Circular
No.842 of 19 December
1978 | 716,843,145 | A Register of Fixed Assets had not been maintained in respect of the fixed assets costing Rs.716,843,145. |
| (ii) Treasury Circular
No.1A/2002/02 of 28
November 2002 | 11,575,484 | A Register of Assets had not been maintained for the computer hardware and software valued at Rs.11,575,484. |
| (iii) Management Services
Circular No.47 of 22
December 2011
Paragraph 02. | 350,000 | Bonus in respect of the year 2011 had been paid in the year 2012 to 140 employees of the Board at the rate of Rs.10,000. As such a sum of Rs.350,000 had been overpaid to the employees contrary to the relevant circular. |
| (iv) Public Finance Circular
No.PF/PE/05 of 11
January 2000 | 32,170,182 | The Board had paid incentives amounting to Rs.32,170,182 without the formal authority. |
| | 800,000 | In addition to the above incentives and contrary to circular instructions, incentives amounting to Rs.800,000 had been paid at the rates of Rs.50,000 and Rs.25,000 in the year under review to 16 of the 31 Staff Officers and 05 Instructors of the Board. |

- (v) Public Enterprises 793,000 (a) Instead of paying the Board of Directors Allowance to the members of the Board of Directors in the year under review at the rate of Rs.6,000 per meeting, a sum of Rs.1,105,000 had been paid at Rs.16,000 per meeting for 09 meetings. A sum of Rs.793,000 had been over paid contrary to the Circular.
- Circular No.PED 58(2)
dated 15 September 2011
Paragraph 02.
- 96,000 (b) The female officer appointed to the Board as the Treasury representative had, while on Maternity Leave from 30 November 2012 to 01 July 2013, participated in the meetings of the Board of Directors and the Audit Committee and obtained a sum of Rs.96,000 as allowances. Nevertheless, the Director General of Establishments of the Ministry of Public Administration and Home Affairs had, by his letter No.EST-7/LEAVE/03/3180(1) dated 19 July 2013, confirmed that while being out of duty on maternity leave, officers cannot perform other duties and it is improper to obtain allowances for such duty.

	144,000	(c)(i) While receiving a monthly salary/ allowances for functioning as the Chairman/ Chief Executive Officer, an officer is not entitled to obtain an allowance for participation in the Board meetings. Disregarding that requirement, an allowance of Rs.144,000 at the Rate of Rs.16,000 had been obtained.
	144,000	(ii) The Managing Director of the Board who is not a member of the Board of Directors had also been paid a sum of Rs.144,000 at the rate of Rs.16,000 contrary to the circular for participating in the meetings of the Board of Directors.
(vi) Public Enterprises Circular No.PED/12 of 02 June 2003 Section 8.3.8 Section 8.3.9	4,279,050	The Board had paid a sum of Rs.4,279,050 to various institutions and individuals as gifts and donations without obtaining prior approval of the Cabinet of Ministers.
	181,009	A sum of Rs.181,009 payable by the Line Ministry to Sri Lanka Foundation Institute had been paid by the Board.

(vii) Public Enterprises Circular Letter No.PE1/000/6(Allow) Vol.II Temporary of 05 June 1998	2,310,000	Even though the entertainment expenses of the Chairman of the Board only can be reimbursed, contrary to that a monthly entertainment allowance of Rs.150,000 had been paid to the Chairman/Chief Executive Officer as well. Four other officers had also been paid monthly entertainment allowances at the rates of Rs.20,000 to Rs.7,500. As such the improper payments of entertainment allowances during the year under review amounted to Rs.2,310,000.
(viii) Public Enterprises Circular Letter No.PED/50 of 28 October 2008	1,800,000	(a) The Chairman of a Corporation or a Board could be provided with an official motor vehicle with 220 litres of Petrol per month and if a motor vehicle of the Board is not used he is entitled to a monthly allowance equal to the quantity of fuel together with Rs.30,000 for his motor vehicle, Contrary to that, a sum of Rs.1,800,000 at the rate of Rs.150,000 per month had been obtained as transport allowance as the Chairman/Chief Executive Officer.

3,382,650 (b) Contrary to the above circular, 30 Officers had been paid transport allowances at the rates of Rs.7,500 to Rs.20,000 during the year under review. Such allowances paid totalled Rs.3,382,650.

(d) Government Procurement
Guidelines

Guidelines 2.7.5

The Secretary to the Ministry had not appointed a Procurement Committee to the Board. Instead, a Procurement Committee nominated by the Board of Directors had been appointed. That Committee comprised, the Chairman, the Managing Director, the Executive Director (Finance) and the Project Director, all of whom are officers of the Board.

(ii) Guideline 4.3

Estimates had not been prepared for construction contracts valued at Rs.141,073,130.

(iii) Guideline 5.4.4

Even though advances amounting to 20 per cent of the contract amount can be paid on the production of an acceptable guarantee, the Board had paid advances outside the limit at the request of the contractors without obtaining proper guarantees. Those ranged between 82 per cent to 100 per cent of the contract value.

(iv) Guideline 5.4.6

Even though a specified amount from each payment to the contractors should be

retained until the expiry of the defects liability period, such retention money had not been recovered from any of the payments made to the contractors.

(v) Guideline 5.4.12

A sum of Rs.141,073,130 had been paid to a contractor during the year under review without obtaining the Value Added Tax Invoices. That had not been brought to the notice of the Commissioner General of Inland Revenue with a copy to the Auditor General to cover the Value Added Tax.

2. Financial Review

2.1 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.63,189,722 as compared with the corresponding net profit of Rs.49,629,173 for the preceding year. Accordingly an improvement of Rs.13,560,549 in the financial result as compared with the preceding year was observed. That had been mainly due to the increase of the other income of the Board by a sum of Rs.13,263,743 and the increase of a sum of Rs.10,000,000 in the Government Grants. Had the erroneous income relating to the year under review referred to in paragraphs 2.2.1(b) and (c) been adjusted, the financial results for the year under review would have been reduced by a sum of Rs.11,754,623.

2.2 Unusual Increases in Expenditure

The expenditure for the year as compared with the preceding year had unusually increased as shown below.

	2012	2011	Difference	Percentage
	-----	-----	-----	-----
	Rs.	Rs.	Rs.	
Electricity	17,596,510	7,269,782	10,326,728	142
Incentives and Overtime	31,725,549	11,075,249	20,650,300	186
Employees Welfare	3,632,148	993,389	2,638,759	266
Travelling Expenses - Local	4,959,019	624,130	1,334,889	696
Board of Directors Allowances	1,391,206	559,858	831,348	148
Publicity Expenditure	5,007,782	1,939,219	3,068,563	158
Security Services	9,087,361	3,402,066	5,685,295	167
Printing and Stationery	6,014,733	1,647,980	4,366,753	265
Fuel and Lubricants	3,277,375	1,644,679	1,632,696	99
Motor Vehicles Overheads	11,170,449	2,572,220	8,598,229	334
Commission and Discounts	8,513,517	2,020,462	6,493,055	321
Sponsorships	4,567,550	753,461	3,814,089	506
Trade Exhibitions	666,906	29,413	637,493	2167
Sales Promotion Expenses	2,577,754	119,850	2,397,904	1333
Interest on Loan	22,134,804	3,021,277	19,113,527	632

The following observations are made in this connection.

- (a) Even though the sales income for the year under review had improved by 73 per cent, the corresponding expenditure had increased by 77.3 per cent.
- (b) Nevertheless, as compared with the preceding year, the expenditure for the year on travelling expenses printing and stationery, motor vehicles and overheads expenses, commission and discount, sponsorships, trade exhibitions, sales promotion expenses and interests on loans had increased largely.

3. Operating Review

3.1 Performance

The following differences were observed between the targeted sales and the actual sales in the Thummulla and other Branches, in the year 2012.

Branches	Targeted Sales	Actual Sales	Difference	Percentage
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	Rs. 000	Rs. 000	Rs. 000	
Thummulla	156,718	261,208	104,490	67
Fort	131,492	119,808	(11,684)	(9)
Katubedda	42,692	35,377	(7,315)	(17)
Katunayake	27,092	9,256	(17,836)	(66)
Kandy	40,292	22,761	(17,531)	(44)
Galle	40,292	10,535	(29,757)	(74)
Nuwara Eliya	7,892	1,331	(6,561)	(83)
Moneragala	2,381	1,116	(1,265)	(53)
Kurunegala	1,265	1,110	(155)	(12)
Battaramulla	29,492	16,889	(12,603)	(43)
New Branches(05)	20,528	10,174	(10,354)	(50)
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	500,136	489,565		
	=====	=====		

The following observations are made in this connection.

- (a) Out of the 15 Laksala Showrooms, the expected targets of one showroom had exceeded by 67 per cent while the expected sales targets of 09 showrooms had not reached over 50 per cent level.

(b) The sales income for the year under review amounted to Rs.489,564,350 while the sales income for the year 2011 amounted to Rs.276,368,521. As such the sales income for the year under review as compared with the preceding year had increased by Rs.213,195,829 or 77 per cent.

3.2 Transactions of Contentious Nature

3.2.1 Procurement of Construction Contracts from Government Institution by the Board Contrary to the Approval of the Cabinet of Ministers.

The approval of the Cabinet of Ministers had been granted by the Cabinet Memorandum No.CM/06/0211/231/004 dated 01 February 2006 for the protection of the local industrialists and for giving priority for the Government institutions to purchase the carpentry products of the Board without inviting bids or inviting for quotations. In addition the Cabinet of Ministers had specified that a Treasury representative should participate as a member of the Quotations Committee.

Nevertheless, in order to obtain approval for carrying out even those authorities not specified in the Act for establishment of the Board, the conditions that “ the prices should be determined by a committee including a Treasury representation” had been totally deleted and the Annexe 01 to the Cabinet Memorandum had been altered to enable obtaining contracts such as laying computer cables, laying electric and electronic lines and other engineering works and sent to the Government institutions with the Cabinet Memorandum and taken action to procure works and services by misleading the institutions. The value of the construction works so procured contrary to the Cabinet Decision up to the end of the year under review amounted to Rs.329 million.

Nevertheless, contentious issues and problems had arisen in connection with the contract works of Government institutions undertaken by the Board due to non-completion, abandoning, not being up to standards, etc.

Several such contracts are given below.

Client Institution	Particulars	Status
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Sri Jayawardhanapura Kotte Municipal Council	Installation of 20 Solar Powered electrical lighting systems at the Welikada Children's Park and the Municipal Council premises	As the construction was not up to the standards Solar panels had not functioned. In this connection the Municipal Council had filed a case against the Board
Southern Development Authority	Various activities such as the installation of the Sound system and air-conditioners and laying cables	The institution had reported various defects
Sri Lanka Broadcasting Corporation	Construction of a Transmissions Tower	Stopped halfway
Crafts Council	Construction of Buildings	Reported various defects
General Hospital Kandy	Repairs to Washing Machines	Reported various defects

3.2.2 Establishment of an Engineering Unit in the Board and Award of Internal and External Contracts to Registered Contractors of the Board

According to the Decision of the Board of Directors on the Board Papers No.2009/44 and 2010/01 submitted to the Board by the Management of the Board based on the subsequently altered Cabinet Memorandum referred to at paragraph 4.2.1 above the Board had established an Engineering Division in October 2009. According to the Board Paper No.2010/01, the function of the Engineering Unit had been stated as “carrying out engineering projects of any description”, and required it to function as a profit centre

established as a support for the Board. Nevertheless the work of the Unit had been suspended from April 2011.

According to the Board Paper No.2011/29 dated 17 June 2011, it had been decided that the work of the suspended Engineering Unit should be reorganized and that is should be established as a new units for the execution of construction works of Government institutions, internal constructions, carpentry works, light engineering works and supplies and services based on the above mentioned decision of the Cabinet of Ministers. Accordingly, action had been taken to award all contracts to the 04 contractors registered with the Board, to award the contracts for repairs to buildings costing less than Rs.2.5 million to a particular private construction institution which was formally the Engineering Unit of the Board, to obtain a profit percentage ranging from 2 per cent to 8 per cent of the income earned by them from external contracts as an income of the Board, and to delegate the powers for entering into contracts with the client institutions to the Chairman of the Board, the Secretary to the Board of Directors or the Director of Finance.

The following observations are made in this connection.

- (a) Even though agreements for all contract works had been entered into for execution by the Sri Lanka Handicrafts Board (Laksala) Engineering Unit, the Laksala did not have such a Unit or the human or physical resources with qualifications and capacity for such unit.
- (b) The accepted methodology had not been followed in the registration of the 04 contractors and none of those institutions had not been registered under the Institute of Construction Training and Development.
- (c) Even though all contracts had been executed in the name of the Laksala. The accounts in that connection had not been disclosed in the financial statements of the Laksala.

3.2.3 Action not taken to transfer Crafts Training Division to the National Crafts Council

The following observations are made.

- (a) According to the decision of the Cabinet of Ministers on the Cabinet Memorandum No.08/2322/349/015 of 08 December 2008, it had been decided to transfer the Craft Training Division operating under the Board to the National Crafts Council. That had not been finalized even up to the end of the year 2012. According to the Letter No.3/4/2/46 dated 06 April 2009 of the Secretary to the Ministry of Rural Industries and Self Employment Promotion 189 employees of the Crafts Training Division that functioned under the Board had been attached to the National Crafts Council with effect from 01 May 2009 in accordance with the above mentioned Cabinet Decision and action had been taken to transfer 132 Training Centres under the Crafts Training Division to the National Crafts Council. Seventy buildings in which those Training Centres were maintained belonged to the Board. Even though the value of the equipment, machinery, implements and tools in those buildings should have been assessed and transferred to the National Crafts Council, action had not been taken even up to 31 October 2013 for the legal transfer of the property even though a period of about 04 years had elapsed after the handover of the employees and properties.

- (b) This position had not been disclosed in the financial statements of the Board for the years 2010 and 2011. The following balances shown under the Crafts Training Division in the Financial Statements for the year 2009 had been shown identically as the balances as at 31 December 2012 in the Financial Statements presented for the year 2012.

Category of Assets / Liabilities -----	Value -----
	Rs.
Non-current Assets	46,298,422
Current Assets	31,351,316
Non-current Liabilities	12,345,384
Current Liabilities	17,591,622

3.3 Idle and Underutilized Assets

The following observations are made.

- (a) Even though the Handicrafts Training Division had been transferred to the National Crafts Council in the year 2009, the Carpentry Training Division at Katubedda had not been transferred to the National Crafts Council. As such, the timber sawing machines and the planning machines and the other allied machinery of that school had been idling and underutilized.
- (b) The three storeyed building of about 20,000 square feet and the hostel with 40 twin beds of the Carpentry Training Project at Katubedda had been idle and underutilized for about 03 years.
- (c) In addition to the above, the building of the Bag Production Centre of about 8,000 square feet and tables and 80 chairs had also been idling.

3.4 Identified Losses

A sum of Rs.538,405 had been paid as a surcharge due to the failure to pay the contributions to the Employees Trust Fund on the due dates in terms of the Employees Trust Fund Act.

3.5 Apparent Irregularities

The Board had maintained 31 Bank Current Accounts. Even though transfers of money from one account to another account were observed, there were instances of obtaining the money in cash instead of being transferred. According to a test check a sum of Rs.650,000 had not been transferred among the accounts in 02 instances. On enquiries made, two other vouchers had been submitted by stating other matters similar to the vouchers submitted previously. As 02 vouchers in different forms had been presented for the same transaction, this matter is of suspicious and contentious nature and as such the existence of such other vouchers cannot be ruled out in audit. Similarly the possibility of the misuse of the Board money as well cannot be ruled out.

3.6 Non- investment of the Provision for Employees' Gratuity

According to the financial statements presented by the Board for the year 2012, a sum of Rs.28,417,509 had been provided for employees gratuity. Even though that money should be invested to meet the future liabilities, it had not been so done.

4. Accountability and Good Governance

4.1 Internal Audit

Action had not been taken in terms of Section13(5)(d) of the Finance Act, No.38 of 1971 for the preparation of an Internal Audit Programme and obtain the concurrence of the Auditor General for the programme. Even though the examination of the effective implementation of the internal control systems of the Board and the financial statements including the vouchers relating to the daily transaction for ensuring the reliability of the accounts and other records should be carried out, an audit of the works and construction of contentious nature and various types of payments had not been carried out by the Internal Audit Division.

4.2 Corporate Plan

Even though the Board had prepared a Corporate Plan covering the years 2011 to 2013, a Corporate Plan in terms of Section 5 of the Public Enterprises Circular No.PED/12 of 02 June 2003 had not been prepared. Nevertheless, the Corporate Plan had not been reviewed in a timely manner and updated.

4.3 Procurement Plan

The Board had not prepared a Procurement Plan for the year 2012 in terms of Section 4 of the Government Procurement Guidelines.

5. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman from time to time. Special attention is needed in respect of the following areas of control.

- (a) Accounting
- (b) Contract Administration
- (c) Cash Control
- (d) Assets Control
- (e) Budgetary Control